

What to Tell Your Sales Force When They are Deciding Whether to Participate in a Reverse Auction As Suppliers?

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Abstract. This paper is intended to help purchasing and supply professionals (a) understand reverse auctions (also called “competitive bidding events”) from the perspective of the supplier; (b) understand when reverse auctions make sense to suppliers, (c) understand effective strategies that suppliers can use when participating in reverse auctions, and (d) effectively coach their sales personnel regarding participation in reverse auctions as suppliers.

Reverse Auctions from the Perspective of the Supplier. For many suppliers the concept of a reverse auction is threatening. It changes the selling process from that of insulating the customer from competitive alternatives, as much as practical, to a process of selling in a fishbowl where the customer simultaneously can compare your sales force’s pricing with multiple competitors. Some specific fears that sales and marketing professionals have of reverse auctions are summarized as follows. Bear in mind that some of these fears may be justified based on past experience.

- Fear of loss of control over the selling process
- Potential to be used as a stalking horse to enable buyer to extract lower prices from current sources
- Fear of being set-up to reveal best offer then be asked to negotiate price, quality, and delivery from a position of weakness
- Fear of bidding in good faith and then finding out that the buyer’s specifications/statement of work are not well thought out.
- Fear that a large amount of upfront effort will result in less sales results than a similar amount of effort put into traditional selling strategies.
- Fear that customers are using reverse auctions to beat down prices
- Fear of revealing pricing to other suppliers
- Reluctance to participate in reverse auctions when the buying organization’s sales/marketing organization is unwilling to participate in reverse auctions as suppliers.

When Reverse Auctions Make Sense from the Supplier’s Perspective. Purchasing professionals can help their sales and marketing colleagues realize that reverse auctions are a fact of life, present new challenges to the marketing process, and offer opportunities to exploit new market opportunities while meeting the needs of existing customers. Purchasing professionals may also play a role in convincing those at the corporate/executive level that

reverse auctions are valid organizational strategies in both sourcing (buying) and supplying (selling) strategies. Participation in reverse auctions is more likely to be productive when:

- The supplier has a thorough understanding of its own cost structure.
- The supplier has a clear cost/quality advantage over other potential bidders.
- The supplier has well thought out bidding strategies.
- The supplier is able to quickly evaluate responses to competitive bids during the auction.
- The supplier has viable alternatives to the business that is the subject of the reverse auction.
- The specifications/statement of work are compatible with the seller's capabilities.
- The supplier is looking for opportunities outside of their current customer base.
- The item that is the subject of a reverse auction fits the supplier's current business strategy.
- The supplier has an interest in gathering market information from other suppliers to benchmark their competitiveness.
- The executive level has bought into the concept of participating in reverse auctions as suppliers.

Effective Strategies for Suppliers. There is no one best strategy for suppliers. The following suggestions should help your marketing/sales professionals effectively participate in the reverse auction process.

- Understand the market environment. Many or few competitors? Excess or slack capacity in the industry? Is industry capacity expanding or contracting? Is industry demand expanding or contracting? Are the buyers well versed in reverse auctions or not?
- Select and focus on events that make sense. Thoroughly research the buyer, their specifications, and their expectations. Participate in pre-event meetings, ask questions, and listen to the answers to your questions. Listen to the questions (and the answers to those questions) of other potential participants. Questions posed by other participants may provide insights regarding their costs, capabilities, and bidding strategies. Answers provided by the buyer may provide insights regarding their needs.
- Have a walk-away price that you will not go below. This is the price you will not go below regardless of the emotions of the reverse auction. Marketing and sales professionals are often competitive and do not like to lose. Make sure they understand that walking away from business that does not contribute to profitability objectives is not losing.
- Develop a bidding strategy. Three important decisions are at what level you start bidding, how often you bid, and your walk-away bid. Alternate bidding strategies include submit only your best low bid, start high and lower your bid with the rest of the market, bid early, bid late, and when to stop bidding. These are all strategies to be considered. Consider the pros and cons of each strategy before the event.
- Influence event parameters as much as possible to favor your product. These parameters include supplier specifications, lotting strategies, terms and conditions, market rules, and award criteria. This can be achieved during one-on-one negotiations before pre-event meetings, or during pre-event meetings. Remember, information that you reveal during pre-event meetings may be heard (and seen) by other bidders.
- Is this new business – what strategies should be considered?

- Is this existing business – what strategies should be considered?
- Conduct cost-volume-profit analysis on each bid scenario. Know your variable, fixed, and overhead costs. Know the impact of alternate levels of business on costs.

A Reverse Auction for Specific Items: A Hypothetical Example. Exhibit 1 summarizes a hypothetical situation where a customer has proposed a reverse auction for twelve items. Please keep in mind that all data presented is hypothetical and presented for instructional purposes only. No inferences should be made from the data, or assumptions, presented in this paper regarding any actual situation. The column headings are as follows:

- ITEM: Item Identifier.
- VC: Unit variable manufacturing and delivery cost.
- TUC: Total unit direct cost. Includes V.C. plus any tooling and set-up costs averaged over the expected volume.

Exhibit 1

HYPOTHETICAL REVERSE AUCTION: ITEM SCENARIO

ITEM	V.C.	T.U.C	AVAIL CAP?	BUS FIT?	SPEC	QUALITY	COMP	TARGET PRICE	MIN PRICE
1	\$10	\$12	YES	NO	YES	YES	MED	\$45	\$36
2	\$10	\$13	YES	YES	YES	YES	HIGH	\$39	\$26
3	\$10	\$10	NO	YES	YES	YES	LOW	\$45	\$30
4	\$10	\$14	YES	YES	NO	YES	MED	\$70	\$56
5	\$10	\$12	NO	NO	YES	YES	HIGH	\$60	\$36
6	\$10	\$15	YES	NO	YES	YES	MED	\$60	\$45
7	\$10	\$12	YES	YES	NO	YES	LOW	\$70	\$48
8	\$10	\$11	YES	YES	YES	YES	HIGH	\$40	\$22
9	\$10	\$10	NO	YES	YES	YES	MED	\$42	\$30
10	\$10	\$10	YES	NO	NO	YES	MED	\$50	\$40
11	\$10	\$12	YES	NO	YES	YES	HIGH	\$36	\$30
12	\$10	\$11	NO	YES	YES	YES	LOW	\$45	\$33

- AVAIL CAP?: Indicates whether the firm has available capacity or will have to add capacity, and cost, through expansion, overtime, or additional shifts. Lack of capacity suggests that profits will not occur below three times TUC.
- BUS FIT?: Indicates the level of the product’s compatibility with the supply chain. Generally, bidding will be more aggressive for business that is a good fit than for business that does not fit well. Adequate profits unlikely at prices below three times TUC.
- SPEC: “YES” indicates that specifications/statements of work are adequate for bidding. Thorough specifications/statements of work usually indicate that fewer contingencies are needed in a bid for surprises. “NO” indicates that specifications/statements of work are poorly thought out and/or loose. This means that bids should include contingencies for post-award negotiations and/or later changes. Adequate profits are unlikely at prices below 4 times TUC.
- QUALITY: Whether the firm can easily meet the specified quality standards. Adequate profits are attained at twice (easily meet quality standards) to four times (difficulty in meeting quality standards) TUC.

- **COMP:** Expected level of competition (HIGH, MED, LOW). Generally, if bidding is aggressive, sit and watch. If the business is important bid aggressively above your minimum prices, then reduce your reductions as you approach your minimum. Bid minimum only if the pace of bidding has slowed. Maintain discipline on the walk-away price.
- **TARGET PRICE:** The price that the seller would like to get per unit. Normally 3 times total unit cost under ideal circumstances.
- **MIN PRICE:** The lowest price that the firm will bid (the walk-away price). Under ideal circumstances, prices below twice total unit cost are not profitable. Capacity, business fit, clarity of specifications, quality issues, and competition should also be factored into the minimum price. In addition, potentials for reductions in TUC should be considered. Here purchasing and supply professionals, as well as others in engineering and production, may contribute to cost reductions.

The specific strategy during the reverse auction event will vary. Some possible strategies are as follows:

- Enter early bids well above target. Monitor responses. If bidding rapidly drops below your target continue to monitor. If bidding stalls above minimum, bid above minimum. If bidding drops below minimum discontinue bidding.
- Monitor bidding. If bidding is aggressive enter occasional bids between target and minimum.
- After all of this preparation bidding does not make sense, don't bid. In some situations it makes more sense to not bid (and reveal no information) than to bid. For example if bidding is obviously going to end up below your minimum price do not bid.

A Reverse Auction for Lots: A Hypothetical Example. Exhibit 2 summarizes a hypothetical situation where a customer has proposed a reverse auction for twelve items grouped into three lots. The column headings are the same as Exhibit 1.

Bidding on lots creates a challenge because the lots, while homogenous to the customer, may be heterogeneous to your sales and marketing professionals. Examination of the lots may identify dynamics that affect bidding strategies. A key step is to analyze the lots and identify possible synergies, nor negative synergies, among the items. For example, simple averaging suggests target/minimum prices for Lots I, II, and III of \$43/\$30.67, \$65/\$46.25, and \$40.20/\$31 respectively. However, if there were substantial cost efficiencies among the items in Lot I, no clear efficiencies in Lot II, and negative cost efficiencies among the items in Lot 3 the target/minimum prices might now be: Lot I: \$41/\$28 (reduced), Lot II: \$65/\$46.25 (unchanged), and Lot 3: \$55/\$42 (increased).

Coaching the Sales Force. Learning is often a two-way street. This means that helping others sell more effectively may also help you learn how to buy more effectively. The following are some fundamentals that purchasing and supply management professionals can share with their sales and marketing colleagues.

- Know the customer
- Understand the rules of the game – which auction company is conducting the auction, or what software is being used for a customer managed auction
- Understand the specifications/statement of work

- Assume nothing – ask questions
- Have a walk-away position
- Consider including purchasing professionals in the bidding team
- Encourage sales staff to participate in the buying side of reverse auctions
- Don't wait until the sales force faces a reverse auction to include them in your reverse auctions buying teams.
- Be open to coaching that the sales force may offer you when you buy using reverse auctions.
- Consider offering to participate in “mock reverse auctions” with your marketing and sales professionals. This could make it possible for everyone to sharpen their skills, reduce the costs of purchased goods and services and increase the revenues of items sold in reverse auctions.

Exhibit 2

HYPOTHETICAL REVERSE AUCTION: LOT SCENARIO

LOT I			AVAIL	BUS				TARGET	MIN
ITEM	V.C.	T.U.C	CAP?	FIT?	SPEC	QUALITY	COMP	PRICE	PRICE
1	\$10	\$12	YES	NO	YES	YES	MED	\$45	\$36
2	\$10	\$13	YES	YES	YES	YES	HIGH	\$39	\$26
3	\$10	\$10	NO	YES	YES	YES	LOW	\$45	\$30
LOT II									
4	\$10	\$14	YES	YES	NO	YES	MED	\$70	\$56
5	\$10	\$12	NO	NO	YES	YES	HIGH	\$60	\$36
6	\$10	\$15	YES	NO	YES	YES	MED	\$60	\$45
7	\$10	\$12	YES	YES	NO	YES	LOW	\$70	\$48
LOT III									
8	\$10	\$11	YES	YES	YES	YES	HIGH	\$40	\$22
9	\$10	\$10	NO	YES	YES	YES	MED	\$42	\$30
10	\$10	\$10	YES	NO	NO	YES	MED	\$50	\$40
11	\$10	\$12	YES	NO	YES	YES	HIGH	\$36	\$30
12	\$10	\$11	NO	YES	YES	YES	LOW	\$33	\$33

Concluding Comments. Reverse auctions, also called competitive bidding events, are here to stay. This means that profits will depend on understanding the process, conducting thorough analysis before the event, executing a well thought out strategy during the event, and revising that strategy as the event occurs. Purchasing and supply professionals have insights that can help their sales and marketing colleagues effectively participate on the selling side of reverse auctions. Purchasing and supply professionals can also learn from sales and marketing colleagues who have participated in reverse auction as sellers.

Finally, a buy-in at the corporate/executive level may be needed before sales/marketing participates in reverse auctions as suppliers. Purchasing and supply professionals can help make the case that participation in reverse auctions is an important component of both sourcing and marketing strategies.