

The Impact of Online Reverse Auctions on Supply Relationships

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The B2B Sourcing Landscape

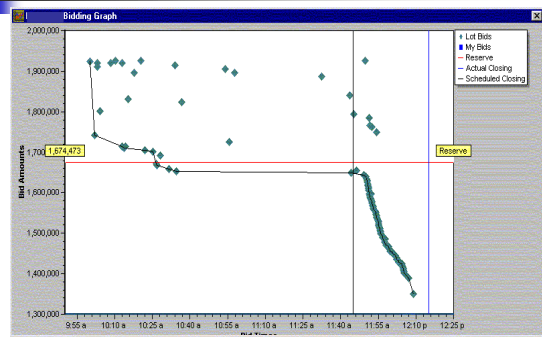
- The stakes: \$1 trillion of \$7 trillion spend
- On-line Reverse auctions
 - Freemarkets is the market leader
 - \$5B+, 4100 suppliers, \$1B savings
 - Standard in Oracle, CommerceOne toolkit
- Technologies do not exist in a vacuum!

How will these impact buyer-supplier relationships?

Online Reverse Auctions

- Auction
 - A market institution with an explicit set of rules determining resource allocation and prices on the basis of bids from market participants.
- Why reverse?
 - Suppliers bid
 - Price falls
- 1 buyer, multiple suppliers
- Sealed vs open bid auctions

Open-Bid Auction



What is the Impact on...

- Buyer's cost savings
- Supplier's suspicion of buyer opportunism
 - Key consideration in structuring relationships
- Supplier's willingness to make dedicated investments toward the buyer
 - Critical for relationship stability and performance

Research Setting

- Major Automotive Supplier
 - Producer of car components
- Auction process
 - Invited, pre-qualified suppliers
 - 33% new suppliers
 - Buyer determines winner
 - Not just price

The Auctions

- 6 auctions, totaling a ~\$200M spend

Auction	Product	# Bidders
Sealed	Transportation	10
	Non-production parts	8
	Semiconductors	7
Open	Plastics	12
	Electrical parts	35
	Metal parts	20
Totals		92

Data Collection

- Web-based survey to pre, post, and control groups

Survey	N	Response Rate	Pre ₁	Auction	Post ₂	Control
Pre	57	62%				
Post	36	63				
Control	48	55				

- Suppliers do not know the winners at post test



The Buyer's Cost Savings

- Cost savings are a percentage reduction from historical costs
- The most important variable in purchasing

Cost savings should be higher in open than sealed bid auctions



The Buyer's Cost Savings

- Significantly greater in open than sealed bid auctions
- *Open bid reverse auctions will save \$\$*



The Supplier's Opportunism Suspicions

- Self-interest seeking *with guile*
 - Information distortion
 - Lying, cheating, stealing, misrepresentation
 - Reneging on explicit/implicit commitments
 - Shirking, failing to fulfill promises and obligations

Opportunism suspicions should be higher in open than sealed auctions



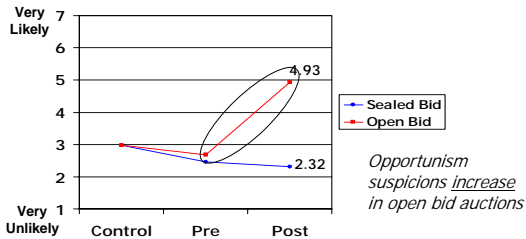
Opportunism Suspicions in Auctions

- [The buyer] talks about the relationship being a partnership and *this [the auction] really takes that away*. There is not a partnership there at all. What they do is take your existing business that you have worked very hard to achieve and maintain. You work with them to give them cost reductions over the years and they send it out across the board for a competitive bid. *I just do not think that is fair.*
-- Supplier (italics added)

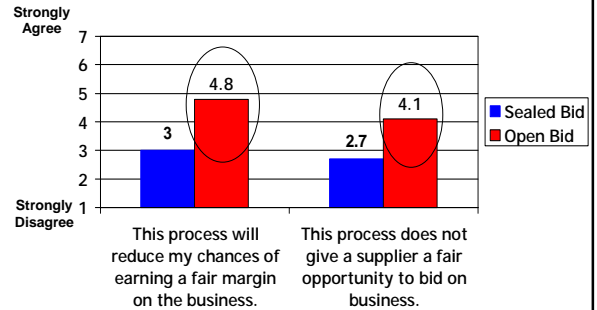
The Supplier's Opportunism Suspicions by Auction Type

How likely is it that [the buyer] will:

Make false accusations, provide false information, expect your firm to pay for more than its fair share of a problem, be unwilling to accept responsibility.



The Bid Process Fuels Suspicions



Open Bid Auction Suspicions

- Exploitative process
 - *All they [the buyer] were going to do was just feel out what the numbers were going to be.* Let's say they're looking at someone in Brazil or some Korean firm out there. At this point in the junction, they weren't going to go with those guys based on what they were. So all these guys were throwing low bids, but it had no meaning as to what was going on. -- Supplier
- Non-viable competition
 - I didn't think the competition we were dealing with in the atmosphere we were quoting really had the wherewithal that we had to supply the parts and do the things we had to do.
- Buyer is "shilling" bids

Note: None of this is "true"

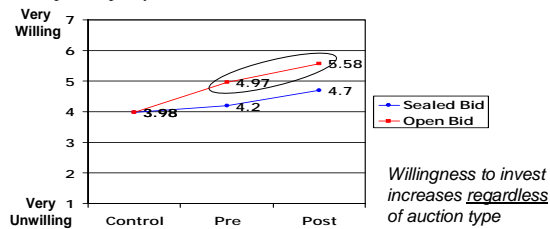
The Supplier's Willingness to Make Dedicated Investments

- Irreversible, tangible and intangible investments
 - Examples: equipment, manufacturing plant, human resources, training

Willingness to make investments should be lower in open than sealed auctions

Willingness to Make Idiosyncratic Investments by Auction Type

Just for [the buyer], we would be willing to provide dedicated: buyer training, production procedures, capital equipment and tools, plant capacity



Why the Change?

- Sealed bid
 - This is an improvement over current processes!
- Open bid
 - New information about competitors
 - Escape auctions
 - Alter the terms of the negotiation
 - Create an "imperfect market" with the buyer where auctions are no longer meaningful
 - Maintain a voice going forward

This is a key opportunity for buyers

Conclusions

- Higher savings in open than sealed auction
- Suppliers feel exploited by open bid auctions
 - Increased opportunism suspicions, which can be harmful in the long-run (Jap & Anderson 2000)
- Paradoxically, they are more willing to make dedicated investments
 - A means to cost-competitiveness
 - Vicious cycle avoidance
 - Long-run determination to remain

Implications

- Use open auctions selectively with this product type
 - An initial screen to long-term partnerships
 - A "wake-up" call to incumbents
 - Realize long-run supply base consolidation is possible
 - ⇒ power erosion, lack of alternatives
- ⇒ Remember, technology and relationships are *interlinked*. We need to consider them both.