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Under the Hammer

While they can be effective when applied in the correct circumstance, there is a current industry trend for using reverse auctions when procuring strategic services. Such inappropriate use not only puts suppliers at an unfair loss, it also disadvantages the buyers implementing the tool

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Reverse auctions, also known as e-auctions, involve companies that wish to buy a product having competing suppliers bid against each other in order to drive down the price. Reverse auctions are not a new instrument in the procurement toolbox – they have been around since the 1990s, and there has been much research into how they work and when they can aid companies in selecting the right supplier for the products or services they are seeking (1,2). When used in the correct scenario, reverse auctions can be quite effective.

Unfortunately, however, a trend has developed in the pharmaceutical industry for using this tool to procure services of strategic clinical research providers – fulfilling none of the criteria for appropriate use of reverse auctions. The following outlines the many reasons why reverse auctions are not the right option for these types of services.

Terms of Use

A clear description of the types of goods and services that are best suited to using reverse auctions has arisen

out of research around their use in procurement (1-5). What we know is that reverse auctions work well when the product or service being purchased is simple, well defined, non-strategic in nature for the buyer, and requires little collaboration between the buyer and the supplier (1,4,5). There should be several suppliers offering the service, and they should have the capacity and skill-set to do it well (2). Ideally, there must be little variance among supplier capabilities to ensure that the suppliers participating in the auction are comparable. It must also be possible

to precisely specify the scope of the service sought, with a thorough and unambiguous description of all the requirements. One article states that “specifiability” is the most important criterion in determining if a reverse auction is appropriate (6).

If we consider the many different types of services in clinical research that are currently being subjected to the practice of reverse auctions, it seems a poor match with the definition above. Let us take medical writing as an example. The writing of a clinical study protocol, a study report, or a summary in Module 2.7 of a submission dossier is a complex, intellectual activity. It involves several stakeholders interacting in a collaborative way, and the documents are part of the company’s strategic clinical development programme. There is large variance in the quality of the documents produced by different providers for a host of reasons. But, most importantly, it is extremely difficult for pharma companies to provide a thorough and unambiguous description of the requirements, mainly because these documents are often moving targets, which change over the course of the project. Unfortunately, this is a necessary part of crafting and developing the documents.

Given this direct polarity to the criteria defined above for when to apply reverse auctions, it makes one stop and think about why the industry is trying to use the tool in such situations. So, let us discuss some of the arguments for using reverse auctions when sourcing clinical research services.

For or Against?

Some contend that a reverse auction helps buyers get an overview of rates in order to better rank competing companies and create a baseline for pricing shaped by averages (7). However, it can be argued that buyers already know the baseline once they receive the original cost proposals. Unless suppliers are routinely offering inflated bids, the suppliers already have a cross-section of the market rates at the starting point. There is no need to have them perform the exercise of reducing their bids based on no further information or change in specification, other than another supplier being more desperate to get the work than they are. In fact, buyers should wonder if forcing suppliers to participate in reverse auctions could make them artificially inflate bids so that they have room to come down during the bidding process, making it look like they are good sports and playing along.

Part of the rationale arguing for reverse auctions is that traditional price negotiations use up a lot of time. It can be difficult to get the real decision-makers together for the haggling and, as a result, negotiations often take several weeks as both parties make suggestions, and then go away to consider and produce counter proposals.

The idea and allure of a reverse auction is that the whole process only takes a few hours (8). Such a time saving would certainly make sense, if the reduction in price that occurred were the result of

a true negotiation – but the truth is, it is not. There is neither an exchange of ideas to better elucidate the scope, nor compromises arising from discussions on why and how the price could come down.

Matters to be Discussed

There should be a discussion to understand what price the buyer is aiming for. If that price is lower than the current estimate for the work to be done, their needs for the project and why their price expectation is lower than the estimate should be sought out. It is also beneficial to determine where workload could be lessened through increased efficiencies, or by shifting priorities in order to achieve a reduced price, while still meeting the needs of the buyer and not risking a loss of quality.

The scope and conditions of the project should be outlined, as well as how the buyer pictures it running and how it can be realised. The proposed rationale for resources should be explained to the buyer, so that they will not only come away with a better understanding of what the price is built on, but will also have an opportunity to actively input on which resources they receive in the package they purchase. Importantly, the negotiation will provide an opportunity for both sides to assess the moving-target aspects of a project, which are not easily described in a specification.

Together, both sides will construct a package that everyone feels is appropriate and effective for the project. All of this is the definition of negotiation: the reaching of agreement

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through discussion and compromise. Consequently, the use of reverse auctions is not a negotiation. It is an audacious request for suppliers to reduce their prices without any good reason other than the fear that, if they do not, they may not get the job.

It also implies that the pricing the suppliers have provided is not a realistic reflection of the inherent value of the service – since, if it were, they could not afford to reduce it, or they would be working at a loss. As a reverse auction is not a negotiation in any shape or form, it therefore cannot reduce the time needed for negotiation, because that is a separate activity.

Weighing up the Costs

The key argument for reverse auctions is the overall reduction in cost that could be obtained for the services purchased. However, some have raised the question of whether companies are really looking at the full equation (9). The reverse auction process is also associated with a cost – not only must the software be purchased, developed and maintained for the buyer's needs, but additional management time must be invested into the process.

Is the cost of this really less than that which is being shaved off from the service price? This becomes particularly relevant if you factor in the risk that suppliers may undercut their desired price to get the bid, knowing that they will find a way to recoup those costs through change orders during the course of the project – at a point when the buyer may not be in a position to reinstate the procurement process to switch suppliers. So, on paper, the savings are only in the beginning – but, if the entire project lifecycle is put into the equation, the added cost of the reverse auction may rarely be compensated for by a true reduction in service cost.

Squeezing suppliers on price means they will squeeze on the service. It is a simple zero-sum equation, and expecting anything different is naïve. Suppliers of medical writing services have small cost/

profit ratios – if you want them to charge you less, they have to provide less service in some form. If they do not, they will go out of business.

Less service need not mean that what is provided is deficient, but – due to aspects being overseen as a result of not having conducted any negotiations – it may prove insufficient in the broader context of the clinical programme as a whole, and may involve additional expense at a later stage. How can this be in anyone's interest? And how can it be a means to ensure a buyer is getting the appropriate volume and level of expertise for the service they are purchasing?

Varied Service

Is it really an ideal solution to select a strategic partner for this type of complex intellectual activity the same way you purchase a kilogram of sodium chloride? If we stay with the example of medical writing, one needs to consider that medical writers will produce the documents that will ultimately carry the full burden of explaining to the authorities whether or not a new product has a suitable and favourable risk-benefit profile. Medical writers will also assist the buyer's teams to effectively communicate why it is worth awarding marketing approval, securing the buyer's stream of future income.

While sodium chloride might be the same from any supplier as long as it meets a certain composition and quality, medical writing services are not all created equal – if for no other reason than that there is a large human element involved in providing the services.

It can be very difficult to assess if a provider has the ability to craft a well-structured document that communicates clear messages, or if their writers have the skills to corral

Products and Services for which Reverse Auctions are Appropriate

- Goods with low complexity that are easily understood by both buyers and suppliers
- Bulk items and goods that are manufactured based upon an agreed standard
- Items that are non-strategic in nature
- Purchases that feature little collaboration
- Goods with little variance among supplier capabilities
- Goods for which there is a sufficient number of suppliers with the capacity to deliver or provide the service

their clinical teams to provide comments on time and have meaningful, effective review processes. Certainly, it is simplistic to think that all clinical documents are equally good. That is why clinical teams prefer to build on a long-term relationship based upon experience and track record, rather than price alone. Yet that is precisely what reverse auctions presume: by telling the suppliers to bid on a medium complexity document (often poorly defined due to the inherent complexities of the scope specification), the price will tease them apart. There is no assessment of skill and experience in this equation.

Same Service, Different Price

You have to wonder what a buyer gets out of an auction in which one company ends with a price that is substantially lower than that of another's, for what is supposed to be an identical product. Such a massive discrepancy can only be because the supplier companies have a completely different understanding of the scope of the project (due to poor specifications), or they have entirely contrasting thoughts regarding what is needed for the same scope (due to different levels of experience). In either case, these bids are not comparable, and it would be foolish to think that the low bidder is likely to provide the same degree of service as the high bidder.

Which leads us to ask: what exactly does the reverse auction bring to the table in terms of useful information in distinguishing between companies

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supplying complex, strategic services in the field of clinical research? The buyers we have talked to emphasise that reverse auctions only provide one part of the equation. Beyond price, there is information on the suppliers’ experience and expertise, and buyers will use that information to distinguish between the suppliers.

If that is the case, having just established that the pricing information obtained from the reverse auction is not helpful when comparing complex services that are difficult to define, and – seeing as auctions do not reduce, or even replace, the task of negotiating the price with the suppliers – we can only wonder why supplier companies are being made to perform an activity that is ineffective and time-consuming at best, and demeaning at worst?

Benefiting all Parties

We suggest that buyers simply compare the starting bids provided, combine this knowledge with the information they have obtained on experience and expertise, shortlist two or three companies, and then have a true and meaningful negotiation with those to select the best fit for the buyer’s needs. This would be a process that everyone could benefit from, saving time by removing the time needed to prepare for and perform the reverse auctions, and money by removing the costs of software, management and maintenance of the necessary systems.

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