

Reverse-Auction Case Studies Effectively & Ethically Lowering Supply Chain Costs

Wes Guillemaud, Founder & CEO
Sorc City.com, Inc., Dallas, Texas
(972) 612-1411 Wes@sorc City.com

Ted Farris, C.T.L., Ph.D., Associate Professor
University of North Texas, Denton, Texas
(940) 565-4368 Farris@cobaf.unt.edu

Timothy G. Hawkins, Maj, USAF, CPCM, C.P.M.
Doctoral Student
University of North Texas

Gene Roth, Corporate Purchasing & Supplier Diversity Manager
Enterprise Rent a Car, St. Louis, MO

Abstract: Although Reverse-Auctions have shown exceptional results in price reduction, time reduction, and over-all Supply Chain efficiency, there are two trends emerging that provide an even greater impact to the Supply Chain: adherence to sound guidelines and the use of Reverse-Auctions by suppliers. Both of these trends are showing positive signs of eliminating problems of the past and fueling the adoption of Reverse-Auctions. The net effect is that many more purchasing groups are saving millions of dollars for their organizations.

The Opportunity: Reverse-Auctions are one of the advanced tools enabling Supply Managers to shift from “administering” the procurement process, to “managing” tools that automate a number of the manually intensive sourcing steps.

This provides the ability to expand both the number of purchases bid each year and the number of bidders participating. In many cases, Supply Managers have seen Reverse-Auctions deliver 20-30 times the number of bids they are used to receiving – even when the purchase would otherwise go through lengthy negotiations.

Firms that embrace Reverse-Auctions as a strategic management technique are consistently enjoying price reductions that average between 12-24 percent. In many cases, the supply manager also gains the advantage of additional market information from the Reverse-Auction provider because of the depth of commodity expertise they acquire. These advantages are in part responsible for the emerging trends.

Trend 1 – Adherence To Sound Guidelines: Reverse-Auctions were once hindered by a lack of commitment by, in some cases the Buyer, and in other cases the Seller. The demise of

several Reverse-Auction providers resulted from a lack of good faith or follow-through on consummating a contract to purchase a good or service bid in a Reverse-Auction, or in honoring a bid placed.

These elements created a Reverse-Auction environment that eroded interest and heated bidding. The result was a loss of trust and effectiveness. Only those providers who implemented a set of guidelines to insure accountability, compliance and follow-through, had the ability to retain trust by participants and deliver effective results.

Holding an ethical Reverse-Auction considers several principles which include: providing all suppliers the same information at the same time, giving all suppliers an equal opportunity to bid, avoiding special exceptions for any supplier, and providing a level of objectivity and anonymity in the process.

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 ISM Principles and Standards of Purchasing Practice: "Avoid the intent and appearance of unethical or compromising practice in relationships, actions, and communications." The following are guidelines that have proven more effective in delivering consistent, reliable results:

- Inform Suppliers that only bids submitted through your Reverse-Auction will be valid and that an attempt to bid in any other manner will disqualify them. This will reduce your work, creates an equal bid event, and stimulates greater bidding.
- Increase the incentive for Suppliers to participate by post larger purchases over longer periods of time. This will attract a larger number of Suppliers, reach deeper in the Supply Chain, and will provide a platform for healthy, long-term relationships.
- Establish realistic price expectations by understanding the market and its' trends. This will prevent a failed event or the perception by Suppliers it was not serious from the beginning, a flaw that can erode Supplier confidence and willingness to cooperate again.
- Be thorough by spelling out all the detailed terms, conditions, and product specifications so that Suppliers bid with full information and there isn't room for interpretation, leading to an incorrect bid. This will eliminate re-starting events and wasted clarification time.
- Use a solution that gives suppliers the comfort of third-party independence. This provides a trust-factor that eliminates Supplier concern of fairness and alleviates Buyer risk.
- Use a Reverse-Auction provider that holds both the Buyer and Supplier accountable to the rules of engagement, backed with penalties in the event either party under performs. This sends the right message to Suppliers that the process is serious, fair, and will be awarded.

Trend 2 – The Use of Reverse-Auctions By Suppliers: Reverse-Auctions have never favored the Buyer because they have always been available to the Supplier to use as the

Buyer does. Innovative Suppliers, and very likely, those who are also more competitive, have utilized this sourcing method to reduce their direct materials and overhead costs in an effort to get more cost-effective and maintain healthy margins. This trend is a key to lowering the total cost of goods even further, throughout the supply chain.

This trend is also catching on because Buyer are less tolerant of resistance from some Suppliers. As one Buyer put it “If any Supplier complains about participating in our Reverse-Auction, I simply ask if they are using spend management methods like this, in the spirit of a true partnership, to lower our prices.”

As a bidding participant, Reverse-Auctions enable Suppliers to meet several objectives including process time reduction and sales cost reduction.

Here are some additional findings from a recent study of one Supplier group:

- Most Suppliers prefer not to compete via RA. While these suppliers prefer not to compete via RA, they want to continue to receive RA opportunities.

Key Takeaway: Don't be afraid to source via RA. Suppliers may threaten not to compete. Nonetheless, be sensitive to their concerns, and reinforce ethics and fairness in your RA sourcing process. For example, state your selection criteria up front in the T&Cs. If you state that price will be 60% of the selection decision, don't change that weight mid-stream.

- A Supplier may be able to reduce its costs of sales (salesperson commissions, advertising, etc.) using RAs as did half of those interviewed.

Key Takeaway: Communicate this possibility to your prospective suppliers to encourage more supplier participation in RAs (resulting in greater competition). RA success relies on sufficient competition.

- In few cases, Suppliers increased their prices (post-auction) even where terms precluded the price increase. This occurred for both RA transactions and traditionally-sourced transactions.

Key Takeaway: RAs don't replace prudent purchasing practices. Buyers should, in their T&Cs, preclude price increases except for specific economic price adjustments (e.g. energy costs such as fuel) and uncontrollable events (natural disasters).

This market feedback is limited in scope but reveals some meaningful insight. It also amplifies the need to apply sound guidelines when utilizing any of the Reverse-Auction models.

Reverse-Auction Models: Successful Reverse-Auctions begin with two key ingredients; defining your criteria, and then determining which model will best meet your needs. Defining your criteria allows you to segment your purchases and will guide you to the appropriate model needed to achieve your desired results. Purchases vary from standard to highly specialized,

low to high risk, strategic to routine, tens of thousands to tens of millions of dollars. The following chart depicts available models and their attributes.

Reverse-Auction Models Available

	Outsourced Model	Consultative	Software	ASP
Characteristics:	Fully Managed Professional Support No software Ready in Hours	Consulting Engagement Lengthy process Software install Ready in Months	Software purchase Implementation Internal support Team Ready in Months	Web hosted app. Internal support Team Ready in Months
Fees:	None for buyer Supplier pays 1-2%	Consulting fees Percent of savings	Software & Maint. License fees Internal support Cost	License fees Training Time/Cost Internal Support Cost
Purchases:	All products and services, \$50k - \$millions	Strategic \$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

↑ Third Party Independence ↑

Source: Sorcity.com, Inc.

The vast majority of purchases 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 profit. It 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 get new business they might not otherwise know about.
➤ 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 solutions, buyers can eliminate implementation costs, time and maintenance of solutions they historically were required to buy or build.

Reverse-Auctions may continue to shown exceptional results in price reduction, time reduction, and over-all Supply Chain efficiency because of the adoption by more Suppliers and the guidelines used to drive fairness. The benefit will be to the entire Supply Chain since more companies within a competing Supply Chain will contribute to the health of the entire Supply Chain.

REFERENCES:

Web Sites.

www.unt.edu



1-800-525-2401

www.sorcity.com

