

It may be redundant to suggest that maximizing one's bottom line is paramount to success. But during this time of sustained economic downturn, the recommendation takes on a relative urgency. With lending sources scarce, the ability to grow one's business through the traditional borrowing-capital investment route is, for now, a deferred proposition. More pressing: analyzing one's ongoing operations and determining whether systems and processes are positioned for maximum efficiency.



**Bidding
WARS**



**Bid
LOW!**

Enter the reverse auction (also known as the e-auction, sourcing event, e-sourcing), a procurement solution that leverages the immediacy of the Internet and the most basic elements of free-market trading in an effort to uncover new suppliers offering potentially significant cost savings on goods and services.

A reverse auction is, as its name implies, an auction where buyer and seller roles are reversed. Whereas in the traditional auction, a seller offers a good or service to a group of buyers who compete in a bidding process, with the offer price rising as the auction progresses, in a reverse auction, sellers compete to win business by offering bids (purchase prices) that decrease in value as the auction unfolds.

With the assistance of the Internet and reverse auction marketers whose preparation often assembles a deep pool of engaged sellers, the bottom-line cost savings for companies can be significant and quickly achieved, along any line item category, including equipment, supplies, labor and professional services.

Kid Wonder, GE Blunder

A March 2000 *Fortune* article traces the history of the reverse auction to 1994, crediting its conception to then 30-year-old General Electric employee Glen Meakem. His idea was to overhaul the drawn-out “golf-course schmoozing” process of haggling with suppliers, or the tedious RFP and sealed bid processes. Rather, as Meakem proposed to his GE bosses, the market for goods and services


could become as efficient as the stock market, generating billions in corporate savings. “This idea [can] transform the global economy!” he proclaimed.

Except GE didn’t listen.

Undaunted, Meakem launched FreeMarkets Inc. in his basement later that year, and by 1999, his venture boasted a market cap of \$7 billion, a reflection of a customer base that included ExxonMobil, United Technologies and Royal Dutch Shell, to name a few.

FreeMarkets was eventually purchased in 2004 by California-based Ariba, a procurement services firm. Today, the company boasts 40 offices in 21 countries and generated \$85.7 million in revenue during the first quarter of its 2010 fiscal year.

“We celebrated the 15th anniversary



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**Bottom Line
SAVINGS!**



BY JERRY SOVERINSKY

of the reverse auction at our annual conference in May,” said Kris Colby, Ariba’s director of spend management services, who explained that the rationale behind using a reverse auction as a procurement tool has remained relatively unchanged over its short history.

“The reverse auction was started primarily as a way to do two things,” Colby noted. “One, it streamlines the negotiation process, taking away a lot of the clutter of phone calls and paper. And two, when you get everyone in the same place doing real-time negotiations, it’s a more competitive process that moves faster. And once companies figured out that [reverse auctions] could drive savings of 12 to 17 percent — a range that has held steady over time — it look off like a rocket.”

Schenectady, New York-based grocery chain Price Chopper has been participating in reverse auctions for three years, and it echoes nearly all of Colby’s comments.

“Before [reverse auctions], we were doing the standard RFPs and RFIs, man-

ual processes that required analysts, conference calls and paper bids that were never immediate,” said Jason Kennedy, Price Chopper’s manager of continuous improvement and supply chain. “The process used to take four to eight weeks, but with reverse auctions, it’s much, much quicker.” And results have been impressive, delivering generous savings to the grocer.

“Our cost savings range depending on the category,” said Ken Gregory, Price Chopper’s reverse auction supply chain analyst, noting that the company has participated in roughly 100 reverse auction events over the past year. “We’ve had some events that earned 50 percent in savings, though the average is probably around 18 percent.”

These numbers would cause any CEO to pause, especially with many of retail’s biggest players already using the process to lower costs. “Of the top 50 or so retailers in the U.S., about two-thirds have real, ongoing auction programs in place,” Colby said. “It’s got a very strong penetration with bigger companies.”

Size Doesn’t Matter

But you don’t have to be a Walmart, Albertson’s or Target to make the process a practical one for your company.

“Ten years ago, maybe it was more appropriate for a company to pass a certain size threshold before proceeding [with a reverse auction],” Colby said. “But the prices on technology and support have come down so much that if you buy goods and services, [the reverse auction] should be an arrow in your quiver for how to do things.”

Other experts agree but cite challenges for the smaller retailer, whose spending behavior might not attract a deep supplier pool. In that case, a reverse auction company can help connect the smaller retailer with a larger retailer and offer aggregate activity.

“[F]or that three-store c-store guy, if he spends \$10,000 on bags and another customer spends \$1 million a year, we do collaborative procurement,” explained Len Kaplan, vice president of sales for Phoenix-based Intesource, a reverse auction specialist. “It’s a great benefit for the small retailer who otherwise wouldn’t have the leverage.”

For home fashions retailer Anna’s Linens (AL), the reverse auction tool has helped the company navigate a rapid expansion (30 percent per year, with 258 stores in 18 states) while ensuring cost control.

“[W]e were growing so fast that our corporate support personnel did not have enough tools to buy properly,” said Mike Harnetiaux, AL’s chief administrative officer. “Our buying, whether product, supplies or services, was handled by each department head for their area... which resulted in varying degrees of purchasing success.”

Investment Costs

Of course, the suggestion that reverse auctions are appropriate for purchasers, no matter their size, requires further qualification. Colby said that base costs start at “\$15,000 to \$20,000 per year for those looking for a small-scale, self-service tool,” and can escalate into the millions for mega-retailers.

“Our biggest program was for a huge department store chain; they spent about \$4 million for a fully supported annual program,” Colby said, adding that the returns, in nearly every case, justified the investments. “On average, ROI ranges from eight to one to 15 to one, a very real and rapid return, with most clients experiencing payback in three months,” he added.

Comprehensive Support

Ariba offers a range of flexible program options — “Over time, our clients tend to take on more of this internally as they get into the process,” Colby said. Intesource,



Companies figured out that reverse auctions could drive savings of 17 percent.

however, distinguishes itself with its comprehensive management solutions.

“We offer a full-service, all-inclusive approach [to staging reverse auctions], primarily in the retail world,” said Kaplan. “We do all of the work, from helping determine appropriate categories to developing a strategy, to researching suppliers, and executing the actual event.”

According to Kaplan, while there’s a cost savings inherent in online solutions,

they’re fraught with risks for inexperienced users.

“There are nightmare stories where suppliers weren’t trained properly, where the spec [the precise good or service required] wasn’t clearly defined and there wasn’t a good strategy,” Kaplan said, adding that a successful reverse auction “consists of due diligence and doing one’s homework...you need a consistent process that works for all of the

disparate parts.”

That process begins, Kaplan said, with the creation of a list of category spends and an overall assessment of the company. “Every department that spends money would be a candidate for this,” Kaplan explained. “It’s construction, services, supplies, IT, HR, distribution, advertising, products, background checks for human resources — every department.”

5 Reverse Auction Myths

An Ariba Executive Summary addresses common concerns for those considering the merits of e-sourcing via reverse auctions:

MYTH 1

Traditional sourcing processes — RFPs, RFIs — work just as well as eSourcing.

TRUTH

With a centralized hub for all sourcing activities, live collaboration and scoring capabilities and faster results derived from the same resources, the reverse auction is a more efficient and effective sourcing process.

MYTH 2

My category can’t be sourced.

TRUTH

Reverse auctions can be held for *any* spend category regardless of size or complexity.

MYTH 3

The reverse auction could threaten our buying relationships and cause more problems than it solves.

TRUTH

“[R]ather than damaging supplier relationships, e-sourcing can actually enhance them by making it easier for suppliers to be assessed on all their capabilities, including...quality, reliability and on-time delivery.”

MYTH 4

Savings are guaranteed when we lock in prices during a sourcing project.

TRUTH

“The only savings realized are implemented savings,” and many companies fail to capture the full amount of their negotiated savings from suppliers. With eSourcing, because it’s a public process, the savings that buyers negotiate are the savings they actually receive.

MYTH 5

It takes too much time to stage a reverse auction and my company is too small to justify it.

TRUTH

Reverse auctions can be implemented and launched in as little as a week with minimal staff. And a well-managed procurement strategy can generate a significant ROI for companies of any size.

Colby agrees, though he's quick to point out that the process doesn't work for name-brand goods, where there's typically just one buying source.

Successful Events

While the rest of the process is relatively straightforward, ensuring success requires four key elements, Kaplan noted. "First, you need a decent spec," Kaplan said, "so that suppliers understand precisely what they are bidding on."

Second, there must be viable supply sources to generate competition. Intersource and Ariba maintain libraries of several hundred thousand suppliers, along with tools and process to assist in qualifying suppliers.

Third, the retailers must be willing to consider a change in suppliers. If the incumbent supplier doesn't feel his business is at risk, or the new suppliers don't have a legitimate opportunity, the integrity of the process is diminished. This is a particular sticking point for many firms.

"Many of our vendors are long-term suppliers with long-term relationships," Harnetiaux said. "Strong relationships have many positive affects, however, it sometimes masks opportunities for different approaches, including better pricing."

Kennedy agrees, and also advises retailers to get the buyers in their own company "to understand that [a reverse auction] makes their life much easier and that they'll be exposed to more potential suppliers... They're the expert, they've bought a category of goods for many years. You need to get them on board."

Finally, market conditions must be favorable for the category.

One, Two, Three, Sold!

The actual auction process is quick and "fun to watch," Kaplan said, noting that reverse auctions unfold in as few as 15 minutes (plus any extensions). During that time, retailers watch a computer screen and monitor the online bidding

process, where anywhere from two to 30 suppliers might be bidding. For suppliers, the process is a blind one; they're unaware of the competition and see only the current bid price (the incumbent supplier typically is invited to participate and usually accepts the offer).

After the auction ends, the buyer can choose any bid — not just the lowest. Pre-bid communications with interested suppliers stipulate how and when the final selection will be made (it's almost never done immediately after the auction), with quality, service and price the most common factors assessed.

What to Expect (When You're Expecting)

Of course, the fundamental reverse auction question persists: Will a reverse auction save you money? For both auction companies and retailers, the answer is an enthusiastic yes.

"Based on our experience, sourcing tens of thousands of events across more than 500 categories, our clients realize savings exceeding 18 percent," Kaplan said, a figure that mirrors estimates from Ariba (17 percent) — and those are not self-serving embellishments, Harnetiaux attests. "[W]e have now run 17 events that in total have generated expected annual savings of nearly \$5 million."

What's in Store for Your Store

While the reverse auction may generate particular appeal during this harsh economic climate, it's a legitimate procurement tool whose longevity will last far beyond the current recession.

"[T]here is no other new initiative at [Anna's Linen's] that has shown such ROI," Harnetiaux said. "It is our intention, where applicable, to expand the use of this tool to the basic buying process for each department and the company as a whole." **NACS**

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