

The Role of Reverse Auctions in Strategic Sourcing

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Case Studies

GlaxoSmithKline

Company Background

GlaxoSmithKline (GSK) (www.gsk.com) is a leading global pharmaceutical company with a strong mix of skills and resources that provides a platform for delivering exceptional growth in today's rapidly changing healthcare environment.

GSK's mission is to improve the quality of human life by enabling people to be more active, feel better, and live longer.

Headquartered in the United Kingdom, the company is the result of mergers of GlaxoWellcome and SmithKline Beecham. GSK has an estimated 7 percent share of the world's pharmaceutical market, and its products focus on four major therapeutic areas:

- anti-infectives
- central nervous system
- respiratory
- gastro-intestinal/metabolics

In addition, GSK is a leader in vaccines and has growing portfolios of oncology products, non-prescription drugs, oral care products, and nutritional drinks.

In 2001, GSK had sales of almost \$30 billion from 140 countries and profits (before taxes) of almost \$9 billion. Pharmaceutical sales accounted for \$25 billion, with 22 percent of these sales coming from new products. Annual external spend is about \$10 billion, with \$7 billion for indirect goods and services and \$3 billion for direct production goods. Currently, GSK has an aggressive goal of taking \$1.5 billion (15 percent) out of its annual spend. It expects a good proportion of these savings to come from the estimated \$1 billion of its spend it plans

to run through e-RAs in 2003.

Management's Expectations of E-RAs

GSK began experimenting with e-RAs in 1999. During this experimentation, the firm's top management as well as their procurement professionals, were pessimistic about the value of e-RAs. However, by 2002, both groups had a dramatic about-face, and strongly believe in the value of the use of e-RAs in conjunction with e-RFX tools. (See Figure 5.)

How GSK Defines E-RAs

GSK has a formal strategic sourcing process to select the appropriate sourcing strategy or tactic for various commodity families. However, they believe that the use of e-RAs is a major and integral strategic tool for their "Sourcing Group Management Process." (See Figure 6.)

GSK's E-Sourcing Tools

GSK is particularly proud of its e-sourcing platform (GalaXy™) which combines decision support tools with state-of-the-art RFx capabilities. (See Figure 7.) They have created an e-sourcing portal (GalaXy™) that houses the "Trak™" systems and e-RFX software (Emptoris ePASS™). Included in this online systems portfolio are:

- SpendTrak™ (122 data feeds from 59 countries) for spend data management
- ConTrak™ for contract development and management
- SourceTrak™ for maintaining supply base information and management of sourcing strategies
- SaveTrak™ for validation, management, and reporting of all savings projects
- ChangeTrak™ which analyzes the impact of material changes in the direct material area
- PlanTrak™ for determining annual material standards
- CapExTrak™ which aids in the management of

Figure 5
GSK Management's Changing Expectations of E-RAs



capital projects

This suite of decision support tools is complemented by Emptoris ePASS™ RFx functionality that supports e-RAs, requests for information, sealed bids, and sourcing optimization.

How Does GSK Decide to Use an e-RA and What is “Auctionable”?

GlaxoSmithKline uses the classical 2 x 2 risk-versus-spend value matrix to determine the appropriate sourcing strategies and tactics for each commodity family. (See Figure 8.) GSK has three main requirements for a category to be “auctionable”:

- Does the category lend itself to negotiation?
- Are there three or more suppliers who are willing to participate?
- Can specifications and customer requirements be clearly documented prior to event?

Table 3 shows the broad array of “auctionable items” that GSK has sourced through e-RAs.

GSK's Use and Results of E-RAs

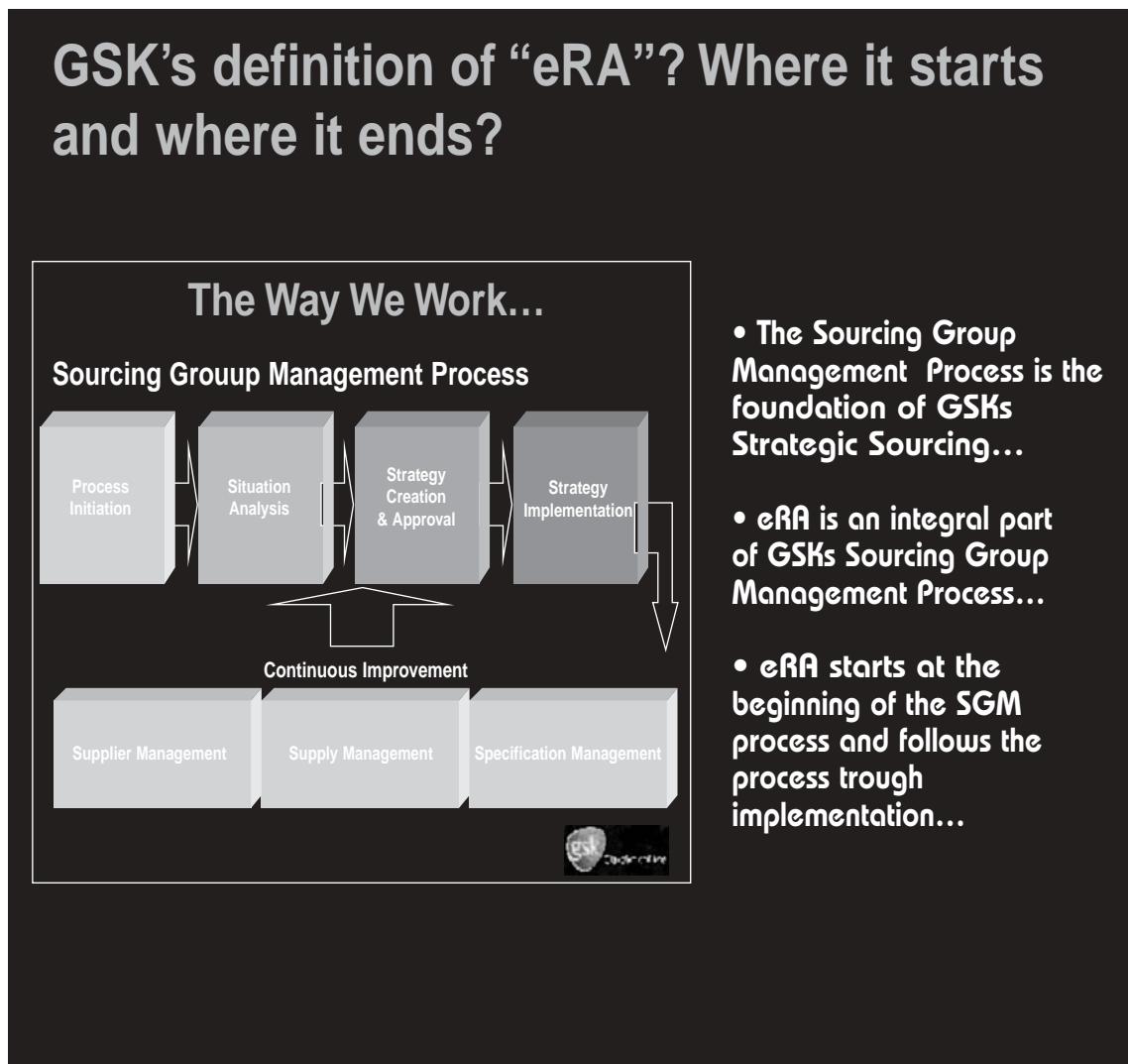
- GSK has held about 190 e-RA events between 1999 and 2002, accounting for \$912 million in spend.
 - There were events were held in 2001 (28 with a

third-party service provider; 17, self-service).

- There were 90 events held in 2002 YTD (20 with service provider; 70 self-service). (Clearly, they are shifting from a full-service to a self-service delivery of e-RA events.)
- GSK has used FreeMarkets as its service provider.
- Savings realized over historical prices to date is \$165 million (18 percent).
- The vast majority of e-RA events are based on price only, however GSK is beginning to experiment with multi-variable bidding so decisions can be based on TCO. In general, bidders only see the ranking of their price during an event.
- Reported cycle-time savings:
 - Overall savings from RFx-to-contract award largely is unchanged.
 - However, “negotiation” cycle-time, on average, has been cut in half.
- GSK plans to use e-RAs about \$1 billion of spend in 2003, and has a goal of running 80 percent of its annual spend through a combination of e-RA and e-RFx sourcing tools.

GSK's General Rules for E-RA Events

Figure 6
GSK's Definition of E-RAs



Bidders:

- Bids are legally valid quotations without qualification. No bids can be withdrawn except for data entry errors.
- Bids are only accepted for complete lots. No partial bids permitted.
- Bids can only be submitted through the online bidding mechanism supplied by service provider. No bids may be submitted via any other mechanism, including but not limited to e-mail, fax, verbal, post, or courier, unless specifically requested by GSK or service provider.
- Participant difficulties must be communicated to service provider immediately. Difficulties include any event or problem that interferes with the bidder's ability to participate in the e-RA and may include,

but are not limited to, data entry errors, software problems, or hardware problems. Participants have five minutes after a lot goes into pending status to notify service provider of any problems. If the service provider judges that any participant has been disadvantaged by a problem, the service provider will correct the problem and may return the lot to open status.

- Bidder is party to Participant Agreement which protects the confidential information of GSK and service provider.

GSK:

- GSK will approve each bidder invited to participate in the e-RA event.
- GSK intends to award business only to participating

Figure 7
GSK's E-Sourcing Tools

eRA as a critical GSK Procurement Strategy ...

eRFX (eRA / eSourcing) has become the predominant strategy for GSK Procurement:

- The GalaXY platform for eRFX provides the technology solution to drive 80% of GSK spend through eSourcing by 2004
- GSK Procurement is reorganizing to leverage technology

Value Proposition = Faster Process + Greater Savings
+ Fewer People

Figure 8
GSK Sourcing Tool Matrix

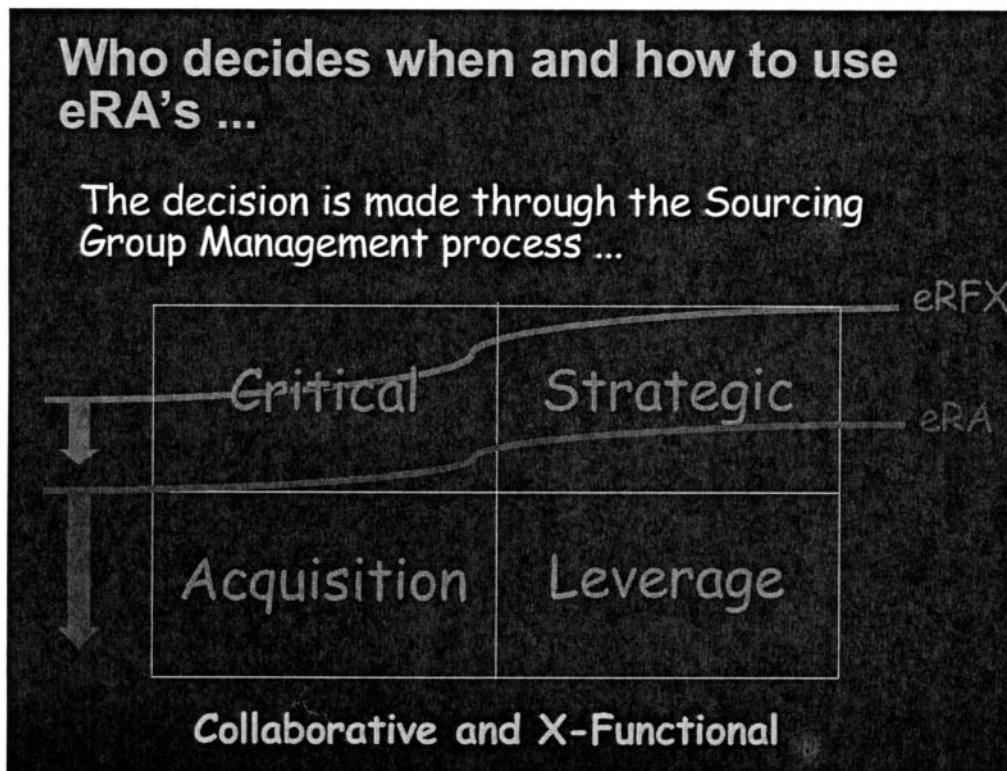


Table 3
Items GSK Sources Via E-RAs

Aluminium Tubes
Caffeine
Capsules
Chromatography Consumables
Citric Acid
Corn Derivatives (Sweeteners)
Corrugated Packaging
Desktops/Laptops
Document Management
Electricity
Elevators
Fire Prevention Systems
Firewalls
Glass Bottles
Global Car Hire
Hotel Room Nights
Iodine
Kraft Paper
Labels
Lucozade Coolers
Malted Barley/Extracts
MRO
Office Furniture
Paracetamol
PC Periphe-RAl (Consortium)
Plastic Bottles
Professional Engineering Services
Promotional Items
Promotional Print
PVC Films
R&D Raw Materials
Road Freight (Primary Trucking)
Solvent - Phenol III
Structural Steel
Sucrose (Sugar)
Supply and Storage Bulk Nitrogen
Telemarketing
Teleservices
Toothpaste Outsourcing
UM R&D Cabling
Vending Machines
Vitamin C & Premix

bidders and to neither negotiate with nor award to non-participants.

- GSK may consider multiple criteria in addition to price to determine the final award.
- GSK may set a bona fide reserve price for each lot, representing the price at which GSK is willing to consider, in good faith, a price quote.
- GSK will refrain from additional price negotiations outside of the e-RA, except to clarify final logistical

details as are typically reserved until after the bidding.

- All parties will prohibit unethical behavior and are expected to notify the service provider if they witness practices that are counter productive to the fair operation of the e-RA.

Contained in the RFQ:

- RFQ questions and updates: additional information, including responses to individual supplier questions, is shared with all participating suppliers via e-mail.
- Lot structures will have clear instructions of requirements.
- Conduct of the parties: GSK will fairly and objectively analyze all bids received against the requirements contained in the RFQ.
- Bidders are to conduct themselves in an open, honest, and ethical manner during the bid process. Any bidder who seeks favor from any GSK employee or agent during the bid process will be disqualified from proceeding.
- Award decisions: GSK strongly encourages all suppliers to bid competitively across all lots to be considered favorably for an award. All prices and pricing structures, as negotiated through the online e-RA process, will become effective immediately following the final award decision. However, GSK will not necessarily award to the lowest bidder(s).

Conclusion

The attitude towards GSK's use of e-RAs is best summarized by comments from people that have been intimately involved in their use, as follows.

- Director of GSK's e-Sourcing: "This [use of e-RAs] is an incredible experience ... while there's risk associated with being an early adopter, the opportunities and rewards of pioneering this space are fantastic!"
- Director of GSK's Global Systems and Processes: "We're going to put over \$2 billion of spend through our e-sourcing program in 2003 with a target of \$1 billion being reverse auctions. This is a tremendously successful program. We are leveraging supply and demand real time, online. This is good for GSK and even better for the supply base. Only the best suppliers can compete long term in this environment. It promotes high quality, low cost, lean processes and innovation ... all the traits we're looking for in supplier relationships."
- Vice President, Procurement Finance: "At the end of the day it's about having made significant contribution to the bottom line. The accountability that this procurement team has achieved within the business is outstanding ... not only are there rigorous processes in place to validate the major savings achieved, but the focus on supply, quality, and service remains consistently high."