Online Auctions

Building Better Government Through Smarter Buying
Introduction

This document provides an overview of the use of Online Auctions being trialed by the Department of Treasury and Finance (DTF) - Government Procurement. It details what an Online Auction is, how an Online Auction works and the anticipated benefits of holding Online Auctions. It encourages the further assessment of Online Auctions as a dynamic and innovative tool for the Western Australian public sector.

The literature research, reports that Online Auctions streamline the procurement process and achieve optimal pricing outcomes. Their use reflects the growing value of employing e-commerce applications as more businesses adopt the Internet for their commercial transactions.

Online Auctions were first introduced around the year 2000, so within Australia they are a relatively new procurement tool. Only a few Australian government sectors have trialed Online Auctions, and none have yet adopted them for routine business. Western Australia’s resources sector has successfully used Online Auctions for a number of years.

With the continuing success of Online Auctions (for example eBay™) as a way of purchasing goods, it has become obvious that real-time internet-based Auctions can be an effective and dynamic tool for efficiently achieving competitive pricing on goods and services.

For Online Auctions to be successfully introduced to the commercial sector, they require the use of special software provided by the buyer. Suppliers can then bid from any location worldwide, providing a reliable Internet connection is available.

Over the past 24 months, Government Procurement has been assessing the value and relevance of Online Auctions, and has built up a body of experience on how best to use this electronic procurement tool.
Online Auctions were first introduced around the year 2000. The US Federal Government initiated a large scale Online Auction for the supply of ejection seats for several aircraft, and achieved a saving of 28% on a contract price of $US2.3 million. Their use as a procurement tool achieved prominence in 2001 when General Electric claimed to have saved $600 million through the use of Online Auctions.

Since this time, overseas usage has steadily increased in both the private and public sectors in the United States, United Kingdom and Europe. The United Kingdom’s Office of Government Commerce (OGC) promotes the use of Online Auctions in the UK public sector and has placed an informative Auction toolkit on its website: http://www.ogc.gov.uk/tools__services_eAuction_decision_tools_4800.asp The DTF has obtained approval to use a modified version of the OGC’s eAuction Decision Tool within the Western Australian public sector.

In Australia, large companies such as Alcoa, Rio Tinto, Woodside and BHP Billiton have all employed Online Auctions successfully within their businesses, while within the public sector, Health Purchasing, Victoria and the South Australian Department of Health have conducted successful Online Auctions.

DTF’s Government Procurement has undertaken a project – a full evaluation trial – aimed at assessing the value and suitability of Online Auctions as a procurement tool for use within the WA Public Sector. The Online Auction project is one of the Government’s Procurement Reform initiatives, approved by Cabinet in 2003. Other jurisdictions are watching how the trial goes here in Western Australia with considerable interest.

**CASE STUDY 1**
An Australian company, which operates in both metropolitan and regional WA, has procured a wide range of goods and services through Online Auctions, including several commodities also procured by the State Government, e.g. office equipment.

The company spends $150 million per annum through Online Auctions – some 25% of its goods and services. It had held 1,100 Online Auctions by April 2005 and had 3,000 suppliers participate in the online Auctions.

Benefits included price reductions of more than 10%, improved specification writing by staff, fewer contract variations, more rigorous procurement processes and an expanded supplier base.

When Online Auctions were introduced, the company experienced some negative pressure, with a small number of suppliers choosing not to participate. While incumbent suppliers were initially not pleased with the introduction of this tool, other suppliers were keen to have the opportunity to break into the market.

The company intends to continue using Online Auctions wherever possible.
Online Auctions

An Online Auction is a dynamic, ‘real time’ tendering process that is conducted online over the Internet. Unlike a traditional Auction, in an Online Auction, the bid price decreases (instead of increasing) and it is the sellers who are bidding to win – not the buyer.

An Online Auction is undertaken as a two-stage procurement process. A tender is called and suppliers are assessed against the qualitative criteria outlined in the tender document. Those suppliers meeting the qualitative criteria are then invited as pre-qualified suppliers to bid online for a specific piece of business, in accordance with an open and fair set of bidding rules and boundaries. The Auction continues until no lower priced bids are placed.

Online Auctions do not conflict with the State Supply Commission’s policy of awarding contracts on the basis of value for money nor do they conflict with any other procurement policy. The assessment of value for money remains as a central component of the procurement strategies.

An Online Auction provides the opportunity to readily identify the true market value of goods and services in an efficient and transparent way. It is not anticipated that suppliers will submit bids at unsustainable price levels. The intent is to produce better tender specifications, increase competition in the marketplace, identify the most efficient supplier and allow buyers to have an improved measure of the true market value of goods and services procured by government.

The initial Request documents are provided to potential suppliers by DTF, typically via its government tender website. The procurement is advertised using traditional methods to alert potential suppliers to the upcoming Tender and Auction, and invites them to submit a response to the Request document. Supplier suitability is assessed on the basis of their response and successful respondents are then invited to take part in the Online Auction.

Online Auctions are one of a number of e-procurement strategies being trialed that aim to streamline procurement processes and achieve the best possible pricing outcomes. Their use reflects the growing importance of e-commerce applications across both the private and public sectors.

Online Auctions follow a clear and precise process, ensuring their ease of use for a variety of product and service procurements. (Refer to Fig. 1 on the next page)
Fig. 1 - Online Auctions within a procurement process

This figure provides illustrates the clear and precise process that an Online Auction follows.
People buyers & suppliers

Online Auctions provide buyers and suppliers with an innovative alternative to the traditional tender process. Our research suggests that there are a number of benefits to both buyers and suppliers, including:

- cost reductions as a result of visible bidding building competition;
- reduced negotiation time due to a streamlined purchasing process;
- increased transparency for suppliers;
- real and measurable results enabling demonstrable savings;
- expansion of the supplier pool;
- new business opportunities;
- a level playing field, particularly for smaller businesses;
- increased supplier market knowledge; and
- a quick and easy bidding process that takes place in real-time.

Our trial aimed to assess whether these benefits apply to the Western Australian government context. By the end of February 2009, Government Procurement had completed fourteen Online Auctions. Savings of approximately 8%, within a range 0.5% to 22% against the estimated purchase price can be attributed to the use of the Online Auction process.

The reaction to date from involved buyers has been almost universally positive, while suppliers involved in the process have participated well, albeit in many cases somewhat reluctantly. Some suppliers have described the process as a transparent and fair alternative to the traditional tender process.

BUYERS

The published literature suggests that Online Auctions provide buyers with an innovative tool for obtaining lower prices and increased timesaving.

It has been estimated that 25-30% less time is spent on administering Online Auctions compared with a traditional tender process, leading to greater efficiency in administration. (*Ellenport, J, 2002, 'Sold to the lowest bidder', Australian CPA, vol. 72, no. 7, p. 59)

To become involved, buyers initially create a clear and concise request document, which is then made available to all interested suppliers.

The document contains all the selection criteria and is the key to a successful Online Auction. It contains:

- detailed specifications of what is to be bought;
- the exact delivery requirements, quantity and instructions;
- business terms including payment, non-disclosure, insurance and safety; and,
- a clear statement that the lowest price does not guarantee the supplier the contract – this is awarded on the basis of the complete value for money offering (lowest bid, suitability, quality, lead time, capacity, service and support).
A well-structured high-standard request document is an essential requirement that will contribute to the overall success of the Online Auction. The document must be structured to allow the buyer to obtain sufficient information to undertake a detailed supplier credentials check. This enables the buyer to firstly choose suppliers for the Online Auction and secondly after the Online Auction has concluded, it helps with making the ultimate decision about which supplier offers the best total value for money outcome, including price, quality and service, and support.

As the Online Auction takes place in real-time via the Internet, it allows the buyer to follow the Online Auction from beginning to end, creating a greater understanding of and engagement with the process.

**SUPPLIERS**
Reverse Auctions provide opportunities for suppliers, including the ability to improve their knowledge of their own goods or services market.

The request document that each supplier must complete prior to being invited to take part in the Online Auction is very detailed. To complete it, the supplier must fully understand their product and production costs.

1 Buyer + Many Suppliers + Interactive Bidding = Reduced Purchasing Costs and Streamlined Procurement

Once a supplier has submitted their response to the request document, the buyer reviews it and all successful parties are invited to take part in the Online Auction.

*The Online Auction is a good methodology for well defined products, whether they are goods or services.*

Vince Rodino, Senior Contract Manager, DET

Throughout a well-managed Online Auction process, training and support are offered to all suppliers. An online demonstration site is available prior to the Online Auction taking place and there is ongoing support for the duration of the Online Auction.

The increased transparency of pricing in the Online Auction process potentially opens up the market to new suppliers, and levels the playing field. (Especially where there is an established incumbent supplier.)

It also enables suppliers to better understand their marketplace position – they are seeing in real time where they stand in comparison to competitors and don’t have to wait for the next tender to re-think their position.

Suppliers need to carefully plan their strategy before the Auction and thoroughly understand their costs and margin requirements, knowing they can submit multiple bids in the same Auction. The Online Auction gives suppliers the opportunity to be more responsive to their potential customers and glean valuable market information from the process.
This figure illustrates how Online Auctions are dynamic, real-time processes conducted via the Internet.
In the DTF trials, the participating suppliers have been requested to provide feedback after each Online Auction.

Participating suppliers range from small businesses to large companies with a national presence, so the feedback is providing a good indication of the reaction to Online Auctions across various industries and sectors, as well as help to identify any issues or concerns.

ADMINISTRATORS
Auction Administrators within DTF’s Tenders Office are responsible for setting up the Online Auction online and monitoring the Auction as it takes place.

DTF is currently using the HedgeHog® software application to facilitate its online procurement programs. This software provides a hosted, web-based interface to facilitate online negotiations without time-consuming or expensive technology integration.

HedgeHog® software allows DTF to self-manage the entire Online Auction process from beginning to end. The program allows Administrators to develop and manage purchasing specifications, identify qualified suppliers locally and throughout the world, facilitate online negotiations and analyse results.

A comprehensive set of guidelines has been established to ensure a consistent approach to setting up and facilitating Online Auctions throughout the DTF evaluation period.

The guidelines are used within the DTF Tenders Office and consist of step-by-step instructions on how to run an Online Auction from beginning to end. The Administrator checklist includes:

- receiving and saving information from the Client Agency requesting the Online Auction;
- preparing and filing specification documents;
- establishing categories and bidder accounts;
- checking and testing bidder email addresses;
- adding bidders’ details to the Online Auction correctly;
- adding GST and other bidding fields correctly;
- correctly setting up all Online Auction fields;
- ensuring that the required goods or services are included, correctly described and quantified;
- ensuring the specification file is loaded and verified;
- setting up and verifying the bidding rules for all bidders;
- setting up the demo Online Auction and adding bidders to the demo Online Auction correctly;
- correctly adding all information fields and setting up all demo Online Auction fields as per the live Online Auction;
- setting up the demo descriptions and including the correct number of demo Online Auction line items;
- setting up and verifying the demo Bidding Rules;
- how the demo Online Auction goes live;
- how the live Online Auction goes live; and
- A PDF version of a Bidders Guide is also provided to each bidder.
ONLINE AUCTION SUMMARY

The first Online Auction was held in September 2007, and by the end of September 2009, DTF had held seventeen Online Auctions.

The Auctions covered a broad range of products – binding equipment, copy paper, software licenses, tractors, farm machinery and IT equipment. Please refer to Attachment A for the complete details.

Other more complex and higher valued Online Auction purchases are being planned for 2009.

For each procurement a tender containing specific Online Auction clauses was called, responses were then evaluated and all suppliers meeting the qualitative criteria were short-listed to participate in the respective Online Auctions.

To date, estimated savings of approximately $1.4 million over the pre-tender estimated price have been attributed to the purchases in our trial.

We have found that there is a general reluctance amongst buyers to participate. While this is not well defined, anecdotally it seems they fear that the Online Auction process will be a contentious issue, or may delay the procurement. However the feedback from suppliers about the way the Auctions have been conducted has been generally positive, although some suppliers have initially been reluctant to participate and some have expressed concern that the process has eroded profit margins.

We are aware that this trial is only partly completed, and our assessment needs to take a longer-term perspective to determine that the savings will be sustainable.

For example an article in the UK journal *Supply Management* (3 January 2008, p12, E-Auctions: bargain or bother?) states that anecdotal evidence suggests that the initial savings attributed to Online Auctions are not sustainable, and that in time the benefits erode or are not repeatable. “A bargain is only a bargain if it’s what you want or need and if it actually delivers the performance you require.” “The key is to understand where to use a particular approach to the market and evaluate the options against the desired outcome.” The current trial has allowed DTF to be in a better position to assess from a Western Australian government perspective.

CASE STUDY 2

As a result of a major Department’s positive experience with its first Online Auction, it quickly followed up with another Online Auction, this time for a three-year software licence.

There were four pre-qualified suppliers who generated 32 bids in just over one hour. The Auction saved 12% ($42,000) against the $360,000 estimated purchase price. The Department’s Senior Contract Manager stated that, “We were happy with the outcome and that the Online Auction worked within the true spirit of an Auction process, with suppliers bidding on exactly the same product.” He went on the say, “Online Auctions are a good methodology for well defined products, whether they are goods or services.” The Department intends to make further use of Online Auctions as a regular procurement tool.
Online Auction – next steps

Our intention is to extend the trial and against the range of products and services considered, we now appreciate the sort of commodities where it works well (such as paper, equipment, machinery, IT software). However we want to extend the trial into other commodities and include services as well as goods. Our standard Request Document templates will include the appropriate Online Auction contract terms and conditions. Hence Contract Managers can include or delete the clauses as appropriate for the procurement under consideration. To encourage wider use of Online Auctions a decision-aid tool has been made available to procurement practitioners to assist in determining whether an Online Auction should form part of a procurement process.

More client agencies will be encouraged to use Online Auctions and participate in the trial. We will also look at extending the trial into services (not just goods) where appropriate.

The Bidder’s Guide is emailed to all suppliers that are invited to participate in an Online Auction. Invited Online Auction participants have access to a telephone support service prior to an Auction and during an Auction.

CASE STUDY 3

An Online Auction was held for the purpose of establishing pricing for copy paper with the negotiated price valid for 12 months. Industry had been advising us that global labour, transport and energy cost pressures meant copy paper prices were set to increase over the contract rates established for the current 12-month period. Some pricing analysis that had been provided indicated increases of around 4% should be expected.

By any measure, the copy paper Online Auction was large and complex. There were six pre-qualified suppliers and 11 lines of copy paper. The Online Auction attracted 462 bids and ran for three hours and 50 minutes. The net result was a 6.8% saving ($208,000) against the estimated purchase price of $3,060,000.

So, rather than a 4% increase in prices as expected, the Online Auction produced a 2.8% saving over the pricing established 12 months earlier. This process established a very competitive price of paper for 2008.

The Senior Contract Manager said “Suppliers found the facility user-friendly and easy to navigate. The Online Auction involved a complex basket of products that included a mix of Australian and imported products. It handled the complexity well and delivered better than expected outcomes.”

Further information on Online Auctions can be obtained from:
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