

CONTRACTORS' TIPS

Risky business

What you should know about reverse auctions

By Earle Goodwin

The advent of computers and high-speed communication has vastly improved the way we do business, and technology will continue to provide us with beneficial innovations in the future. It's hard to think of reverse auctions or online bidding events in that category.

For those who have not yet heard about these, a typical reverse auction includes all of the same steps as a regular tender call – pre-qualified bidders are sent tender packages, they're invited to inspect the site, and they prepare their bids. It's at this point that the two processes diverge.

With a normal bid, a contractor places their response in a sealed envelope and delivers it to a designated place by a specific time. Then it's opened with the other bids, analyzed and the job is awarded.

In the case of a reverse auction, a contractor logs onto a web site at a particular date and time and enters a price. In a typical session, the bidder sees how their bid ranks against the others. At this point another bid can be entered and the bidder can see where that one ranks, and so on. There is no limit to the number of bids that a contractor can enter. The bidding continues until there is no further meaningful activity, even if this means extending the auction. Eventually, a winner of the auction is declared. At this point, in some cases, the winning bidder is given time to submit backing documentation and, if everything seems to be in order, the contract is awarded.

The standard tender method is not without its problems. For example, some of the most colourful battle stories in the industry deal with heroic attempts to get a tender to its destination on time. Internet-based closings, through e-mail or a secure web site, make eminent sense.

On the other hand, the standard method has a lot to recommend it, too. First, because there is so much at stake, it's important that a system be in place that both parties can regard as fair. Let's face it, when there is a lot at stake, there is a lot of temptation to cheat. The standard bidding method has been developed over a long time. During that time, it has had a chance to evolve, incorporating rules to increase the fairness in the system along the way. This is important because it's the trust that both sides put in the system that makes it valuable. From a contractor's point of view, nobody wants to put the time and energy into developing a quote when it's just going to be used for price shopping.

Proponents of reverse auctions often claim that these events find the fair market value. But this presumes that a vendor in the marketplace will not drop their price below market values. We all know that they will, and it's hard to believe that the buyers don't know this too. Contractors will go below market value for any number of reasons: to hold onto valued employees when times are slow, to establish a relationship with a new customer,

or to hit a number that will make their bank manager happy. Or, because they simply made a mistake.

We can't underestimate that last point. Buildings are quirky things and no two are exactly the same. Each comes with its own peculiar set of challenges. And, while estimators are adept at coming up with prices that are usually reasonable, they are still called "estimators", not "determiners."

The government of New South Wales in Australia recognized this when they wrote up their procurement guidelines for reverse auctions in 2001. In a section under "When to Use Reverse Auctions" entitled "Type of goods", they state, "The use of reverse auctions is to be restricted to the procurement of products or commodities with little or no value-added or service component." They go on to list the characteristics of suitable products for this type of procurement where they flatly state, "no services or added benefits specified in the requirement, for example, there must be no labour hire component such as a requirement for installation services."

This seems like a reasonable exclusion. The labour component of a quote is usually where "actual" strays from "budget" and is the most likely area where costs can't be recovered through change orders. Also, it is relatively easy for a vendor of hard goods to determine a walk-away price. In most cases, their product has already been manufactured or they have contracts with their suppliers that set their purchase price. Contractors aren't allowed the luxury of submitting their price after they complete the project.

Those who issue reverse auction tenders warn bidders to know their walk-away price before they start the auction. But, with so much slippage in a construction quote, and a contractor's innate competitiveness and optimism, many find it difficult to adhere to that warning. There is a tendency to start rationalizing that "maybe everything will go right" or "maybe I can renegotiate a better price with my suppliers" or "I can probably survive if I take a point off my profit." And these are just the honourable justifications. It's disconcerting to think about some of the areas an unscrupulous contractor might consider.

Almost everyone agrees that we should look at taking advantage of the new communication tools that are available to us. There is really no need to have people racing around and taking chances on the roads to meet a deadline when the information can be sent down communication lines at the speed of light. Some of the rules, though, may need tweaking. In fact, the Canadian Construction Document Committee (CCDC) is hoping to release a revised CCDC 23 – *A Guide to Calling Bids and Awarding Construction Contracts* this summer. The discussion draft, released in January 2003, included a section on electronic receipt of bids. But, when you're dealing with a system that is intrinsically sound, you don't have to overhaul it completely to improve it.

As a contractor, of course, it's your prerogative to participate in a reverse auction. If you are confronted with one and are wondering what alternative you have to participation, most contractor associations are aware of this practice and will be able to advise you of your options.

Securing work is one of the most important things an electrical contractor does. It's also one of the riskiest. There's really no reason to increase the risk involved in responding to a tender. EB

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