

Reverse Auction: Will It Change the Way Sourcing is Done?

In their frantic efforts to reduce cost to attract and retain customers, retailers / buyers have now innovated a new way to source – through reverse auction. Under this system, buyers / retailers issue specifications and invite, online, lowest bids for the garments from across the world. *Apparel Online* discussed this new phenomenon with Devangshu Dutta, a textile and apparel industry professional and international consultant, on the future of this alternative to sourcing as is being done today. This, he felt, could only be possible for mass product categories rather than small, niche products that we specialize in. We also spoke to Lalit Gulati of Modelama and Richa Exports who has actually participated in reverse auctions, but failed to click, as suppliers from Bangladesh and Indonesia could quote much less than what he could possibly afford.



Dr. H. K. SEHGAL

In the sheer fight for survival, retailers are attempting to give more respect to “value for money”, which the consumer is seeking more vigorously than ever before. They are cutting corners to provide products to the consumer at the lowest rates to pass on the benefit to their consumer. One of their latest tools is “Reverse Auction”, which places the onus for competitive bidding on their suppliers with the support of new electronic methods.

Now imagine a fictional scenario. The room is dimly lit. All eyes stare transfixed at the projection of a computer screen. Every number must be legible to those gathered around the conference table this early morning.

Suddenly the image projected on the wall comes to life. The reverse auction pilot test has begun. Dollar figures flash as vendors from around the globe bid for the apparel order at hand. The atmosphere in the conference room has changed from one of apprehension to excitement as it becomes evident that the price that will be paid for today’s order will become quite competitive indeed.

Someone whispers encouragement for a long-time vendor as the group watches the contractor place his online bid in real-time. This spurs another buyer at the table to rally behind one of her favourite supplier, “Come on, you can do it! Just a little lower.” And all the while the dollar amounts on the screen become smaller and smaller and smaller still.

Will the increasing use of business-to-business (B2B) exchanges and reverse auctions to procure apparel and soft goods change the way the retailers and the vendors conduct business with each other?

First let us understand how the system works.

What are B2B Exchanges?

B2B exchanges are online marketplaces that enable trading partners to conduct real-time business communications with each other, whether they are issuing requests for quotes (RFQs), bidding for orders, sharing product forecasts or collaborating on product development. Exchanges usually are classified as public or private. Examples of public exchanges include Global NetXchange and the WorldWide Retail Exchange (WWRE).

Examples of private exchanges include Wal-Mart's Retail Link and other portals that individual retailers, brands and trading companies have established for B2B communications with their own networks of customers and suppliers.

What are Reverse Auctions?

Reverse auctions involve bidding for orders – such as for a new type of product that a retailer needs produced to its specifications. The orders could be for everything from basic towels to private label jeans and dresses.

How It Works

Typically, before an online auction takes place via an exchange, the retail buyer issues product specifications and order requirements via the exchange to a select pool of approved vendors who are invited to participate in the auction. Request for product samples are usually issued at this time so that the buyer will have samples on hand to examine / approve prior to the auction. At the designated auction start time, the vendors log into the auction via the Internet, and begin submitting their prices to win the business. Bids are automatically processed in real-time, and the exchange automatically guides the vendors through the auction process. In some cases, vendors can see the prices being offered by competing vendors, although the identity of the other vendors is not revealed to them. The auction typically closes after a pre-determined period of time, which may be hours or days, and the retailer then determines which vendor will win the business based on the price and other variables at the retailer's discretion, such as each vendor's quality record, shipping history, etc.

BREAKING MYTHS

A study by M. L. Emiliani of Lally School of Management, Hartford, USA and D. J. Stec of the Centre for Lean Business Management, Kensington, USA has listed some pointers relating to the concept of reverse auction. The key highlights, though not specific to the garment industry, are:

- Online reverse auctions do not yield a quick return on investment.
- Online reverse auctions do not deliver fast savings.
- Unit price realisations are difficult to measure accurately.
- The time to source parts is not actually reduced from weeks to hours.
- There are no substantive benefits for suppliers to participate.
- The savings were not as great as advertised by online reverse auction services providers.
- Online reverse auctions do not teach buyers and suppliers how to jointly solve problems.
- Online reverse auctions are inconsistent with ethical business practices.
- Online reverse auctions trigger opportunistic behaviour among suppliers.
- "Total cost" RFQs do not in fact account for total costs.

There can be many variations of the reverse auction business model, depending on differing retail procedures and exchange tools, but this is the gist of the process.

Who Is Using Exchanges and to What Extent?

Pertaining to apparel and soft goods procurement, the major public exchanges are being used by some of the world's largest retailers but not many mid-tier or smaller retailers. For instance, among GNX's members are retail heavyweights like Sears, Roebuck and Co., Federated Department Stores, Pinault-Printemps-Redoute (PPR), Carrefour, Linens'n'Things and Bed, Bath and Beyond. WWRE members include such major players as JCPenney, Kmart, Target, Target, Gap, ShopKo.

WINNING STRATEGY – Deepak Mohindra

The assured success or the winning strategy for bidding in reverse auctions can only happen when all the members of the supply chain get together and jointly bid or the bidder should be a vertically integrated unit.

Since the fabric constitutes some 65% of the total garment cost, the mills should be willing to reduce the cost of fabric by one cent for every two cents reduced from the manufacturing cost of the exporter / bidder.

The costing of a product should be transparent and open to all members of the supply chain with a total professional approach and an attitude to win. This alone will see the bidder get any foothold. To save on extra fabric width-wise or length-wise, the mills should not hesitate for any re-adjustment of the looms or re-working the pattern by the supplier. The bidders should also be encouraged to increase productivity through better incentives. All factors, including flexibility, which is India's strength, should be built into the process to get any foothold in the bidding process.

What Worries Vendors?

The advantage of reverse auctions is that all parameters are accessible in one place prior to bidding for an order, and the auction provides valuable insight into whether a price is “realistic”. On the flip side, it “hurts partnerships because price is not everything”. Although vendors must pass through the same retail approval processes and are competing for business based on the same set of specifications, they may not be getting credit for producing a better product.

This, however, does not reveal the full story.

Apparel Online asked Devangshu Dutta if “reverse auction has a future as an alternative to the sourcing option”. He says, “Reverse auctions have been most successful in standard and commodity supply areas, where a like-for-like comparison can be made.

“Fashion goods mostly do not fit the description of ‘commodity’. Other than design, or look and feel, small qualitative changes or even labelling and packaging changes can create cost differentials, which can upset the standard reverse auction method.”

He adds, “A retailer with almost US\$ 3 billion of fashion buying per year, is reported to have sourced only around US\$ 20 million over a two-year period through reverse auctions in an e-market in which it has a direct financial / equity investment. Say, if 75% of that US\$ 20 million was this year, that is still only 0.5% of the total sourcing. Note that, as an equity-holder, this retailer has a vested interest in making this e-marketplace survive.” There may also be other motivations.

Devangshu says that, despite the fact that it is traditionally believed that there are increasingly more suppliers in the world than buyers, the reverse auction platform had most buyers registered than suppliers. So despite the technology, he asks, is the buyer really getting the best choice – are the best suppliers even participating in the reverse auction?

Second, despite all the contractual flim-flam, there were deals that did not go through, even if the buyer got his target price met by one or more of the suppliers.

Thirdly, the activity, and all that buzz, seems to be bunched around the very end – maybe even the last couple of minutes of the reverse auction. The result could be that the reverse auction gets extended – but how many times will it get extended and until when? Is that time really bringing the savings needed, he questions, or could those savings/ better margin have come from other areas? Reducing costs from specialised, non-commodity or engineered products needs discussion and collaboration between the buyer and the supplier, not an impersonal reverse auction, Devangshu feels.

The Indian Concern

There is, however, one grace. India's strength is not so much in "mass production" as in niche products in smaller quantities. Apparently, reverse auctions will not be possible in such cases. To that extent, the suppliers would be relatively safe from the onslaught of international competitive bidding. It is only the big players making basic garments, who might have to face the music, but then they, because of their inherent strengths, can possibly compete. Again, this concept will take its own time to catch up.

On balance, it is felt that the technology-enabled reverse auctions are here to stay, but their importance is often blown out of proportion – perhaps there is a lot more hope or a lot more fear than there should be, Devangshu concludes. One could not agree more. ❖

Source: *ApparelOnline* (www.apparelresources.com)

EXPERIENCE – Lalit Gulati

Lalit Gulati of Modelama is one of the very few Indian exporters, who have actually participated in this process. Talking of his experience, Lalit said that the choice of vendors is entirely a prerogative of the buyers, who know which particular product can be made by which suppliers (manufacturer-exporters).

“The buyers give us the style and specifications, and we make the sample. They also quote their price for the product, say \$5 a piece. Now, once the competitive bids start, every two minutes there will be price reduction by different bidders. Suddenly there is a price quotation of \$3.60. Now, we cannot bring our price down to that level. Though we have tried to offer our bids, we have never been able to get any business. Generally it is only for basic products, where such a reverse auction system is possible, which again is bagged by other countries like Bangladesh or Indonesia. Reverse auction is not possible for value-added and fashion products, which are our niche.

“In yet another case, both Modelama and Richa jointly participated in the reverse auction process but failed to get business even when we were reducing the rates – when quoted at \$7.20, we offered to reduce to \$5.60, but someone made an offer at \$4. At this price level, there were no margins left at all and though we wanted the business to come to India, we could not go down to that level.”

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