



DiamondCluster International

Reverse Auctions in the Flexible Packaging Industry

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DiamondCluster is a global digital strategy and solutions firm

Global Scope

Global capabilities and perspective:

- ◆ Public company, established in 1994. Result of merger between DTPI and Cluster Consulting
- ◆ More than 1150 practice consultants worldwide
- ◆ 12 offices in North America, Europe and Latin America
- ◆ Clients in over 35 countries

Digital Strategy & Solutions Delivery

Seamless approach and capabilities, from strategy through implementation:

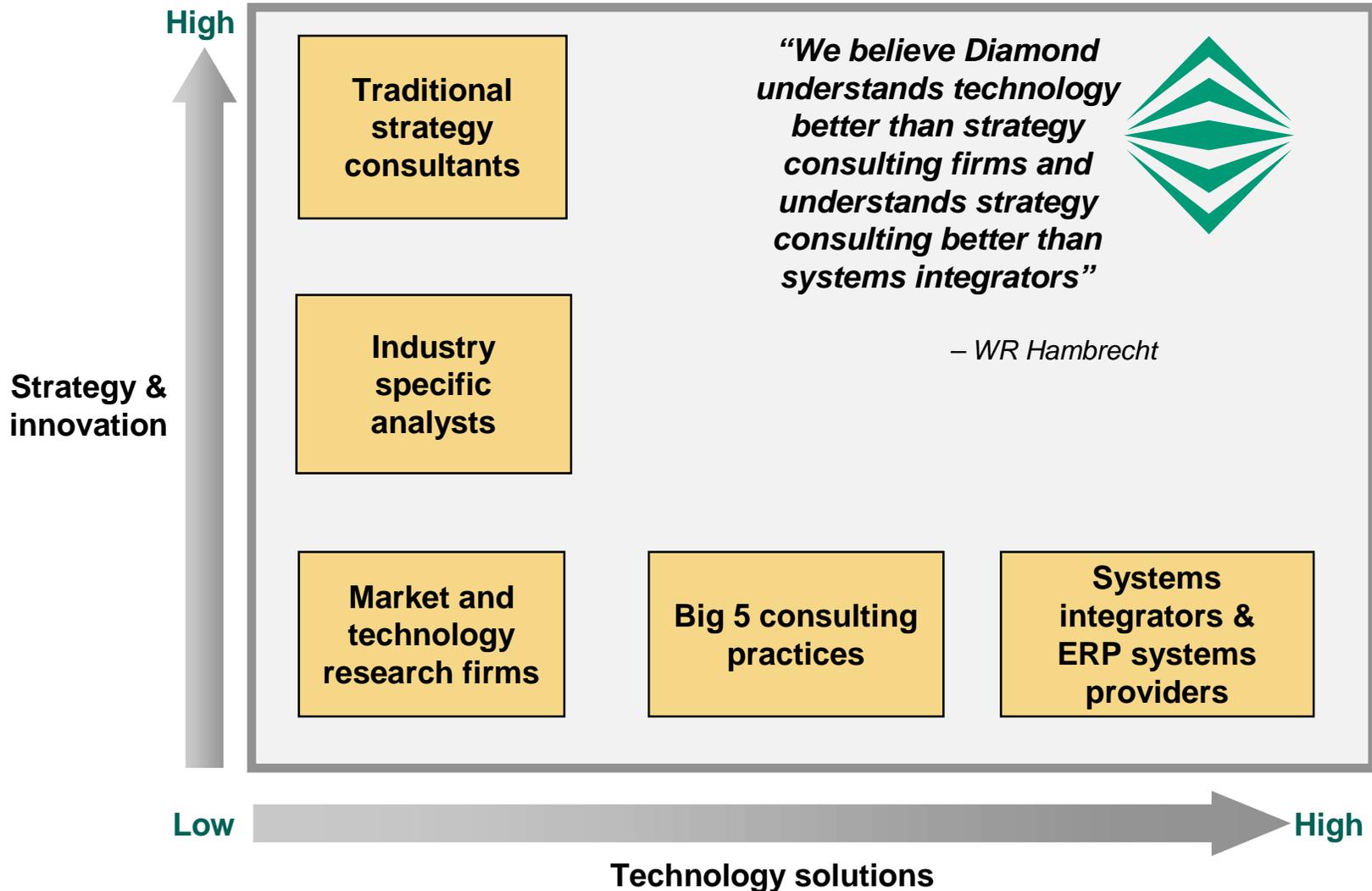
- ◆ Technology transformation
- ◆ Business and technology strategy
- ◆ Industry analysis and market insight
- ◆ IT planning and architecture design/development
- ◆ Execution / program management excellence

Focus of Our Client Work

Focus on four broad strategic agendas:

- ◆ Core business growth and profitability
- ◆ Core process renovation
- ◆ E-commerce strategy and implementation
- ◆ Technology infrastructure and innovation

DiamondCluster: Analysis intensive, “solution” agnostic



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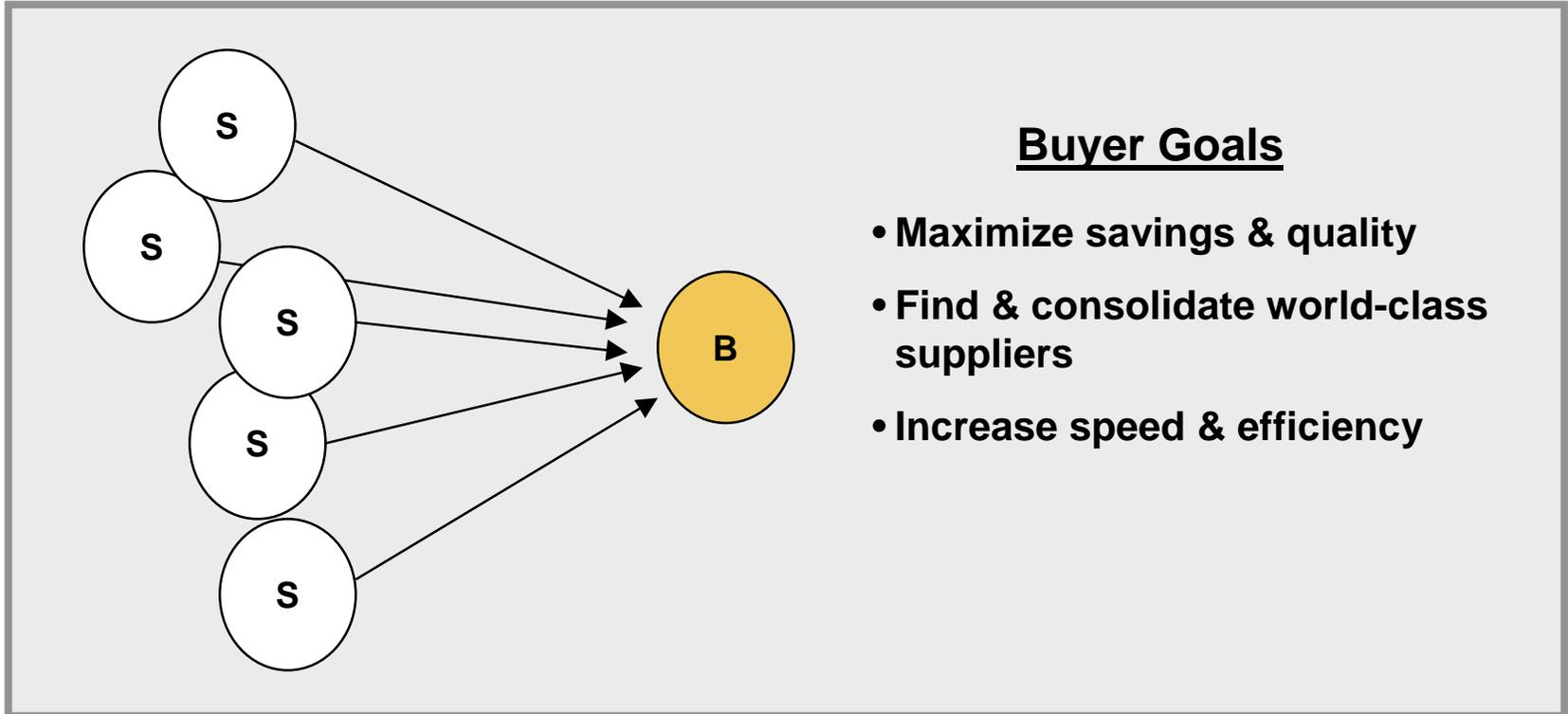
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What is a Reverse Auction?

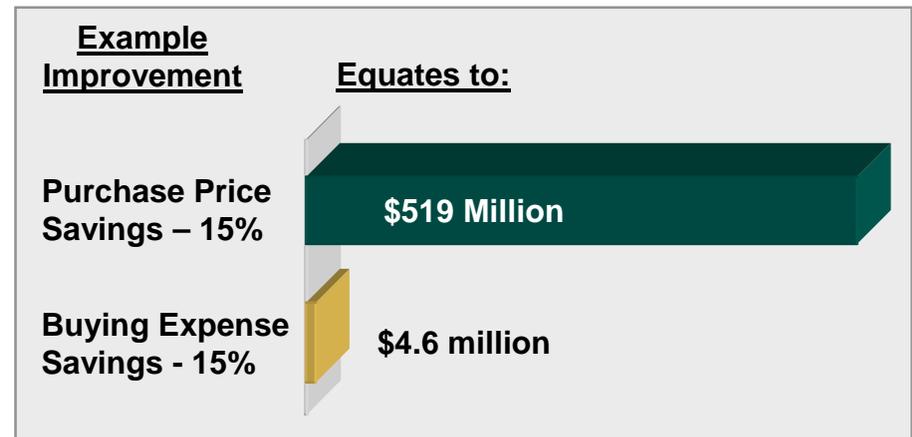
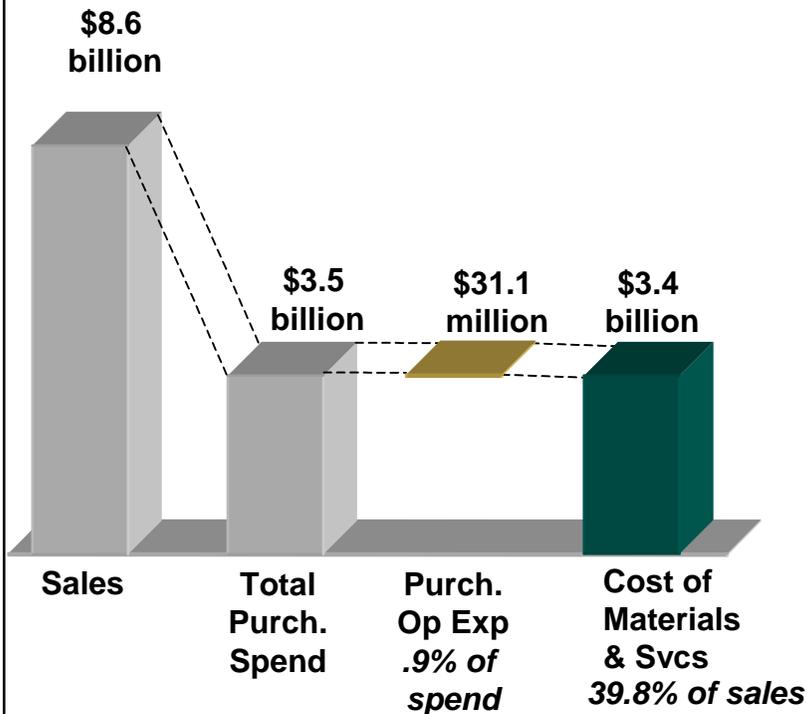
- Downward auction in which suppliers competitively bid to fulfill a buyer's unique purchasing request (e.g. direct / indirect goods and services)
- Buyer's objective is to obtain goods or services at lowest possible price (all other factors being equal)



Why Reverse Auctions?

Benchmarking Sample of 281 companies in 23 Major Industry Sectors

Average Sample Company Characteristics



Reducing COGS can dramatically impact shareholder value

A study of the earnings impact of a reduction in COGS for the 30 largest S&P 500 companies (sorted by COGS) showed a,

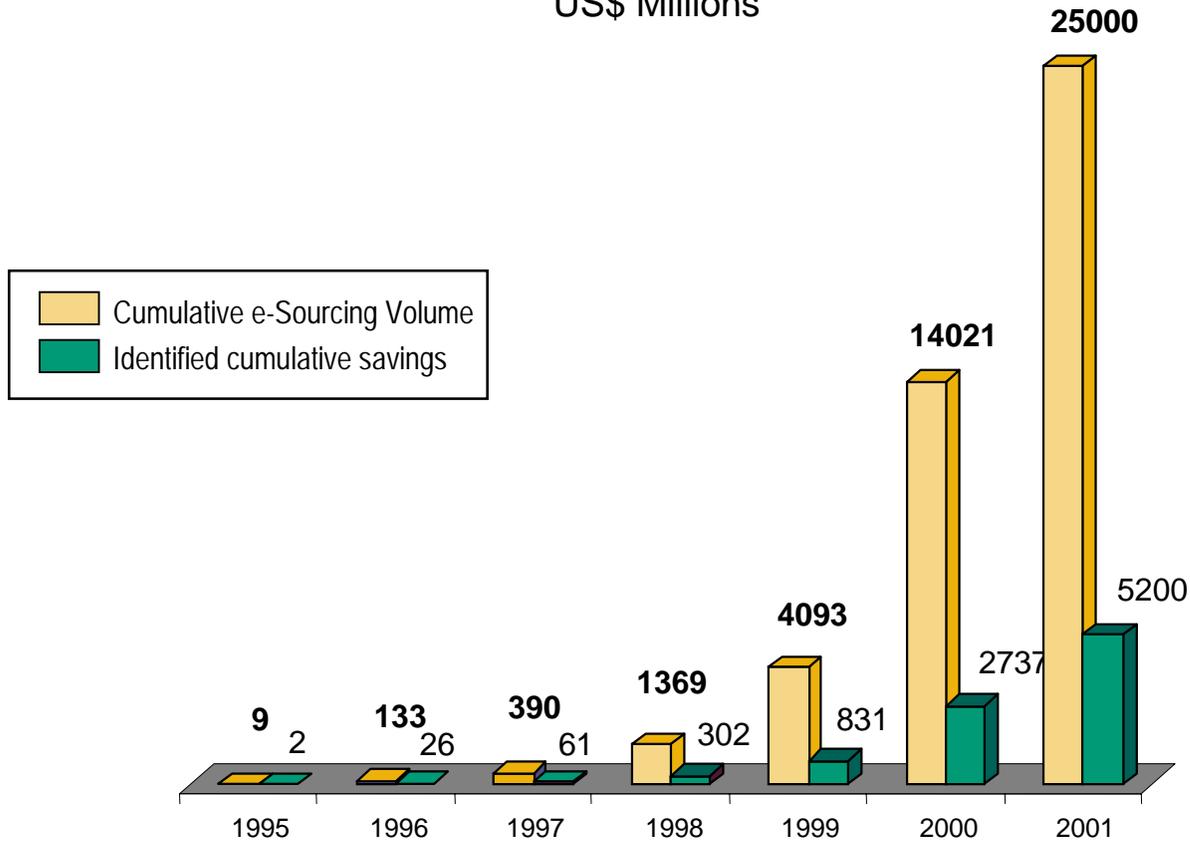
- **1% reduction in COGS = 17% increase in EPS**
- **3% reduction in COGS = 52% increase in EPS**

Morgan Stanley Dean Witter – 7-25-2000

Aren't Reverse Auctions just another dot-com phenomenon?

If the leaders' growth is any indication, the Reverse Auction market is here to stay

FreeMarkets e-Sourcing Value
US\$ Millions



The e-Sourcing market is expected to grow to \$3.5B in revenues – a CAGR of 75% - through 2005*

* AMR Research 2001

What makes a good candidate for a Reverse Auction?

3 Question Test:

1. **Is the material or service specifiable?**
2. **Are there sufficient qualified suppliers of the material or service?**
3. **Is there reason to believe that prices can be reduced?**
 - Market information / research
 - Significant engineering component
 - Significant labor component

As a general rule, the more “engineered” the commodity or service is, the higher the likelihood that it will be a candidate for Reverse Auction

Who are the Reverse Auction players?



Almost every supply chain software provider, e-marketplace or B2B exchange claims to offer some form of reverse auction capability

Reverse Auction providers come in one of two basic forms. . .

- **Software application.** A buyer can opt for a a tailor-made solution, buy packaged software, or license use of an application/ASP solution
 - Charges can be percentage fees on the traded volumes with fees on added services, or an initial fee plus a yearly contract
 - Among the solution providers: PurchasePro, CommerceOne, BT Ignite, FreeMarkets, eBreviate, Ariba, SAP, Oracle
- **Third party service provider.** Providers charge customers either a fixed fee or a percentage of the purchase volumes traded, plus services such as support, training and market making
 - Services (e.g. training, market making, supplier database access, marketplace hosting, etc.) can be purchased a la carte or as part of a comprehensive package
 - Service providers include companies like FreeMarkets, eBreviate, and various B2B marketplaces

Know who you're dealing with – avoid the amateurs

They offer some combination of the following. . .

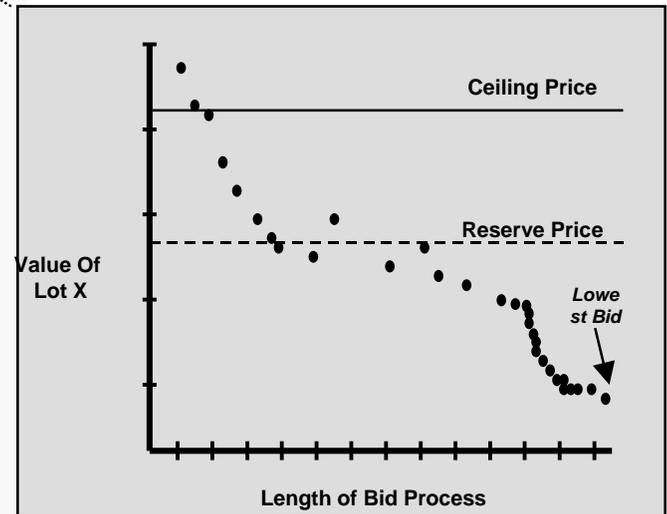
- **Technology** – auction platform, project / workflow management, online RFX creation and publication, supplier management, ERP/MRP integration
- **Support Operations** – monitoring & enforcement, supplier training, auction coordination, multilingual customer service
- **Information** – supplier profiles, performance & ratings
- **Market Making Service** – opportunity assessment, RFQ preparation, supplier identification/recruiting/selection, lotting/auction strategy, and project management

What goes into preparing a reverse auction?

The Reverse Auction itself is just the tip of the iceberg

Reverse Auction Overview:

1. **Evaluate and select spend**
 - Confirm savings potential
 - Assess supplier market
2. **Prepare RFQ**
 - Define detailed specifications
 - Formulate lotting strategy
 - Set ceiling & reserve prices
 - Set bid increment
 - Select appropriate auction format
 - Project manage preparation and dissemination
 - Refine RFQ
3. **Select suppliers**
 - Establish supplier qualifications
 - Solicit supplier interest
 - Screen / qualify suppliers
 - Select suppliers
 - Train suppliers on rules & procedures
4. **Conduct auction**
 - Enforce rules & procedures



Buyers structure their auctions in many ways to ensure successful outcomes – it's NOT just about price

Buyer tools / techniques

- **Total Cost RFQ**: buyer creates “all-in” RFQ document to ensure “apples to apples” comparison of supplier responses
- **Ceiling Price**: buyer sets opening bid level in RFI or draft RFQ to test market reaction to price reductions and to screen out non-competitive suppliers
- **Reserve Price**: buyer sets winning bid threshold to ensure successful outcome
- **Lotting Strategy**: buyer organizes spend into manageable/biddable chunks to maximize supplier competition and spend coverage
- **Auction Formats**:
 - **“Transformational” Auctions**: buyer assigns weightings to certain commodity/service features that are not reflected in bid prices
 - **“Index” Auctions**: buyer establishes moving baseline (e.g market index) which suppliers must bid to beat
 - **“Rank” Auctions**: buyer only discloses bid rank to competing suppliers – does not share bid amounts (to prevent collusion) with participants
 - **“Multi-Year Contract” Auctions**: buyer establishes NPV bids to allow suppliers to factor in their individual pricing strategies and factor in such things as up-front tooling costs.

Implications for buyers and sellers

	Pros	Cons
Buyers	<ul style="list-style-type: none"> • Savings on the cost of goods <ul style="list-style-type: none"> - Buyers claim savings on goods purchased ranging from 10% to 67% (1) • Contact with new potential suppliers <ul style="list-style-type: none"> - Sellers are pre-screened by the e-marketplace • Faster, more effective negotiation process • Supplier consolidation • Less paperwork; lower transaction cost 	<ul style="list-style-type: none"> • Challenges old “relationships” • If conducted unprofessionally, auctions can destroy credibility and trust which suppliers have in buyer’s organization
Suppliers	<ul style="list-style-type: none"> • Fast, cheap sales channel • Access to new business • Market intelligence • Less paperwork, resulting in lower transaction costs 	<ul style="list-style-type: none"> • Likely decrease in prices and margins <ul style="list-style-type: none"> - but...half of the companies buying through reverse auctions don’t choose the cheapest supplier

(1) Among the companies which made declarations on their or their clients’ savings: Deutsche Telekom, Whitbread Leisure, Owens Corning, FreeMarkets, BT Ignite, Siemens

Reverse auctions bring clear advantages to buyers, but are considered a menace by suppliers...

Agenda

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Facts vs. fiction

Fiction

- All reverse auctions are the same
- Price is all that matters
- Lowest bidder gets the business
- R.A.'s are best for commodity goods
- Any supplier can participate
- The real negotiation takes place behind the scenes (after the auction)

Facts

- Great divide between providers
- False – other factors matter
- False – other factors matter
- False – most success has been in “direct” materials
- Not true – only qualified (invited) suppliers can participate
- Reputable service providers frown on such behavior – sanctioning participants as necessary

Much more fiction than there are facts available – consider the source

What can you do about Reverse Auctions?

- **Hate them if you must, but do not ignore them**
- **Educate yourself about them and the companies behind them**
- **Develop a company policy / SOP on “how to play” (or not)**
- **Develop a bidding strategy process**
 - Information gathering and analysis (what do you wish you knew?)
 - Bid strategy formulation
 - RFX response process / format
- **See your firm from your customers’ perspective**
 - What value is it that you are really adding for them?
 - What value is it that they are getting from competitors?
 - What value could they be getting from you that they are not today?
- **Over-communicate the value / differentiation of your product**
 - Make sure it’s something your customer values / cares about
 - Determine what value your customer places on that differentiation

What can you do about Reverse Auctions? (2)

- **Scrutinize your cost structure**

- If R.A.'s reflect market prices, what can you learn about your cost structure? What are your competitors doing to streamline theirs?

- **Leverage technology**

- Reverse Auction revenues are growing at 75% CAGR. Other technology driven disablers are on the horizon. Is your company organized in a way to efficiently deal with these industry trends?

Reverse Auctions strategies that will NOT work...

- **Ignore them**
- **Industry boycott of Reverse Auctions**
 - OPEC
 - Inevitable “rogue supplier”
- **Pockets of resistance approach**

Thank you

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