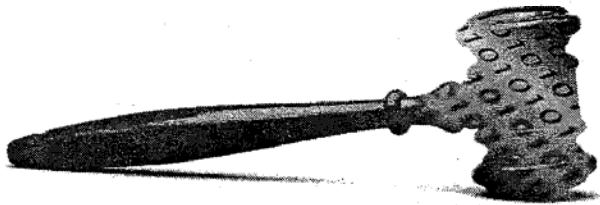


trend

Going, Going, Gone

Electronic reverse auctions are efficient.
But they could alienate your best suppliers.

by Sandy Jap



MANY COMPANIES today are using online reverse auctions to procure everything from raw materials and transportation services to engineered parts, springs, molded plastics, and stampings. By forcing suppliers to bid for contracts, such auctions can produce dramatic reductions in the cost of supplies. Internet auctioneers have put billions of dollars in products and services on the auction block, creating huge savings for buyers.

But do reverse auctions carry risks as well as benefits? To answer that question, I recently spent a year working with an organization that annually procures billions of dollars worth of components. I studied the results of six auctions that the company held in which a half-billion dollars worth of goods changed hands. Three were sealed-bid auctions, where suppliers simply submitted their best bids electronically directly to the buyer; three were open-bid auctions, conducted by a third-party auction service provider. I surveyed the participating suppliers, both before and after the auctions, and also surveyed similar suppliers that did not participate. My goal was to assess how opinions of the buyer changed as a result of the auctions.

On the positive side, I found that these auctions not only save buyers money but also can increase the competitiveness of the supply base. Suppliers that participate in open-bid

auctions are able to benchmark competitors and their cost structures, which can lead to greater efficiency for all suppliers. Auctions also

increase suppliers' willingness to make dedicated investments on behalf of buyers: hoping to avoid endless rounds of bidding gives suppliers a strong incentive to differentiate themselves and work closely with buyers to lock in their business. What's more, the technology underlying reverse auctions is rapidly advancing. Soon, companies will be able to consider many variables, not just price, to evaluate suppliers and their bids.

But I also found that auctions tend to undermine relationships with suppliers. Sellers can feel exploited by the process, and when the event is over, they are then less trusting of the buyer. As one supplier put it: "[The buyer] talks about the relationship being a partnership, and this [the auction] really takes that away....

What they do is take your existing business that you have worked very hard to achieve and maintain...and they send it out across the board for a competitive bid. I just do not think that is fair." Such reactions can damage business relationships, ultimately eroding the economic performance of both buyer and supplier.

Furthermore, some suppliers cannot sustain sharp price reductions over the long term. Yes, buyers may enjoy sav-

ings the first few times they run an auction, but those savings may come out of suppliers' profits. Those suppliers that can't compete at the lower price levels will eventually be forced out of the industry, or there may be a consolidation of the supplier base. Either way, buyers end up with fewer alternatives, and bargaining power shifts to suppliers.

Buyers should understand the pros and cons of reverse auctions and use them strategically. They can, for example, hold an initial round of auctions to reach a wide range of suppliers, gain a sense of market pricing, and send a wake-up call to complacent incumbents. But the auctions should be followed by the development of long-term sourcing arrangements through which suppliers can add tremendous value and exper-

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tise in the customization of parts and the refinement of the buyer's production processes. Such relationships, carefully crafted and managed over time, can be a key source of competitive advantage, yielding enormous payoffs for both parties.

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