



Best Practices for Long-Term Success

WHITEPAPER



Advancing the Strategic Sourcing Process through Online Reverse Auctions



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Executive Summary

Any business interested in implementing a comprehensive Enterprise Supply Management solution knows the importance of strategic sourcing. When approached intelligently, strategic sourcing enables companies to generate new value by reducing the total cost of purchased goods and services while maintaining high levels of quality. Furthermore, strategic sourcing value extends throughout the organization — from enhanced business processes to more efficient resource usage to higher Return on Investment (ROI).

According to a recent report, there are three critical components to achieving a successful strategic sourcing process: technology, information, and expertise. Each of these elements has a direct, influential, and mutually beneficial relationship with the others. Proper usage of technology, for example, can harvest a greater quantity of more useful information. And, with a greater arsenal of information, personnel can increase its collective expertise level. Likewise, with precise management of information and the appropriate expertise at hand, organizations can define the optimal processes that enable technology to be leveraged to its highest potential.

Few technology-based strategic sourcing tools demonstrate this mutual connection as do online reverse auctions. Because they provide a flexible environment for determining pricing, auctions hold tremendous potential for generating value. But they also require considerable preparation, understanding, and expertise in order to achieve lasting success.

This paper explores the role of reverse auctions within the strategic sourcing cycle, and provides guidelines for implementing best practices to help maximize the value of a sourcing event, for buyers and suppliers alike.

The Role of Online Auctions in the Strategic Sourcing Cycle

Auctions typically can be defined in one of two ways: forward or reverse. A forward auction is the most familiar consumer-world scenario, where potential buyers bid in an ascending price structure, and the items for sale go to the highest bidders (e.g., Sotheby's and eBay). A reverse auction, however, is the more dominant auction type for businesses conducting online strategic sourcing. In this scenario, a company usually is looking to procure certain goods or services and accepts descending bids from suppliers interested in winning the business relationship. But it is important to note that the chosen bid is not always the lowest price. Many reverse auction platforms allow suppliers to compete on both price and non-price variables — and, ultimately, the buyer agrees to purchase from the supplier with the lowest overall total cost.

In general, reverse auctions spark healthy competition, and as such, they help participants gain insight into true market valuation — not only for the goods or services being procured, but also for their own business relationships. In an online environment, this competition peaks in value potential. Here's why:

- Network-based auctions enable a larger number of suppliers to come together at one time, increasing buyers' chances for obtaining the most competitive prices while bringing suppliers within reach of new business prospects.
- Furthermore, by appropriately leveraging the Internet environment and related technology-based tools (such as an event management system), buyers can extend their supply reach while streamlining the procurement process. As a result, all participants can dramatically cut sourcing cycle times and resource requirements.
- Finally, because they provide participants price visibility throughout the event, online reverse auctions help eliminate unethical practices such as bid shopping, thereby ensuring suppliers of cost-efficient, value-added, and fair business relationships.

Online Auction Practices Can Affect the Outcome

A successful auction, therefore, is one in which both the buyer and seller are satisfied, and some measure of value has been generated for both players for the specified term of the relationship. Given the number of variables involved in hosting and participating in a reverse auction online, however, it can be difficult to ensure that the needs of all participants are being effectively addressed. As such, it is extremely important to consider which practices best meet the objectives of the sourcing event while simultaneously serving the needs of those participating. This is of particular significance to the company hosting the auction, but it also applies to those placing bids.

Best Practices from the Buyer's Perspective

Generally speaking, buyers — those hosting the sourcing event — have three areas in which the use of best practices can promote greater long-term success: event preparation, event management, and event summary.

Event Preparation

The success of any online reverse auction hinges on a number of dynamic or flexible factors. Buyers with a clear objective and an understanding of what a successful event means for the sourcing event should recognize how these factors can affect that objective and take adequate measures to stay on target by first walking through an event preparation checklist (Fig. 1). Variables include:

- ***Event objectives***

Buyers first should take time to establish specific goals for the event. These could include obtaining lower prices or better terms, testing the spot market, or setting a baseline from which to negotiate further with an incumbent supplier offline. The event objectives not only will determine the success of the event, but they will also determine the strategy for managing the auction as well as for selecting a bid. Additionally, be sure to define the bid package requirements (what the winning bid must include, such as materials only, freight included, etc.), and be prepared to respond to related questions or changes.

- ***Online environment***

Any organization conducting critical business on the Internet requires a certain level of reliability, as well as a continuity strategy for seamlessly surviving unplanned technical or network difficulties. Sourcing events demand the same level of preparation. By adequately understanding the technology in play during the auction, and anticipating the solutions and/or support required to address potential problems, buyers will be setting the stage for a smooth event. Buyers should pay particular attention to browser types and settings, network connections (e.g., dial-up or DSL), and other everyday variables that might affect a supplier's ability to participate fairly and successfully.

- ***Types of items being auctioned***

In order to ensure accurate, fair pricing, buying organizations should fully comprehend what items they are looking to procure, including all relevant details. In order to generate the appropriate level of interest from participants, buyers should also aggregate (or disaggregate) the goods or services being sourced into specific line items — while being careful not to over-aggregate (which might limit the number of potential suppliers) or to be overly granular (which might limit supplier interest).

- ***Time limits***

Setting the duration for an online reverse auction can be somewhat tricky. In terms of lead time, buyers should consider what they are asking of bidders and leave ample time for accessing RFQ details and constructing proper bid packages. In terms of live event duration — how long the auction itself actually lasts — buyers need to consider the type of items on auction. Some

goods and services are short-lived and require rapid procurement in order to preserve value, while others can afford a greater time limit for the event. Nevertheless, as long as the correct lead time is given, the duration of the event generally is based on the number of bids expected to be placed and is typically shorter than most people expect.

■ **Number of participants**

One of the main reasons for hosting an online auction is that it brings together a group of bidders large enough to promote competitive pricing. Buyers should be sure well in advance of the event that there are sufficient suppliers willing and able to participate. Generally, a minimum of four active bidders is required to drive competition.

■ **Communication requirements**

Finally, after understanding and deciding on the parameters of the event, buyers should be able to communicate these details to all participants clearly and comprehensively.

- For example, consider providing an introductory letter outlining an upcoming schedule of activities related to the auction (such as training, conference calls, RFP submissions, the live event itself, bidding updates, and announcement of the event outcome) — and being sure to include information on critical deadlines.
- Employ tools that help ensure clear communication, such as attached spreadsheets or models for complex pricing.
- Provide conference calls or training classes to help suppliers understand the system to be used for managing the event.

In short, buyers must take specific measures to ensure that suppliers understand the auction parameters and that the auction is being used as the pricing portion of the strategic sourcing cycle.

1. Are the event objectives clearly defined?
2. Are the bid package requirements clearly defined?
3. Is the event technology configured correctly?
4. Is adequate support in place to manage all possible technology-related questions or concerns?
5. Are all participants aware of the items on auction?
6. What is the lead time for the event?
7. What is the duration of the auction itself?
8. How many participants will be involved?
9. Is the schedule of activities prepared?
10. Have all the event requirements been communicated to the participants?
11. Are training classes or conference calls scheduled?
12. Is the event management team ready for the live event?

Fig. 1 - Event Preparation Checklist

Event Management

While the event preparation stage is about defining and understanding the information related to an auction, the event management stage centers on running the auction according to plan by ensuring the availability of critical expertise and technology. Buyers should have:

1. An event management system configured to the specifications and objectives of the auction;
2. An event management team in place to run the system and respond to participants.

By leveraging both of these components, buying organizations have much to gain. With a comprehensive event management system deployed, buyers have access to the tools they need to most effectively manage the competitive dynamics of pricing during the auction, from visibility to value-based adjustments. In addition, they have the necessary technology to manage process automation and ensure faster, more accurate communication between auction participants. And, with the guidance of a team of event management experts, buyers can be sure this technology is functioning optimally, configured correctly, and well supported. Furthermore, an event management team ensures the buyer of a smoothly coordinated auction that stays focused on the original objectives.

Event Summary

One of the primary reasons for including an auction in the strategic sourcing process is because it can generate extensive and long-term value for the buying organization. Achieving this objective, however, requires a careful analysis of each sourcing event after its completion in order to understand the bids received, who placed them, and how smoothly they were entered in the system. Conducting this type of post-event examination helps buyers identify several things:

1. Which suppliers most value the business;
2. Whether or not the preparation, technology, and expertise were adequate to meet the event's objectives;
3. Which specific practices worked — or did not work — for that particular procurement need.

Future events can then leverage this information to generate greater value whenever possible, and the individual business units involved can use the data to justify expenses, adjust budgets as necessary, or demonstrate new value acquisition.

Best Practices from the Supplier's Perspective

Buying organizations, while typically the hosts of online reverse auctions, are not the only ones responsible for ensuring their success. Suppliers should make efforts to utilize the information given to them to promote healthy competition, fair pricing, and smooth event management.

Preparation

Inasmuch as the buyer has a responsibility to clearly outline and communicate the definitions and parameters of the event, the supplier holds the responsibility of accepting and understanding those definitions and parameters. Specifically, each supplier should understand:

1. How it can both provide and obtain value in the context of the auction;
2. The requirements being auctioned;
3. The time limits and deadlines involved;
4. The total bid package as specified by the buyer.

Suppliers should then apply this understanding toward developing a functional, competitive bidding strategy — one that accommodates the auction type and the event management system in use. If suppliers are unfamiliar with the event management system, they should communicate all questions to the buying organization and take advantage of any training courses provided. Suppliers should feel prepared to place bids and leverage price visibility to their best advantage. In addition, suppliers should be prepared to accept a negative outcome in the event. That means defining limits and taking measures not to exceed them or to overextend resources.

Participation

Once a supplier is comfortably and adequately prepared for an auction, accurate and timely participation is critical to ensuring success. If technical issues arise, a supplier should have the means in place to contact support resources and resolve problems before they conflict with the bidding strategy or the auction's duration. Like buyers, suppliers are also responsible for managing competitive dynamics. That means paying attention to bid package changes, watching prices, and remaining as flexible as possible in order to stay aggressive. Suppliers should also be certain to communicate bids clearly and comprehensively, with resources on hand to address any questions or concerns the buyer might have.

Conclusion

Online auctions are detailed and often complex, but they offer numerous advantages to both buyers and suppliers within the context of the strategic sourcing cycle. Buyers can generate new value throughout the organization by reducing cycle time, cutting procurement costs, and extending their supply reach. Suppliers can forge new and lasting business relationships, competitively demonstrate their value in a particular context, and ensure the use of fair sourcing processes. Through the use of best practices for understanding, preparing for, and managing the auction process, participants can better maximize the value potential of the sourcing event and come closer to achieving a successful outcome.

For more information, contact Perfect Commerce at 877-871-3788 or visit www.perfect.com.

About Perfect Commerce

Perfect Commerce has been delivering On-Demand Spend Management solutions since 2000. The company supports the local needs of more than 200,000 global users. These users choose from the 25 million sku's Perfect Commerce manages and transact with 11,500 suppliers across its network to realize bottom line savings. Its customers benefit from the company's experience with on-demand requirements, long standing commitment to an OPEN Buyer/Supplier Network concept, and a best-in-class, marketing leading approach for product information management and search.

Perfect Commerce's solution footprint covers spend analytics, sourcing, procurement, contract management, invoice management, and the first Open Buyer/Supplier Network. Its customer base includes nearly every major industry segment with the highest focus and concentration on financial services, energy/utilities, manufacturing and higher education.