

Reverse auctions in the Australian public sector

By Kevin Burke, Director, Trade Interchange (Asia-Pacific) Pty Ltd.

With thanks to Steve Moro, Director, Strategic Procurement Unit, Department of Health, South Australia, Dennis O'Keefe, CEO, Health Purchasing Victoria and Anthony Chesler, Portland Group for their valuable contributions.

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South Australia Department of Health - Examination Gloves

Executive Summary

In its first reverse auction (RA) for medical examination gloves in 2002, SA Dept of Health (Human Services at the time) wiped 25% off its \$1.25M annual spend and significantly and permanently changed the landscape and culture for suppliers. Where there was once comfortable incumbency achieved through years of skilfully executed relationship building and a confidence of account ownership, there is now a relationship that is appropriate for the type and volume of supply.

Having subsequently completed renewal of the gloves contract in 2005, again using reverse auctions, SA Dept of Health now pay 40% less than they were paying in 2001, have an appropriate supplier relationship and have a very successful contract.

The decision to use reverse auctions

Purchasing examination gloves in South Australia (SA) prior to the letting of the 2002 contract was no different to the situation existing all over Australia. Procurement was carried out by individual hospitals, units and regions and, as is usually the case in these situations, the price for the same item varied widely from hospital to hospital. In a similar exercise, Health Purchasing Victoria (HPV) found some hospitals paying up to 80% more for the same needles and syringes.

With the centralisation of procurement came the opportunity to reduce costs through the increased volumes resulting from aggregated demand and also to change the culture of entrenched supplier relationships. For supplies that met appropriate criteria, reverse auctions were seen as a tool that had the potential to achieve these aims.

Examination gloves were chosen as the RA pilot supply because of the ability to clearly specify the item, the existence of a good number of competitors (11 shortlisted and invited to participate) and the value of the contract (\$1.25M prior to auction) which would encourage competitive bidding.

Reaction to the process from the long established incumbent group of suppliers was that the new arrangements weren't credible. They assumed that they would still be able to supply directly to the individual hospitals and units. Some suppliers were over confident of their position based on their supply relationships. This reaction confirmed that some of the incumbent suppliers had attempted to nurture unhealthy and inappropriate relationships especially given the non-strategic nature of the supply.

One of the most valuable characteristics of RAs for the public sector is the ability to 'negotiate' on price, something that is not usually undertaken using the established sealed bid process. In fact, the negotiation takes place between the suppliers. They establish the market price. The buyer and buying organisation is simply an observer and not a party to the negotiations. Along with increased probity (every item of the negotiation is recorded, supplier identities are not revealed) and transparency (all bidders have exactly the same information at the same time) we have the reasons for the explosive growth in the use of RAs in the public sector in North America and Europe.

Pre-auction process

The Portland Group (called PerfectMarkets at the time) were engaged as consultants and the reverse auction service provider for the SA Department of Health. Apart from the RA itself, they worked with SA Health to complete the data collection and analysis (to determine aggregated volumes and logical lots), specification formulation, development of purchasing compliance procedures to prevent circumvention of the new contract and potential supplier discovery.

The usual RFI procedures took place resulting in a shortlist of 11 suppliers that could meet the qualitative requirements. These suppliers were then invited to bid for the contract through a reverse auction process. The reactions of the suppliers ranged from vehement objection (incumbents) to excitement (new potential suppliers).

This is where the ride can get bumpy. Where an incumbent sees a risk to their established business through the introduction of a radical new process (reverse auctions), it is not unusual for them to challenge the legitimacy of the exercise. As reverse auctions are introduced to your organisation it is wise to consider and prepare for this eventuality through advice or briefings to senior members of your organisation beforehand.

The Auctions

As was the case in the SA glove contract, on-line reverse auctions typically run for somewhere between 30 minutes and 1 hour. At the end of this brief period, 11 suppliers have been through an intense but fair and transparent, buyer optimised, price negotiation.

Whilst the reverse auctions yielded a 25% cost saving, the contract was not necessarily to be awarded to the lowest bidder (all bidders knew this prior to participation). Following the auctions, the qualitative weightings were factored into the pricing which produced the ultimate winner. A new vendor was chosen for the 3 year contract.

Contract renewal - 2005

Three years later, when the contract came up for renewal, a decision was taken to again use reverse auctions for the price negotiation component.

This time the reaction of the vendors, especially the unsuccessful ex-incumbents from the previous round, was markedly different. Their willingness to participate and the appropriate nature of their interactions was encouraging.

The renewal auctions took a step forward by incorporating the qualitative clinical criteria into the bidding. This is achieved by applying objective weightings to each criterion for each supplier prior to the auctions.

Clinical Criteria - Examination Gloves. SA Dept of Health 2005	
Ease of Dispensing	Ease of donning
Skin Irritation	Retention of tactile sensitivity / touch
Strength	Odour
Comfort and Fit (short-term wear)	Grip
Comfort and Fit (long-term wear - 45 min – time permitting)	Sleeve Rollback (To be tested while wearing a gown)
Double-gloving	Suppleness /elasticity /flexibility
Length of cuff	Ease of removal

The resultant weightings for each supplier are then applied as percentage bid weightings during the auction. This has the effect of encouraging more competitive bidding as the leading supplier at the end of the auction knows they have won on the combination of both price and a major component of the qualitative criteria.

The results were excellent with a price 20% below that achieved in 2002. A further interesting aspect was that it was reclaimed by one of the original pre-2002 incumbents.

It is the intention of SA Health and Vic Health Procurement to expand their use of RAs as a price negotiation tool. On a global basis, the medical field is one of the leading industries in the use of reverse auctions.

Other medical examples

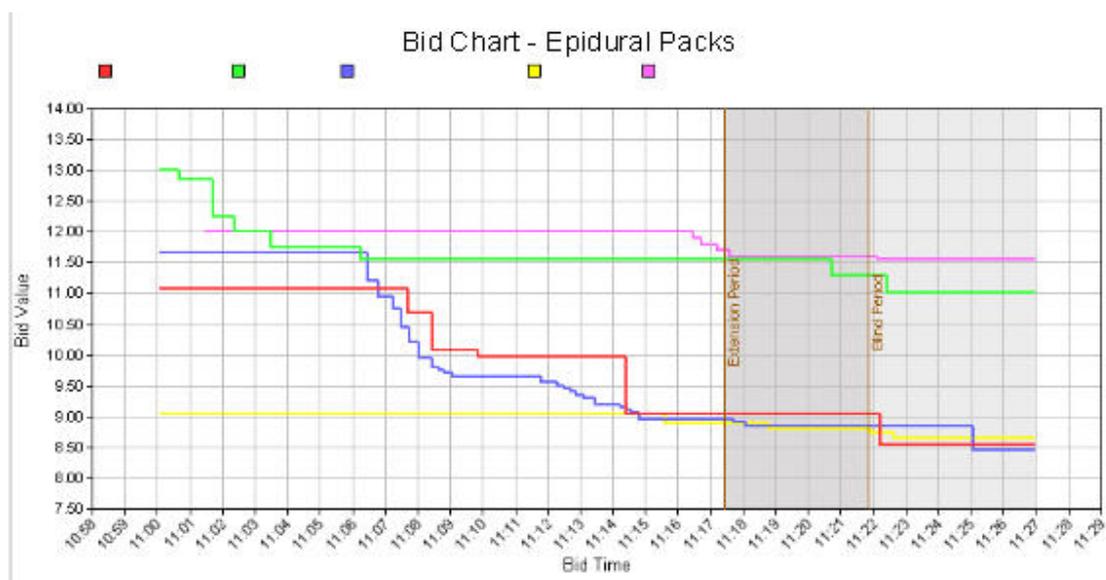
Examples of medical items auctioned through the Trade Interchange reverse auction service:

Suction Equipment, Soft Pack Dressings, Surgical Gloves, Laparoscopic Ports, Endoscope – Snares, Cleaning Brushes, Forceps, IV Fluids, Central Venous Lines, Epidural Packs, Spinal Packs, Spinal Needles / Plexus Needles, Bandages, Bowls / Procedure Packs, Tray Wrap, Swabs, Linen, Gowns, Breathing Systems / Connectors / Masks / Filters, Oxygen Therapy, Power Tools, Volumetric Infusion Pumps / PCA Pumps / Syringe Pumps / Anaesthesia Pumps, Sharps Bins, MRI Scanners, Cement Mixing Systems, Pulse Lavage, Wound Drainage, Saw Blades, Mobile X-Ray machines, Anti Embolism Stockings, Cotton Wool, Sterilisers, Beds & Mattresses, RMO Service Provision .

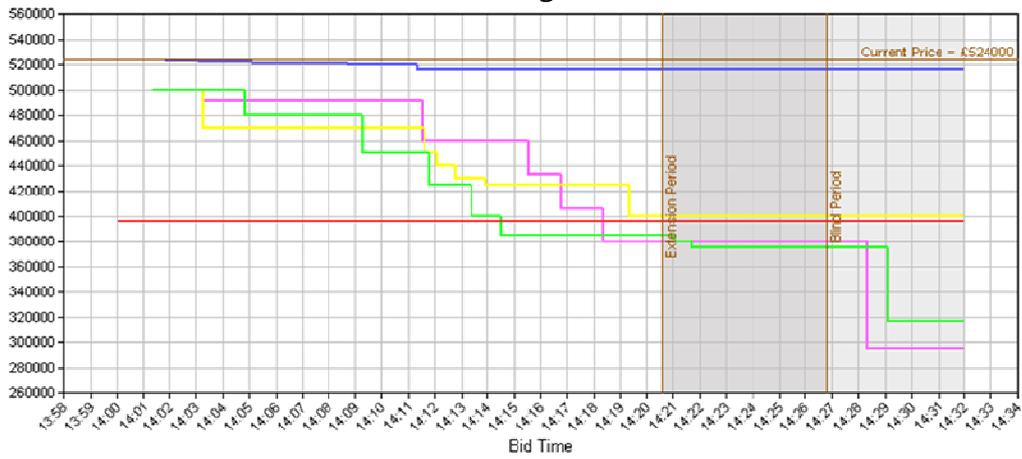
Bid charts - medical examples

The following charts show actual results from medical auctions managed by Trade Interchange.

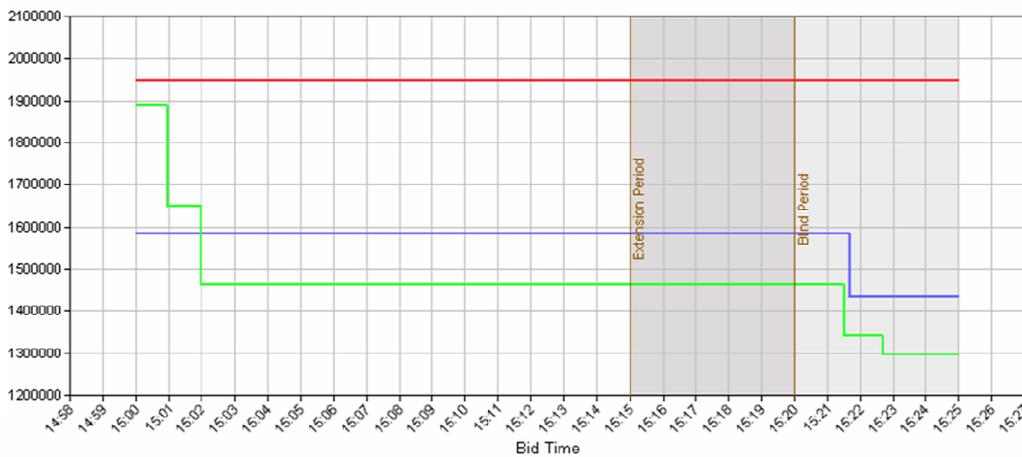
- The vertical axis represents the bid price.
- The horizontal axis shows the time.
- Each coloured line represents a supplier's series of bids.
- The dark grey section is the period during which an extension is triggered if there is a new leading bid.
- The light grey section is the optional sealed bid or 'blind' period. This is a set period of time during which bidders can make a best and final offer.



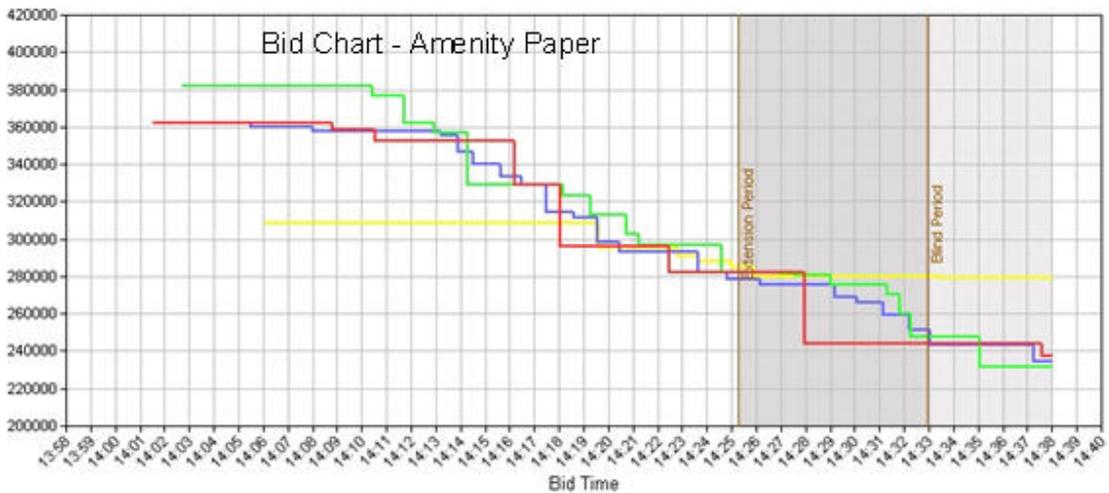
Bid Chart - Surgical Gloves



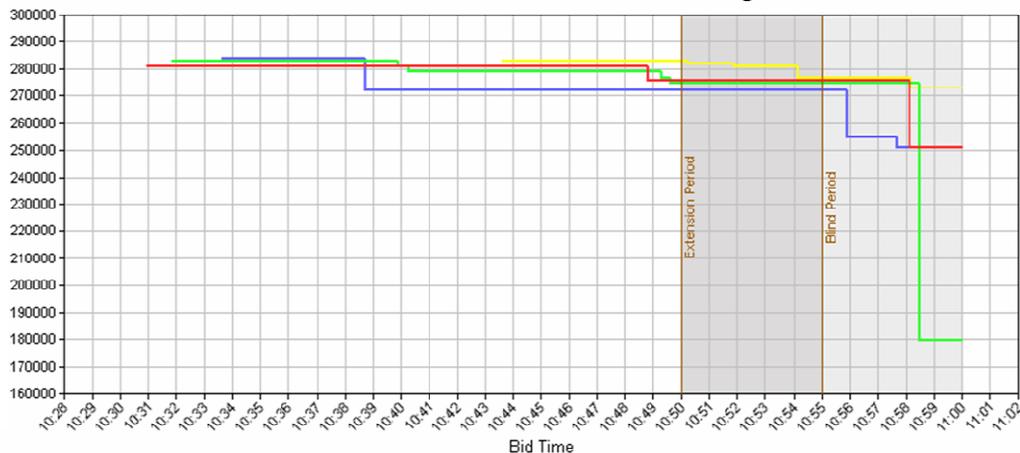
Bid Chart - Operating Theatre Power Tools



Bid Chart - Amenity Paper



Bid Chart - Anti-Embolism Stockings



Trade Interchange is a specialist provider of reverse auction services. The organisation has been established for 6 years (originally in the UK and now in Australia) and has directly managed more than 1,000 reverse auctions on behalf of clients. Though this experience, Trade Interchange provides a guided, low risk and tactical service that can be trialled and implemented with minimal impact on current business practices.

The organisation operates as an independent 3rd party employing a fixed fee business model in order to enable a strong ethical approach and high levels of probity. As a specialist provider (no generic procurement consulting services), Trade Interchange can comfortably dovetail with procurement consulting organisations engaged on wider briefs.

www.tradeinterchange.com.au
+61 (0)2 8002 1341