

E-Procurement — Reverse Auctions and the Supplier's Perspective

Edward P. Moser

Like buyers, suppliers can benefit from on-line auctions. By researching the auction intelligently, a supplier can determine how low to bid while continuing to make money.

As discussed in the companion article in last month's issue of *Pharmaceutical Technology*, many of the inputs to pharmaceutical development and manufacturing, from excipients to contract laboratory services, increasingly are being purchased through e-procurement processes (1). One of these processes, the on-line reverse auction, allows buyers to exchange information with sellers and solicit and accept bids from multiple sellers in a Web-based electronic marketplace.

The allure of lower prices, a broader supplier base, faster cycle times, and a more-efficient procurement process attracts buyers to reverse auctions. On-line buyers often save money on purchases of goods because the nature of the reverse auction tends to force a supplier to progressively reduce its asking price.

As a result, it is not surprising that suppliers can feel threatened by reverse auctions. Many long-time suppliers have trouble adjusting to on-line arrangements because of the personal nature of the relationships and negotiating tactics that they have formed with buyers through the years. Familiarity with, or fear of, technology also

may come into play. "If a company is 40 or 50 years old, the computer is not its first tool of choice — the phone is," said Dr. Bruce Diel, president of Chemfinet Services, Inc. (Overland Park, KS).

Major purchasers may compel suppliers to participate in auctions, and smaller suppliers are more susceptible to such pressure. Carol Rozwell, vice-president at GartnerG2 (Stamford, CT), said that such a supplier should determine the probability that it will need to participate and then plan accordingly.

By forcing bidders to progressively lower their bids, reverse auctions can reduce supplier profit margins and even threaten corporate viability. "Yes, there are winners and losers in reverse auctions," said Roddy Martin, a service director for

THIS MONTH:

**82 E-Procurement —
Reverse Auctions and the
Supplier's Perspective**

Edward P. Moser

88 Outsourcing Outlook

Jim Miller

**90 The Pharmaceutical
Development of Inhalation
Medicines and the Value of
Outsourcing**

**Robert N. Woodhouse,
R. Harris Cummings,
and Thomas N. Feinberg**

Development of inhalation medicines offers new opportunities for contract service providers.

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Just as buyers can use auctions to increase their supplier base, suppliers can regularly check e-marketplaces for new selling opportunities.

AMR Research (Boston, MA). According to a report by research and consulting firm IDC (Framingham, MA), “the power in the sourcing process defaults to buyers. They are, after all, the ones who control whether, with whom, and how money is spent” (2).

However, Martin noted that suppliers, drawing from their on-line auction experiences, are getting smarter and have learned how to retain profitability. If a supplier researches an on-line auction intelligently, it can determine how low to bid while continuing to make money.

Like buyers, suppliers can benefit from on-line auctions in various ways. For example, in traditional auctions, bids are sealed. In contrast, suppliers can alter their bids during an on-line auction, increasing their chances of winning the contract. They also can bow out of the process at any time. By opening up the bidding process, an on-line auction can give suppliers access to buyers with whom they may not otherwise have contact. “Suppliers who don’t have the business should participate [in an auction] because it’s a chance at getting the business,” said Michelle Hincks, marketing vice-president for ChemConnect (Houston, TX). This is particularly true for smaller firms, which can leverage an auction to boost their public exposure. If a purchaser reviews bids with an open mind, a new supplier with a carefully prepared bid may land the contract. Just as buyers can use auctions to increase their supplier base, suppliers can regularly check the e-marketplaces of buyers for new selling opportunities.

In addition, some suppliers have adopted the attitude, “If you can’t beat them, join them.” Such suppliers purchase their own supplies in reverse auctions. This

approach can produce savings throughout the supply chain for buyers and suppliers alike. Of course the supplier, like the buyer, must calculate carefully whether the cost of establishing and maintaining electronic auctions will improve the bottom line.

It is critical that suppliers fully understand the auction process. A supplier must become completely familiar with the auction’s rules, requirements, and software tools. All the details of a complicated bid must be worked out beforehand. Otherwise, suppliers can easily make “rookie mistakes” under the pressure of on-line bidding, according to industry observers. One way to reduce error is to select an experienced, well-established e-marketplace that can serve as a stable training ground for the novice on-line participant.

If a supplier decides to use a public auction house, it should select one that fits its business strategy. A report from GartnerG2 states that some of the less-successful chemical-industry e-marketplaces have “alienated sellers by bypassing their services and eroding their brand identities” (3). The report suggests that a supplier should register with an e-marketplace that supports and enhances its existing business processes instead of one that tries to change the way the supplier conducts its business.

Suppliers, like buyers, must make many decisions before participating in an on-line auction. They must decide, for example, how low they can bid and still obtain an acceptable return. Suppliers also must factor in the buyer’s location to calculate shipping costs.

Rozwell noted that suppliers must keep close tabs on their buyers because buyers are sometimes “lax in administering their procurement process.” In a sluggish economy and in the pharmaceutical sector where many e-marketplaces have shut down, a supplier also should examine a buyer’s financial status.

Market conditions will influence the value of an auction for both buyers and suppliers. Suppliers should be wary of auctions in which market prices are falling because supply is exceeding demand. They can be more confident in an auction in which market prices are rising and pro-

duction capacity is tight. Suppliers have a better negotiating position when their numbers are few and the supplier base is less fragmented. A supplier that can outbid competitors in the sale of highly commoditized products that are common in reverse auctions is likely to dominate the market. In the end, suppliers benefit most when their relationships with long-term buyers are mutually beneficial.

For both buyers and suppliers, electronic auctions help spur the automation of what can be a painstaking procurement process. Indeed, one factor blocking some suppliers from on-line auctions is their lack of basic Internet capabilities. E-marketplaces or in-house on-line auctions rationalize inventory management and transaction tracking and automate time-consuming tasks such as calculating shipping costs and exchange rates.

On-line exchanges provide the storage and exchange of standardized, electronic documents that are critical to procurement such as requests for quotations, proposals, and information. The mere conversion of paper documents to electronic forms can free up employees for higher-value tasks such as price negotiation and postbid analysis. E-marketplaces offer databases that store evaluative data about companies, including industry certifications and production techniques. They even can enable the holding of traditional, sealed-bid auctions through electronic means — bids may be distributed to and collected from suppliers without any give-and-take on prices. When opting for an on-line exchange, finding one that offers all the required functionality is important. In addition, the exchange should be market-savvy enough to regularly upgrade services based on user feedback.

Along with selecting the right auction service, “there’s a whole lot of stuff that participants need to do behind their own firewalls,” said Martin, who added that the availability of integrated information and decision-support information systems is critical. In-house or contract expertise in information technology is vital in accomplishing this integration.

Both buyers and suppliers must keep in mind that every auction is unique and will differ according to price trends, data availability, the number of suppliers, and other variables. E-procurement demands con-

Contract Services

siderable time and resources from companies to make it work. According to Rozwell, a key question for a would-be auction participant is, "Are you willing to make the big commitment to on-line purchasing?"

Private and public auctions

One way of gaining the electronic benefits of on-line auctions while retaining traditional supplier relationships is to use private reverse auctions, also referred to as *corporate trading rooms*. These auctions can be hosted on public trading sites or individual company sites.

Several analysts detect an industry trend toward private auctions and away from public ones. "Consortium trading exchanges have not lived up to expectations," said Martin. According to Rozwell, most on-line auctions are private with a limited, but specialized, supplier base — a "small circle" of suppliers focused on one sector.

Private auctions enable buyers to retain trusted, credit-worthy suppliers without risking a decline in service quality with new suppliers. Furthermore, they can minimize security concerns about the exposure of sales data, buying patterns, and other sensitive information to competitors and customers. For these reasons, private auctions often are geared toward high-dollar transactions of critical goods. At the same time, buyers can rapidly exchange key information with customers and suppliers by drawing on e-commerce technology (4). Private auctions, Martin noted, may make it easier to consolidate data management and business process management systems, including the so-called "back-end applications" such as product scheduling, sales forecasting, and purchase order tracking.

A private auction, by definition, has a more geographically restrictive supplier base than a public consortium. However, one way to broaden the supplier base of a private auction is to hold multiple private auctions for suppliers from different regions.

Auctions conducted through public trading consortia have their own advantages. They can benefit suppliers and buyers who are keen on expanding their client base by advertising a company to an audience that is potentially global in scope. They enable one-stop shopping in which

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a buyer can find a variety of suppliers in one place instead of searching through the Web sites of many suppliers. Public auctions also are particularly well suited for "spot" transactions in which the emphasis is on rapidly finding sufficient players to make a quick transaction (4). And established e-marketplaces offer a wealth of experience and functionality that private companies might acquire only with considerable time and expense. Public consortia also can help companies bolster their in-house business- and data-management capabilities.

When deciding whether to use a private or public auction, or even whether to use a reverse auction, preparation is paramount. Both buyers and suppliers should consider carefully what strategy makes the most sense for their businesses before committing themselves to the new electronic marketplace.

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