



# Selling in the 'brave new world' of procurement

Andy Moorhouse, consultant at Huthwaite International, shows how to fight back

**T**he transformation of procurement from humble back-office function within the business to front-line strategic weapon has had a dramatic impact on the buyer/seller landscape, changing it forever.

In the battle to achieve bottom-line results and improve shareholder value, huge investment has been made by global organisations in developing their procurement function. Supported by similar levels of expenditure in technology, there is now a wealth of tools, processes and best practice expertise available to help procurement maximise its negotiating power in this new environment.

In particular, the development of the reverse auction has significantly strengthened the hand of the procurement professional in managing – and controlling – the sales process. This tool has been embraced to varying degrees by procurement organisations, but is a widely-accepted business practice that is here to stay.

## Price, price, price

It seems that no product or service is beyond the reach of the reverse auction. Having exhausted the easy opportunities in sourcing commodities, procurement managers are now reverse auctioning complex services and difficult supply markets. Indeed, after successfully auctioning a £350 million legal services contract, the procurement director of a leading financial services provider stated: "If it can be invoiced, it can be reverse auctioned."

The common perception among selling organisations is that reverse auctions commoditise their offering, destroy established relationships and focus single-mindedly on price. And

who can be surprised at this mindset, when the vice president of supplier management in a Fortune 100 firm has publicly observed: "There is no reason suppliers should like reverse auctions. They are a tool that is designed to transfer margins from them to me."

Finally, when participating, suppliers can get into a bidding war that drives prices down below their bottom line, as the 'herd mentality' takes over. The sales director of an industrial product distributor explains: "It was one of the most frightening experiences I have ever had. I went in with a limit, was soon bidding far below it and realised I had lost control."

## Fighting back

By contrast, in the face of this onslaught, little has changed on the supplier's side of the table. Since the inception of reverse auctions, there has been no parallel development of a 'best practice' approach to help the seller operate in this new and more sophisticated procurement environment. Unsure how to respond, many selling organisations have adopted a simple binary stance: play the game or walk away.

However, with the average auction contract valued at £1.2 million, simply refusing to play is a dangerous and expensive strategy. To date, the only way to learn the rules of the game has been to take part, with sellers making many mistakes along the way – a very steep and costly learning curve.

To minimise the cost of this learning experience and help break through the commoditising effects of reverse auctions, Huthwaite International conducted a global research study to identify successful auction strategies and define a best-practice approach for supplier participation.

The resulting insights identify five

common traps that inexperienced sellers fall into and clarify how leading selling organisations are combating the impact of reverse auctions. In particular, this article offers real-world examples of the strategies used by incumbent suppliers to defend their accounts in the face of reverse auctions, and so retain the business.

Importantly, many of the lessons learned in dealing with reverse auctions can be applied more broadly in dealing with other aspects of the procurement process.

## Trap 1: Believing the lowest bidder wins

It is well established that procurement will maximise price competition between rival bidders – and so extract the largest discount in a reverse auction – by guaranteeing the contract to the lowest bidder. If this auction award rule is not used, and the contract can be awarded to any supplier, sellers have little incentive to bid furiously to secure the first-place position.

However, the Huthwaite study showed that the 'lowest bidder wins' rule was applied in less than 17 per cent of auction events. The clear implication therefore is that, in four out of five reverse auctions, the contract may be awarded to *any* bidder, irrespective of their final position. Contrary to common perception, price cannot be the sole determinant.

And here lies the real issue: to maximise price competition, it is in procurement's best interests if sellers believe they have to be the cheapest to win.

Competing suppliers can be forgiven for thinking this way when procurement comes out with phrases such as, "it is our intention to award to the lowest bidder" or "we guarantee to meet the first-placed bidder

immediately after the auction."

Unfortunately, such conditioning statements do affect the behaviour of inexperienced participants, as the European sales manager of a global packaging company explains: "We were under the impression the lowest offer would win and that you would stand or fall on the day." He goes on to say: "They didn't tell us that the cheapest price was guaranteed the contract, but everybody thought it would be like that."

This price-focused mindset drove the supplier into a bidding war which resulted in his firm securing an unprofitable contract *below their walk-away price*. The sales manager concludes: "Our strategy was to finish first with the lowest price, but this was the downfall of the strategy!"

The reality, by contrast, is that 92 per cent of incumbent suppliers retained the business *without* being the cheapest. Indeed, the most common bidding position was to finish in third place.

As procurement has conditioned suppliers into believing they have to be the cheapest to secure the contract, sellers often make the mistake of bidding aggressively for first place. Thus, before deciding whether to participate in a reverse auction, it is first essential to understand if the contract is guaranteed to the first-placed bidder, as the rules chosen by procurement have a huge effect on both suppliers' bidding strategies and the auction outcome.

For auction success, suppliers must:

- Ignore procurement's conditioning statements
- Determine, before bidding, where they want to finish in the rankings
- Consider that procurement may not conduct the event with integrity and get absolute clarity on the contract award criteria.

Finally, unless procurement explicitly states "lowest bidder wins", being the cheapest will not guarantee success.

**Trap 2: Following procurement's rules**

After inviting or coercing suppliers into the reverse auction process, procurement produces a large number of rules regarding how they must participate. These say:

1. If you want to deal with us all transactions will be electronic.
  2. You must not circumvent the formal process, or you will be excluded.
  3. If you try to place an offline bid you will be disqualified...
- ...the list goes on.

In response, many inexperienced sellers feel they have no power and their only option is blindly to follow the process or to reject the invitation. The sales manager from a global facilities management company identifies this mindset: "Our only tactic is bidding online down to our worst position, in either small bites or big steps."

Indeed, an analysis of the case studies highlighted that incumbents who followed the process strictly – and got bogged down in the mechanics of the bidding process – had a reason to be pessimistic, as they

were only successful in retaining the contract 41 per cent of the time. However, the research uncovered that incumbent suppliers can greatly enhance their chances of success by not following the auction rules set by procurement.

The two most successful strategies documented in the research both involved a powerful posing statement, where the successful incumbent said to procurement: "We respect you and the investment you have made in your e-procurement systems – but this is not the way we do business. We will give you our absolute best-and-final offer but will not be drawn into a bidding war."

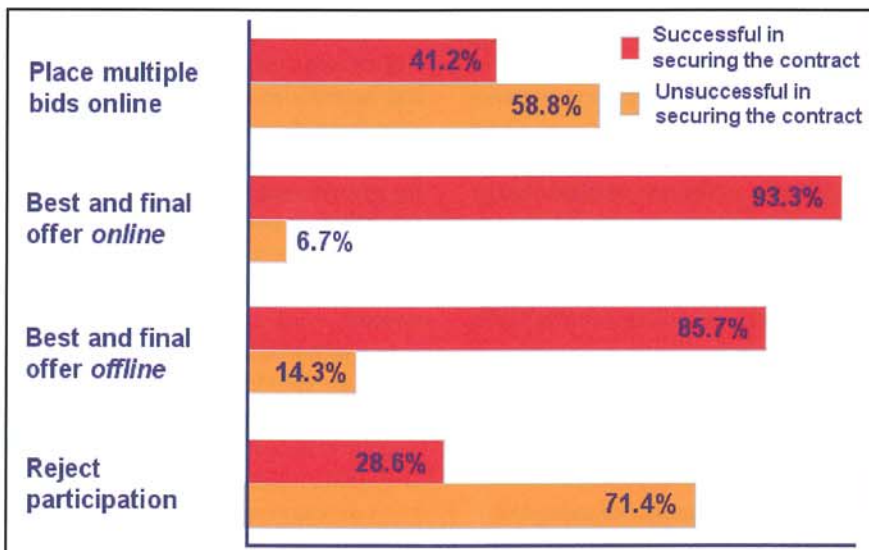
The sales director of a global facilities management organisation explains how this approach can be an effective strategy if bidding online: "Our strategy was quite ruthless – we told procurement we would go in hard at the start and put in just one best-and-final offer. In the feedback session, procurement said that the auction hadn't really worked as they hoped it would. The two other competitors had a bit of a battle, but as we set the best price initially, the auction didn't escalate downward into a bidding war."

A powerful opening position can undermine the dynamic bidding environment in the auction and is a way for the supplier to assert its position. That being said, anecdotal evidence from several procurement professionals is that the best-and-final offer is sometimes better than what they hoped for.

In a similar fashion, circumventing the formal process and presenting an offline bid can also be an effective strategy, but only for incumbent suppliers.

The vice-president of strategic accounts for a global logistics provider explains: "We drew a line in the sand and said to procurement, 'We just don't participate in auctions. We won't agree to the terms, and we won't access the system'."

However, they insisted on meeting procurement and presenting a hard-copy proposal. As the incumbent supplier, they successfully retained two multimillion-dollar accounts with





this approach. One major caveat: no organisation in the study won any new business by circumventing the process and presenting an offline bid.

Care must be taken, of course, in adopting an extreme alternative strategy, such as rejecting participation entirely. The results of the research were stark here: 72 per cent of the incumbent suppliers refusing to participate were unsuccessful, as procurement easily replaced their offering with that of another provider.

Taking a 'helicopter view' of procurement's selection process, it is clear that when procurement professionals choose to conduct a reverse auction, they identify the product or service being auctioned as a commodity or non-strategic purchase and believe that the balance of power is clearly in their favour. Put simply, they see it as a buyer's market.

The key to success here is in recognising the real balance of power between buyer and seller. At its most basic, a supplier's power is determined by its fallback position. That is, what else can you do with

what you have for sale? Rejecting participation only works under very specific supply market situations (i.e. when it is a seller's market and the product or service is in very short supply).

Thus, tips for successful participation include:

- Follow the process, but don't follow it slavishly
- When playing outside the rules, ensure you communicate your intentions and set expectations upfront
- If you decide to participate, a powerful opening position can be most effective
- Rather than refusing to bid, treat the auction as a different medium for submitting your best offer
- However, if there are only three real players, refusing to participate may be an effective strategy as the auction collapses without a sufficient number of bidders.

### **Trap 3: Believing the specification is accurate**

With all of the best practice expertise available to help procurement set up

the reverse auction process, it is understandable if suppliers believe the specification is an accurate reflection of the real business need. However, 53 per cent of reverse auction specifications analysed contained ambiguous specifications, open to interpretation by competing suppliers.

The results of an ambiguous specification can be incredibly damaging for both buyer and seller, as the national sales manager from a plant hire organisation explains: "We bid with our full service solution included in our £3.4 million bid; however, the variation in the RFP (Request For Proposal) meant that procurement was not comparing 'apples with apples'."

"A new market entrant was awarded the contract after bidding £2.5 million, but they had no service support network or spare capacity, which meant their generators were not operational for one-third of the time. Within two months of losing the auction, we were contracted to provide emergency rentals." Whilst the incumbent recovered some of the lost business, the total cost to the customer of running both contracts, including fines and compensation payments, was greater than £4 million.

### **'Like for like comparison'**

So how should suppliers respond to an inaccurate specification? There are two key points to be gleaned from the above case study.

Firstly, the incumbent included its full service offering in the £3.4 million bid, rather than meeting the minimum specification requirements. Secondly, and even more worrying, the incumbent supplier did not clarify the specification before the auction, let alone attempt to influence procurement before the RFP was written.

Before participating, therefore, suppliers should ensure procurement professionals understand the financial and personal implications of their ambiguous specification and where it can be misinterpreted. In response, it is essential to:

- Ideally, define real business requirements and influence the specification pre-auction
- After RFP is received, scrutinise the specification and clarify any ambiguity before bidding
- If you are a high service provider, ensure you only meet the bare specification, bid with a 'naked' solution and re-invoice the additional service components later!

#### **Trap 4: Thinking the auction is the end of the buying process**

Procurement professionals typically position reverse auctions as an 'accelerated negotiation' and go to great lengths in explaining how this process reduces the time to the contract award and the cost of sale for the supplier. It is therefore understandable if sellers believe that the use of an auction signals the end of the decision process.

In fact, an incredible 88 per cent of incumbent suppliers are involved in further post-auction negotiations. Yet, critically, when further negotiation takes place, only one in 10 is informed, pre-auction, that post-auction negotiation is going to happen.

In addition to any ethical considerations, this behaviour has huge implications for the selling organisations as, if they give their 'best-and-final offer', they have nothing to trade during the post-auction negotiation. Only when procurement explicitly states, 'lowest bidder wins' can the seller expect the decision to follow the auction directly.

However, post-auction negotiations should really come as no surprise, as procurement has to be confident that it is making the right decision – especially in the case of an unknown supplier or if the solution is complex or untried. Indeed, Huthwaite's research found that final contracts were not awarded for an average of nearly two months after the auction, as procurement considered the potential ramifications of its decision.

In turn, this provides the opportunity for incumbents to capitalise on these concerns and highlight the implications and true cost of switching suppliers, in terms

of time, hassle, disruption, expense and risk.

#### **Expect the unexpected**

There are clues as to whether post-auction negotiation will happen. Suppliers should plan and prepare for further face-to-face negotiation when the following indicators are visible:

- Procurement says: "We reserve the right to award the contract to any participant"
- Procurement won't commit on a date for the contract award
- Only the suppliers' rank (rather than bid value) is visible.

Finally, as part of the overall bidding strategy, sellers should figure out what they will trade in post-auction negotiations if they drop to their bottom line.

#### **Trap 5: Not taking a strategic approach to planning**

It might go against one's instincts, yet the Huthwaite research found that there is no significant correlation between time spent preparing for an auction and success rates. All research participants identify a bottom-line or walk-away price. And both successful and unsuccessful participants spend significant man-hours (typically between 22 and 27 hours) on cost-modelling calculations in order to prepare for the reverse auctions.

Critically, however, the average time spent planning a bidding strategy by successful bidders was 9.2 hours – three times that of their unsuccessful counterparts. So what do successful selling organisations do during this planning time?

The sales director of a global services company responds thus: "We had a long and hard discussion that went right through the business – should we bid or not? We spent a lot of time trying to work out our fallback options and planning bidding scenarios. We also tried to get a best practice overview of what to do from speaking with our divisional colleagues."

In short, it is clear that both successful and unsuccessful sellers make considerable time investments in the preparation stages. However, successful participants spend

significantly more time on planning their bidding strategy and considering their strategic options.

#### **Conclusion: it's all about control**

The strategies for success are typically learned through participation and sellers endure a very steep and expensive learning curve before understanding how to play the reverse auction game. Yet, as has been seen, there are a number of effective methods for combating reverse auctions.

Successful suppliers are playing the game but learning to bend the rules to their advantage. Rather than refusing to play, a more effective response is for suppliers simply to treat the online event as a vehicle for submitting their best offer. By not following procurement's rules slavishly, suppliers retain control and maximise their perceived power in a reverse auction event. Experienced incumbents are comfortable finishing ranked in third place and understand that a reverse auction is merely a supplier-conditioning tool, used to make the buyer feel more powerful.

Finally, if the process lacks transparency and you suspect the event will not be hosted with integrity, challenge procurement and ensure it is explicit on the award criteria. But however good your planning, don't get caught up in the frenzy of a bidding war.

For the bottom line, both literally and metaphorically, is that no deal is better than a bad deal. Thus, in reverse auctions as elsewhere in life, the key to success is in knowing the rules and how to play the game. ■

#### **contributor**

Huthwaite International, an ISMM Corporate Member, is a global sales and negotiation consultancy whose research and consultancy interests lie in identifying the evolving role of procurement and determining a best practice approach for dealing with its consequences.

Tel: 01709 710081

Email: [info@Huthwaite.co.uk](mailto:info@Huthwaite.co.uk)  
[www.huthwaite.co.uk](http://www.huthwaite.co.uk)