

Benefits and Drawbacks of a Buyers' Auction from a Suppliers Perspective

Supplier Benefits of Buyers' Auctions

1. Ability to react to competitor's price
2. Provides a visibility of competitors' market pricing
3. Reduced negotiation process time
4. Provides impetus to improve competitiveness
5. Provides more level playing field for suppliers

Supplier Drawbacks of Buyers' Auctions

1. Customer focused on price alone
2. Supplier forced to focus too much on solving cost problems
3. Reduces long term competitiveness of suppliers
4. Drive down price below sensible economic level
5. Buyer becomes too dominant

Conclusion

The findings in Fig 4 are quite astounding. Not only do they refute the claim that buyers' auctions are adversarial, they actually show that auctions improve the buyer-supplier relationship in all performance measures.

In our experience, auctions are almost always conducted at the end of an exhaustive purchasing process, with most buyers only inviting suppliers to bid that have passed a rigorous evaluation process. This process typically centres around a strong product or service specification. This is illustrated in Fig 5, where a comprehensive specification was the most important enabler to a successful auction. Demonstrating that auctions both increase standards in the purchasing process and improve transparency, with buyers being more upfront about their requirements.

Using performance objectives, one of our aims was to investigate the perception that auctions were essentially driven by price, and

counter to modern purchasing practice which advocates long-term supplier relationships, reduced number of suppliers, transparency and overall effectiveness. However, our findings suggest this perception is unfounded. We discovered that developing a strong supplier relationship was the key objective within an auction-based negotiation. And with most contracts being awarded to incumbent suppliers, it appears that buyers' auctions are not used simply to reduce the incumbent supplier's price – with only 22% of suppliers reporting to have won an auction solely on that basis. A very encouraging result, as suppliers are crediting buyers with making a balanced judgement.

In addition to the improved purchasing process, we conclude that auctions have marginalised price within the ongoing buyer-supplier relationship. By this we mean that by using the auction to obtain a competitive market rate, the buyer and supplier can now concentrate on contract execution. In particular,

In addition our research with suppliers established:

- 65% of suppliers who won contracts as a result of a buyer's auction believed that they won it on more than just price.
- All suppliers interviewed said they would continue to participate in buyers' auctions.
- Over 65% of suppliers questioned thought that buyers' auctions would continue for at least the next 3 to 5 years.

the supplier may take the view that as they are now seen to be price competitive they will only lose the contract if they fail on factors analysed in Fig 4.

We found that auctions were being used to purchase a wide range of different commodities/services. An interesting result, which perhaps warrants further research, as there may be links between types of commodities and use of auctions.

Finally, over 65% of suppliers said that they thought buyers' auctions would continue for at least the next 3 to 5 years, contradicting the view that auctions have a very limited lifespan.

The I-ADAPT team believe that this research will help the understanding of buyers who are contemplating using buyers' auctions. We hope that all buyers recognise this research for what it is – a tool to help them achieve an improvement in the cost of their acquisition with no serious downside in supplier service levels.

“Although auctions typically run at the end of an exhaustive offline selection process wherein suppliers are only invited to partake if they've passed a rigorous product and service evaluation, this research critically highlights that suppliers in Internet-based auctions continue to deliver right through to the contract and service delivery stage.”

Roy Ayliffe, Director of Professional Practice, CIPS
www.cips.org

Here are some typical comments our researchers received during their investigations:

“Easier for supplier to compete for business”

“Improves discipline in tendering”

“Auctions have proved to be more effective than traditional means of tendering”

“Technology was there to be used and we decided to use it”

“Good process, good speed, good price”

“We enjoy a good working relationship with the successful supplier and retain relations with non-successful suppliers”

“Beat market over what we would achieve through face-to-face”

“Absolute maintenance of quality and service standards. Not the case that it drives down total cost”

“It is important to do due diligence on all suppliers”

“Suppliers happy they could still get a profit”

“Suppliers were initially suspicious yet have accepted that auctions are becoming increasingly common”

“No negative impacts”

“The auction is simply a way of negotiating prices more efficiently”

“No noticeable change in supplier behaviour”

“There has been no negative effect on long term relationships with suppliers”

“Positive, built a stronger relationship”

“With the ease of re-tendering via online auctions, suppliers are realising that it is better to proactively look at ways of improving efficiency and reducing cost, than risking the re-tendering of the business”

I-ADAPT

Independent Assessment into the Development
of Auctions as a Purchasing Tool

**A Study to Determine the Impact of Online
Auctions on the Buyer and Supplier Relationship.**

Place Bid

I-ADAPT introduction

Buyers' Internet-based auctions came onto the purchasing scene in the late 1990's, made possible through the development of Internet-based applications. Auctions have since grown at least tenfold each year. In fact, we estimate that around 2,500 successful auctions took place in the UK in 2002.

Their success as a purchasing tool is attributed to their ease of use and surety of results – in the last 100 auctions run by Oracle and BT, typical price savings were between 15% and 22%. Buyers have published numerous savings over the past two years, evangelising the new purchasing tool.

What Happens in a Buyer's Internet-based Auction

A buyer's Internet-based auction begins with the buyer posting their requirement for a product or service on an Internet site. The buyer then invites suppliers to bid against each other online – their names only visible to the buyer.

The key difference between an Internet-enabled auction and a traditional purchasing process, is that all suppliers can usually see their bid along with the current lowest bid, as well as having the opportunity to re-bid as many times as they wish.

Research Objective

With so many price savings since the introduction of buyers' auctions, academics and purchasing practitioners alike have questioned what impact this is having on the buyer-supplier relationship. It is believed that this approach to negotiation, with the obvious focus on price, must be having an adversarial effect. Also, many argue that such price saving achievements will inevitably result in a deterioration of other factors, such as quality, delivery/reliability, flexibility, account

management and overall dependability. These factors are crucial to any successful contract execution and would therefore create tension in the relationship.

Therefore, the purpose of our research – we believe the first of its kind in the world – is to investigate what adversarial impact, if any, buyers' Internet-based auctions are having on the buyer-supplier relationship.

The research was conducted by professionals from The Chartered Institute of Purchasing and Supply (CIPS), The University of the West of England, Bristol (UWE) and Oracle (who were main participants in the successful I-SAVE research, which investigated savings in the procure to pay process of which final conclusions were published in July 2002) along with BT who have significant experience and expertise in this area.

The research is called I-ADAPT:

Independent Assessment into the Development of Auctions as a Purchasing Tool

Research Method

The research was primarily carried out using a telephone-based questionnaire, devised and conducted by senior researchers at UWE. The aim was to sample at least 10% of the potential auction user population (buyers) and 1% of the auction participant population (suppliers).

The research commenced in October 2002 and was completed on schedule in March 2003.

Buyers' questionnaire

In addition to finding out about any adversarial impact on the buyer-supplier relationship, we also wanted to investigate:

- The range of commodities/services organisations were using auctions to purchase.
- What percentage of auctions were being awarded to the incumbent supplier.
- If buyers were still planning to develop relationships with the shortlist of suppliers they had used auctions to select.
- Why buyers were choosing to incorporate auctions into their acquisition process.
- What criteria buyers used to judge the success of an auction.
- What the key enablers and inhibitors were to a successful auction.

Suppliers' questionnaire

To investigate the buyer-supplier relationship fully, we were keen to assess how participating suppliers viewed buyers' auctions, with specific reference to the following:

- The main benefits and drawbacks of participating in an auction.
- If they believed they had won an auction solely on price.
- If they intended to continue participating in auctions.
- If they believed buyers' auctions would play a part in the future.
- How they thought their relationship with the buyer had changed since the introduction of auctions.
- How they have had to adapt to participating in buyers' auctions.

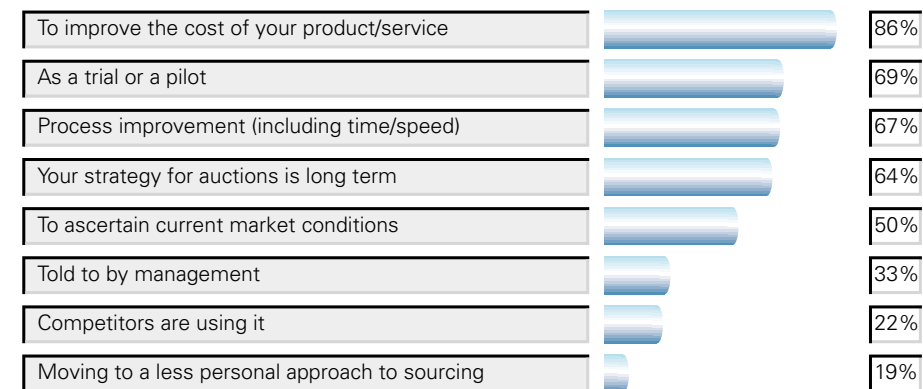
I-ADAPT key findings

Over the next three pages we set out our I-ADAPT findings. These cover responses from both buyers and suppliers. They address the buyer-supplier relationship, key enablers and inhibitors and the benefits and drawbacks to suppliers.

Reasons for Choosing an Auction

We asked buyers what motivated them to choose an auction as part of their purchasing process.

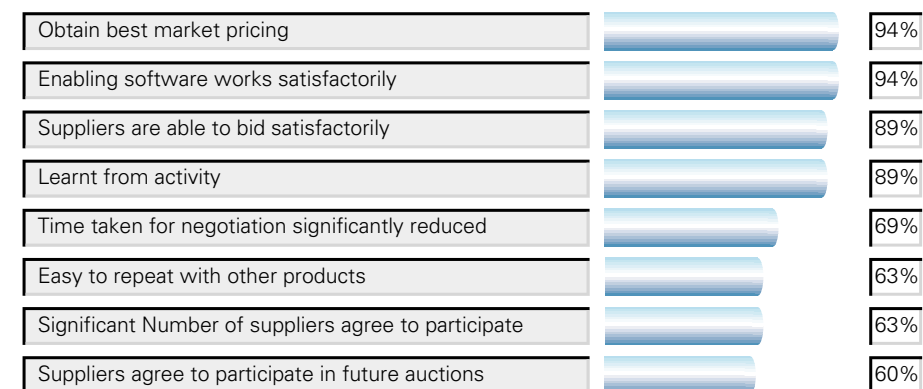
Fig 1: Reasons for Choosing Auction



Success Criteria

Buyers were asked what criteria they used to decide whether an auction was a success.

Fig 2: Success Criteria



Supplier Management Initiatives

Buyers were asked what specific Supplier Management Initiatives they were using in their auction-based procurement process.

Fig 3: Supplier Management Initiatives



It was not surprising to us that the key reason for choosing an auction was to reduce cost supported by a need to reduce the process time. However it was somewhat surprising that many buyers are still in pilot/trial mode although this was mitigated by the majority of buyers seeing auctions as part of their long-term strategy.

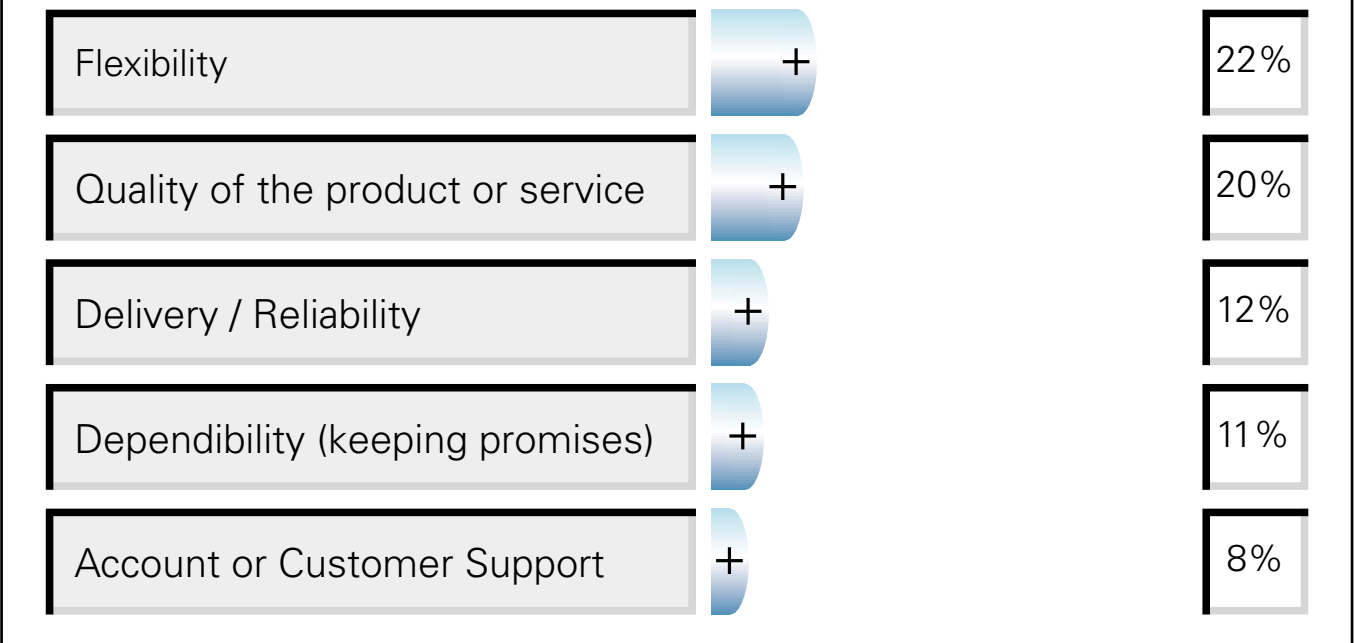
Obtaining best pricing was the top criteria and the software worked satisfactorily for both the buyer and supplier. Interestingly, learning from the experience scored highly, which backs up the findings in Fig. 1 where many buyers were still in trial mode.

The results were surprising as auctions have not generally been perceived as encouraging the development of supplier relationships, yet this was recorded as a major objective by many of the contributors.

I-ADAPT key findings

This was the most crucial part of the research. We asked buyers on a scale of 1 to 100 (50 being no change) how had the suppliers performance changed since using an auction to establish a new contract. The graphic below shows the % change in five key performance factors.

Fig 4: Performance Measures (all)



The results were dramatic with every measure showing an average improvement of between 8% – 22%. We fully expected to see no change or a reduction in at least one or two key factors. In particular we were expecting the so called 'soft' factors of flexibility, dependability and account management to deteriorate as the reduced suppliers' margins led to a reduction in the level of support provided to their customers. As you can see this was not the case.

Top Six Key Auction Success Enablers and Disablers

Commodities included: PPE, cheese, tyres, consulting, packaging, carrier bags, tyres, airfreight services, printed reels of film, vehicles, grid transformers, office furniture, mobile phones, A4/A3 paper, janitorial supplies, electronic appliances, stationery paper, general office supplies, electric goods, professional services/HR, gas, electricity, accountancy services, IT service contracts, storage, quantity surveying services, furniture, sale of debt, elements of building work, printed forms, IT monitors, gear panels, large transformers and food commodities.

60% of auctions were awarded to the incumbent supplier.

Key Success Enablers

1. Comprehensive specification for product/service
2. Supplier auction training
3. Sound supplier pre-qualifying process
4. Selecting suitable commodity
5. Enabling Software
6. Clear auction objectives

Key Failure Criteria

1. Lack of supplier participation
2. Unsuitable commodity/service
3. Lack of competitive supply base
4. Poor training of buyer/supplier
5. Auction timing
6. Others