Online Auctions

A BuyIT e-Procurement Guideline
Issued by the BuyIT Best Practice Network
November 2004

Primary Contributors:

Supporting Contributors:

ARI BA®

BAE SYSTEMS

NHS Purchasing and Supply Agency

OGC

Office of Government Commerce

Capgemini

Rolls-Royce

Shell

This guideline is available on the BuyIT website: www.buyitnet.org. The materials may be adapted freely and used for your own e-business strategy development, but may not be re-used or sold for direct commercial gain.
The information in this document is given in good faith but IT World cannot accept any liability consequent on reliance upon the information contained in this document.
Online Auctions
A BuyIT e-Procurement Guideline

Forewords ................................................................. 3

Key points ................................................................. 4
  Return on Investment ................................................. 4
  True Market Prices ..................................................... 4
  Benefits to both parties .............................................. 4
  Who is using online auctions? ............................... 4
  What is an online auction? ........................................ 5
  How does an online auction work? ....................... 5
  What makes a successful online auction? ............. 7
  Benefits of online auctions .................................. 7
  Risks associated with online auctions ................ 8

Organisational Considerations ........................................ 8
  Building the business case ................................ 8
  Designing a purchasing and category strategy .... 9
  The procurement organisation in the era of online sourcing .... 9
  Getting supplier buy-in ...................................... 9
  Driving best practice ......................................... 9
  Supplier implementation .................................. 9
  Online auctions and e-procurement ................ 9
  Get the word out .............................................. 9

Selecting an online auction service ................................ 9
  What does my business need? Assessing internal needs .... 9
  What are the options? ................................... 9
  Main benefits of each service type ......................... 9
  How do I decide which type of service to choose? ... 9

Success factors ....................................................... 9
  Preparation ..................................................... 9
  Ethics .......................................................... 9
  Selecting the best bidding format .......................... 9
  Sourcing Optimisation ...................................... 9
  The event itself ............................................. 9
  Who pays? .................................................... 9
  Post-event activity .......................................... 9

What is the future for online auctions? ......................... 9

Functionality checklist ............................................. 9

Case studies .......................................................... 9

The BuyIT e-Procurement Best Practice Network .......... 9
Forewords

The use of Online Auctions is a significant development in good procurement practice - and a prime example of where the use of ICT can benefit organisations. Where used appropriately, there have been many positive outcomes in both the public and private sectors - to the benefits of both the organisations and their suppliers. I am delighted that the BuyIT Early Adopter organisations have produced this Best Practice Guideline, which provides clear guidance to help others take full advantage of the many benefits that can be achieved from these developments.

Paul Boateng
Chief Secretary
HM Treasury

The global marketplace is changing fundamentally. Suppliers around the world are now able to sell their wares and compete on a global scale. A strategic focus by boardrooms on Spend Management, supported by internet technologies, is already seeing many blue-chip buying organisations achieve massive cost savings through new supply chains.

Knowing where these new suppliers are, and how best to source from them, is key. As is having the right tools and processes in place to deliver the savings. Online Auctions is one of the areas where IT can make an immediate impact – this document helps you understand how.

Steve Muddiman
VP of Marketing for EMEA
Ariba Inc.

Online Auctions are an important element in the success of e-Procurement both from the buyer and supplier perspective. As well as producing significant sourcing benefits, used properly they can also improve supplier relations and help to raise the profile of procurement within organisations. They must, however, be used within the context of a wider sourcing strategy. There is also the need to adhere to best practices on areas such as ethics and communications. Developed by BuyIT members, this Best Practice guideline provides a clear understanding of all these issues from both a buyer and supplier viewpoint and is an invaluable aid to help organisations gain the benefits of Online Auctions.

Frits Janssen
CEO
BuyIT Best Practice Network
Online Auctions
A BuyIT e-Procurement Guideline

Introduction to this Guideline
This Guideline describes the benefits and use of Online Auctions (often also known as e-Auctions) within an enterprise and sets Online Auctions in the wider context of Global Supply Management. It also provides advice to assist buyers and suppliers choose a suitable solution that integrates the technology with services and supply market knowledge, enabling them to make optimum use of the tool.

This Executive Summary has been written for CEOs and senior managers to provide an outline understanding of the role of Online Auctions in e-commerce and the important strategic questions to ask.

This guideline should be read in conjunction with the Executive version of the BuyIT ICT Best Practice Guideline on Online Auctions which provides more in-depth information on the subject. Both guidelines can be found at http://www.buyitnet.org

Key points

Return on Investment
Experience shows that online auctions deliver a rapid return on investment.
Online auctions are an important element in a global supply management strategy designed to reduce the total cost of bought-in goods and services.
Sustaining that ROI requires a comprehensive program of change.

True Market Prices
Online auctions exploit internet technology to enable companies to arrive at true market prices for direct materials, capital goods and services.
Most online auctions take the “reverse auction” format where suppliers seek to secure business by tendering lower bids than their competitors. However this does not mean that the lowest bid necessarily wins: today’s auction technology enables the buyer and supplier to take into account many non-price factors.

Benefits to both parties
Online auctions provide benefits to suppliers as well as buyers, and can help arrive at more robust commercial relationships than the old sealed bid system.
The standardised RFQ process that precedes an auction event improves understanding of requirements and reduces operational risk.

Who is using online auctions?
Over recent years online auctions have become more widely accepted as a purchasing tool in large organisations. Here are a few examples:
H.J. Heinz, one of the world’s best known processors and marketers of foodstuffs and condiments, has conducted hundreds of online events, identifying savings in excess of ten percent on a spend volume of approaching one billion dollars.
Global pharmaceuticals company, Aventis, has used online sourcing events to drive greater standardisation in the purchasing function and to assist suppliers in focusing on the technical aspects of the pre-bid, focusing on the internal customer’s needs.
White goods manufacturer, ElcoBrandt, used an online sourcing platform to standardize its RFQ creation process. It found that this forced buyers to look more carefully at the specification, saving time and risk. The company also reported savings of around ten percent on items such as ball bearings and heating elements and on non-production items such as transportation and printing.
Online Auctions
A BuyIT e-Procurement Guideline

The UK’s largest buying consortium Nisa-Today’s reported a 500 percent incremental return on investment compared with traditional sourcing, and average project savings of 22 percent from online auctions. The company also reported reduced risk and an improvement in the procurement process.

What is an online auction?

An online auction is an internet-based activity, which is used to negotiate prices for purchasing or sale of direct materials, capital or services.

<table>
<thead>
<tr>
<th>Forward (Seller) Auctions</th>
<th>Reverse (Buyer) Auctions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td>Open</td>
</tr>
<tr>
<td>Closed</td>
<td>Reverse</td>
</tr>
</tbody>
</table>

Online auctions can be used to sell: these are called Forward (or Seller) Auctions and closely resemble the activity on B2C auction websites. Companies have used forward auctions to sell off surplus assets or in times of shortages – highest bid wins.

However most companies are now using Reverse (or Buyer) Auctions, where purchasers seek “market pricing”, inviting suppliers to compete for business in an online event. The objective is typically to arrive at the lowest possible total cost; however this must not be confused with lowest price. There may be other objectives such as supplier consolidation or finding new suppliers to reduce risk.

Auctions can be either private/closed where there are typically few bidders who have no visibility of each other’s bids, or open, where a greater number of participants are invited. In this case participants have visibility of either their rank or the bidding itself.

When used, the technique can replace the conventional methods of calling for sealed paper tenders or face-to-face negotiations.

How does an online auction work?

In an online auction the buying organisation prepares a specification of the goods or services to be bought (using standard RFQ templates) and then decides how to structure the online auction event (auction format, strategy etc.)

The buying organisation selects bidders, sends them copies of the specification, commercial conditions and bid rules and arranges for suppliers not yet experienced in the process to be trained.

At the start of the event itself, suppliers log on to a website. They can place and modify bids at any time during the event. The identities of bidders are usually masked; however, suppliers are provided with a view of the prices being entered or their ranking in relation to other suppliers involved in the event.

Typically events will run for an hour or less with extensions occurring if bidding continues in the last few minutes.

The objective of the auction is to derive the lowest total cost for a good or service during the sourcing process. This does not necessarily mean that the lowest bid wins, though of course one of the aims is to identify the lowest open market pricing. An important feature of an online auction is that the results gained are highly visible and bids are comparable.

Online auctions can typically secure cost reductions in the order of 10 to 20 percent on the first event for a particular commodity and three to five percent in subsequent events. Combined with their quick implementation, and relatively low entry cost, they can therefore secure a very rapid return on investment. However, it must be emphasised that success depends on at least the same market knowledge and sourcing skills as the paper-based process it replaces. Typically, more time is invested up-front in achieving a very tight RFQ specification than in a traditional sealed bid process, but this saves time that would otherwise be spent on post-bid negotiations and clarifications. Online auctions should not be regarded as a technology-
only solution – you should regard online sourcing as a tool that will help to drive best practice, not as a technology fix that can replace skills and experience.

In fact, to secure the maximum returns from online auctions, traditional skills need to be enhanced and extended through a programme of global supply management. Such a programme aims to balance the potential cost savings of online auctions with the potential risks (for example, to ensure internal compliance and to ensure that new suppliers, possibly from new low-cost countries, are brought on board quickly and effectively with the right supplier implementation strategies).

A systematic approach is also required to sustain the momentum delivered by early gains. Typically a company’s first experiences with online auctions will be good, as they will pick the “low-hanging fruit”, possibly leading to spectacular cost savings on individual items. But the long-term gains will come as a result of increased spend visibility across the enterprise and savings on “non-traditional” areas. For example, in addition to achieving savings on key production components, a manufacturing operation might extend online sourcing to cover capital expenditure or legal and financial services.

Companies that have adopted such an approach report that they have found that it has brought additional value and resulted in solutions that have proved to be robust over time.

Online auctions can be used independently of e-Procurement initiatives, or can be integrated, for example through a catalogue-based purchasing system. In fact, a company can deploy online auction events irrespective of whether it has e-Procurement, ERP, participates in a marketplace or has none of these. This is also true of suppliers, who simply need an Internet browser to take part in an event.

Typical Reverse Auction Event

![Typical Reverse Auction Event Diagram](image-url)
Online Auctions
A BuyIT e-Procurement Guideline

What makes a successful online auction?

Online Auctions Do’s and Don’ts

Strategy
- Is this a core competence for my business?
- How does this fit with my Procurement strategy?
- How will this fit with other eProcurement activities?
- What approach to take: full service, supported or self service?
- What % of my spend is eAuctionable?
- What do I want to achieve by running eAuctions?

Preparation
- Decide on no. of suppliers to invite
- Provide clear specification
- Ensure there is sufficient market competition- or review approach
- Gain internal commitment to implement the result
- Develop robust lot strategy
- Agree evaluation criteria
- Set bid decrements
- Train suppliers
- Agree bid format & timing of event
- Set clear rules for the event
- Set opening price

Event
- Ensure proxy bidding process in place
- Monitor supplier bidding
- Monitor technology reliability
- Monitor bidding tactics
- DON’T
  - Act unethically
  - Get carried away with the hype… the lowest bid isn’t always the best answer

Follow up
- Finalise sourcing decision
- Obtain internal approval to decision if required
- Give feedback to all suppliers, successful or not
- Capture knowledge gained
- Review new supplier capabilities
- Devise supplier implementation strategy
- Monitor progress to ensure identified savings are realised
- DON’T
  - Underestimate the importance of follow through

Buyer
- Plan to reverse auction everything
- DON’T
  - Plan the event at the wrong time
  - Review new supplier capabilities

Supplier
- How much will this impact my sales pipeline?
- How best to respond
- How will this impact my customer relationships?
- How will I tailor my approach by customer/product/timing?
- What do I want to achieve?
- DON’T
  - Refuse to participate on principle

Benefits of online auctions

The use of the online auction process provides benefits to both buyers and suppliers:

Supplier benefits – once trained in online auctions, suppliers find them easy to participate in and they give exposure to a business opportunity without the usual lengthy sales process. Suppliers have more information on market pricing and the evaluation process than they would get from a traditional sealed bid tender. An anonymous online event creates a “level playing field”, i.e. a fair and competitive market. Suppliers are also given more than one opportunity to bid, thus taking away some of the risk and guesswork inherent in sealed bids. The award process is transparent and suppliers generally receive a fast decision after the event. Suppliers can, of course, use online auctions to arrive at market prices for their own purchases of raw materials and components, thus potentially driving down costs throughout the supply chain.

Buyer benefits – by increasing the competition between suppliers, buyers arrive at true market pricing, which will typically lead to significant savings. They also increase their ability to test new suppliers, reducing operational risk. The advanced RFQ technology in online auction software enables buyers to achieve best total cost (costs and risks) as opposed to “cheapest” – a range of factors can be considered and weighted e.g. quality, delivery and specification. As part of a comprehensive global supply management strategy, online auctions offer significant potential for internal learning and skills development, and potential reduction in the elapsed time of the overall sourcing cycle.

Benefits to both buyer and supplier – buyer-supplier relationships are no longer one way; buyers and suppliers can see the bids of other suppliers in real time, creating a true market and enabling suppliers to benchmark themselves against their peers. The greater transparency of this process therefore highlights the integrity of the buyers’ sourcing decisions. Supplier relationships are thereby enhanced. Online auctions also
facilitate true globalisation: suppliers can be encouraged to participate and bid regardless of location. The better standards of specification (through the RFQ process) can lead to a much better understanding by both the buyer and the supplier of what is being bought and what is being supplied.

**Risks associated with online auctions**

With any process, there are risks associated with its use. It is important that buyers and suppliers understand these risks so that their effects can be minimised. For example, suppliers may feel that they are not able to demonstrate the overall value of their product or service in an auction that is focused on lowest price bid. Conversely, suppliers that make the lowest bid but are then not awarded the business may feel cheated. This risk can be overcome by being clear about the weight of the no-price or so-called “transformation factors” during the pre-bid.

Without effective change management and training of both buyers and suppliers expectations may never be reached and inexperienced suppliers may bid below a sustainable price.

A negotiation strategy (and/or event strategy) is therefore essential to deliver the best result in an online auction. Again, it is necessary to stress that online auctions are only a tool in the buyer’s toolbox, and in the wrong hands a tool can do more harm than good. Strong programme management is imperative to ensure effective choice and prioritisation of commodities, and the full realisation of the benefits identified.

These issues are discussed in the next section, “Organisational considerations”.

**Organisational Considerations**

While many organisations have experimented with online auctions on a “just do it” basis, often experiencing positive results, the full benefits will not be realised unless online auctions are integrated within a new organisational framework. As we will see, online auctions can generate significant return on investment and help drive best practice within the procurement function – but they must be used correctly.

Think of online auctions as a tremendously powerful tool – like a chainsaw – that can deliver fantastic benefits in the hands of a skilled and experienced workman, but can also do irreparable damage in the wrong hands!

**Building the business case**

Building online auctions into the purchasing process involves change, and organisational change management requires you to build a business case and win the buy-in of a number of important stakeholders. These stakeholders often have conflicting interests and it is critically important that you do not over-sell the benefits to any of them. You must tread a fine line between exciting people about the opportunity while being completely honest about the input that will be required from various functions and individuals. You must also be honest about the potential pitfalls.

For example, senior management and the finance function will be excited by the message that online auctions can help identify cost savings. However there are already several problems here: if you do not have a strategy for implementing new suppliers rapidly, the identified savings will not be fully realised, and if the new suppliers do not work out you may end up simply creating new business risks and higher costs. You are also likely to find that your line management (for example, engineers, R&D, production) is less than thrilled by the cost savings argument: they will have their own favoured suppliers, and they will be suspicious that a low-cost option will be forced on them at the expense of quality. Many will argue that online auctions are fine in theory, but would not work for “their” commodity or service. The solution is to put the processes and structures in place to support internal customers as “business partners”: the procurement function must link into the organisation’s business goals and objectives.

Contract approvals boards will need convincing that the online auction process is fully fair and transparent. This will not be difficult so long as they are involved and consulted. Suppliers – especially incumbent suppliers – will likewise want assurances that the competition will be fair and that the online auction process is not simply an exercise in squeezing their margins. You will need to make the case that suppliers must set their own margins, regardless of the tender process, and they must be ready to work away from a bidding event if pricing becomes unprofitable. Also remind them that they too are buyers as well as suppliers – online auctions can help your suppliers to drive out costs too, to everyone’s advantage. Finally procurement
managers themselves may see online auctions as a threat to the established way of doing things – nobody likes to be moved out of their comfort zone unless they can see some benefit. You must prepare yourself for resistance and you must have answers; some people are always more resistant to change than others. Make the case that online auctions are only one element in the changing face of procurement, and that overwhelmingly the trend is to provide new opportunities for the procurement professional within the enterprise, and to raise the profile of the purchasing function.

As we will see, an important element in answering the concerns will be to reshape business processes and the purchasing organisation, and to build new skills and competences.

Your first task will be to win over senior managers – you need top-down support to get the project started. But you will also need highly visible support to build traction for the initiative. Go in to the meeting well prepared to present your case, and keep the meeting to the agenda – do not make unrealistic promises, but demonstrate the potential effect savings could make to the bottom line, without hiding the risks. Ensure that you get budgetary commitment to support change such as buyer training and technology investments.

Also, be sure to assess carefully how quickly your organisation can adapt. Some organisations are more mature and ready for change than others. If your company has many different business units, try to determine which are most likely to be enthusiastic, and which are likely to deliver positive results fastest. Getting a project off to a good start with highly visible results will obviously help build a strong case for further investment.

Designing a purchasing and category strategy

If you wish to drive best procurement practice across the organisation, you will need to develop category strategies that are flexible and responsive to budget holders’ needs. Effective category management is essentially about working with stakeholders as business partners, providing the solutions that bring those partners maximum value. To do this you have to be close to the business partner, so you must either run category management as a decentralised function, or you must create a centralised function that understands its role is mainly concerned with supporting business partners, avoiding bureaucracy creep. For spend categories that are common to all business units and functions (for example office supplies) a more rigidly centralised approach is more appropriate.

In all cases, a clear framework of governance and clear allocation of accountabilities will be key do effective change management. In general the carrot works better than the stick: make it easier for the successful business units to cooperate with the new standards and processes, give public recognition for successes, and be prepared to do a lot of handholding with those business units that want to be cooperative but are slow to make headway. Use the stick (for example, setting MBOs or requiring all purchases over set thresholds to be tendered through online auctions) only where business units’ buyers are being neither cooperative nor successful.

Which categories of spend should you tackle and in what order of priorities? Demand planning is a key performance lever that will optimise the impact of online auctions. Demand planning describes the process of systematically identifying, evaluating and prioritising project opportunities. In a large organisation this will typically involve looking at spend across a diverse set of businesses and combining this to go to market in the right sequence. Again, category expertise at the centre, combined with the skills to persuade people of the benefits of combining their spending power through a regional or global online bid process will generally bring people on board.

Go for the low-hanging fruit first to establish traction and build confidence.

The procurement organisation in the era of online sourcing

Strategic sourcing requires new skills and capabilities, but the procurement function is itself under pressure to reduce costs. So there is clearly a resource issue: how do you reorganise to drive change? The answer to this question depends very much on the individual organisation, but organisational research has indicated that the solution for large geographically dispersed companies is to build up a core team that will lead change from the centre, identify opportunities across the enterprise and transfer knowledge to the business units and the different geographies.
Online Auctions
A BuyIT e-Procurement Guideline

A typical flexible hybrid solution under a Chief Procurement Officer might consist of geographical networks embracing centralised or local clusters of category excellence, supported by a central team providing core procurement and contract services, and functional excellence in global supply management. Key competences will include expertise in online sourcing itself, and business improvement (BI) teams for important buying groups such as (see diagram) contract manufacturing and commodities.

A key role of the functional excellence and online sourcing teams will be to identify the “able and willing” in the local buying organisations and to train them in best practices, processes and technologies. They in turn will take the lead in educating local teams.

Getting supplier buy-in

There is more supplier acceptance of online auctions than there once was, but still you need to tread carefully to get their buy-in. Visit suppliers or invite them to briefings to explain carefully the principles not just of auctions, but more broadly of online sourcing. They will have concerns, but they will have useful input too: they know their businesses better than you do, and what they tell you will help you optimise your strategies for online bidding events, for example by identifying better ways to evaluate the relative strengths and weaknesses of suppliers. You should therefore focus on constructive discussions about how to make the process work optimally – move quickly beyond the “to online bid or not to online bid?” debate by politely but firmly stating that this is part of the way you now do business. As a result of hard talking up front, online sourcing will help you to create precise and detailed RFQs that will improve communication and reduce business risks further down the road.

You should also be careful about how many suppliers you invite to the online sourcing events. Too few and their may not be sufficient competition to arrive at a true market price. On the other hand if you invite too many the event will be difficult to manage and suppliers will be discouraged from bidding, feeling they are unlikely to win. Some companies have made their first steps even easier by limiting their first online sourcing events to categories of spend that only involve known, local suppliers. Once the lessons have been learned they can be applied more broadly.

Many buying organisations underestimate the amount of time it takes to educate suppliers in online auction tools. Suppliers with less tech-savvy sales teams may need some extra handholding through their first events, and here the assistance of the auction technology provider can be invaluable.
Driving best practice

Before you can make much progress with online sourcing you need to put some people, process, performance measurement and knowledge capabilities in place.

The first requirement is a clear understanding of the supply base and the criticality of each supplier to the business. Typically organisations segment between strategic partners, value-added suppliers and commodity product suppliers. You will also need to build up market intelligence to gain a clear understanding of the dynamics of the market sectors and to define sector strategies. Online sourcing should be considered for every competitive tender – increasingly, they are used for highly complex projects and for indirect (serviced) spend categories – but it will not make sense in all cases and the auction event strategy will have to be tailored carefully according to the criticality of the supply category and the market dynamics. However, online sourcing methods may be appropriate even where a buyer decides that an online auction is not – for example online RFQs and RFPs can help expedite the communication between buyer and suppliers and can help drive a standardised sourcing process across the organisation.

A large organisation needs to get clear visibility into its spend across all business units. This is often a challenge if the organisation’s supplier and purchasing data is scattered across a large number of ERP and legacy systems. You will need processes that demonstrate that you are sourcing in a rigorous and consistent way, and that supplier relationships are being managed transparently. Online sourcing should be linked into the contracts system. Buyers need to know when contracts are going to come up for renewal, and the business units can only follow contract agreements that have been negotiated if they know where to find those contracts.

To drive credibility for what you are doing in online sourcing, it is important to have performance-reporting tools and KPIs in place, showing the impact on the bottom line. Basic project management and knowledge management competencies must be in place.

Supplier implementation

The purpose of online auctions is to determine market price for goods and services and to identify suppliers who will deliver at lowest total cost. What you do either side of an auction event is more important than the event itself however. As discussed, it is important to get supplier input during the pre-bid (for example through participation in building the RFx) to ensure that they feel a part of the process. A key advantage of online sourcing is that price is taken out of the equation at this stage, and buyers and suppliers focus on understanding and meeting technical elements of the bid, i.e. meeting the customer’s real needs.

It is also vital that when training suppliers you educate them to “walk away” from an auction if the price is too low.

Equally important is the work that you do after the online auction event. Savings identified in online auctions are rarely fully realised without extensive post-award activity to ensure compliance with the contract. For example, organisations will typically optimise their spending practices and contract compliance in one business unit but not across the enterprise (silo optimisation). So you need purchasing compliance and governance processes in place to ensure organisational accountability, visibility and tracking of savings, and audit ability.

There are a number of actions that organisations should take to improve the quality and speed of supplier implementation, including:

Internal actions

- Measure savings percentage implemented and time to implement by branch, plant, commodity, owner etc
- Set goals (departmental and individual MBOs) for implementing savings

External actions

- Establish relationships and accountabilities
- Set programme goals to bring suppliers up to quality standards, technical drawings etc
Online auctions and e-procurement

While the distinctions are frequently blurred, while online auctions are a part of the strategic sourcing process, e-procurement generally relates to transactional buying processes. Organisations should ensure that there is tight integration between the two – prices and terms negotiated through online sourcing should be fed into the e-procurement systems.

Get the word out

Ensure that everyone in the organisation knows about online sourcing in general and gets to hear about your successes in online auctions. Produce a brochure with an executive-level introduction, and send out a regular newsletter. Create a supplier-facing communications medium as well explaining what you are doing and why, and demonstrating supplier benefits.

Selecting an online auction service

What does my business need? Assessing internal needs

Before assessing the level and type of services available, it is critical to assess internally your needs and objectives. The following questions should be considered.

* Is global supply management (including global supply strategy, market and commodity expertise, spend management, supplier selection, negotiation, supplier intelligence, low cost country sourcing) a core competence for my business? Should it be?

If buying represents an important long-term market differentiator for your business, you might see the use of online auctions as the next stage in maintaining this position.

* How far advanced are we in supply management techniques? How far do you wish to travel, and how quickly? What would be a sensible roadmap for moving forward?

Four stages can typically be observed in most organisations:

- Traditional: purchasing techniques are still fully manual
- Emerging: the organisation has experimented with online auctions, but these have gained no traction and though there has been an impact on the bottom line, only an insignificant volume of spend has been addressed, and online auctions are not integrated within the procurement process
- Progressive: online methods are being standardised for sourcing and e-procurement. A significant proportion of spend is being sourced online, enough to deliver competitive advantage
- Next generation: the organisation is integrating online sourcing within a complete strategy for global supply management and is sourcing upwards of 50-80 percent of external spend online

How do online auctions fit within my overall supply management strategy?

Consider whether they represent a stand-alone online sourcing tool to be used to bring quick returns from ‘spot’ buying of commodities; or whether you see them becoming part of the buying process for all goods and services (direct and indirect) in a seamless continuum which includes spend analysis and strategy, requirements management, sourcing management, supplier implementation and development, and supplier relationship management.

How developed is my purchasing department’s knowledge of the supply market?

An online auction requires a detailed specification and knowledge of the market prior to the event. A robust overall purchasing process and capability is required to deliver success.

What is the structure of my purchasing department (centralised/decentralised)?
Online Auctions
A BuyIT e-Procurement Guideline

Different procurement structures will demand differing provider solutions. For example, a centralised European strategic sourcing group with high overall spend visibility and detailed commodity sourcing plans will have differing needs to a decentralised primarily transactional group. Both can benefit from online auctions but to maximise the benefit differing provider solutions may be required.

What % of my expenditure is suitable for an online event?

A few high value items may constitute a major proportion of addressable spend. But you will need to consider factors such as spend categorisation, segmentation and market structure if you are going to identify the commodity groups that will benefit most from online auctions. In addition you need to consider the existing contractual arrangements.

What is my experience to date with the use of online auctions and B2B?

If your organisation has no (or very limited) experience of online auctions, there will almost certainly be erroneous pre-conceived ideas among your purchasing team. You should move to address these early on, in partnership with your provider. In particular you must put to rest the idea that online auctions will ever replace human expertise on supply management. Online auctions are an important tool, but like any business tool, they are only effective in the hands of a professional. If you have invested in a software-only solution without the necessary support services, it could be that initial experiences have been negative, causing disillusionment about online solutions. Conversely, if you have worked on isolated auctions (typically with a consultant) it may be that you have experienced one or two spectacular successes but online sourcing has failed to gain any traction within the organisation. In this case, you need to re-educate your purchasing team to view online auctions in a wider context.

What is my objective when considering online events?

A basis for an online auction strategy can be purely to establish real-time market pricing for procured products and services and to increase the transparency of purchasing decisions. However there are other key benefits to the organisation, and there are potential risks too. It is important that these benefits and risks should be fully appreciated prior to any provider and service selection. They might include:

- Supplier rationalisation: reducing the number of suppliers to improve supplier relationship management
- New supplier identification (to turbo-charge the competition)
- Low-cost country sourcing: identifying suppliers in unfamiliar low-cost countries such as China, India and Eastern Europe
- Manufacturing outsourcing – your objective might not be simply to source commodities, but to outsource operations. What are the benefits and risks?
- Other operational re-engineering

What resources do I have available to support implementation?

The internal resources you have available for buyer and supplier training, event support and change management will have a large bearing on the level of service you will need from the service provider. A detailed consideration of the commitment of your organisation to the process needs to be undertaken (a self service tool without commitment to use or sufficient internal training resources is a wasted investment and will cause disillusionment).

What will be the impact on supplier and internal stakeholder relationships?

The online auction tool itself is a negotiation interface between the buyer and supplier. It is therefore important to consider the cultural fit of the provider’s system – the look and feel of the processes – with your own organisation and that of your suppliers. Once adopted these may have an impact on your reputation within the supply base.

What are the options?

There is a range of software and service providers offering online auctions capabilities today:
Online Auctions
A BuyIT e-Procurement Guideline

As an add-on to the functionality of their e-Procurement application e.g. CommerceOne, Oracle, Ariba, mySAP

As part of marketplace functionality e.g. Covisint, Exostar, CPG Markets

Niche providers that focus solely on supporting online auctions e.g. B2eMarkets, Goodex, and Portum. Often a software-only provider will partner with a consultancy to provide a comprehensive service to the client company

Providers that offer online auction solutions backed by a range of service and knowledge support solutions for global supply management, e.g. ARIBA

Many of the online bidding providers are also major players in e-Procurement solutions such as catalogue-based online purchasing.

However, the functionality of their online auction solutions and the level of support provided are generally not as rich as from the providers whose expertise is firmly rooted in global supply management. The type of provider and level of service and which is most suitable is dependent on your business needs and internal business profile. In particular it depends on the current maturity of your purchasing operation, and where you want to go with it.

**Full support:** the provider drives and executes the whole sourcing process, including selection of best areas of expenditure for auction, supplier search, selection of event type and event preparation and execution.

**Supported events:** typically the customer decides on which areas of expenditure are to be auctioned and the event strategy. The provider manages the preparation and running of the event.

**Self-service:** the customer manages all aspects of an online event apart from technical support of the technology.

**Global supply management**: online sourcing is integrated within a complete supply management platform, giving the customer the ability to design, automate, and manage their entire end-to-end supply management process.

The four types of service available, with typical support packages, are described in the table below. A second table highlights the main benefits of each service type.

<table>
<thead>
<tr>
<th></th>
<th>Full Support</th>
<th>Supported Events</th>
<th>Self Service</th>
<th>GSM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customer empowerment</strong></td>
<td>Provider helps raise awareness and educate your purchasing community about online bidding</td>
<td>Customer decides on the commodity or service to be bid online</td>
<td>Customer decides on the commodity or service to be bid online</td>
<td>Provider’s supply management analytics, knowledge base and consulting services enable customer’s purchasers to analyse enterprise spend</td>
</tr>
<tr>
<td><strong>Strategy definition</strong></td>
<td>Provider aids in assessing the spend within your organisation suitable for online bidding</td>
<td>Customer constructs the strategy behind the RFQ creation and decide on how to ‘lot’ the business</td>
<td>Customer constructs the strategy behind the RFQ creation and decide on how to ‘lot’ the business</td>
<td>Customer draws up strategy for requirements management based on analysis of spend data and commodity information. Provider supports</td>
</tr>
</tbody>
</table>
# Online Auctions

## A BuyIT e-Procurement Guideline

<table>
<thead>
<tr>
<th>Event definition</th>
<th>Provider suggests the appropriate ‘bidding format’ (see below) to use and structure the event in the system appropriately</th>
<th>Customer selects the suppliers invited to the event (sometimes with the help of a supplier database maintained by the provider)</th>
<th>Customer selects the suppliers invited to the event (sometimes with the help of a supplier database maintained by the provider)</th>
<th>Online process information and event history database suggests optimum event structure and bidding format – supported where necessary by provider consulting services.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supplier selection and training</td>
<td>If necessary, provider will suggest suppliers in their database which the customer may want to consider in their online event</td>
<td>Provider trains the suppliers prior to the event</td>
<td>Customer is responsible for supplier training.</td>
<td>Solution provides in-built functionality for enhanced sourcing event management; backed by consulting and education services such as supplier training.</td>
</tr>
<tr>
<td>Event management (technical)</td>
<td>Provider resolves any connection or firewall issues impacting the supplier’s ability to log on to the system</td>
<td>Provider monitors and supports the event on the day</td>
<td>Customer is responsible for running and monitoring events</td>
<td>Sourcing services available to prepare for events where required. Market operations services available on the day.</td>
</tr>
<tr>
<td>Event management (rules and processes)</td>
<td>Provider ensures processes are followed and rules are enforced (both rules for suppliers and for buyers)</td>
<td>Customer is responsible for post event analysis and tracking implementation</td>
<td>Customer is responsible for setting processes and rules regarding the event</td>
<td>Sourcing tools and process information provide robust and structured environment for event management.</td>
</tr>
<tr>
<td>Technical support</td>
<td>Provider monitors the online event on the day and provides technical support to the suppliers where necessary</td>
<td>Provider monitors the online event on the day and provides technical support to the suppliers where necessary</td>
<td>Provider is responsible for technical support if there are issues with the provider’s server or system (customer is responsible for assistance to buyers and suppliers for any technical support).</td>
<td>Provider supports with software implementation and maintenance and technical support.</td>
</tr>
</tbody>
</table>
## Online Auctions
### A BuyIT e-Procurement Guideline

<table>
<thead>
<tr>
<th></th>
<th>Full Support</th>
<th>Supported Events</th>
<th>Self Service</th>
<th>GSM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decision support</td>
<td>Customer makes the final sourcing decisions and approves each stage of the process. Provider assists with post event analysis</td>
<td>Customer makes the final sourcing decisions and approves each stage of the process</td>
<td>Customer is responsible for final sourcing decisions, post event analysis and tracking implementation</td>
<td>All decisions with customer. Provider service includes in-built platform support for customer’s award decisions, contract management and post-event analysis and tracking information.</td>
</tr>
<tr>
<td>Supplier implementation</td>
<td>Provider may customer assist with post event analysis and tracking implementation</td>
<td></td>
<td></td>
<td>Integrated software and tools for implementing and managing new suppliers.</td>
</tr>
</tbody>
</table>

### Main benefits of each service type

<table>
<thead>
<tr>
<th>Full Support</th>
<th>Supported Events</th>
<th>Self Service</th>
<th>GSM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provider helps to drive the process through the organisation</td>
<td>Customer is able to focus on core auction skills (provider responsible for administration of events)</td>
<td>Facilitates in house growth of online bidding expertise across the whole auction process</td>
<td>Provider delivers complete solution platform to enable a fully programmatic approach to GSM, of which online auctions constitute an important part.</td>
</tr>
<tr>
<td>Provider draws on experience to expel any misconceptions surrounding the process</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provider acts as an enforcer of the rules and processes surrounding an online bidding event. This often improves the reception within the supply base as the provider is viewed as an objective, independent adjudicator who provides a fair and ethical platform on which the event is run</td>
<td>No strain on internal resources for non strategic elements of online bidding (technical checks, call centre support etc)</td>
<td>Increases buyer ownership of the process</td>
<td>Customer is fully in control of decision-making based on a full range of flexible event management options and the knowledge and experience stored in an event database. Early identification of potential cost savings and likely risks.</td>
</tr>
<tr>
<td>Service may include assistance in market analysis and identifying suppliers to be considered for invitation to an online event.</td>
<td>Provider acts as an enforcer of rules and is viewed as an independent adjudicator providing a fair and ethical platform on which events are run</td>
<td>Facilitates online bidding as the default methodology for determining market price</td>
<td>Online access to market analysis, commodity information and other resources. The provider’s expertise is available online, backed by tailored</td>
</tr>
</tbody>
</table>
Online Auctions
A BuyIT e-Procurement Guideline

| Provider is responsible for training the suppliers and the administration during events which enables the customer to concentrate on the strategic thinking behind online events | Increased flexibility to customers who can create internal supplier training packages and adopt processes to suit their business | Complete package of training and education resources available online, backed by ad hoc services as required. |

How do I decide which type of service to choose?

The above choices are not necessarily mutually exclusive: providers typically offer a flexible portfolio of products, and different service levels may be appropriate to different areas of your business. For example, an organisation might start with a full service solution but then invest in self-service for smaller items of spend.

Questions for providers could include:

- What is the long-term vision/sustainability of the provider within the market? It is important to answer this question first; do not be distracted by detailed technology checklists!
- Is the provider essentially a software-only vendor, or can it provide a full service embracing technology, information and consulting services?
- Does the provider develop the software or is it bought in?
- What is the provider’s technology roadmap?
- What is the scope of support available – local, regional or global coverage?
- What is the depth and breadth of the support – how deep is the provider’s commodity knowledge, and how extensive is the market reach?
- What results (volume sourced, identified savings) can the provider demonstrate?
- What is the provider’s experience of organisational change management and programme development and rollout?
- What is the product portfolio of the provider – i.e. can the provider offer full support, supported events, self-serve and GSM?
- How does the provider align with your business culture?
- How secure is the system and use of company data held within it?
- How robust are the provider’s tools (e.g. can it run events concurrently and what is the maximum capacity?)
- What pricing and pricing structures are available? (Full support may be charged as a % of the spend whereas self service may be a licence fee – consider the objectives you have and make sure the pricing structure aids those objectives)
- Does the company or provider host and maintain the service?

A suggested functionality checklist is provided at the end of this guideline.
Success factors

Having selected your service provider and specified the way you wish to use online auctions, there are some factors that lie behind a successful auction event. Here is a checklist of items to consider.

Preparation

Preparation is a critical phase in creating a successful online auction:

How much competition exists within the market?

Consider the number of invited suppliers and the need for a minimum number to compete. What is the complexity of the market? Are there any reasons why an incumbent supplier should be given preference e.g. for providing break-through technology.

Specify your requirements accurately and in a readable format – this is essential for suppliers to compete fairly on event day.

Is there internal commitment to implement the event result? Work with the stakeholders prior to an event and ensure they have agreed and support the process.

Ensure that the event is structured to enable the outcome to match your required strategy. For example if you are looking to consolidate your supply base, you will need to reflect that in the number of lots created as potentially each lot could be sourced to a different supplier.

Agree all evaluation criteria prior to the event – to gain full benefit the online auction must be the final pricing negotiation.

Choice of bid format – select carefully the most appropriate bidding format for the category being bid and the conditions within that market at the time of the event – see Bidding Formats, below.

Training of suppliers – communicate with the invited suppliers on a regular basis. Ensure they understand why the process is being used, how it will work and what they can expect during and after the event – see Ethics, below.

Set clear rules for the event – ensure both buyers and suppliers are subject to ‘rules’ of the event. These might include guidelines on discussions allowed before and during the event between the two parties, ensuring a cost breakdown will be provided by the supplier after the event and enforcing that offers are not accepted by the buyer through any channel other the online auction.

Opening price – If this is set at the wrong level it will have a detrimental effect on the event outcome. It should be higher than the anticipated market price.

Bid decrements – care is needed to allow the right granularity for bid decrements to encourage bidding.

Pre-loading of first bid – Ensure that this is done by suppliers prior to the event as it often takes far more time than anticipated.

Ethics

While there is far greater acceptance of online auctions by suppliers than just two years ago, they are still perceived by many as swinging the balance of power in favour of the buyer. It is therefore incumbent on buyers to ensure that suppliers are treated fairly and helped to make the transition to using this new tool.

If it appears that buyers are misusing the technology to their own advantage e.g. by placing their own bid to drive the price down in an event, online auctions will fall into disrepute and take-up will be strongly resisted. You must be squeaky clean if online auctions are to work.

Only invite suppliers to bid who are capable of providing the products or services under auction. The buyer confidence in the suppliers should be sufficient to award the contract to the best price. This means that it is essential to pre-qualify suppliers comprehensively.
Online Auctions

A BuyIT e-Procurement Guideline

All parties should be given adequate and full communication of the online auction process and products or services under auction to ensure that suppliers are appropriately prepared.

Suppliers that have not experienced online auctions will require more familiarity training. Running a dummy event is a useful way to do this. Key is the recognition that the event is only a small part of the process and that thorough preparation is vital. Because the event is so rapid and judgement can go out of the window in the excitement, suppliers must understand their own minimum price position and be encouraged to stick to this.

It is also fair and wise to follow up after the event. Suppliers who were not successful in winning the business may not have understood fully how to exploit the online auction event; they may appreciate feedback and help in identifying how far they fell short of the prevailing market price. This dialogue is important for longer-term competition and a sustained reduction in market prices. It helps to maintain sufficient suppliers in the marketplace and ensures that the market inefficiencies (not just margins) are being identified and eradicated.

Selecting the best bidding format

There is a diverse range of bidding formats available from providers in the market. Some of the most popular bidding formats and their application are described below:

- Traditional Reverse Bidding enables buyers to collect bids from suppliers and evaluate them on the basis of price and other factors.
- Transformation Bidding enables buyers to transform non-price factors into price factors for better comparison and evaluation of suppliers.
- Rank Order Bidding protects buyers where supply markets are thin or when they don’t want to reveal the market price for an item. It can also protect against supplier collusion. Suppliers only see their bid and current rank, hiding other bidders’ pricing.
- Multivariate Bidding allows suppliers to compete for business on the basis of multiple non-price factors such as quality, lead-time, payment terms and warranties. Suppliers see their ranking and the improvement they need to make in their pricing to become the most competitive bidder overall.
- Index Bidding allows buyers to solicit bids from suppliers relative to an established index used to measure fluctuations in (for example) the economy or financial markets. Index bidding is appropriate for commodities whose prices fluctuate greatly over time: the index is represented as zero and bids can be positive (premium) or negative (discount).
- Line Item Bidding allows buyers to collect individual bids for each line item in a ‘lot’, or bundle of items to be awarded to a single supplier.
- Cost Breakdown Bidding gives buyers insight into suppliers’ cost structures

Sourcing Optimisation

The bidding formats above are likely to remain the mainstay of online sourcing for the foreseeable future. However these formats are becoming more sophisticated, incorporating advanced techniques such as optimisation.

In addition to helping buyers to look at multiple factors (from price to delivery terms), optimisation technology also enables buyers to apply constraint-based rules (such as split of business) to arrive at the best sourcing award decision. An example will help to demonstrate how optimisation can help a buying organisation to reach a better sourcing decision:

Situation: A buyer for a high-technology company needs to source a high-quality injection moulded casing for a new product line due out the following quarter. Quality, speed and the ability to scale up production are as important as price. In addition, the sourcing director has specified that the buyer will need to award business to three suppliers, with no single supplier getting more than 50 percent of the business.
Solution: Using a technology solution that includes optimisation functionality, the buyer can introduce multiple criteria to measure different supplier capabilities (e.g. lead-time, capacity, price) while also entering business rules that the sourcing director has specified (for example three suppliers).

Result: Based on supplier responses received during the bidding event, the optimisation tool will automatically provide the buyer with the ideal award scenario after the market.

The event itself

Typically events will run for an hour or less with extensions occurring if bidding continues in the last few minutes. Proxy bidders allow suppliers to continue to bid if there is a technology failure.

Supplier tactics are likely to reveal themselves during the event; for example, waiting until the last few minutes to bid or bidding aggressively early on to ‘scare away’ the competition. It may be necessary to warn a supplier if they are deliberately trying to disrupt or ‘spoil’ the event, but this is rare if the suppliers have been properly prepared.
Example of Supplier Tactics

Who pays?
The cost savings driven by online auctions generally provide a handsome return on the investment made in the vendor’s products and solutions. On the other hand the online auction process reduces the sales cycle for the seller and provides an opportunity for further business. Consequently some users of online auctions have introduced funding models whereby suppliers that win contracts are required to pay a rebate based on the value of the business.

Post-event activity
The auction event may be over but the benefits will not be realised until a number of post-event activities are completed, including:

- Suppliers submit cost breakdown where it has been pre-requested
- The sourcing decision is made and notified, followed by the normal contractual processes
- Monitor implementation once the online event has been completed
- Feedback is provided to all suppliers who took part in the online event – see “Ethics” above
- Capture knowledge gained, review and revise strategies, refocus and realign core skills accordingly
What is the future for online auctions?

With a well-constructed implementation plan and careful management of the process, online bidding is seen as an efficient mechanism for purchasers and suppliers to open up competition and find the competitive market price over a sustained period of time. Whether such savings are implemented will be down to how the major companies then deploy process improvement and supplier development tools to drive cost out of the supply chain for good.

Early adopters are now using the process over a vast range of products and services beyond commodity goods and services – low complexity specification items. Some software providers have expanded their offerings out from the auction process elements of Request For Quotation and negotiation to make online auctions an element of the complete global supply management process.

The boundaries for the application of online auctions are moving well beyond market perceptions. As the illustration above, developed by London Business School highlights, a ‘grey’ zone exists where auctions are challenging the application limits of partnerships. As the goods or services become more difficult to specify and the relationship between purchaser and supplier becomes more integrated, online auctions become less about price reduction and more a tool for collaboration that will reduce risk and total cost of ownership.

Functionality checklist

When discussing your requirements with a potential service provider, it may be useful to construct a functionality checklist to ensure the capability of the provider matches your business needs. An example checklist is shown below:

Reverse Event
Forward Event
Bid Decrement
Reserve Pricing
Start Price
Bidder details are masked
Pricing is exposed to the bidders
Multi Variable Parameters can be set
Optimisation
The event can be viewed by your organisation
Reports can be produced
Multiple currencies can be accommodated
Multiple events can run concurrently
Multiple buyer and supplier logins are available
A secure confidential environment is provided
Future integration with transactional procurement system
A variety of bidding formats are available – e.g. rank, index linked
View only access to the system available
Messaging
Online help and training
Multiple languages
Online Auctions
A BuyIT e-Procurement Guideline

Case studies
The UK NHS Purchasing and Supply Agency (PASA) has run a number of e-Auctions on medical supplies, using the UK Office of Government Commerce’s (OGC’s) Framework. Savings of up to 80% were achieved on some items. Full details can be found at http://www.pasa.nhs.uk/ecommerce/eAuctions

The OGC themselves have many examples of other successful UK Public Sector Auctions. These can be found at http://www.ogc.gov.uk/index.asp?id=1001028 One example from this is a local council which has saved over £1 million through e-Auctions.

Another example is a leading pharmaceutical company with annual sales of approximately €18 billion had a highly decentralised buying operation, the legacy of a long history of mergers and acquisitions. As part of a board-level initiative to share best practices and common processes across the enterprise, the company aimed to improve its purchasing and achieve a double-digit reduction in total purchasing costs over three years.

The key enabler for this transformation was the implementation of a common platform for online sourcing, backed and supported by a central team of sourcing professionals.

The company established momentum for the project by identifying “low-hanging fruit” and low-risk commodities such as European office supplies. As the company built up its confidence with the online sourcing tools, it ventured into categories that are more central to the business such as packaging, materials and external manufacturing.

Through the combination of online auction technology with expertise in global supply management, the company has successfully applied the principle “think global, act local” to its business operations, leveraging its huge buying power. As of spring 2003 the company had sourced more than €150 million in goods and services through online auctions, identifying savings of more than €37 million.

The company reported that in evaluating solutions to help advance its supply management initiatives, it looked for a provider that not only offered robust technology, but also knowledge and services to support the use of the technology and reduce the risk of implementing it.

The BuyIT e-Procurement Best Practice Network

The BuyIT e-Procurement Best Practice Network was set up with the backing of UK Online for Business and the government's e-Envoy at Cabinet Office to enable UK-based organisations to share experience and accelerate their take-up of e-Business. The Network provides a national programme of facilitated dialogue events, research and guidelines aimed at senior managers in the top UK companies.

An e-Procurement Experience-Sharing Group supports the introduction of e-enabled Procurement systems and processes in member organisations by providing an independent, informal and confidential forum for its members and production of relevant Best Practice Guidelines.

Membership of the e-Business Network is open to private and public sector organisations. For a full list of members and access to all the published guidelines please visit our website: www.buyitnet.org

The BuyIT e-Procurement Best Practice Network is managed by IT World Limited.
For more information contact David Eakin, Director Professional Services at David.Eakin@itworld.co.uk
47 Catherine Place, London SW1E 6DY
020 7828 7300 fax: 020 7828 7990 http://www.buyitnet.org