# Procurement auctions - goods and services procurement guide

## Introduction

Find out how to buy goods and services using a procurement auction.

## What is a procurement auction?

A procurement auction is a process for approaching a competitive market to **buy** goods or services.

A procurement auction or a **reverse auction** is when a number of sellers compete with one another to win the business of one buyer.

A procurement auction usually requires suppliers to pre-qualify, before they can take part in the auction. Pre-qualifying involves:

* meeting all mandatory supply criteria,
* agreeing to auction and contractual terms and conditions, and
* agreeing to scope and specifications.

This means that during the auction the suppliers compete primarily on price.

It is possible but rare for suppliers to compete on non-price criteria in an auction. Complex procurement auctions may involve the real time assessment of a combination of price, non-price and associated elements.

## When to use a procurement auction

There are no rules for when to use a procurement auction. Similar to traditional tenders, for a successful event, you need a competitive market where sellers compete against each other to supply the goods or services.

The decision to use a procurement auction as the market approach involves assessing:

* the need for the good or service;
* the risk and complexity of the procurement; and
* a market analysis and review (the same way as determining the market approach for any procurement).

One or more of the following characteristics may lead to using a procurement auction:

* the goods or services requirements can be clearly specified;
* standardised, commercial-off-the-shelf solutions (commodities) are available or possible;
* price is the primary or sole basis of competition;
* there is a competitive market with enough suppliers able to provide the good or service and required and willing to take part; and
* there is an opportunity for savings.

Procurement auctions tend to deliver more benefits with fewer risks, for procurements in the Leveraged and Transactional [complexity](https://www.buyingfor.vic.gov.au/complexity-goods-and-services-procurement-guide) quadrants, but always consider the merits of using a procurement auction on a case-by-case basis.

## Benefits

Benefits of a procurement auction may include:

* cost savings through low prices;
* transparency, fairness, process credibility and accountability
* increased supplier participation and competition due to perceptions of greater probity (as a result of the transparency of an open process where all participants are aware of the rules and the competitiveness of their bids);
* time savings (through a reduced negotiation phase);
* real time price feedback for participating suppliers;
* elimination of unconscious bias; and
* procurement cost efficiencies, particularly when used for frequent, repetitive buying.

## What to consider

### Agency capability

Does the agency have:

* an established procurement auction process with an electronic bidding system?
* expert or experienced auction practitioners?

An agency may not need a high level of procurement auction capability to conduct auctions of low risk and complexity. An agency may need help when planning a procurement auction for the first time.

Auctions of higher risk and complexity need appropriate expertise and possibly customised systems.

Each agency must adhere to its internal policy setting when conducting a procurement auction.

If an agency does not have the capability or technology to run a procurement auction, there are service providers who are able to assist.

Agencies should also consider engaging appropriate experts from the market to plan and run auctions, including the use of their online systems as this may deliver better value than establishing in-house capability.

### Preparation for a procurement auction

Preparation for a procurement auction will need some changes to the traditional procurement process. Changes may affect time and resources, especially when conducting an auction for the first time or if the auction is complex.

Under a standard tender process, negotiations usually occur with one or two short listed suppliers (towards the end of the tender process). For a procurement auction, clarify/negotiate offers(before the live auction), to a point where price is the main remaining factor for competition.

Before they can take part, suppliers may need training. This will depend on:

* the complexity and customisation of the auction process, and
* the familiarity of the market with procurement auctions.

Consider up front:

* what preparation is necessary for the buyer’s auction team;
* the amount of time and effort required to plan and conduct the procurement auction;
* clarification/negotiation of the bids to prepare for price competition; and
* the process required to train suppliers to take part in the procurement auction.

### Incentivising suppliers to take part

Consider how to incentivise suppliers to take part in the auction and to compete.

In the right context, a procurement auction will enable the buyer to achieve the best value for money through:

* active competition; and
* price revision (as suppliers bid against each other to ‘win’ the contract).

The auction process provides:

* transparent, timely feedback to suppliers regarding the competitiveness of their bid, and
* an opportunity to improve their offer.

The auction process must:

* maintain supplier confidentiality; and
* be a reliable, trustworthy system and process.

### Auction design

In a **descending price** auction, suppliers lower their price until they are no longer willing to submit any further bids within the auction time period. There are several ways to structure a descending price auction:

* **Positional bidding**. A type of descending price auction where suppliers can see the position of their bid only i.e. 1st, 2nd, 3rd etc, but they are not aware of the value of the bids.
* **Leading price bidding**. All suppliers can see the amount of the lowest bid but not the identity of the leading bidder, nor the position of their bid (unless it is the lowest).
* **Descending clock**. The auction that runs for a predetermined time. The auction will have internal rules applicable to timing to ensure all bidders get the same opportunity to continue bidding. It can be a positional bidding or leading price bidding event.

There are many other procurement auction designs that are searchable on the Internet. Some other types of reverse auction designs include:

* **Dutch Reverse** – Begins with a low opening price that increases in set values at fixed intervals. A seller places a bid, thereby winning the auction and agreeing to supply the good or service (item) at that price. This type of auction would suit a procurement of multiple items as each item can be auctioned separately and suppliers can bid on as many or as few items as they wish to supply. The auction closes when bidding on all items has finished or by reaching the reserve price and the buyer is not willing to buy above that price.
* **Japanese Reverse** – Starts with an opening entry price point. Each supplier must accept the price point or withdraw from the auction. The price decreases in predetermined decrements. Participants either accept the price point at each decrement or withdraw from the auction. The winner of the auction will generally be the last participant.
* **Best Value Reverse** – Suppliers provide a best value proposed solution. Evaluation is on weighted and scored price and non-price factors. The outcome is not determined or won on the lowest price.
* **Economic Design (complex auctions)** – Some procurements will need custom designed auctions due to their unique nature.

### Communication

Communication with suppliers is essential throughout the procurement process, from advertising the procurement and advising the use of a procurement auction, to:

* answering questions about the process;
* supplier conditioning and training;
* advising terms and conditions; and
* procurement auction rules.

It is also important to promote the buyer-supplier relationship, especially when participating in a procurement auction for the first time.

### The procurement auction rules (bidder/participant terms and conditions) are an important document in explaining to suppliers the auction process and how the auction will run. The terms and conditions govern the relationship between the buyer and supplier. They should inform the supplier how the auction will run and the obligations of each party. They are part of the formal contractual process and should involve legal in drafting and reviewing the auction rules.

### New suppliers and small and medium enterprises

As part of the market analysis and review, consider the ability of small and medium enterprises to take part. Small and medium sized businesses may be new to the market and/or new to supplying to government and may need extra support during an auction process.

Using an auction process should not disadvantage small and medium enterprises in competing against established larger suppliers. Some markets may only comprise small and medium enterprises and as a result, agencies should consider the appropriateness of using an auction process.

### Identifying and managing risks

Procurers need to consider the risks in any procurement activity and market approach, but there are some extra considerations associated with a reverse auction. It is important to understand these and be able to respond should they emerge.

Procurement auction risks for consideration and mitigation during the design and conduct of a procurement auction include:

* participation by suppliers (successful auctions require suppliers to compete);
* higher prices (procurement auctions won’t always deliver lower pricing);
* unavailability of goods (products may be redirected to higher margin buyers, compromising quality and or availability of goods and services);
* diminished investment by suppliers (the good or service becomes commoditised and suppliers don’t invest in improvement opportunities);
* sustainability of supplier margins, goods and service pricing (drawing investment away from the supply market and reducing competition, innovation and diminished efficiency and impacting longer term pricing); and
* technology and capability issues (internal and supplier).

### Innovation

It can be difficult to acquire innovative or unique goods or services through a procurement auction. These purchases focus on non-price elements that require detailed analysis and direct collaboration with suppliers. If a procurement auction process is selected to procure such goods and services, it may be necessary to design a complex, customised auction process that includes evaluation of both price and non-price elements. This is likely to need specialist expertise.

### Reverting to a standard tender

Procurement auction planning should include the risk that at some point in the process, it may be preferable or necessary to revert to a standard tender process and not proceed with the auction. For example, following pre-qualification, there is insufficient competitive tension for a competitive bidding process to occur.

The tender and or procurement auction terms and conditions need to provide the buyer with the opportunity to revert to a standard tender process.

## Value for money

Achieving value for money in a procurement auction follows the same principles as other procurements. Value for money involves consideration of price and non-price factors. Selecting a market approach is the outcome of an agency’s planning and market analysis; choosing an appropriate market approach is fundamental to obtaining value for money.

Agencies should consider the internal costs or savings of conducting an auction compared with other approaches to the market when assessing value for money. The Value for money assessment should include the cost of running the procurement auction process, particularly if it requires engaging an external provider to run the process.

Using a procurement auction is not more or less effective than using a standard tendering approach in obtaining value for money. A procurement auction may deliver superior outcomes in the right context and should be part of an agency’s market approach considerations and overall procurement planning.

## Reporting and assessing auction outcomes

There are no specific reporting requirements when using procurement auctions in Government. Agencies may decide to develop their own metrics and data collection processes to evaluate cost savings, process efficiencies, aggregation and other benefits (priced and non-priced) that the procurement auction has produced, for example:

* the results of the actual auction compared to the pre-auction estimate;
* if any post auction negotiations were required;
* the performance of the winning supplier; and
* a cost-benefit analysis of the reverse auction compared to a traditional sealed bid approach.

Using this guide. This guide accompanies the [goods and services supply policies](https://www.buyingfor.vic.gov.au/goods-services-supply-policies). There are 5 supply policies:

* Governance policy
* Complexity and capability assessment policy
* Market analysis and review policy
* Market approach policy
* Contract management and disclosure policy

This guide supports the Market analysis and review and Market approach policies.

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