

## An Review of Reverse Auctions

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**Abstract:-** Auction is a process of buying and selling goods or services by offering them up for bid ,taking bids and then selling the items to the highest bidder. In economic theory an auction may refer To any mechanism or set of trading rules for exchange .It is characterized by the competitive and dynamic nature by which the final price is reached .the electronic auctions are auctions conducted online. There are many types of auction like English auctions ,sealed first price auction ,Vickrey auction,Forword auction, Reverse auction ,Silent auction ,top-up Auction and so on.

A reverse auction is defined as a dynamic, real-time negotiation between a purchasing organization and several pre-qualified suppliers competing against one another to win the opportunity to supply goods or services to the purchasing organization. This paper examines how and when to use reverse auctions and how to make them work for your business. Included are two examples of reverse auctions and an analysis of the bidding strategy. The benefits of reverse auctions for both the buyer and seller are examined.

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### Introduction

Auctions have been around for centuries. People with goods wanted an efficient way to sell those goods to people who wanted those goods. For many people, the memory of an auction involves a fast-tongued auctioneer belting out numbers to a loosely organized crowd. Historically, the highest level of technology used for an auction involved plugging a microphone into a wall.

Then someone realized that the Internet could be more than a paperless catalog. The Internet could be used to expand the universe of potential buyers for any one item. It could be used by buyers to compare goods more efficiently and accurately. Anyone could enjoy an auction from a comfortable seat unencumbered by time or location.

The online auction proved to be a great application of technology for those wishing to sell products. Traditionally, the auction represented the seller and involved one seller to many buyers. Auctions helped drive up prices for the seller But what about those people wishing to buy goods and services? Fortunately, technology worked equally well for buyers, especially buyers working on behalf of a professional organization. Now auctions could be used to represent the buyer and help drive prices down.

Over the years, various auction formats were devised and executed, including the most well-known format, the reverse auction. Rather than having one seller with many buyers, a reverse auction involved one buyer with many sellers. Sellers placed decreasing bids on a set of goods or services and followed the same set of rules. Strategic sourcing is an important component of successful supply chain management. Traditional sourcing methods are frequently time consuming exercises that yield inexact and often wildly fluctuating results. A typical buyer's dream scenario generally has volumes of spend data available for analysis, multiple qualified suppliers knocking on the door jockeying for business and an unlimited amount of time available for supplier selection, contract negotiation and eventual cost savings. Unfortunately, this is rarely, if ever, a realistic occurrence. Data collection is a time consuming process,

often with imperfect results if data has been categorized incorrectly, if it's available at all. While suppliers are never lacking in quantity, are they qualified to the level your company demands? Finally, project schedules do not always give a buyer as much time as he or she would like to conduct the critical research needed to provide the best contract for their employer.

A reverse auction is defined as a dynamic, real-time negotiation between a purchasing organization and several pre-qualified suppliers competing against one another to win the opportunity to supply goods or services to the purchasing organization (What are Reverse Auctions). While traditional auctions work to increase bids on an item for sale, reverse auctions work in the opposite manner: They instead work to drive prices down during the buying process so that they lowest bidder with the best services wins. They can be viewed as an alterative to one-on-one negotiation (Reverse Auction Best Practices, 2006). Reverse auctions were first introduced in 1995 by FreeMarkets, a company acquired by Ariba in 2004 (Ariba and Freemarkets, 2004; Emiliani & Giampietro, 2006). They gained popularity in the late 1990s with the Internet boom when more companies and even overnments began using them for sourcing and procurement, and today reverse auctions continue to be an increasingly important part of procurement .

### Working of forword auction and reverse auction

There are really only two categories of auctions — forward and reverse auctions. There may be variations with these based on a number of factors, including the progress of the auction and the criteria for determining the “winner” of the auction.

Forward auctions take the form of a single seller offering an item for sale, with buyers competing to secure the item by bidding the price upward. Forward auctions are far-better understood by the public at large than reverse auctions as to how they operate, due primarily to the fact that they are widely used at the consumer level. They are also widely

used when the goal is for the seller to receive the most money possible for the item being offered at auction. Thus, a forward auction should be utilized for sales of goods and services of all types, whether conducted online, offline or a hybrid of the two.

Reverse auctions are the other major form of auctions. In a reverse auction, a single buyer makes potential sellers aware of their intent to buy a specified good or service. During the course of the actual reverse auction event, the sellers bid against one another to secure the buyer's business, driving

the price to be paid for the item downward. Thus, the winning bidder is the seller who offers the lowest price. Reverse auctions are most typically used for procurement by private companies, public sector agencies and nonprofit organizations. Reverse auctions are not a short-term tactic for procurement operations, but are, in fact, a proven method for long-term management of indirect spend — delivering significant savings and process efficiency. For more information on reverse auctions and the procurement process.

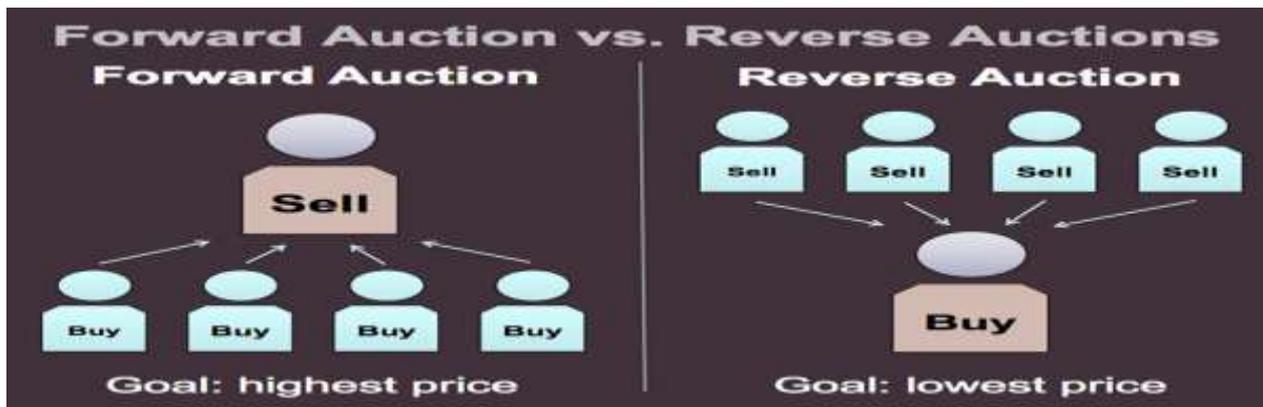
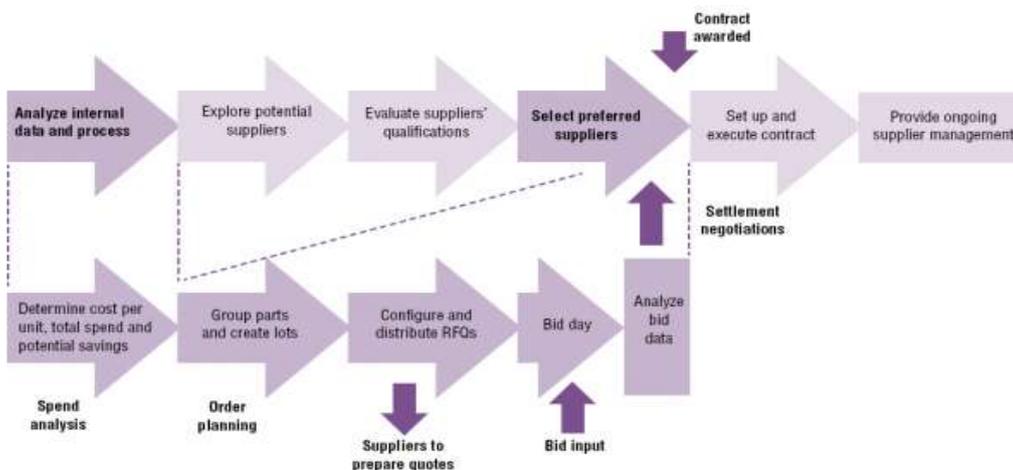


Fig. Forward and reverse auction



Balanced View of Reverse Auctions

While some people recommend using reverse auctions for every purchase and others do not want reverse auctions to be used at all, we are proposing a more balanced view. Reverse auctions are not always the best tool or even a desirable one for some purchases. However, for other purchases they are extremely powerful and will produce the best results. The trick is to use reverse auctions in situations where their use would deliver more value than the use of other tools. For most companies, these situations occur quite frequently. For example, reverse auctions are ideally suited for purchases of raw materials, processed goods, travel, printing services, capital equipment, components, and many other items. Reverse auctions work best when price is a key point of negotiation for the buying organization.

It might make sense to use more than one strategic sourcing tool to conduct a purchase. Sometimes sourcing personnel will run an RFI to qualify suppliers and to make sure that each supplier's offering is comparable with others in terms of quality and specifications. Then later, the organization will run a reverse auction to arrive at the best possible pricing. Using other sourcing tools in combination with reverse auctions increases the scope of purchases for which reverse auctions can be used. This is because each sourcing tool will be used to check different things. RFI's would be used to assess quality and production standards while the reverse auction would be geared toward getting the best pricing available from the qualified vendors.

### **When to Use**

There are several factors that go into the decision on whether to use reverse auctions. These factors include: the specifications of the products, the structure of the supply base, the market pricing structure, projected lead times, contract status, the costs of switching vendors, the distribution complexity, the savings opportunity, the size of the purchase, and the strategic nature of the supplier relationships. This next few sections will discuss these factors in additional detail and explain the situations where these factors make reverse auctions a good choice for a purchase.

#### ***Product Specifications***

The specifications of a product are an important factor in determining whether this product is an appropriate purchase for reverse auctions. Reverse auctions are generally more conducive to a purchase where the specifications are simple and there are not a lot of differences between supplier offerings. This is true if the items being purchased are commodities or if the specifications for the items are defined by a well accepted industry standard.

#### ***Structure of Supply Base***

One of the most important elements needed in a purchase for conducting a reverse auction is a large and competitive supply base. As a general rule, if you do not have at least 3 strong, qualified, and competitive suppliers that will participate, you should not conduct a reverse auction to make the purchase.

#### ***Pricing Structure***

This is not as important as some of the other factors, but it should still not be overlooked. Reverse auctions work well as a means of price discovery. However, you should not use reverse auctions when there is limited supply or at a time when the price is fluctuating rapidly. In these cases, suppliers may be hesitant to lower the price since they may think they could sell the product for more tomorrow. You generally want to use reverse auctions when the pricing trends are somewhat stable and suppliers can actually make forecasts and pricing projections for the value of inventory that they hold or plan to produce.

#### ***Lead Times***

The lead time required for the product or service is important for determining whether the item is an appropriate purchase for reverse auctions. Reverse auctions are suitable if there is a lead time long enough to conduct the purchase within the allotted time frame.

#### ***Contract Status***

Another important consideration for reverse auctions is the

contract status. Reverse auctions are generally used for contracts that will be shorter term in duration. Reverse auctions are also useful for contracts that may be expiring in the near future since this is the time to review purchasing options.

#### ***Cost of Switching***

The cost of switching vendors is also a very important consideration. Reverse auctions would generally be used only if there is little or no cost associated with switching to another qualified supplier.

#### ***Delivery or Distribution***

The type of delivery schedules or distribution requirements associated with the purchase should also play a role in the decision to use reverse auctions. For purchases with an irregular and complex delivery requirements or where logistics is a substantial portion of the purchase, reverse auctions may not be the best option or should be used in conjunction with other purchasing tools. The reverse auction process is more conducive to purchases that have simple distribution requirements as well as a predictable and easy to understand delivery schedule.

#### ***Savings Opportunity***

In order to use reverse auctions, there should be an opportunity for actual savings over other purchasing methods and tools. This sounds obvious, but it can sometimes be overlooked. The possible level of savings will be dictated by many factors that range from the effectiveness of current sourcing efforts to the amount of pricing flexibility that suppliers have. The savings opportunity needs to be greater than the cost in time and resources needed to organize and run the reverse auction event.

#### ***Purchasing Process***

Reverse auctions are best used as part of a centralized purchasing process. In this way requirements from different parts of the company are aggregated in an attempt to maximize a company's purchasing power. While reverse auctions can be used in a decentralized approach, they are more commonly used in a centralized one. A centralized approach often realizes the maximum benefit from reverse auctions since purchases from many areas are grouped together.

#### ***Size of Purchase***

The size and dollar value of the purchase is also an important determinant of whether or not to use reverse auctions. Reverse auctions are often suited for higher dollar purchases because they do take time to set up and organize. If the purchasing organization has a reverse auction process in place that is set up to run periodic reverse auctions

already for these suppliers, then reverse auctions could be used for lower dollar purchases.

**Tools used**

**RFX tools provide buyers with:**

- The ability to list your RFX and Reverse Auction as a Public or Private Listing
- The ability to upload unlimited attachments, including specifications, drawings, documents, and presentations.
- Capability to export bulk line items and key event details to Microsoft Excel
- Ability to work offline and populate bids in Excel for RFP opportunities, then upload back into the system
- Capacity to maintain an original copy in Excel as an audit trail
- Single Line or Multiple Line Listings
- Each line item can have its own products or specifications associated with it.
- Suppliers can bid on a basket of items, or on individual items.
- Multiple Currency Support
- Reverse Auctions can be conducted in a Ranking or Lowest Bid Format.
- Ability to invite your colleagues or clients as reviewers to monitor the status and results of your RFX listing.
- Ability to invite pre-registered suppliers or your own suppliers via their email addresses.

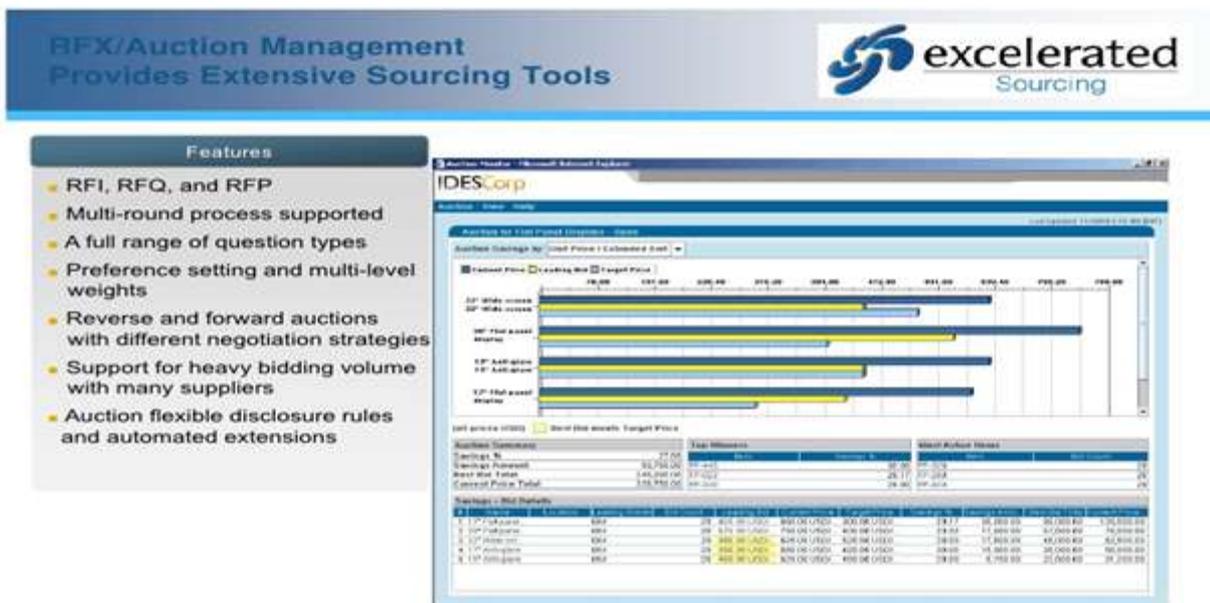
- Storage of your RFX event and the ability to copy and rerun your event in the future.
- Virtually unlimited event storage, for an audit trail of your sourcing events.

**Contract Management Repository:**

- Track original contract document locations.
- Upload and store copies of contracts.
- Track responsible spend or category owners.
- Filter and view contracts by a variety of criteria including expiration data and contract dollar amount.
- Get email notification in advance of a contract expiration date.

**Supplier Benefits:**

- Registered suppliers can get invites to participate in RFX events from existing or entirely new customers
- Suppliers can create a free catalog to showcase their business.
- Suppliers can market their products and services and gain valuable SEO links back to their own website by building a profile and completing a catalog.
- Suppliers get published in the WhyAbe.com free supplier directory.
- Work on line item bids offline, in Excel, and come back to upload your bid at a later date.



**Conclusion**

Based on the criteria listed above, many companies could use reverse auctions quite effectively for large portions of their total purchases. It is important when a company reviews the current levels and categories of spend to do an analysis based on the factors listed above. This should provide an organization with a basis for making a decision whether or not it makes sense to use reverse auctions for that category or for part of that category of spend. By using

reverse auctions at the right time, correctly, and in combination with other best practice sourcing tools companies can maximize the value and benefits that arise from their sourcing efforts.

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