

Online reverse auctions and their role in buyer–supplier relationships

Alan Smart, Alan Harrison*

Cranfield School of Management, Cranfield University, Bedford MK43 0AL, UK

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Abstract

Despite the move in recent years towards supplier partnerships, buying firms need at times to make use of competitive procurement strategies for certain purchases. This study examines the impact of reverse auctions on buyer–supplier relationships through six case studies, analysing primarily the supplier perspective through participant interviews. The authors identify that there are potential benefits for both parties in a reverse auction, which can offer tendering and transactional cost advantages. For buyers, it offers a competitive procurement process. The effect on relationships will depend on the extent to which buyers employ the auction as a price weapon, or whether it is used primarily as a process improvement tool.

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1. Introduction

Increasingly within practitioner circles, the Internet is being recognised as the mechanism which will have the greatest impact on how companies operate in the next decade. Growth of Internet business through fast access to the World Wide Web has been exponential in the last few years, led by the USA, with Europe and the Asia Pacific region following close behind (Boston Consulting, 2000; Forrester, 2000a). Despite some recent, initial casualties in the ‘dot com’ economy, both Business to Consumer (B2C) and Business to Business (B2B) sectors continue to grow, with established industries and market sectors adopting new web-based channels to market. However, it is in the B2B sector that e-commerce has the greatest potential for growth and impact on company performance, through the opportunities it presents for: faster entry into new markets, expansion of global business models, lower transaction costs, and improved supply chain management (Kalakota and Robinson, 1999; Chopra and Van Mieghem, 2000).

Within the B2B sector, many firms have recognised the opportunity to focus on cost reduction opportunities, in particular through the use of electronic

procurement (eProcurement) mechanisms. The first eProcurement tools launched were designed to facilitate online search, requisition and ordering, through applications providing access for buyers to suppliers’ electronic catalogues. These applications had little initial impact on supplier relationships as they were set up in co-operation with an established supplier base who provided an electronic product catalogue linked to a price list. The eProcurement model forecast to have greater impact has been the electronic exchange or marketplace (Kaplan and Sawhney, 2000; Yankee Group, 2000). The early eMarketplaces established were either horizontals, such as mro.com offering one-stop shopping for commercial buyers across many industries through access to a wide variety of products, or verticals such as plasticsnet.com, with a specific industry offering designed to attract buyers and sellers from within the same sector. A further mechanism which has grown in use alongside these eMarketplaces has been the online reverse auction.

Online reverse auctions (ORAs) are exactly the way they sound: traditional auctions in Reverse (Smart and Harrison, 2002). Instead of a seller offering a product for sale to the highest bidder, a buyer offers a tender or contract for the supply of specific goods or services. Suppliers compete for the right to the contract by bidding *reducing prices*, until a final price—the lowest—brings the auction to an end. Reverse auctions are hosted by many eMarketplaces as a means to enhance

*Corresponding author. Tel.: +44-1234-751122; fax: +44-1234-751712.

E-mail address: a.harrison@cranfield.ac.uk (A. Harrison).

the site's product offering. Auction software companies have appeared, such as Freemarkets, Moai Technologies and eBreviate, using examples of substantial price reductions achieved in recent auctions, to tempt industrial buyers. Forrester has predicted that the online B2B auction market would reach \$52 billion in 2002 (Forrester Research, 2000b). This has produced a raft of media articles suggesting that huge cost savings are available if companies merely move their tenders into the auction model. Similar speculation has suggested that partnerships and long-term supplier relationships are a thing of the past and that buyers must move to a more aggressive price negotiation model in order to compete.

This paper describes research that was commissioned by a major consulting firm into ORAs carried out in six case examples. It was possible to interview both buyer and seller parties to the auctions, and hence to develop conclusions about the role of ORAs in buyer–supplier relationships.

2. Background and research questions

The literature on supply chain management and buyer–supplier relationships has highlighted the two procurement strategies available to buyers, which a number of commentators have bracketed as either 'competitive' versus 'collaborative' or 'adversarial' versus 'partnership' (Leavy, 1994; Burton, 1995; Patterson et al., 1999).

Despite the move within many industrial sectors towards closer, longer-term relationships with suppliers, a growing body of research has suggested that partnerships can create problems of their own, and that their success depended upon clear implementation criteria (Burnes and New, 1997; Krause, 1997). There has also been a tendency to consider partnerships as the most appropriate strategy without considering the difficulty of managing them, or to view them over-optimistically (Cousins, 1999; Burnes and New, 1997). Forker and Stannock (2000) have demonstrated that there can be a better understanding between buyer and supplier in the 'competitive' exchange and that market mechanisms may be a better method of satisfying the needs of contracting firms in many buying situations. Similarly, Parker and Hartley (1997) suggested that within the procurement continuum (ranging at one end from competitive purchasing on spot prices to fully integrated ownership of suppliers at the other) many different types of relationship are possible and illustrate that under partnership agreements, suppliers can end up with lower prices than in competitive bargaining. Olsen and Ellram (1997) have indicated the need for more specific research into the dangers of the partnership approach versus the benefits of opportunism. In the case of Marks & Spencer

in the UK retail market, many of the long standing partnership arrangements with UK suppliers were abandoned in favour of lower cost sourcing from overseas and a more flexible approach to supply sources. These changes have been driven by the need to adapt to changing market conditions and to improve competitiveness through diversified sourcing.

Leavy (1994) has highlighted that firms need to be aware of the advantages of the different procurement strategies whilst Cox (1997) and Gibbs (1998) have suggested that buying firms should not pursue partnership relationships alone, but select the appropriate strategy, either competitive or collaborative, in accordance with industry and market conditions. It is possible therefore to pursue a composite strategy (Burton, 1995) taking the best from both approaches and applying them in accordance with the competitive needs of the buying firm. Furthermore, as the growth of Internet-based business creates the opportunity for lower transaction costs between firms, e-commerce will reduce the cost of integrating larger numbers of suppliers, allowing for a more versatile approach to supplier relations (Roberts and Mackay, 1998). One key aspect of partnership sourcing has been the reduction in supplier numbers (Lamming, 1993) and firms need to assess, in a world enabled by e-commerce, how and when supply sources can be extended by adding more competition, with no additional transaction cost to the buyer.

This debate provides a context in which to examine and understand the role of reverse auctions in supply chain relationships and the questions our research sought to address are:

In what ways do reverse auctions impact on price levels for suppliers?

How do reverse auctions impact on buyer-supplier relationships?

3. Research design

In emerging, new situations where an exploratory approach is required, case studies are one of the more attractive options available to researchers (Yin, 1993). The case study method was chosen by the authors for the following additional reasons:

- desk research indicated that there was virtually no literature on this subject apart from a small number of journal and media articles on USA online auctions (as at May 2000),
- no previous academic studies on the specific research subject could be found.

The project sponsor was able to provide access to two cases of reverse auctions which were active or at the planning stage. With their assistance, it was possible to

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