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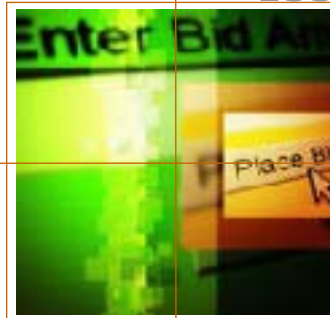
E-SOURCING: MORE THAN JUST ELECTRONIC AUCTIONS

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Introduction

The success of a reverse auction cannot be measured immediately and solely based on the savings achieved; experience shows that problems can arise, including serious problems, when the product or service to be auctioned is inappropriate.

I am going to describe a recent case to you, which genuinely happened, although I will omit the names of the companies involved. A large company, which operates in a regulated sector, decides to outsource its information systems. The purchasing company, after preparing a detailed document with the conditions and specifications (you know, about 200 pages of technical jargon), carried out a reverse auction, with the assistance of consultants from a known eSourcing platform, which is owned by a large Spanish company. Only the leading companies were invited to participate in the auction and the competition unleashed by the process resulted in a substantial saving being generated. One of the world's five largest technology companies was awarded the contract.

Taking into account that I am only familiar with the version of the purchaser and not wanting to draw hasty conclusions, I will restrict myself to relating what took place after the auction: the service provided did not match the client's expectations or, according to the client, the technical standards agreed. Following numerous complaints, the client applied the agreed contractual penalties and, since the deficiencies were not resolved, the client withdrew the contract. The lawyers of both parties are still negotiating, but it is more than likely that the matter will end in court.

The explanation of what happened is simple: the purchasing company, probably poorly advised, got the "how" right (the use of an auction) but the "what" wrong (the service to be auctioned). Factors such as the "specifiability", competition among suppliers, appropriate volume or clarity in the auction rules are essential factors, but are insufficient when the good to be auctioned is inappropriate.

The limited application of the auction is demonstrated by the survey sponsored by the Spanish Association of Purchasing and Provisioning Managers (it can be requested at <http://www.futurepurchasing.com>): only 15% of the 406 purchasing managers interviewed in our country believe that electronic auctions can be applied to more than 10% of their purchases.

On the other hand, nearly all the platforms and companies that are dedicated to eSourcing are wholly convinced about the reverse auction. One possible reason for this gap is the business model of the majority of these platforms, which are based on commissions and success fees. The reality is that a correct eSourcing platform (or electronic negotiation) should offer more. ITbid, our own platform, offers different powerful negotiation tools depending on the requirements of distinct purchases, when the use of a reverse auction is not recommended.

Our intention is precisely to demonstrate to our clients that eSourcing offers substantial advantages in nearly all negotiations, provided that the correct negotiation tool is chosen. Experience shows us that the key factor is the alignment of the purchasing strategy with the electronic negotiation tool. Our methodology is based on considering the position of the product or service to be acquired from three different perspectives, represented by three quadrant matrix graphs:

- Economic importance / Supply complexity matrix (Kraljic matrix)
- Specifiability / Competition between suppliers matrix
- Change of supplier cost / Agreement duration matrix

Economic importance / Supply complexity

These are the first pair of criteria to consider when choosing an electronic negotiation tool. Kraljic (Harvard Business Review, 61, 1983) had already studied them as a basis for the four possible purchasing strategies: strategic, leveraged, non-critical and bottle neck products.

The auction is only recommended for highly leveraged products, meaning those products with a high value and a minimum or small risk. In nearly all other cases, requests for quotations (RFQ), requests for proposals (RFP) or MRO negotiations in the case of non-critical products, will be much more appropriate. The most frequently used tool on a day to day basis in a purchasing department is RFQ.

Specifiability / Competition between suppliers

Many of our colleagues believe, incorrectly in my opinion, that this is the only criteria to consider when deciding whether to use an auction. As we saw in the initial example, having excellent specifications does not rule out conflicts that may arise if the product or service to be purchased is inappropriate.

The process of a reverse auction requires clear and unambiguous specifications and a high degree of competition between suppliers. Once again, if they do not fulfil these conditions, it is better to opt for the most natural form of negotiation such as the RFQ.

Change of supplier cost / Agreement duration

This is the third criteria when choosing an electronic negotiation mechanism. It seems obvious to state that the higher the cost of changing a supplier or the longer the duration of the agreement, the higher the risk associated with the negotiation. Therefore, without being as strict as the previous two criteria, an auction would be ill-advised in those cases in which the duration and/or the cost of changing the supplier are high.

In light of the above, we can clearly see why the case at the start of this article was a disaster: it fulfilled the criteria for specifiability / competition, but not for importance / complexity or cost of change / duration. In short, it committed itself to excessive risk, where under no circumstances could the savings obtained compensate for the potential losses incurred from the provision of the service.

Conclusion

Many of the better known electronic negotiation platforms revolve directly around auctions. Sadly, this situation has arisen because for many purchasing managers, electronic negotiation is equal to a reverse auction, when this is categorically not the case. An incorrect knowledge of what it is and of what eSourcing allows, combined with an inappropriate use of auctions has brought about unsatisfactory experiences, such as the one described at the beginning of this article, and "bad press" for eSourcing in general.

Undoubtedly, the reverse auction is ideal for obtaining savings, but the conditions under which it is applied must be carefully examined, always taking into account that eSourcing includes other negotiation tools (RFQ, RFP) which have definite advantages and are appropriate for the majority of negotiations.