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GUIDANCE NOTE on the use of E-PROCUREMENT, INCLUDING REVERSE BID AUCTIONS, for HVACR PRODUCTS IN THE CONSTRUCTION INDUSTRY

Introduction

The HEVAC Association actively supports e-commerce activities. Within this context e-procurement, which is progressively being used more frequently by customers and member companies alike, can be viewed as a valuable tool within an organisation's purchasing strategy.

On-line procurement, from a technology viewpoint, is broadly about automating parts of the process. Where implemented correctly, on-line procurement can support the process and benefit the customer and the business.

This Guidance Note on the use of e-procurement for the purchase of HVACR equipment and services provides an explanation of aspects of:

- E-Procurement and recommendations on its use and limitations
- Product manufacturers views on Best Practice
- Reverse Bid Auction issues

The Guidance Note is divided into three sections **A**, **B** and **C**:

Section A addresses **E-Procurement**

Section B gives recommendations on **Best Practice**

Section C addresses the HVACR product or services suppliers issues with on-line **Reverse Bid Auctions**

SECTION A

E-PROCUREMENT

E-Procurement (or e-tendering) is similar in concept to traditional paper tendering but is done on-line. As in sealed bid tendering it can have a fixed closing date and can be described as **on-line closed bid tendering**.

Process Summary

- Client invites suppliers to pre-qualify for inclusion on selected list for on-line tendering
- Client up-loads enquiry documents to a secure server
- Automatic e-mail advice to selected suppliers
- Suppliers view enquiry on-line and bid by up-loading their tender submission anytime before the closing date. (A supplier's tender remains confidential and can only be seen by the client on the closing date)
- Amendments, queries and feedback are available on-line to all parties
- Tender evaluation is made on-line
- The client appoints the successful bidder and provides feedback to the unsuccessful suppliers

Supplier selection is based on quality, performance, capability and price.

The Perceived Benefits of On-Line Trading

- Improved speed of communication
- Simultaneous Issue of all Information
- Reduction in transaction costs
- Audit Trail for Documentation
- Secure Bidding Environment
- Increase in Personnel Productivity
- Standardisation of Processes
- Monitoring and Evaluation
- Supply Chain Integration

SECTION B

RECOMMENDATIONS ON BEST PRACTICE

The scope of this section covers complex equipment and services that are driven by client specifications and thus have an element of bespoke added value. It is recognised that products or services that can be clearly defined by pre-established specifications or standards may be suitable for e-procurement purely on a price basis.

The objective of the e-procurement process must be to obtain best value and not purely lowest cost, therefore the criteria laid out below should be considered in order to develop proper value for money principles.

1 Route to Procurement

Indication should be given at the time of the initial approach to potential suppliers whether the ultimate procurement process will be conducted on-line.

2 Pre Qualification Criteria

To determine which suppliers can be involved in the on-line procurement process, pre-qualification criteria should be set to establish if a supplier is suitable. Examples of such criteria may be:

- Financial Stability
- Availability of In-House Expertise
- Established in Industry
- Historical Performance
- Other

3 Training

Companies that meet the pre-qualification criteria should be 'trained' on the methodology to be used for the e-procurement process.

4 Tendering Companies

It is considered important that there is transparency and openness in the on-line process, therefore the names and number of companies competing in the tendering process should be disclosed to the bidders.

5 Value Criteria

There is a series of value criteria that will affect the overall procurement decision. To establish a level playing field for all tenderers, weightings should be applied to criteria in order of their importance to the procurement decision. The bidders should be made aware of the weighting factors.

Examples of such criteria may be:

- Ability to meet specification
- After Sales Support
- Life cycle costing
- Environmental considerations

6 On-Line Procurement Duration

Tendering companies should be informed of the e-procurement start and finish dates.

7 Feedback During the Tendering Process

Feedback should be provided to the tendering companies throughout the bidding process and should include an individual company's relative position in the bidding process.

8 Review of Tenders

The client should review all bids during and at the end of the tendering process and consideration given to the best value being offered by each tenderer, the criteria for which will have been determined in item 5 above, '**Value Criteria**'.

On the award of the contract both the winning and losing bidders should be informed of the reason why they were or were not successful in obtaining the contract.

SECTION C **ON-LINE REVERSE BID AUCTIONS**

With on-line reverse bid auctions, as the description indicates, the procurement process is based upon a reducing price auction. It can be generally similar to e-tendering up to the price submission request.

Process Summary

- Selected suppliers receive a limited time to submit a price. The time allocated can be hourly or less
- Prior to the price request a specification, scope, terms and conditions etc need to be established to assure an equal basis for all bidders
- The on-line site is opened at the designated time, a starting price is normally provided by the client and the reverse bid auction commences. All suppliers are on-line but anonymous throughout the bidding period. They are aware of the reducing prices and their ranking eg 1st, 2nd, 3rd, etc
- The auction closes when the lowest bid has been established within the set time frame
- After closure of the on-line site a successful bidder is appointed. This is normally the supplier in pole position on closure

Supplier is normally selected on price.

The **Appendix** gives a more detailed description of the Reverse Bid Auction process.

Potential Drawbacks with Reverse Bid Auctions

The HEVAC Association recognises that products or services that can be clearly defined by pre-established specifications or standards may be suitable for reverse bid auctions on purely a price basis, however, member companies who have dealt with such auctions, and also sister trade organisations, have expressed concerns with respect to the use of reverse bid auctions for the procurement of construction products and services as the process, and its outcome, does not necessarily reflect best value for the customer. Proper value for money principles need to be applied that address such issues as full compliance to specification, quality, safety and life cycle costs.

As the current operation of on-line reverse bid auctions is a radical departure from existing procurement practices and is, therefore, open to risks and pitfalls, the following are often cited:

- Reverse bidding auctions do not respect the prevailing industry practices for procurement in this industry, such as the 'Re-Thinking Construction' initiative.
- Clients, suppliers and design professionals are familiar with traditional tendering processes and understand their obligations and responsibilities. Contracts awarded under the reverse bid auction process may create a greater likelihood of errors, disputes, bad faith and an increased risk of claims.
- There is a risk of 'cut-throat' pricing by the bidders where corners may be cut and quality compromised.
- On-line reverse bidding auctions may be governed by the laws of the location of the client's service provider which may be remote from either the client or supplier's location.
- Extensions to the auctions finishing time and date may be interpreted as a form of pre-closing negotiation or 'bid shopping' which should be discouraged as it compromises the spirit of a fair and open competitive process.
- No mechanism for suggesting or evaluating innovative alternatives.

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APPENDIX

How On-Line Reverse Bid Auctions Usually Work

- Pre-qualified bidders are invited by the client to participate in the auction. Specifications et al and instructions on how to participate in the auction are provided in advance of the event.
- The on-line auction is scheduled and usually conducted on behalf of the client by service provider. The auction has a specified opening and closing time (often one hour).
- All bidder identities are kept confidential during the auction event.
- The client usually enters a starting price as a guide for the bidders.
- Initial prices are then submitted by each bidder and these prices are ranked with the lowest bid given the highest ranking. Each bidder receives feedback of their own ranking relative to the others.
- Bidders can submit as many new lower prices as they wish up to the closing time of the auction and rankings are revised accordingly.
- A time extension to the auction may be triggered by the client via his service provider if one of the top ranked bids changes.
- The auction closes when no new bids are received and the closing time or extended time period has expired.
- All bidders are notified of their final rankings based upon price with only the final price of the winning bid disclosed.
- The service provider notifies the client of the bidding results and the client initiates the follow-up and award of the contract to the winning bidder.

Variations of this process do exist based upon the client's policy on conducting the reverse bid auction.