



A Giant Step Forward for eAuctions

The new EU directive on public procurement and what it means for eAuction theory and practice



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Introduction

The EU directive on public procurement came into force in the UK on 31 January 2006. It simplifies, clarifies and modernises the provisions of the existing directives by consolidating three existing directives for public works, supplies and services contracts into a single text.

Whilst many of the basic provisions remain the same as in the existing directives, new clauses have also been added to take account of modern procurement methods and developments in best practice. For the first time these include explicit conditions on framework

agreements, eAuctions and so-called “dynamic purchasing systems”, as well as a provision on competitive dialogue, and new requirements for the award of large public procurement contracts.

As eAuctions have long been a key tool for buyers, the EU directive also encourages the use of more advanced auction types that combine multiple non-price attributes in addition to price. Buyers who take advantage of these advanced auction types will find themselves more effectively sourcing complex categories where many attributes other than price must be taken into account.



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1. Contract award under the EU directive

The EU directive imposes new stringent requirements for contract award. The decision for awarding contracts must be based either on price alone or based on MEAT (the Most Economically Advantageous Tender). If awarding on the basis of MEAT the buyer will need to specify in the contract notice the relative weightings of the different attributes that determine the award decision. The criteria to be used in awarding a contract need to be unambiguous with each scoring parameter assigned a numerical value, resulting in the winning bidder being selected purely on the basis of their score.

If an electronic auction is to be used as part of the tender process then the eAuction may need to allow the suppliers to “bid” on a number of different attributes that make up the contract award process. Price is only one attribute of many, which may include delivery, quality, environmental characteristics and so on.

Whether an eAuction is being used or not the contract will have to be awarded based on the attributes

specified in the contract notice. This will require buyers to be clearer in specifying their requirements and, as a result, will pay dividends later on in the process.

Example attributes that can be used as the basis for contract award

Price	Support level
Lead time arrangements	Servicing
Warranty	Quality
On-call cover locations	Delivery
Environmental characteristics	Running costs
Minimum order quantities	Payment terms

2. eAuctions under the EU directive

The following auction types are allowed under the new EU directive:

- price-only eAuction
- weighted eAuction
- multi-attribute eAuction

Price-only eAuction

Prior to the eAuction the suppliers are scored according to the criteria in the contract notice. Only suppliers who meet the buyer's minimum requirements are taken forward to the eAuction. During the eAuction, the suppliers compete on price alone. The lowest priced supplier must be awarded the contract.

Price-only eAuctions will continue to be excellent tools for the majority of sourcing exercises where all suppliers are bidding on fixed specifications or where any additional features offered by suppliers beyond a minimum requirement are irrelevant to the buyer.

Weighted eAuction

In this method, the suppliers are scored according to the criteria in the contract notice. Prior to the eAuction this score is used as an input into a score rule that will adjust the supplier's price bids to level the playing field amongst the suppliers.

During the eAuction the suppliers can modify their price bids, but cannot modify any non-price attributes. Each supplier's price is adjusted according to the score rule, with the contract being awarded to the supplier with the lowest adjusted bid.

In a weighted eAuction, any competitive information shown to suppliers (e.g. best bid or rank) is based on the adjusted values of all suppliers' bids. Where there are significant and relevant non-price differences between suppliers this approach will result in suppliers seeing a truer picture of their relative competitiveness. For example, if weightings include service levels, then suppliers have a true picture of what they need to bid in order to deliver best value overall.

Multi-attribute eAuction

In this method, the suppliers are scored according to the criteria in the contract notice. Prior to the eAuction this score is used as an input into a score rule that will adjust the supplier's price bids to level the playing field amongst the suppliers.

During the eAuction the suppliers can modify not only their price but also some of the non-price attributes – for example to shorten lead times in order to improve their overall position. It is not necessary for all non-price attributes to be negotiable in a multi-attribute eAuction. For example a supplier might be able to "bid" on lead time but not be able to "bid" on ISO certification status.

3. Designing and choosing the right eAuction under the EU directive

The challenge facing buyers and eAuction designers is twofold:

- selecting the optimal type of eAuction based on the category and supply market
- where the tender is based on MEAT, calculating the weightings and score rule to be used to identify the most economically advantageous tender.

The score rule

The most practical approach, for buyers and suppliers alike, is to use a conversion rate that converts non-price points into pounds (if it is a price eAuction), and then to adjust the supplier's bid by this merit score. The merit score represents the relative economic value of the non-price elements of a supplier's tender. This merit score might be fixed (in a weighted eAuction) or it might be negotiable (in a multi-attribute eAuction). The adjusted bid is called the supplier's comparator score. The lower the comparator score the more advantageous the overall bid, taking price and non-price into account.

Suppliers are shown their bid and their comparator score. They must also be shown their rank (based on all the comparator scores) and may be shown the leading comparator score.

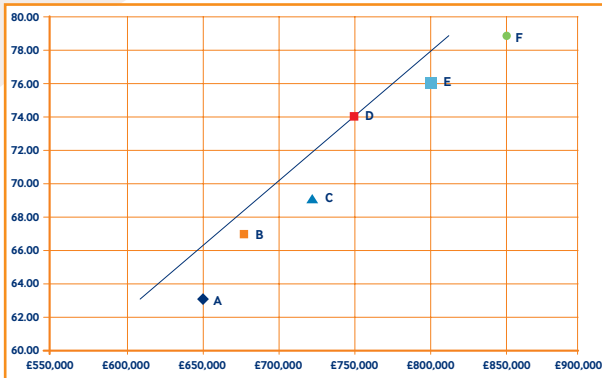


An example

Assume the conversion rate has been set at 13,000 “pounds” per point. Scores are out of 100. A benchmark score of 60 has been set – any supplier with a score above this has a merit score of 13,000 for each point above 60. The merit score is subtracted from the price bid to calculate the comparator score.

Supplier	Overall price	Overall score	Merit score	Comparator score (bid - merit score)	Rank
A	£650,000	63.00	39,000	611,000	5
B	£680,000	67.00	91,000	589,000	2
C	£720,000	69.00	117,000	603,000	4 =
D	£750,000	74.00	182,000	568,000	1
E	£800,000	76.00	208,000	592,000	3
F	£850,000	79.00	247,000	603,000	4 =

Plotting this information on a graph gives a clearer indication of the relative positions of the suppliers in the auction.



In the graph, supplier D is winning. The dark blue line shows all the price/non price combinations that are equivalent to the winner. The steeper the line, the more important price becomes. The flatter the line, the more important the non-price factors become. In other words supplier B needs to cut the price by £22,000 or increase the score by 2 points to win. In this example the winning line is a straight line, because the conversion rate is a fixed conversion rate. There are also more sophisticated variants that use a curved line which are used if the relative importance of non-price factors differs depending on the contract value.

If done as a price-only eAuction

If this negotiation were set up as a price-only eAuction the buyer would first need to qualify out the lower-score suppliers who do not meet the minimum requirements.

For example, suppose the buyer only allowed suppliers to bid who have a score above 70. This would remove suppliers A, B and C from bidding – even though in this case supplier B (and possibly supplier C) have a good chance of being able to deliver the best solution if their non-price scores are considered. Furthermore, supplier F has less chance of winning this business in a price-only eAuction because both his price and non-price scores are very high. However, supplier F might have

been able to make a more competitive offer if allowed to change some of the non-price elements of the tender (e.g. offering shorter lead times). In a price-only eAuction the buyer will never know if this could have happened and it would look like a contest simply between suppliers D and E.

Supplier	Overall price	Overall score	Rank
A	£650,000	63.00	
B	£680,000	67.00	
C	£720,000	69.00	
D	£750,000	74.00	1
E	£800,000	76.00	2
F	£850,000	79.00	3

- Suppliers A, B and C are out of the bidding
- The eAuction would favour supplier D (the supplier with the lowest admissible score)
- Very unlikely that supplier F can compete on price-only (would have to drop price by over £100,000 or 11.77%)

Price-only eAuctions are the best auction type to use where all suppliers must meet a minimum requirement and the buyer does not value any additional features/quality of the supplier's bid beyond that minimum requirement.

If the non-price differences between suppliers are significant, and the extra features/quality that some of the suppliers offer do provide more value to the buyer, then price-only eAuctions will lead to a sub-optimal result because they will favour the lower price/lower score suppliers.

If done as a weighted eAuction

If there are non-price differences in value between different suppliers (e.g. service levels) then weighted eAuctions will offer advantages over price-only eAuctions for the following reasons:

- the buyer can include more suppliers in the eAuction than would be possible under price-only conditions. This is because suppliers with lower scores and lower prices can still be included in the eAuction and can compete on a level playing field with suppliers who have higher scores and higher prices
- it gives a truer view of the relative competitiveness of the different tenderers' bids. For example, although supplier F would be very unlikely to win a price-only eAuction, supplier F may well be able to deliver best overall value for money.

During a weighted eAuction, as suppliers drop their price they move leftwards on the graph shown on the previous page.

More suppliers can be included in the competition and all suppliers can compete effectively against each others' overall offerings.

Supplier	Overall price	Overall score	Merit score	Comparator score (bid - merit score)	Rank
A	£650,000	63.00	39,000	611,000	5
B	£680,000	67.00	91,000	589,000	2
C	£720,000	69.00	117,000	603,000	4 =
D	£750,000	74.00	182,000	568,000	1
E	£800,000	76.00	208,000	592,000	3
F	£850,000	79.00	247,000	603,000	4 =

- Supplier F would only need to cut their price by £35,000 or 4.12% of current bid
- Supplier B would only need to cut their price by £21,000 or 3.10% of current bid

Often a weighted eAuction can result in more aggressive bidding from the lower-scoring suppliers, and can therefore lead to bigger savings than in a price-only eAuction.

The downside of a weighted eAuction is that the tenderers can only influence their price during the auction event, not their non-price scores.

If done as a multi-attribute eAuction

Multi-attribute eAuctions have a major advantage when specification can be varied at the discretion of the supplier within agreed tolerances. This is because the buyer may not know the most efficient specification level for the suppliers. For example, the buyer may offer two alternative specification levels only to find out subsequently that a third option would have been available at a far more attractive price had it been offered. Suppliers know their cost base better than buyers do. Therefore if suppliers are able to flex non-price factors (within reasonable limits) they can often come up with imaginative solutions that better meet the buyer's requirements than simply responding to a fixed specification.

With a mandatory score rule that applies to all possible alternatives, the bidders have an incentive to bid a given score by offering the most efficient combination of price and quality, thereby maximising the potential gains from trade.

Supplier	Overall price	Overall score	Merit score	Comparator score (bid - merit score)	Rank
A	£650,000	63.00	39,000	611,000	5
B	£680,000	67.00	91,000	589,000	2
C	£720,000	69.00	117,000	603,000	4 =
D	£750,000	74.00	182,000	568,000	1
E	£800,000	76.00	208,000	592,000	3
F	£850,000	79.00	247,000	603,000	4 =

Suppliers can bid expressively in a multi-attribute eAuction:

- Supplier B can drop their price by 3.10% as in the weighted eAuction example
- Or supplier B can increase their score by 1.62 points (e.g. by shortening delivery time, making minimum order size smaller, extending warranty terms)

Multi-attribute eAuctions will not be appropriate in all cases but, used judiciously and designed correctly, will deliver excellent results for buyers and the supply market as a whole.

If there is no eAuction at all

Of course, buyers do not necessarily need to use an eAuction at all. Buyers could simply award contracts based on a Sealed Bid.

However, both theory and practice point to the fact that a sealed bid plus dynamic negotiation will produce a better result than a sealed bid alone. The market is best able to deliver the buyer what he really wants if competitive information is available, and suppliers are able to respond to that competitive information.

4. Implications for buying organisations

The implications for buying organisations are that buyers will need to plan the contract award criteria and the negotiation process from the earliest stages of the sourcing project. In particular buyers should now:

- specify in the contract notice that they reserve the right to use an eAuction
- plan the weightings to be used for the various criteria even before the contract notice is published – irrespective of whether an eAuction is to be used or not.

Public sector buying organisations who prepare thoroughly up front will find themselves achieving better value for money outcomes. The EU directive positively encourages this best practice and gives public sector buyers the opportunity to surpass their private sector counterparts in the sophistication of their sourcing decisions.

5. Implications for eAuction providers

As well as implications for buying organisations, the requirement for a score rule also has clear implications for eAuction software design and the development of more sophisticated multi-attribute technology.

eSourcing technology will now have to provide for bidding on a range of attributes as well as price, and will have to incorporate the complex mathematics of the score rule so that buyers and suppliers can negotiate online on a range of attributes.

TradingPartners multi-attribute and weighted eAuctions already allow bidders to submit bids comprising several variables in addition to price. The new directive effectively makes these types of eAuction mandatory for the public sector, unless the only criterion to be considered in the sourcing decision is price.

As the advantages in multi-attribute eAuctions will become more irresistible to buyers from both the public and private sector, eAuction providers will need to be able to understand their clients' specific needs and match the appropriate form of eAuction to the precise situation. Most importantly, they will need to be able to explain to customers all the options available and which of these will produce the best results. eAuction providers will also need to offer the sourcing expertise to guide buyers through the sourcing process, from calculating the weightings and score rule through to facilitating the final negotiations.

6. eAuctions overall

Over the past half decade or more, internet auctions have grown to become a key tool for procurement professionals. eAuctions have become the de facto standard for discovering the true fair market price for goods or services, whether the market itself is rising or falling.

eAuctions have developed significantly since they started to be used as a procurement tool. The new EU directive has encouraged them to take a further giant step forward.

7. Further information

To discuss any of the issues raised in this document, or to find out how TradingPartners can help you with any of the following procurement needs:

- Supplier sourcing
- Quotations
- Tenders
- Specifications
- eAuctions (price-only, weighted, multi-attribute, English and Japanese eAuctions).

Please contact us on **020 7261 0000** or email info@tradingpartners.com.

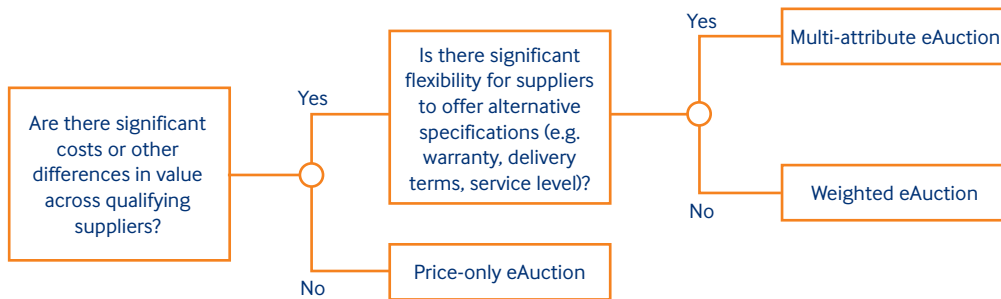
TradingPartners is one of the first eSourcing providers that has the capability to comply with the EU directive and run price-only, weighted and multi-attribute eAuctions. We have also run many eSourcing projects for the public sector in the last 3 years, including the NHS, central government, local government, and the MoD.

Appendices

i. eAuction types decision tree

Whatever eAuction project you decide to run, in all cases the best practice is to consider the potential eAuction types, and the weightings for price and non-price criteria, at the outset of the sourcing project.

TradingPartners can guide you through the entire negotiation process from before the publication of the contract notice through to the final contract award. The decision tree below should also help.



ii. Summary of eAuction types

Type of negotiation	Benefits	New directive issues
Sealed bid only		The weightings and contract award criteria still need to be calculated and published
Price-only eAuction	Best kind of negotiation where all suppliers must meet a certain minimum threshold, and any extra offering beyond that threshold is irrelevant	Low scoring suppliers will have to be qualified out of the eAuction process – and the fewer suppliers in the eAuction, the less competitive the eAuction becomes High quality/high price suppliers cannot compete effectively
Weighted eAuction	High quality/high price suppliers can compete effectively on a value for money basis Final price is a truer fair market price than the final price in a price-only eAuction	Conversion rate must be calculated and be transparent; suppliers can only influence their price
Multi-attribute eAuction	For complex categories this is most likely to deliver the buyer what the buyer really wants at a fair market price	Conversion rate must be calculated and transparent

iii. Contract award under the EU directive

If a contract is to be awarded on any basis other than price-only, then the EU directive states that: "... the contracting authority shall specify in the contract notice or in the contract documents or, in the case of a competitive dialogue, in the descriptive document, the relative weighting which it gives to each of the criteria chosen to determine the most economically advantageous tender." (Article 53 paragraph 2.)

Only if "... weighting is not possible for demonstrable reasons ..." can the buyer rank the different criteria in order of importance.

In order to take advantage of eAuctions in the tendering process, "contracting authorities which decide to hold an electronic auction shall state that fact in the contract notice." (Article 54, paragraph 3.)

If an eAuction is being used then, prior to the eAuction "contracting authorities shall make a full initial evaluation of the tenders in accordance with the award criterion/criteria set and with the weighting fixed for them." (Article 54 paragraph 4.) Tenderers who have made admissible tenders "shall be invited simultaneously by electronic means to submit new prices and/or new values; the invitation shall contain all

relevant information concerning individual connection to the electronic equipment being used and shall state the date and time of the start of the electronic auction." (Article 54 paragraph 4.)

Furthermore, when inviting a tenderer to eAuction, the results of each tenderer's initial evaluation must be incorporated in the invitation to the eAuction. (Article 54 paragraph 5.)

The eAuction itself can be run on either a price-only basis or based on allowing the suppliers to modify non-price attributes of their bids. Price and non-price attributes are combined by a special formula that will "... determine automatic re-rankings on the basis of the new prices and/or new values submitted. That formula shall incorporate the weighting of all the criteria fixed to determine the most economically advantageous tender, as indicated in the contract notice ..." (Article 54 paragraph 5.)

The contract must be awarded to the winning supplier based on the rules specified in the contract notice – though Article 55 provides protection for buyers against abnormally low tenders.

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