

By Alan Buxton

Does E-Auction Design Matter?

Electronic reverse auctions are becoming more sophisticated, and supply executives now have several viable choices if they elect to use them.

Electronic reverse auctions are well embedded as key supply management tools in today's competitive buying environment. From their origins of delivering savings on commodity items, e-auctions have matured to the point where the vast majority of goods and services can now be sourced faster and at better value with an auction than without an auction. However, in order to take advantage of the increased sophistication of electronic reverse auctions, buyers must pay special attention to auction design. Getting it wrong can mean an ineffective auction and upset suppliers. Getting it right, on the other hand, almost certainly guarantees lower prices and the possibility that optimal results can be achieved without disruption to supplier relationships.

So how do you get it right? To begin with, it helps to know what type of auction would best fit your needs. There are four main types of auctions used in procurement:

- Descending bid auction;
- Descending clock auction;
- Ascending clock auction;
- Weighted/multiattribute.

Choosing and designing the appropriate type of auction for the negotiation is critical. You need to know the key differences before you can decide which auction is right for your situation.

Descending Bid E-Auctions

A descending bid e-auction is the most common type of procurement auction. In this type of auction, the suppliers open the bidding at a predetermined price and bid against each other in descending order to drive that price down.

These auctions are most effective when:

1) They include several suppliers that share a similar cost base. Many commentators state that a descending bid auction should contain at least four suppliers. The reality is a little more subtle: Descending bid auctions should contain several suppliers that share a similar cost base. This is important to remember because descending bid auctions are most effective when suppliers are bidding on a level playing field.

Recommendation: Look beyond familiar supplier

lists in order to increase the number of bidders taking part in an e-auction and ensure any new suppliers are carefully qualified to maximize effective competition.

2) The suppliers are competing to win. If suppliers suspect that there is room for price negotiation outside of the auction or that the buyer is using the auction simply as an information gathering exercise, they will hold back in their bidding during the auction. The buyer must make winning the auction a sufficiently attractive prize while at the same time reserving the right to award the contract to a supplier at the buyer's discretion, not necessarily the supplier that came in first.

Recommendation: Guarantee to meet the first placed supplier soon after the auction. During the auction, use messaging techniques to ensure suppliers are bidding to the best of their ability.

Descending Clock E-Auctions

In a descending clock auction, the auction manager states a price and bidders have to "accept" a specified price level (agree to supply at that

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price) or withdraw from the auction. In other words, imagine a clock which, instead of hours and minutes, displays price levels. When bidders accept a certain price level, the auction manager lowers the price level (the hands of the clock swing downward) by a defined amount and again asks bidders to accept or withdraw at that level. This kind of auction continues until there are no further bids placed.

Descending clock e-auctions work well when there are three or fewer suppliers, when there are significant differences in the cost base among bidders and when the contract is of different value to the different bidders. For example, a supplier targeting increased market share or trying to break into a new geography might accept a lower price than would otherwise be the case.

Ascending Clock E-Auctions

In an ascending clock auction, the buyer offers a very low price — lower than

suppliers would accept. The price gradually increases (the hands on the metaphorical price-level clock swing upward) until a supplier chooses to supply at that price. The buyer has to award the contract to the lowest-priced supplier because this is the only price revealed during the auction process. Ascending clock auctions are limited to those categories where price is genuinely the only differentiating factor among bidders. Buyers will usually be better off running descending clock auctions or even using traditional sealed bids.

Weighted/Multiattribute E-Auctions

Although the technology for these kinds of auctions is not new, they have only really started to be used on any

significant scale in the past 18 months or so. In these kinds of auctions, nonprice factors are rolled up into a merit score, which reflects all of the relevant nonprice attributes, which will vary by category and can include operating ability, quality and style of goods, health and safety requirements, supply chain management processes and anything else that goes into an award selection over and above price. This merit score is then subtracted from the supplier's price bid to arrive at a comparator score. The comparator score represents the relative value of each supplier's bid, taking into account price and nonprice attributes. Suppliers are ranked based on their comparator score.

The difference between weighted and multiattribute auctions is in the negotiability

of nonprice parameters during the auction. In a weighted auction, suppliers cannot modify the nonprice elements of their bid. In a multiattribute auction, suppliers can modify certain nonprice elements of their bid (for example, shortening lead time) to improve their overall offering.

The important thing for any buyer to remember, regardless of experience, is that not all auctions are created equal. Supply management auction design and the tools available to buyers are maturing to a level where more categories are auctionable now than ever before. Additionally, there are special kinds of auctions tailored to different categories and supply market environments. If buyers think carefully about the optimum design of the auction and make sure the auction is managed by an experienced procurement auction manager, they will achieve the best result possible. **ISM**

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