Chapter I
Point Counterpoint: The Online Reverse Auction Controversy

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ABSTRACT
In this chapter, the online reverse auction is introduced through a series of points and counterpoints on the use of the tool. Tom Gattiker, Boise State, and M. L. (Bob) Emiliani, Central Connecticut State, identify and debate eleven points in the use of online reverse auctions.

INTRODUCTION
Reverse auctions used in industrial business-to-business procurement have continued to be a controversial practice since their introduction in 1995. The controversy extends to buying organizations, suppliers, the business press, industry trade associations, and to the academics who study them.

Regardless of their merit, reverse auctions are likely to be with us for some time. As a result, buyers and sellers who participate in reverse auctions should thoroughly understand the benefits, shortcomings, risks, and costs of using or not using Internet-enabled reverse auction technology.

In this chapter, we offer a debate on the subject of Internet-enabled reverse auctions. Thomas F. Gattiker, Boise State University, develops a series of points in favor of the use of reverse auctions...
as a procurement tool, while M. L. Emiliani, Central Connecticut State University, develops the counter arguments.

This eleven issue point-counterpoint chapter is intended to provide readers with a brief outline of the key issues surrounding reverse auctions.

POINT-COUNTERPOINT

In the following pages, there are eleven points that Gattiker and Emiliani debate on reverse auctions. While Emiliani, who provided the counterpoints, is a strong opponent in his research on auctions, Gattiker, who provided the points, is neither a proponent nor an opponent of the reverse auction tool. Both authors make convincing arguments on the advantages and disadvantages of auctions.

Point #1: Reverse auctions yield significant purchase price savings.

For example, 65% of auctions studied by Wagner and Schwab (2004) resulted in purchase price savings of over 5 percent. Greater savings have been reported by others. The total cost savings are likely to be less than the purchase price savings due to contract leakage, non-conformances, and other post-award problems (Emiliani & Stec, 2002, 2004). However, even when we take these factors into account, savings still remain in many instances.

Counterpoint: Buyers should not assume reverse auctions will deliver savings in every case, either on a unit price or total cost basis.

While there is much emphasis on total cost, the primary measure of reverse auction success is unit price savings using the purchase price variance (PPV) or similar metric. This metric is known to be defective and leads to higher total costs (Emiliani, Stec, & Grasso, 2005). Reverse auction savings can range from negative value, which costs the buyer money; to neutral, where no savings are achieved; to a positive average gross savings of 10-20%, but where net savings are typically half or less (Emiliani & Stec, 2002).

Point #2: Reverse auctions decrease the time and resources needed to conduct the sourcing process.

For example, Smeltzer and Carr (2003) report that companies achieve a 25-35% reduction in time required to go from RFQ distribution to choosing a supplier. Time savings are accompanied by similar decreases in administrative costs. Since much of the work (supplier pre-qualification, RFQ preparation, development of award strategy, and so on) is reusable, time and administrative cost savings for subsequent auctions may be greater than for first auctions. In fact, subsequent auctions may take only one tenth of the time required for the first auction (Carter, Beal, Carter, Hendrick, Kaufman, & Petersen, 2004).

Counterpoint: The use of reverse auctions does not guarantee a decrease in the time and resources needed to source goods and services (Emiliani & Stec, 2004, 2005).

The bulk of the time savings is in price negotiation, though additional pre- or post-auction activities may take place, thus offsetting the expected time savings. The time it takes to source via reverse auctions will also depend upon the use or non-use of decision-support tools. Likewise, administrative costs may or may not decrease. The purchase of reverse auction software and related services will offset some or all administrative savings. Subsequent auctions may not take a fraction of the time required for the first auction if sellers determine it is not in their interest to participate in reverse auctions.

Point #3: Reverse auctions also allow companies to more efficiently manage purchasing human resources.

This is because auctions reportedly enable the average buyer to achieve price savings that are
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