



How Should Smaller Companies Use Competitive Bidding?

By Sime Curkovic

Typically, buying organizations in large companies will use several rounds of the competitive bidding process to pick a low cost supplier. Buying organizations will send out RFQs to get bids from suppliers. Unfortunately, several iterations of the competitive bidding process can be very resource intensive, especially for smaller companies. Larger companies have been able to somewhat reduce their costs by using expensive information-based technology (e.g., electronic reverse auctioning), but this approach is out of reach for small companies.

The data seems to indicate that going through several iterations of the competitive bidding process does not get the lowest price. Why? Suppliers pad their quotes from beginning to end because they know the game. Data indicates that the most effective way to get the lowest bid is to tell suppliers that they will only have once chance to bid/quote on the business. If they really believe that, then they will deliver their best quote the first time around, because it is the *only* time. However, very few companies actually make bidding a one shot deal. Most companies are too greedy and are not convinced that the one-time-only cycle works.

Another problem with competitive bidding is that you are just trying to get suppliers to low ball each other, and that means you are just hacking away at their profit margins. If you have a current supplier that charges \$1.00 per part, and it costs them \$.90 to make it, they have about a 10% margin. If you have them re-bid and re-bid and re-bid on the business, and they finally agree to \$.93 per part, you are indeed paying less per part, but you have reduced their margin down to nothing. Smaller companies with larger industrial customers have often been victimized by such approaches. So, why would a smaller company use the same strong arm tactics on its own suppliers?

In a perfect world, buying organizations would sit down with suppliers and help them reduce their direct costs (i.e. labor and material). Most of a supplier's costs are probably already coming from direct labor and material, which means there are probably some significant cost savings to be had. What if you could help a supplier cut direct costs by 30% and then told them they could still keep the 10% margin? That supplier would say "Thank you," because their margins would not change. They would just be more cost competitive, and probably end up getting more business because of it. Meanwhile, you would now be paying around \$.70 per part.

There is nothing stopping a smaller supplier from asking its larger customer for assistance in reducing its direct costs. A larger customer probably has the resources and skill sets to offer just this type of assistance. Asking for assistance demonstrates the type of cost improvement intentions that customers often seek in suppliers.

Smaller companies should take a strategic approach to their sourcing decisions, even for commodities. That often requires a careful analysis of how their customers manage them. Perhaps it may also involve deciding to not use the same tactics with their own suppliers. Smaller companies can look to the overly aggressive tactics of their customers to better manage their own supply chains. Perhaps their customer will end up asking them for help.