

**PROCUREMENT**

**PERSPECTIVES**



# REVERSE AUCTIONS: A ROADMAP FOR SUCCESS

## Introduction

NASPO gathered information from a handful of states that have achieved notable results with their online reverse auctions in the past couple of years. The successful implementations and state perspectives have been summarized to help others follow a roadmap to success. This Procurement Perspectives paper consolidates examples and tips for success from Connecticut, Kentucky, Mississippi, New York, and Rhode Island.

## Online Reverse Auctions: What Are They?

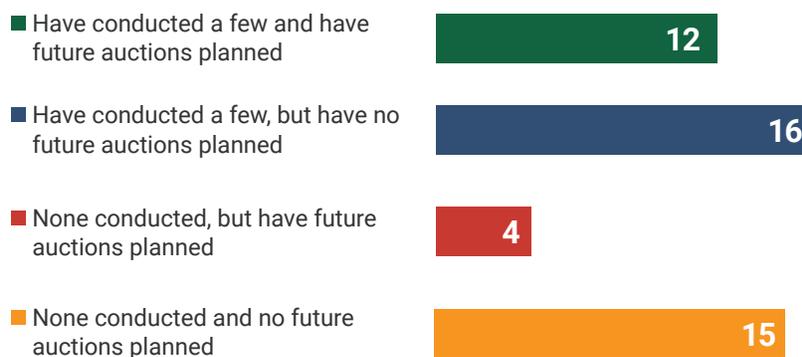
According to NCMA's CMBOK Lexicon<sup>1</sup>, Reverse Auctions are transactions in which a single buyer of a single item (or a lot of items) receives decreasing offers from prospective sellers. The auction ends at a predetermined time, and the item is purchased from lowest offeror for the lowest offer price. Online Reverse Auctions are referred to as eAuctions.

These online reverse auctions are one type of tool available to state central procurement offices allowing multiple vendors to compete in real time, in a fixed-duration bidding event.

## Authority for Reverse Auctions

Many states have statutory or regulatory authority to conduct reverse auctions; however not all states having this authority conduct reverse auctions on a regular basis. The chart below shows a few statistics regarding current usage and plans for conducting reverse auctions from 48 states responding to the 2018 NASPO Survey of State Procurement Practices. A total of 16 states plan to use auctions in the future while 15 states have never conducted them and have no plans to use them in the future.

States' Experiences Conducting Reverse Auctions  
Source: 2018 NASPO Survey of State Procurement Practices



<sup>1</sup> National Contract Management Association Contract Management Body of Knowledge (CMBOK) 4th Edition Chapter 4

We have provided sample statutory authority to conduct reverse auctions, describing the context in which they can be used. Mississippi illustrates a more recent example where reverse auctions were mandated in January of 2018 per HB 1106 and HB 1109 (as a part of purchasing, spending and transparency reform measures enacted by the legislature in the 2017 Legislative Session). The new requirement to use reverse auctions as the primary method for receiving bids for purchases over \$50,000 applies to state agencies and local governments. It does not apply to state institutions of higher learning and any public contract for design or construction of public facilities, including buildings, roads and bridges.

#### Kentucky Revised Statutes (KRS) Chapter 45A.080: Model Procurement Code. Competitive sealed bidding

1. Contracts exceeding the amount provided by KRS 45A.100 shall be awarded by competitive sealed bidding, which may include the use of a reverse auction, unless it is determined in writing that this method is not practicable. Factors to be considered in determining whether competitive sealed bidding is not practicable shall include:
  - a. Whether specifications can be prepared that permit award on the basis of best value; and
  - b. The available sources, the time and place of performance, and other relevant circumstances as are appropriate for the use of competitive sealed bidding.
2. The invitation for bids shall state that awards shall be made on the basis of best value.

#### Connecticut General Statutes Chapter 58: Purchases and Printing

Sec. 4a-60b. Reverse auctions. Use by contracting agencies authorized.

1. For the purposes of this section:
  - a. Reverse auction means an on-line bidding process in which qualified bidders or qualified proposers, anonymous to each other, submit bids or proposals to provide goods or supplies pursuant to an invitation to bid or request for proposals; and
  - b. Contracting agency means a state agency with statutory authority to award contracts for goods or supplies, or a political subdivision of the state or school district.
2. Notwithstanding any provision of the general statutes, whenever a contracting agency determines that the use of a reverse auction is advantageous to the contracting agency and will ensure a competitive contract award, the contracting agency may use a reverse auction to award a contract for goods or supplies, in accordance with any applicable requirement of the general statutes and policies of the contracting agency. The contracting agency may contract with a third party to prepare and manage any such reverse auction.

#### Mississippi House Bill 1106 amending SECTION 31-7-13 of the MISSISSIPPI CODE OF 1972

Bidding procedure for purchases over \$50,000.00.

1. Purchases which involve an expenditure of more than Fifty Thousand Dollars (\$50,000.00), exclusive of freight and shipping charges, may be made from the lowest and best bidder after advertising for competitive bids once each week for two (2) consecutive weeks in a regular newspaper published in the county or municipality in which such agency or governing authority is located.
2. Reverse auctions shall be the primary method for receiving bids during the bidding process. If a purchasing entity determines that a reverse auction is not in the best interest of the state, then that determination must be approved by the Public Procurement Review Board.

## Reverse Auction Roadmap for Success

A reverse auction is deemed successful when the outcome achieved includes:

INCREASED TRANSPARENCY

INCREASED SAVINGS AND FAIR PRICES

INCREASED SUPPLIER PARTICIPATION

EFFICIENT USE OF TIME AND RESOURCES

FAIR COMPETITION

NO PROTESTS FILED

How can we make sure reverse auctions are a win-win for both parties participating in the online transaction? Unfortunately, there is no formula, or secret recipe that can be applied to guarantee success with every reverse auction. Reverse auctions are just one sourcing tool that public buyers can use to get the best pricing. Some commodities tend to work better than others with this method. However, the following considerations should be included in the reverse auction process as a roadmap for success.

We defined 5 helpful steps and best practices as a Roadmap for Success:

### 1 Research the market and determine if this tool is appropriate.

- Conduct market research and evaluate suitability based on factors like high-dollar, volume purchasing, centralized spend, opportunities for savings.
- Choose the most appropriate auction parameters and feedback.

### 2 Make sure there is enough competition among suppliers.

- Conduct auctions when there are enough vendors to create competition – can be as few as two suppliers. The more suppliers the more competition.
- Understand the market. Make sure that specifications can be bid by at least 2-3 suppliers who are motivated to give you a good price.
- Strategically “lot” the business at the front end to be attractive for suppliers.
- Organize the business into logical supply lots within each auction (e.g., medical, doctors, nurses); janitorial supplies (cleaning supplies, plastic bags, etc.).

### 3 Communicate auction potential up-front and set clear expectations for suppliers.

- Create a process for conducting auctions and educate internal stakeholders.
- Communicate auction potential to suppliers so they understand the expectations.

## 4 Provide clear and detailed requirements and specifications.

- Include well-defined specifications in the solicitation to ensure success. Prepare the specifications in such way that makes it easier for vendors to prequalify.
- Detailed requirements and specifications for the good or service procured through reverse auctions can help prevent a “No Award” due to non-compliance with the specifications.

## 5 Educate suppliers prior to participating in the online reverse auctions.

- Education is key. Provide personal one-on-one training for suppliers on how to participate in the online auctions and what are the do’s and don’ts.
- Make sure suppliers understand the system and process used. This is especially important if you are using a new third-party system that suppliers may not be familiar with.

The chart below lists some of the recognized benefits experienced by public buyers and suppliers in a successful reverse auction transaction.

Reverse Auctions Buyer Benefits	Reverse Auctions Supplier Benefits
<ul style="list-style-type: none"><li>• Real-time pricing</li><li>• More competition</li><li>• More small business participation</li><li>• Governments can meet small business goals</li><li>• Transparent and fair processes</li><li>• Fair prices driven by competition</li><li>• Automated and streamlined sourcing process</li><li>• Achieving savings</li></ul>	<ul style="list-style-type: none"><li>• Real-time pricing</li><li>• Level playing field for all suppliers</li><li>• All suppliers can participate and compete, including small businesses</li><li>• Fair competition for all suppliers</li><li>• Fair prices driven by competition</li><li>• Anonymity and identity protection during the online transaction</li></ul>

## What Types of Goods and Services Work Well with Reverse Auctions?

### Top 7 Types of Goods/Services

- Janitorial supplies
- Office supplies
- Road salt
- IT Hardware
- Fuel
- Heavy Equipment
- Trailers

### Reverse Auction Exceptions?

- Complex professional services
- Construction procurement
- Commodities for road and highway construction and maintenance
- Procurements or projects for unique specifications and too many variables and conditions

Some states' codes specify limitations on the use of reverse auctions. The reason being that reverse auctions seem to work best for procuring commodities. Reverse auctions seem to work very well for service contracts, especially for small contracts with less complexity. Reverse auctions exceptions can include professional services, construction procurement, or projects with unique specifications.

See below for examples of statutory limitations on some types of procurement in two states, Kentucky and Virginia.

#### Kentucky

There are limitations on the use of reverse auctions per Kentucky's Revised Statutes (KRS Chapter 45A.187: Model Procurement Code).

"The reverse auction process shall not be used to procure architectural, engineering, or engineering-related services as described in KRS 45A.730; underwriter, bond counsel, or financial advisors as described in KRS 45A.850; or contracts for construction as described in KRS 45A.030 which are required to be bonded as described in KRS 45A.185 and 45A.190 or those projects which would require the preparation of stamped drawings."

#### Virginia

Professional services and construction purchases (bulk purchases of commodities used in road and highway construction and maintenance, and aggregates) are types of procurement for which reverse auctions should not be used, per Virginia's Code, Title 2.2, Chapter 43: Public Procurement Act specifies appropriate uses of reverse auctioning in § 2.2-4303. Methods of procurement.

## Tips for Success for Suppliers and Buyers

A question that is often asked is are there any challenges to using a reverse auction as a sourcing tool? What can public buyers do to maximize its benefits?

Opponents of reverse auctions, or public buyers who did not achieve the expected savings with reverse auctioning argue that reverse auctions:

- have no valid method of measuring savings
- don't guarantee the lowest price
- encourage race-to-the bottom prices that are detrimental to both buyers who may not get high quality and standards for the goods/services they acquire as well as suppliers who may have not assessed their cost appropriately.

Live polling results from the NASPO 2019 Exchange conference — which brought both suppliers and public buyers together for a breakout session on reverse auctions show that buyers and suppliers can have different perspectives about this sourcing tool. The different perceptions could be due to valid concerns about unsuccessful outcome of past reverse auctioning events, or due to misconceptions that still exist about the value of reverse auctions. 86% of the public buyers in the audience believe that reverse auctions can be a win-win for both parties participating in the transaction. However, only 55% of the suppliers in the audience believe they can be a win-win for both the public buyer and supplier.

Well-run reverse auctions should produce the expected outcome and maximize benefits. Follow the 5 steps discussed in this paper and make sure reverse auctions are the right approach for your sourcing.

Next, research the market for the good or service you are looking to procure and make sure there is enough competition, a level playing field for all suppliers who are likely to participate. Provide clear specifications, educate suppliers and set the correct expectations to ensure success for both parties.

Education for the vendor is very important. Education for central procurement office staff as well as for agencies can contribute to the success of a reverse auction. Being available live for suppliers during the auction can also help address issues.

Also, if possible and allowed under state policies, a “best value” reverse auction approach can be used, which takes other factors and selection criteria into account in addition to price to ensure service quality.

In addition to the roadmap for success, we are providing some advice and tips for both suppliers and public buyers to help you maximize the benefits and overcome potential barriers. These recommendations and words of wisdom are provided verbatim, as shared by the state procurement leaders from Connecticut, Kentucky, and New York participating in the panel discussion at the 2019 NASPO Exchange.

## Challenges/Pitfalls

Follow the roadmap and tips from state CPOs to prepare for your next auction and avoid pitfalls.

### Tips for Suppliers

- Bid realistic prices that you can support throughout the contract so that the contract won't have to be cancelled because the supplier cannot perform per the agreed terms.
- Make sure you understand what you have to price out in advance and be ready for the auction.
- Read instructions received from the auction vendor carefully and make sure you understand the process, timing of when you have to sign in and participate, etc.
- Do your research and be familiar with the prior contract and spend. The state is looking for additional savings so doing your research can give you a good sense of how low you can go.

## For Public Buyers

- Don't be afraid to try reverse auctions.
- Don't be intimidated. Once you get past your first reverse auction you will like them. It's not for all procurements, use it as a tool in your toolbox when it makes sense.
- Rely on your peers from other states so you don't have to reinvent the wheel.
- Do research and consider using reverse auction companies that can help you run your auction instead of buying expensive software, or hardware to run it in-house.

Mississippi's Department of Finance and Administration, Office of Purchasing, Travel and Fleet Management (OPTFM) and the Office of Management and Reporting System (MMRS), conducted a 6-month review to evaluate the results of the reverse auctions conducted since the new legislation was adopted. 20 reverse auctions were conducted since January 2018. Some of the common issues identified included: vendor login issues; vendor's lack of understanding of the process/system functionality; vendor participation; insufficient prep work by agencies before the auction and know-how to create an auction. The reviewers produced a list of tips and recommendations for state agencies, which can be followed to increase the success of reverse auctions. See below for a chart summarizing those 5 recommendations based on Mississippi's experience with reverse auctions.



## About NASPO

The National Association of State Procurement Officials (NASPO) is a non-profit association dedicated to advancing public procurement through leadership, excellence, and integrity. NASPO represents the directors of the central purchasing offices in all 50 states, the District of Columbia, and the territories of the United States. For more information on NASPO, please visit [www.naspo.org](http://www.naspo.org)

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