

## The Reverse Auction: A Strategic Perspective

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**Abstract.** All too often, the use of reverse auctions has been characterized as simply a tactical tool for rapidly reducing Supplier pricing to break-even or unsupportable levels. In this session, we will analyze and evaluate the reverse auction process and share our learnings from hosting a number of auctions.

**The Opportunity.** Taking a strategic perspective with regard to reverse auctions helps Buyers and Suppliers understand that the reverse auction is a tool (technology is the enabler, not the driver of the sourcing decision) that can lead to benefits for both sides. While the Buyer may benefit from reverse auctions by speeding up the negotiation process and achieving breakthrough price reductions, these benefits may be diminished by damaged supplier relationships. Countering the widespread impression that reverse auctions are one-sided and benefit the Buyer much more than the Supplier has been a challenge for Purchasing departments ever since reverse auctions were introduced in the late 1990's.

Our discussion of reverse auction benefits will focus on the less obvious "win-win" or mutual benefits, and we will solicit input from the audience to think about additional benefits. Let's look at some of these common benefits:

- **Speed**
  - ❑ The web enabled aspect of reverse auctions allows a global management team to participate real time in the bidding process. The specific time frame for the auction event forces the key players to focus on the bidding process and to make, rather than postpone, key decisions that lead to the optimal proposal. Anything less puts the Supplier at risk of losing the award.
  - ❑ The quick collection of breakthrough proposals speeds up the sourcing decision and enables more rapid award of business, thus helping the winning Supplier(s) grow sales faster.
  - ❑ Quicker award of business, conversely, benefits the Buyer, as the Buyer can take advantage of the negotiated improvements faster and book the savings more rapidly.
  - ❑ Overall cycle time reductions reaching to the >70% range
- **Unifying Force**
  - ❑ 82% of companies in chemicals, oil and gas, mining and metals and utilities are conducting their purchases of indirect materials online.
  - ❑ 1/3 of Dupont's purchases to be done online.

- ❑ Large volume Buyers making the most progress in online purchases – Public Sector entities as high as 17% of all purchases, and US Automotive OEM's want to put most of their purchases through e-commerce (\$230 billion annually).
- ❑ Early adopters are distinguishing themselves in the marketplace. Buyers are achieving breakthrough levels in supplier performance, and top Suppliers are gaining market share faster and more efficiently.
- **Wider Playing Field**
  - ❑ Online bidding can be opened to *qualified* Suppliers around the world.
  - ❑ Format is standardized and results are more easily recapped.
  - ❑ New Suppliers may introduce leap-frog improvements and ideas.
- **Focus on Continuous Improvement**
  - ❑ Transparency of information provides a real time benchmark to Supplier management.
  - ❑ Buyer can use this information to drive continuous improvement among their selected Suppliers.
  - ❑ Terms and year-over-year continuous improvement commitments may also be auctioned and benchmarked.

Conversely, there are risks associated with reverse auctions. These risks, if not pre-empted, could impact negatively the Supplier/Buyer relationship.

## **Risks**

- Transparency reveals information on the Buyer's strategy and may mislead or weaken Supplier response. For example, the Supplier may be able to determine the true driver behind the sourcing decision: price, specific terms, market image or technology. So, if the Buyer chooses to negotiate with some one other than the low bid, then the Supplier who is targeted for negotiation realizes that another variable (other than lowest price) may be at play, and may impact their willingness to lower their price.
- Transparency weakens ability for Buyer to negotiate to desired price level if not attained through reverse auction. If the low bid is above the amount that the Buyer intended to pay, they have little impetus to improve as they realize that they are in the low bid position.
- Price levels may be higher than expected by Supplier. Supplier may have been willing to price at a lower amount, but the auction did not drive the price to those levels. In other words, the sealed bid left more room for negotiation.
- Technology is allowed to drive rather than enable the result. Technical restrictions may not allow for a full explanation of the proposal—or as robust of a proposal. For example, depending on the reverse auction tool it may not be possible to fully explore switching costs, terms and other variables.
- Select a non-proven, new Supplier for wide application, diminishing the importance of loyalty and service from established Suppliers.

- Lose credibility in the marketplace by not following through on the stated strategy. For example, the auction's transparency would reveal if "low bid" vs. "total cost" variables were the real selection criteria.
- Technical meltdown/issues may lead to an incomplete and inaccurate result.

**Objectives.** The workshop aims to expand the audience's understanding of the reverse auction tool, through the authors' presentation, as well as through active participation from the audience. We will address the reverse auction topic from both the Buyer and Seller perspectives. Learnings from the presentation will be:

- **Define key "Strategic" elements of Reverse auctions**
  - ❑ The Supplier may see greater benefit and value in the reverse auction process if in return they obtain a long term contract ensuring stability of business. A long term contract (3 to 5 years typically) would ensure that the Supplier can implement a capital and continuous improvement plan so as to achieve the improvements committed during the reverse auction.
  - ❑ By driving prices to the market levels, high cost producers (who will not be in position to win this specific auction) are encouraged to put a renewed emphasis on eliminating waste from their processes so as to be in the winning position next time.
  - ❑ Efficiency in data gathering is improved and the sourcing team can spend more time in higher value activities, such as making the most robust sourcing decision.
  - ❑ Transparency of data enables the Supplier to benchmark their offering against the market place, and drive their focus to areas where they need to improve.
- **Answer "What is Auctionable"**
  - ❑ Flexibility is key—no absolute rules in selecting categories that are auctionable.
  - ❑ Supplier relationships are not auctionable even for "commodities."
  - ❑ The greater the R&D and service levels required, generally the less auctionable the item.
  - ❑ The more standardized, "off-the-shelf" the item, generally the more auctionable the category.
- **Identify Supplier Selection Criteria**
  - ❑ Same as with traditional RFP, but in addition due to the potential for new and global Suppliers consider:
    - Distance from facility
    - Establish baseline price (starting point) for Suppliers to commit to before the event – should eliminate non-competitive Suppliers
    - Check for conflict of interest with other bidding Suppliers—e.g., ensure no customer-Supplier relationships exist among bidders, or strategic alliances.
- **Identify Ethical dimensions around Reverse auctions**
  - ❑ Set rules for sourcing selection up front, and ensure compliance.
  - ❑ All bids count—they are from legitimate and qualified Suppliers.
  - ❑ Adequate time is allocated to conduct the auction – no undue time pressure.
  - ❑ Any third party participation has been explained and cleared with the Suppliers.

- ❑ RFP materials have been provided to the Suppliers with adequate time to prepare for the reverse auction. It is important to remember the reverse auction itself is rapid, but timing around the preparation of the bid remains the same as with the traditional RFP.
- ❑ Seller who agrees to participate must follow auction guidelines.

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