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The Creative Approach To Reverse Auctions

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It's a catch-22: choosing a supplier via a reverse auction doesn't make sense unless your requirements are fairly large. But trying out a new technology on a significant contract may not seem like such a good idea to many procurement professionals. The reverse auction is a proven effective tool for cost reduction, but a lot of things can go wrong if you're not careful.

For starters, procurement professionals have never had to establish a reserve price for an RFQ (request for quote), much less decide whether to allow automatic extensions or set bid increments. (For definitions of these and other terms, please see the glossary following this article.) Most probably have no idea what these basic reverse auction elements are!

Moreover, if you don't adequately specify the products or services you're purchasing, or if you conduct your event a bit carelessly, you risk alienating important suppliers and even inadvertently increasing your costs. Check out an interesting column, [Response to a Proponent of Reverse Auctions](#) by North Carolina State University professor Rob Handfield for examples of some the problems that can occur.

That's why Jamie Orzell and Jerry Lighthouse, former colleagues at Kodak, launched a new business. Armed with a license from the highly respected Procuri online sourcing tool, they formed [Advanced Purchasing Technology](#) to help companies structure and run online events. A number of well-known firms, including Birds Eye Foods, the Commonwealth of Massachusetts, and the University of Rochester, are among Advanced Purchasing's clients.

Orzell and Lighthouse became interested in reverse auction technology when Kodak bid in an online event for a major customer, GE. Since then, the pair has collectively sourced more than \$300 million in goods and services through over 200 events. They draw upon the rich set of experiences they chalked up running auctions to assist clients.

Advanced Purchasing recently helped a client source office supplies, a commodity that is tricky at best to price out. That's because most larger organizations buy hundreds if not thousands of different office supply line items, from pens and paper to binders and toner cartridges. It's impractical to quote out thousands of individual line items, and negotiating a simple discount off list ignores the potential for volume pricing on high-usage supplies.

According to Orzell, Advanced Purchasing helped this client solve this sourcing issue by grouping the 1500 different office supply items it bought into 13 biddable categories. Each prospective supplier was encouraged to price these groups two ways: once with the prices it would love to get, and the second time using the lowest prices it would accept. These two sets of prices gave each supplier their opening and lowest acceptable bids for the auction. Advanced Purchasing's suggestions worked: the successful event yielded over \$800K in annual savings over a three-year contract for the buyer.

Besides helping companies try this tricky technology, Advanced Purchasing also markets its services as a reverse auction solution for companies that anticipate running only three or four bids per year. I would expect this option to interest smaller firms that have only a few high-dollar contracts, as well as organizations with only a few items or services suitable for this sourcing tool.

A Bird's Eye Point of View

If you love vegetables, chances are that you know Birds Eye Foods. That's because they are the largest processor of frozen vegetables in the U.S. with familiar brands including Birds Eye Viola, Birds Eye Simply Grillin', Freshlike, and McKenzie's.

Birds Eye Foods has been a long-time user of reverse auction technology because it has been, for them, an effective tool for sourcing suppliers and reducing costs. For instance, Birds Eye tried a reverse auction when an incumbent supplier proposed a price increase for its products. The results were not just an avoidance of the increase, but a 15% decrease, according to Paula Bell, procurement manager. While one of Bell's colleagues demonstrated that he could achieve the same type of savings by negotiating directly with the supplier, Bell noted that the negotiation ran on for days.

Until recently, Birds Eye had been using a third-party service that set up and ran reverse auctions on its behalf. After a while, the Birds Eye procurement group found itself wanting to bring the capability in house. "We were saving a significant amount of money with our previous solutions provider, but we were also paying a lot to have them run the auctions for us," said Bell.

She looked into buying software for the team, but she was discouraged with the 6- and 7-figure price tags she found. When she learned about Advanced Purchasing Technology and the opportunity to transition with them to a less-expensive leasing arrangement with Procuri, she jumped at the chance.

“APT’s founders offered us so much as a result of their years of experience in purchasing and reverse auctions,” said Bell, describing how they helped her team set up auctions, choose appropriate supplier participants, and prepare everyone well in advance. “The auctions we run with APT are set up much better than the ones our previous solutions provider ran,” she said.

For example, Advanced Purchasing advised Birds Eye to require all suppliers to submit an opening ‘pre-bid’ prior to an auction. “In the past, after an auction, we had suppliers tell us that they made a mistake during bidding, and that they’ll have to revise their pricing,” said Bell. She followed Advanced Purchasing’s advice, and now her colleagues have the opportunity to review suppliers’ opening bids and flag problems before the event starts. “This has greatly reduced errors during the auction,” said Bell.

A Reverse Auction Glossary

Automatic Extension: A feature of most reverse auction systems that allows the deadline of the event to be automatically extended if suppliers are still actively reducing their proposed pricing.

Bid Increment: The smallest amount that a supplier can reduce its bid. Bid increments keep suppliers from reducing their bids so slowly that it inhibits the downward progress of the auction.

Pre-bid: The ability for suppliers to submit an initial price before the actual event. A pre-bid can help the buyer identify in advance a supplier that hasn’t understood the requirements for the contract.

Ranking: One means of displaying the relative bids during an event. Bidding suppliers are ranked first, second, third, and so on, in the order of the attractiveness of their bids. The buyer can configure the event to show suppliers theirs and others’ ranks, in addition to, or instead of, the actual prices bid.

Reserve Price: The highest price the buyer will consider for a contract award. For example, if a buyer sets a reserve price of \$1 million for a contract, it is saying that it will not agree to pay more than \$1 million for those goods and services.

Standing Offer: An offer to buy certain goods or services at any time from a seller that can meet the requirements and a specific price.

