

REVERSE AUCTIONS: THE WAY EVERYONE WINS

THE SIMPLE ECONOMICS OF LIVE PRICING

a white paper by Scout RFP



EXECUTIVE SUMMARY

Reverse auctions help organizations successfully realize cost-savings without sacrificing quality and supplier relations. For years, they have been a vital piece of the strategic sourcing suite. Despite this, many enterprises have yet to use reverse auctions to their greatest potential. In some cases, sourcing professionals haven't explored the benefits of reverse auctions and as such have not embraced the methodology. Others have — often valid — concerns about the process. The reality, however, is that using reverse auctions for the right categories drives better business value.

To better understand enterprise reverse auctions, we surveyed over 100 sourcing, procurement, and finance professionals from around the world. After compiling their experiences and opinions, we emerged with several conclusions about reverse auctions — from the business world's perception of them to their wide-ranging capabilities.

KEY TAKEAWAYS

- Adoption of reverse auctions is rising. They're most popular among A) large enterprises, both public and private, and B) Millennials and younger GenXers.
- Reverse auctions make a bottom-line impact across the enterprise through their ability to increase the efficiency and efficiency of the sourcing department.
- Enterprises that successfully run reverse auctions prioritize high quality for a good price, rather than automatically awarding to the lowest bidder.
- Successful reverse auctions are run in a buyer's market to source commodities, simple services, and other items with a low cost of changing.
- Collaboration and transparency — two keys factors that contribute to a successful reverse auction — can only be achieved by running the auction through technology that adequately supports it.

This paper explores trends and opportunities with reverse auctions and how your enterprise can employ them to deliver a bigger impact to its bottom line.

WHAT IS A REVERSE AUCTION?

A reverse auction is a fixed-duration event, hosted by a single buyer, in which multiple suppliers compete for business by bidding the price down — generally for a known SKU or generally accepted service. Unlike a traditional auction, the price point decreases as the reverse auction progresses.

WHY USE REVERSE AUCTIONS?

Reverse auctions can be an invaluable asset for strategic sourcing. When executed and used appropriately, they can significantly reduce purchasing costs without sacrificing quality and service. Couple this with a fixed time duration, and they actually require less total resources and support a quicker time-to-market timeline than traditional RFX sourcing.

In a reverse auction, buyers can specify exactly what they want and allow suppliers to bid openly for their business. By adding the element of supplier competition, purchase prices typically normalize to a market-driven price. Gartner estimates that enterprises typically save 10-20% when they deploy reverse auctions as part of their sourcing strategy.¹

WHERE DO REVERSE AUCTIONS COME FROM?

The application of reverse auctions was first made ubiquitous in 1995, when a former General Electric (GE) executive founded an internet auction platform to run the tender process. Six years after inception, GE claimed savings of more than \$600 million — and net savings of more than 8% — by sourcing through reverse auctions. Gary Reiner, GE's CIO at the time, extolled the benefits of reverse auctions in a 2008 interview with Fortune, saying that the organization used them for nearly a third of its total buy.²

“We auction about 30% of our total buy. We spend a lot of time upfront communicating with our potential suppliers, so we’ve agreed on delivery requirements, on the specs that we want, on the quality that we need, and then the only thing remaining is price, and that’s what the auction is all about. And to maintain the integrity of the auction, we commit that if you agree to everything we’ve communicated, and you win the auction, you get the business.”

Gary Reiner, Chief Information Officer at General Electric
 (“Information Worth Billions.” Fortune 10 July 2008)

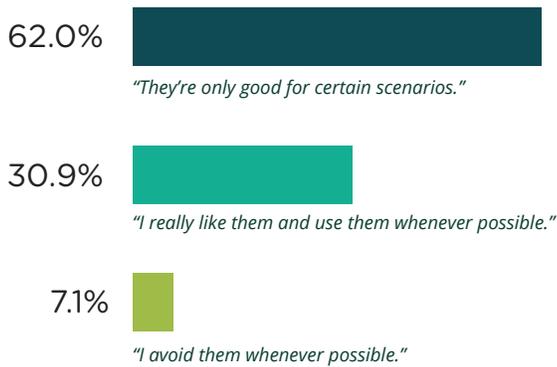
More and more enterprises, interest piqued by the prospect of collaborative bidding and fair market pricing, have begun using reverse auctions. In Purchasing's 2003 Annual Benchmark E-Sourcing Survey, 15% of respondents said they were using reverse auctions. By the 2006 survey, that number had jumped to 31%.³ Our research found that in 2006, reverse auction usage was at 57.4% among respondents.

WHO IS USING REVERSE AUCTIONS?

Most enterprises recognize the potential of reverse auctions. As mentioned above, over 50% of our respondents are using reverse auctions to some extent.

When asked about their general thoughts of reverse auctions, the majority of respondents came out in favor of them:

What are your general thoughts on reverse auctions?



So, what types of enterprises are utilizing reverse auctions in their strategic sourcing arsenal? While there seems to be equally enthusiastic buy-in from the public and private sectors, larger enterprises are far more likely to use reverse auctions than enterprises with fewer than 1,000 employees:

Company Size	Percent who advocate reverse auctions	Use reverse auctions for over a quarter of their items sourced
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10,000+	60.0%	16.7%
1,000-9,999	44.4%	12.7%
100-999	21.1%	10.5%

It's true that reverse auctions have traditionally lent themselves better to bigger enterprises and large government entities. Sizeable publicly traded companies, including Target, Dell, and General Electric are said to be some of their greatest proponents.⁴ This is primarily down to budgets and capacity; the bigger the enterprise, the more money and manpower it has to explore new sourcing opportunities and tools. As a fairly recent entrant to the strategic sourcing playbook, reverse auctions traditionally fell under that category.

However, the evolution of technology has made reverse auctions more accessible to enterprises of all sizes. In their early days, companies had to set up a 'war room' to run reverse auctions. Budget-holders, procurement, IT, and the auction vendors would be held up for hours, even longer when a tech problem arose (which wasn't at all uncommon in the late 1990s). This scene was very similar on the supplier side as well. With today's easy-to-use mobile technology, companies don't need a war room, endless hours, or a large enterprise-level budget to successfully deploy a reverse auction.

There's also an age component that can't be ignored. Our research showed that 95% of professionals aged 30-44 are using reverse auctions to some degree. Millennials and younger GenXers are the inventors of the sharing economy and live in a virtual world, and as such, are reconfiguring the sourcing process within the enterprise. This new wave of sourcing professionals are more apt to embrace streamlined processes that have been simplified by cloud technology.

TAKEAWAY:

Adoption of reverse auctions is rising. They're most popular among A) large enterprises, both public and private, and B) Millennials and younger GenXers.

WHAT ARE THE BIGGEST BENEFITS TO USING REVERSE AUCTIONS?

Our respondents ranked their top benefits to using reverse auctions, and unsurprisingly, cost savings topped the list. Enhancement of the sourcing and procurement process came in a close second, which is also no surprise; as the office of procurement and sourcing becomes more consultative and outcome-focused, it also must become more focused on efficacy and efficiency.

Biggest benefits to using reverse auctions (ranked) :

1. Reduction of purchasing costs
2. Enhancement of the procurement process
3. Increased efficiency in the market

Cost savings afforded by reverse auctions lead to better business outcomes across the enterprise. For this reason, one of the world's largest tech companies uses reverse auctions for over one fifth of its total supplier spend. This same company claims that they are saving over 15% between the reverse auction pre-bid and final bid of contracted suppliers.⁵ The public sector is also an advocate of reverse auctions. In a pilot program in which the Defense Finance and Accounting Service, Air Force, and Coast Guard used reverse auctions, the U.S. General Services Administration reported resultant savings of 12-48%.⁶

Reverse auctions also impact business outcomes through more streamlined sourcing processes. Sourcing professionals can manage more spend and more events due to the efficiency of running an auction. By expediting the negotiation process, category managers are freed up to focus on strategic sourcing and analysis. The entire bidding process can be concluded in under an hour.

DO REVERSE AUCTIONS REALLY ONLY BENEFIT THE ENTERPRISE BUYER?

Most stated benefits of reverse auctions revolve around the enterprise buyer, namely, that they get high value for money. While the majority of respondents (69%) stated that they think running reverse auctions benefits the enterprise, less than half (45.2%) felt that they similarly benefit suppliers. The general perception is that reverse auctions can burn out buyer-supplier relationships.

This can certainly be true, particularly if reverse auctions are over or misused. However, the perception that buyers are willing to sacrifice quality for price, or that they intend to force sellers' hands into accepting rock-bottom prices, is misplaced. In actuality, taking a "lowest bidder wins" approach would be a severe tactical error for buyers. This can lead to an "suicide bidder" situation, one in which a seller wins with a very low price but later proves unable to handle the job (a phenomenon that half of our respondents have experienced).

Instead, buyers should award based on a combination of highest quality and best price. This is the go-to strategy of enterprises that successfully execute reverse auctions. In fact, the lowest price bidders are only contracted in about a third of all reverse auctions performed.

Sellers who proactively engage in reverse auctions can also reap significant rewards, namely, the chance to compete transparently against competitors with more finely-tuned control. Reverse auctions put sellers in the driver's seat; they can choose when to pull out of an auction and always know where they stand compared to the other bidders. Reverse auctions also give sellers increased exposure and connect them to buyers from all over the world.

TAKEAWAY:

While reverse auctions have more obvious benefits for the buyer, they also present huge opportunities for the seller. Enterprises that successfully run reverse auctions will prioritize high quality for a good price, rather than automatically awarding to the lowest bidder.

WHAT SITUATIONS ARE CONDUCTIVE FOR REVERSE AUCTIONS?

Not all sourcing situations call for reverse auctions. Some types of spend aren't conducive to running one, or perhaps the market conditions aren't right. However, if you capitalize on reverse auctions in the appropriate situation, the returns can be enormous.

First, identify whether it is a seller's market or a buyer's market. If the former, sellers are in high demand and may not be as apt to participate in a reverse auction. In a buyer's market, on the other hand, reverse auctions provide an opportunity for buyers to keep prices down and for sellers to differentiate themselves and win critical business.

Next, determine the spend category that you're looking to source. Reverse auctions are most successful when they're employed to source purchases with a low cost of switching and clearly defined specifications that don't vary much between suppliers, such as certain commodities and simple services.

The key is to source something that you can clearly define, so you can pre-qualify it. You also need to be sourcing something that has several viable suppliers, as reverse auctions aren't effective unless they have three or more bidders.

TAKEAWAY:

Use reverse auctions in a buyer's market to source commodities, simple services, and other items with a low cost of changing.

WHAT DOES IT TAKE TO RUN A SUCCESSFUL REVERSE AUCTION?

Although reverse auctions seem fairly straightforward on paper, they're actually more nuanced than they first appear. After identifying whether it's the right situation to employ a reverse auction, it must be executed strategically. Fortunately, reverse auctions are easier to launch than ever before using today's cloud-based solutions.

Beyond the art of building a successful RFP, additional factors that contribute to a successful reverse auction are, as ranked by our survey respondents:

Most important factors to running a successful reverse auction (ranked):

1. Transparent bidding environment
2. Collaborative ability
3. Bid extension
4. Minimum bid decrement

If you've executed an RFP using a tool that isn't equipped to run reverse auctions, achieving collaboration and transparency — and by extension, pulling off a successful event — can be difficult at best, impossible at worst. Suppliers are similarly reliant on adequate technology to engage; more than 50% have felt disadvantaged by an inability to showcase their full capabilities within an electronic bidding mechanism.⁷

It is absolutely crucial to employ specialized reverse auction technology that facilitates communication between stakeholders, enterprise buyers, and suppliers — and catalyzes an organized yet dynamic bidding process. By eliminating the oftentimes charged element of face-to-face negotiation and letting technology be the umpire, sourcing professionals are able to have a solid relationship with the winning supplier.

TAKEAWAY:

Collaboration and transparency — two keys factors that contribute to a successful reverse auction — can only be achieved by running the auction through technology that supports it. Enterprise buyers must select their reverse auction technology carefully.

FIVE STEPS TO RUNNING A SUCCESSFUL REVERSE AUCTION

1

Gauge the market and determine spend specifications.

First, determine whether a reverse auction is the best way to source the item you're looking to purchase. Typically, but not always, these will be commoditized products or services with low cost of switching. Then, collect historic category-spend data and projected future spend. If possible, drill down into line-item detail and outline any market trends.

2

Run an RFI beforehand to ensure you're getting a valid comparison.

Identify potential suppliers and ensure that they meet the basic qualifications to participate in the reverse auction. This is a good time to suss out new suppliers and ensure that all suppliers are aware of the reverse auctions parameters.

3

Outline the reverse auction strategy and finalize all terms up-front.

No reverse auction is the same. Determine the appropriate strategy and create rules and specifications that will lead the auction to a successful outcome.

4

Train your suppliers and internal stakeholders.

Education is critical to a successful reverse auction. Get buy-in from internal stakeholders, making sure that they understand the benefits and tradeoffs of auctions. Ensure that your suppliers understand why you're running a reverse auction, and how it will be managed and judged. To give them the opportunity to become familiar with the tool prior to the auction, invite them to log in ahead of time to draft their bids and ask any questions beforehand.

5

Execute a dynamic reverse auction.

Choose what your suppliers are able to see at a line item and total bid level — lowest price, overall bid rank, etc. — and expedite the auction by setting the minimum decrement that suppliers must decrease their bids by each time. Maximize value and prevent eBay-style bid sniping by allowing your auction to extend when last-minute bids are received.

CONCLUSION

Since their invention in the early 1990s, reverse auctions have been proven to positively impact the bottom line. When executed successfully, reverse auctions help enterprises attain significant cost savings without forfeiting quality or deteriorating supplier relations.

Although they are predominantly used by larger enterprises (and favored by the tech-savvy younger workforce within those enterprises), reverse auctions have something to offer organizations of any size.

The fulcrum upon which a successful reverse auctions rests is a proper e-sourcing tool — one that facilitates collaboration and transparency.

When considering reverse auctions, effective sourcing departments will:

- Regard reverse auctions as a multi-variable equation, one that includes quality (first and foremost), price, and other value-added factors
- Conduct reverse auctions only when the situation warrants one; for example, when sourcing commodities
- Treat suppliers fairly, conscious of the fact that unsuccessful sellers ultimately lead to unsuccessful buyers

By carefully planning a reverse auction, educating all parties involved, and executing it using technology properly equipped for the job, enterprises can reap benefits including (but not limited to) reduction of purchasing costs, enhancement of the procurement process, increased efficiency in the market, and access to a global supplier base. As a figurative cherry on top, they can also enjoy savings that exceed 20%.⁸

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Scout RFP provides a new breed of cloud-based strategic sourcing solutions that help organizations achieve better outcomes and make a bigger impact. Leading brands like Intuit, CEMEX, Splunk, Jo-Ann Stores, ServiceNow, Cerner Corporation, and Zebra Technologies trust Scout's automated sourcing and auction platform to deliver greater value through collaborative business engagement. 22,000 active users across 55 countries have chosen Scout's simple, effective interface to streamline supplier selection, centralize data, and make more informed purchasing decisions, faster. Scout is headquartered in San Francisco, and funded by New Enterprise Associates (NEA) and GV (formerly Google Ventures).

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