Abstract

Buyers are increasingly turning to online applications in their negotiations with suppliers. This means that more and more suppliers are facing the demands to negotiate and trade via e-markets, auctions and e-procurement systems etc. Special types of e-markets are working as transactional forums, increasing competition and resulting in an intense focus on price, whereas other types of e-markets support collaborative long-term relationships.

From a marketer’s perspective the two different outcomes of e-market participation demands special strategies and approaches. This paper describes and analyses the impact of buyers using reverse auctions in their negotiation with suppliers and outlines four potential, strategic possibilities as answers to the competitive landscape created by reverse auction participation.

The paper covers the rationale for, and theories of, transactional and relational marketing followed by a company case, finally we discuss potential solutions.

Keywords: online reverse auction, buyer-supplier relationships

INTRODUCTION

The truly revolutionary impact of the Internet Revolution is just beginning to be felt (Drucker 2002) and e-commerce and e-markets are starting to be incorporated into every-day business. E-markets can be defined as a digital infrastructure that supports industrial commerce, examples of e-market applications are auctions, catalogues, exchanges etc. The potential of e-commerce and e-markets cannot be questioned and as much as 50% of total online business is expected to be conducted via e-markets by the end of 2005 (Zank and Vokurka 2003).

With these new applications, buyer-supplier relationships are increasingly being digitalized with new possibilities and threats as a result. As we show later, the Internet, by means of various portals and e-markets, brings buyers and sellers closer together and thereby improves communication and coordination between the two, potentially promoting closer long-term relations. At the same time, e-markets and especially auctions promote the competitive aspect of trading, potentially leading to more transactional one-off deals. Thus, it seems that Internet applications may lead to very different results with different implications for buyers and sellers.

The aim of this paper is to understand how e-markets and especially auctions can and will influence ongoing relationships between buyers and suppliers. This interest arises partly from theoretical observations (Emiliani 2000; Emiliani and Stec 2002; Jap 2003; Tully 2000) and partly as a result of intensive interaction with the business world through which we have observed how these applications change the rules of interacting in traditional industries – a change that potentially defines new winners and losers. Examples of how the Internet has empowered the buyer and resulted in new rules and the restructuring of traditional industries are many. The turmoil in the airline industry is an illustrative example. On the changes in this industry, an analyst from SalomonSmithBarney writes (in the report ‘The Internet – Dilution or Revolution’ (1999)):

By freeing customers to shop around for the lowest fares [instead of relying on travel agents, who have things like override commissions in mind], overall industry revenue may be getting diluted. This phenomenon would obviously work in favour of the low-fare airlines as opposed to the larger hub-and-spoke-carriers.
In this paper, we have chosen to focus on e-markets and specifically on the ‘reverse’ auction application, where sellers bid instead of buyers, and prices go down instead of up. These auctions are standard on many e-markets and highly profiled companies like GM, GE, Hilton, AMD, Ford, Carrier Aircon (Emiliani 2000; Freemarkets.com 2004; Scanmarket.com 2004; Tully 2000) and many more are using them. Buyers use these reverse auctions, because they feel they are efficient and they offer a short-cut to price savings. This includes using reverse auctions as a way to ascertain a market price and eliminating outliers. Although not the focus of this paper, a quick look in the newspapers and academic articles indicates that buyers obtain savings in the range of 5–40% by using reverse auctions compared to the initially quoted price on the auctions (Smart and Harrison 2003; Tully 2000). We take note of these possible savings, but focus on how this application influences the relationship between sellers and buyers, in particular how the suppliers respond to the use of reverse auctions. More and more research (Emiliani 2000; Emiliani and Stec 2002; Jap 2003) shows that sellers regard auctions as creating frictions in or directly damaging their long-term relationships with business partners, which they have struggled for years to build. In this relation Emiliani and Stec (2001) note: ‘Online reverse auctions lead to a breakdown of cooperation between the buyer and sellers, as the buyer seeks to satisfy its own selfish desires.’ In spite of this, research by Jap (2003), indicates that suppliers, to pursue their interests, respond to these auctions by being even more willing to make dedicated investments into strengthening the relationship. In other words, suppliers respond to the buyers’ wish for more transactional marketing by offering more relationship marketing.

In this context, the aim of this paper is to discuss; what happens to buyer-supplier relationships when reverse auctions are used and how the supplying companies adapt to these new market conditions. The context and the data collection method are described in the next section, followed by a discussion of transaction and relationship marketing and how e-commerce influences the buyer–seller interaction. Next, the findings from a case study are presented and possible solutions to the dilemma observed are discussed.

**CASE COMPANY AND DATA COLLECTION**

The case – A transnational Danish company

The research for this paper was conducted in a transnational Danish company. The company’s experience with auctions dates back to 1998, when an important buyer adopted this new transaction application and invited the case company to participate. Since then, the company has participated in several auctions and this paper draws upon these experiences to discuss the issues presented above.

The company consists of three relatively autonomous divisions with a total of 15 business areas. The company is the market leader within many of the markets where it operates. It produces components for technical equipment and systems to control dynamic processes. The company has sales subsidiaries in over 50 counties and production sites worldwide.

Although all divisions were studied, this paper primarily presents the findings from one specific division with seven business areas, selected because this division has had the most extensive experiences with reverse auctions. The research was conducted from April to November 2003. During this period, online auctions and electronic bidding were starting to become known tools used in the transactions between buyers and sellers. The process of reverse auctions experienced by the company is very similar to the typical reverse auction process (Kumar and Feldman 1998; Sashi and O’Leary 2001). A more detailed case description appears later in the paper.

**Research strategy and data collection**

In the absence of prior theorizing about a topic, Eisenhardt (1989) finds that an explorative research design, taking its point of departure in the empirical reality, makes an appropriate place from which to start generating new theory. In order to gain a deeper understanding of how the use of auctions influences business relationships and to capture the complexity of this situation, the research included several cases of reverse auctions and intense interaction with the staff in the case company. The cases belong to the same division of the company.

The process of data collection was organized around a number of in-depth case studies. For a couple of months, our office moved to the company headquarters in order to meet, observe and interact with the involved individuals within their natural context. The study was conducted in two stages. First we started by reviewing historical data, i.e. reports, records from participation in different types of e-marketplaces and auctions, general company materials to understand the company, its products and to gain a first-hand overview of the experience the division had with different e-marketplace applications. This stage also included a review of theoretical frameworks in order to generate relevant and interesting questions in relation to the reality we were trying to understand (Grönross 1994; Jap 2003; Kumar and Feldman 1998; Porter 1985; Sashi and O’Leary 2001; Williamson 1975). The outcome of stage one was a first set of ‘themes’ to be discussed in stage two – with the employees who had been involved in the auctions. Examples of themes are; customer types and
relations, industry structure and competitive situation and e-marketplace and auction experiences.

It is important to stress the fact that the list of themes only served as an overall agenda for discussion and as a tool to ensure an ongoing dialogue. It was important to make the discussions as open as possible around the identified themes as well as around themes and issues that were not on the list. The new issues emphasized by the respondents were added to the list before it was sent to the next respondent. Thus, we constantly removed and added new issues to the list. Examples of new issues are; the value of knowledge, digital relationships versus offline relationships and auctions and their implications on global pricing structures. The fact that themes were constantly added and removed from our list underlines our explorative approach to knowledge creation with its constant focus on new insights that may lead the research in new and unexpected directions (Layder 1993).

The data collection included numerous meetings, dialogues, informal talks and lunch conversations. The fact that we were able to stay in the actual environment to be studied gave us a solid understanding of the company and its operations and it served as an important reference point before, during and after the dialogues. A total of 15 interviews/dialogues were conducted with employees, who were involved, in various degrees, in the reverse auctions and they all possessed the decision authority within their specific fields. Table 1 lists the different employees that were interviewed.

At first, our attention was directed towards the Sales Managers of the seven business areas in the division’s units in Denmark, Germany, France and the US. After this first round of dialogues, we directed our attention to, for example, Marketing Managers, Business Development Managers and IT Managers who are typically used as consultants or facilitators who are able to answer questions of a more technical nature.

Data analysis

In inductive explorative studies, data analysis is often hard to distinguish from data collection since theory building is grounded in the data as an iterative process in which the emergent frame is systematically compared with evidence from each case (Eisenhardt 1989). In this way, the analysis ran parallel to the data collection and from business area to business area. As the study progressed we moved from theory to data and vice versa and through this process, our understanding gradually emerged, building the foundation for modelling the process.

For both within-case and across-case analysis, we used standard documentation techniques (Eisenhardt 1989; Glaser and Strauss 1967; Yin 2003) based on notes and taped dialogues, we acquired within-case analysis evidence. First, the dialogues were transcribed. Hereafter, the transcribed document was rearranged in accordance with the list of themes, which had evolved during each dialogue. This phase also served as our coding phase. If a new phenomenon was discussed, it was given a new code and added to the list to be included in the next dialogue. In this way, the analysis of the initial data influenced the design of the subsequent list of themes that was used for further data collection (Bryman and Bell 2003). This cumulative process ended when we had completed the dialogues with the relevant employees. This included further discussions, with some, for further elaboration of certain points of view. The constant movement between the process of interpretation and the empirical world (the organized dialogues and daily interaction in the company) validated our findings as we got feedback from the empirical context during the interpretation and analysis of the data.

FROM TRANSACTION TO RELATIONSHIP MARKETING

Marketing grew out of economics as a distinct discipline around the beginning of the twentieth century. As the discipline developed and gained momentum through the first three quarters of the century, the primary focus was on transactions and exchanges (Sheth and Parvatiyar 1995). However, since the early 1990s, a reconceptualization within marketing from transactions to relations can be observed (Grönross 1994; Heide 1994; Webster 1992). Grönross (1994) advocates that the change in thinking is a shift in paradigm. The shift that Grönross (1994) refers to is the emergence of Relationship Marketing and later on the Customer Relationship Marketing (CRM) tradition. Grönross (1994) believes that this new understanding will emerge as the dominant marketing tradition and thus replace the conventional Four Ps (McCarthy 1960) and the Marketing Mix.

The transaction-oriented literature focuses on the transaction and the basic idea that in the real world there is always some friction between buyer and seller (Hollensen 2001). This friction manifests itself in, for example, opportunistic behaviour and bounded rationality (Williamson 1975). The friction is regarded as a significant obstacle to the efficient functioning of the
market. The drivers of transaction marketing are seen as autonomous actors, who, through competition, pursue their self-interest. Through competition, buyers are offered a choice, and this choice motivates suppliers as marketers to create higher value offerings. The independence and ‘arm’s length relationship’ are considered vital for marketing efficiency as independence offers industrial actors freedom to choose the best partner and to preserve their self-interest at each decision point. This results in the lowest cost purchase through bargaining and bidding (Sheth and Parvatiyar 1995).

This transaction formula has gradually been contested by approaches focusing on the relationship between suppliers and customers. Although closely related, various versions of modelling the relations have emerged within the relationship-marketing tradition. The American version of Relationship Marketing is very pragmatic and concerned with how the marketer can use relations in a profitable manner. The calculation of a product’s profitability over its life cycle is complemented with calculations of a customer’s value over the customer life cycle. Key account managers are the implementers of this new strategy towards customers. Customer Relations Management (CRM) followed ‘the tool’ to collect data on and monitor customers through integrated ICT-systems. The European version of relationship theory had its starting point in the service sector and among scholars of marketing and purchasing. They focused more on the very relations and developed the network approach to the understanding of industrial markets (Hakansson 1982).

Both approaches, however, have a number of common tenets, including the importance of trust and long-term commitment. The two approaches also agree that mutual cooperation leads to the best environment for value creation. Relationship marketers explain that interdependencies reduce transaction costs and generate higher quality while keeping governance costs lower than exchange marketing (Morgan and Hunt 1994).

Thus, the situation today is that we basically have two streams of thought, the conventional transaction marketing and the relationship marketing traditions. Figure 1 illustrates the basic differences in the two streams. To highlight the differences in the two streams, we have compared the rationale of the two regarding the central dimensions in the theories in Table 2. These two streams of research are also reflected in the literature of digitalization and e-business. Allen and Fjermestad (2001), for example, have shown how to apply the Four Ps framework to e-commerce. Similarly, Romano and Fjermestad (2003) and Scullin et al. (2004) have related e-commerce to CRM.

Figure 1 and Table 2 represent the two extremes of how interactions between buyers and sellers can be

![Figure 1. Main differences between relationship- and transactional marketing. Source: Sheth and Parvatiyar (1995)](image)

### Table 2. A comparison of relationship- and transaction marketing

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Transaction marketing</th>
<th>Relationship marketing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall goal</td>
<td>Increase profit</td>
<td>Increase profit</td>
</tr>
<tr>
<td>Business perspective</td>
<td>Win–lose</td>
<td>Win–win</td>
</tr>
<tr>
<td>Duration</td>
<td>Short term</td>
<td>Long term</td>
</tr>
<tr>
<td>Organizational borders</td>
<td>Clear</td>
<td>Fuzzy</td>
</tr>
<tr>
<td>Closeness</td>
<td>Distance</td>
<td>Close ties</td>
</tr>
<tr>
<td>Business definition</td>
<td>Products and factories</td>
<td>Customer relationships</td>
</tr>
<tr>
<td>Market value</td>
<td>Product and prices</td>
<td>Present and future problem-solving capability</td>
</tr>
<tr>
<td>Purpose of marketing</td>
<td>To create sales</td>
<td>Selling is beginning of relationship</td>
</tr>
<tr>
<td>Objective</td>
<td>To make the next selling transaction; find the next customer</td>
<td>To satisfy the customer you have by delivering superior value</td>
</tr>
<tr>
<td>Price setting</td>
<td>Determined by competitive market forces; price is an input</td>
<td>Determined by negotiation and joint decision making; price is an output</td>
</tr>
</tbody>
</table>

organized. In practice, most arrangements fall between these two extremes. For example, Webster (1992) regards the market as a place where different types of exchange actions are made, and in this regard, he also operates with two extremes in the form of pure transactional exchange and pure collaborative exchange. Moving from one end to the other, the market is divided into different types of alliances with the strengths and content of the relationship deciding the exact type of exchange action.

The Internet and the battle between relationship and transaction marketing

When the Internet was introduced, in the mid-1990s, some, and notably the economists, were cheering as their dream – the perfect competitive market seemed to come true. The Internet would create transparency in the market and in many cases make middlemen redundant (Gilder 1994). Buyers and suppliers would be better informed and thus able to act more rationally. The price would be the most important competitive tool and because of lower coordination costs between market actors, it would be cheaper to buy than make, which would turn the market into the most efficient coordination mechanism. Several academics, including Malone et al. (1987) and Gurbaxani and Whang (1991) have discussed these arguments with special attention to e-markets. The Internet was believed to create ‘the new economy’, based on a new set of economic and business formulas. It was expected that economies would become more competitive and efficient. However, the bursting of the so-called Internet bubble put an end to the dream, but not to the Internet, which may not create a revolution, but which will influence market relations in an evolutionary way (Colman et al. 2001).

The relationship-oriented marketing researchers were also cheering. The Internet provided them with a tool that could improve interactions in terms of frequency and speed; it enabled them to reach partners across a wide geographical space and, perhaps most importantly, allow partners to work on common projects and access common databases and other resources. The Internet makes it possible to integrate companies administratively even if they are separated by ownership. Applications for the widely known Customer Relationship Marketing (CRM) software systems called e-CRM were invented (Romano and Fjermestad 2003; Scullin et al. 2004). These e-CRM systems are believed to increase customer loyalty (Taylor and Hunter 2002) and thereby promote commitment and brand loyalty.

Although both marketing streams relate to the Internet, they use it very differently and with different outcomes as a result (Shaw 2000; Zwass 2003). The transaction-marketing stream sees the Internet as a way to increase efficiency in transactions, bring down coordination cost and create a transparent market. The relationship-marketing stream sees the Internet as a way to enhance cooperation and collaboration with the customer and as providing more intensive interaction between producers and their customers or suppliers.

What seems to take place in practice is that the Internet revitalizes the basic conflict between a buyer and a seller: The seller wants to sell at the highest price and will try to make the customer loyal through additional services and the buyer wants to buy at the lowest price while at the same time requesting services. While the transaction marketing literature always has acknowledged this basic conflict of winning or losing, the relationship marketing literature aims at building mutual interests and win-win situations. The customer would benefit from not only the product but also the general competence of the seller to improve the competitiveness of the customer. In turn, the buyer would become loyal and willing to pay a premium price, reflecting the access to and value of this additional competence.

E-markets as a relational and transactional platform

E-marketplaces have been defined and discussed since the work of Malone et al. (1987). In the beginning, the e-market research was focused on EDI-networks (Electronic Data Interchange), but later, when the Internet was more widely used, the research addressed e-markets based on an Internet infrastructure. Over the past 10 years, the Internet has evolved from being a tool for the few to becoming a common tool for most types of businesses in the developed world. Especially since the late 1990s, the number of consumers and companies online has exploded.

Several different and overlapping explanations exist as to what an e-market is and how to describe and explain the phenomenon (Bakos 1991, 1997; Clemmons et al. 1993; Dai and Kauffman 2002; Daniel and Klimis 1999; Lennestrand et al. 2001; Malone et al. 1987; Strader and Shaw 1997; Wigand and Benjamin 1995). Strader and Shaw (1997: 187) provide a short and precise definition of an e-market: ‘An electronic marketplace (or electronic market system) is an inter-organizational information system, that allows the participating buyers and suppliers to exchange information about prices and product offerings. The firm operating the system … may be a market participant – a buyer or seller, an independent third-party, or a multiform consortium.’ The above definition only defines the e-marketplace as a medium to facilitate the exchange of information between organizations. However, it is important to note that the e-markets also offer facilities to support negotiation and conducting transactions between buyers and sellers.
E-markets should not be regarded as technological interactions supported by humans. They are human interactions supported by technology (Kambil and Heck 2002). This means that the e-market can promote competitive or collaborative aspects of trading, depending on both different types of applications (catalogue, auction, exchange etc.) and on how they are used by buyers or suppliers (Lennestrand et al. 2001). Mahadevan (2003) concludes that, according to the set-up, e-markets can be divided into three distinct categories: collaborative mechanisms, quasi-market mechanisms and pure market mechanisms and thus agrees that e-markets promote both relational and transactional parts of trading. The fact that different types of e-markets promote different elements of the relationship–transactional continuum is to some extent neglected in today’s research. One of the few attempts to define and discuss the two types of e-markets can be found in Christiaanse and Markus (2003), who state: ‘transaction-oriented marketplaces are characterised by catalogues, auctions or exchanges, and support for negotiated pricing, [while] collaboration marketplaces are characterised by planning capabilities such as continuous planning, forecasting and replenishment or product life-cycle management.’

This distinction is, in our view, beneficial, though not completely satisfactory. In reality, there are several examples of catalogues being used in a relationship-oriented manner. In other words, the catalogue can be used as both an application for easy and efficient location of the right product with no focus on price and as a mechanism to compare different product offerings from competing suppliers and thereby locating the right price. This implies that what defines a transactional or relational e-marketplace is the type of applications (auctions, catalogue, etc.), which the e-market provides as well as how the buyers are using these applications.

For this reason, we add the dimension of ‘buyer focus’ to the discussion, i.e. does the buyer focus on a reduction of process costs or product price (Peixe et al. 2004). A focus on reduction in process costs implies a more relational approach, as the buyer is not aiming at bringing down the costs associated with the actual product but focusing on the process of buying, including the exchange of goods, information and backup if unforeseen things happen. When the buyer is focused on bringing down the price of the product by using special e-market applications as a negotiation or comparison mechanism, we see this as a transactional orientation, because the buyer is focused on the single deal and thus not on the process or relation between buyer and supplier.

Having presented e-markets, the next step is to discuss the framework in relation to the case company we deal with in this paper.

THE RESEARCH SETTING

The case company is, as mentioned, a transnational Danish company. The company is the market leader within many of the company’s operational markets. It is organized into three divisions, producing components for technical equipment and systems, the aim being to control dynamic processes. Example products are temperature sensors, pressure transmitters and electronically operated valves.

The divisions – foundation and history

Products and markets. The division under investigation is the largest of the three with more than 50% of the turnover of the company. Organizationally the division is divided into several different business areas (BA), each having direct responsibility for marketing and sales.

The BAs serve customers worldwide and work as an independent sales organization. In addition, the division has a Key Account Management (KAM) group that collaborates with and handles large customers that often buy products across the different BAs.

The products produced and sold by the division are usually sold as components to Original Equipment Manufacturers (OEM), who integrate these components into sophisticated equipment that is used by a large number of different industries and consumers. Other customers include contractors and wholesalers. The division focuses on developing new products, additions and features to original product designs. Today, competition companies are increasingly able to produce products that can substitute the company’s products and, therefore, competition is ever increasing.

The division only operates on the B2B market selling components used in production at OEMs or as replacement sales to the aftermarket via wholesalers. Typically, frame agreements covering one or several years are signed and the products are supplied on a weekly or monthly basis. The products are not pure commodities, such as Maintenance, Repair and Operation (MRO) supplies. However, over the years, the company has experienced how the industry has evolved and how the perception of some of the products has changed from very complex and highly unique through a process of standardization to be regarded nearly as a commodity, where price is an increasingly important issue in the communication between buyer and supplier.

E-markets and online auctions

Having been a player in the industry from its inception, the case company has witnessed several changes in the purchasing habits and management orientations in the
industry. The first time the division was introduced to an online reverse auction was in 1998. The request came from a large buyer and the case company was taken by surprise, as it had never tried to trade nor negotiate this way before. Since 1998, the division has been invited to several auctions in the different business areas. It seems that the trend continues and that auction is a tool that will be used increasingly in the future.

Presently, the typical way to negotiate in the industry is still via conventional face-to-face negotiation. However, over the past years, negotiations have changed in nature to focus on price rather than technical features. This development, accompanied by the purchasers’ awareness of financial savings that have been made in the automobile industry through the purchasing process, confirms the trend towards Internet-based negotiation and thus reverse auctions. In total, the company has been invited to participate in 20 to 25 Internet-based auctions since 1998. In numbers, it does not seem much. However, it is the significant customers in the business, who are using the auctions and therefore the trend has a large impact on the business. Two vertical e-markets, OrigoTech, Sweden, and Asiamarket, Singapore, have also attempted to establish themselves in the industry. However, they both went out of business because neither buyers nor sellers wanted to participate and the e-markets could not reach a critical mass. OrigoTech closed in 2001 and Asiamarket in 2002. Thus, for the time being, the reverse auction is the most used e-market application in the industry.

The salespeople, who have been involved in the reverse auctions, tell stories with great wonder and surprise. Basically, it is a surprise to them that technical products, like those they sell, can be items for auctions and that the division is treated almost like a pure commodity supplier. Independent e-markets or auction houses typically host the reverse auctions. The customers that use these reverse auctions are buyers with a relatively high bargaining power due to the significant volumes that they trade through the reverse auctions. The reverse auction process is usually initiated by the buyers sending out invitations to the suppliers, asking them to participate in the auction. The buyers then send a contract to the invited suppliers, which the suppliers have to sign. This contract defines the rules for participating and the supplier can accept the contract by signing it or choose not to participate. Changing or altering the contract is not an option.

After signing the contract, the supplier receives a login and password to the website that is hosting the auction. On this website, the supplier can see and download the specifications that define the quantity, quality, delivery terms, etc. On the basis of these specifications, the suppliers are asked to quote an opening price. Only the cheapest 70% of the invited suppliers will be able to participate in the actual auction. When the auction starts, the case company can see the opening prices of all invited suppliers and now the bidding starts. The auction runs for a predefined time period, typically two hours, and if a company lowers the price 5 minutes before the reverse auction is set to stop, the auction is automatically prolonged by 5 minutes. In this way, the auction runs until the last bid and lowest price is received. There is a clear tendency for the contracts negotiated via reverse auctions to become larger in size. The first cases using reverse auctions were relative small in size, around USD 2-3 million. However, the recent cases have been around USD 25-30 million. Another clear trend is that the auctions are becoming more global in nature. Typically, the different regions in the world, Europe, Asia and the US, are negotiated in separate auctions with an interval of either days or weeks. Suppliers from all over the world compete for the deals in all the different regions, and this underlines the global nature of the reverse auction cases.

To summarize the e-market experience of the case company, it is clear that the customers are not demanding higher efficiency related to the process of trading. They focus on bringing the actual price of the purchased product down. Using the distinction between process and product costs, the reverse auction belongs to the second category, focusing on determining the price of an actual product, and, therefore, it is regarded as a transaction-oriented e-market, i.e. the application is used to increase the competition between suppliers to bring down the product price. Buyers often report savings in the process of ordering and negotiating the price. However, these savings are obtained internally in the buying company and not as a result of process improvements between the buying and supplying company. Jap (2003), in this relation, notes, ‘Online reverse auctions … emphasise short-term price savings and can simplify and support negotiation’ and thus agrees that a reverse auction is a transactional mechanism, focusing on competition and price.

A need for relationship and close cooperation between buyers and suppliers

The use of auctions as described and explained above is indicative of a clear trend towards increased competition and it indicates a transactional mindset among the buyers. However, this focus on price competition is not the only trend that can be identified among the customers.

Even though R&D in the industry in which the division operates is relatively limited, there is still a need for improving product designs and developing new additional product features. Traditionally, suppliers have handled these development activities alone or in cooperation with customers. In this way, the first supplier with a new product feature could benefit from a premium price, as he was the only one on the market who could initially offer the product feature.
As a response to the price pressure caused by the use of the reverse auction, the case company has tried to increase the number of R&D projects in collaboration with the customers. The hope was that this would prevent customers from using reverse auctions and thereby secure the company a premium price. The customers have responded positively to this offer from the case company and several R&D projects have been initiated. These projects are typically dealing with developing adaptations to already existing product designs or building several individual products together so that the customer’s production is more efficient. The projects were handled in an incremental way, in an informal spirit and as a natural part of the ongoing relationship. The collaboration was in general successful. However, when the case company was ready to sign the contracts for the new products, they were at times taken by surprise. The production outlines and the drawings of the products were now sent to competitors in the industry and an auction was set up. The case company now had to compete for the orders for the products, which they had developed in cooperation with the customers. Thus the operation was a success, but the patient died.

This implies that the case company possesses knowledge and competences beyond that of the basic product. However, the company is not able to reap the advantages from this knowledge, because the customers test the prices in the open market via reverse auctions, when the design process is finished. As a result of the reverse auction, the case company does not get any premium price for the newly developed product and as such is not able to generate enough revenues to cover the R&D costs.

This leaves the company in a dilemma. The case company now has the experience to participate in and win orders through online reverse auctions. However, as shown above, the very participation gives rise to a dilemma related to how to finance and cover the cost of R&D activities, especially those that are of the incremental type and related to the adaptation of products to customers. Adaptation processes can be costly. However, when the new specifications are available, the adaptations may be of a nature, which other competitors can accommodate without too much effort within their present production activities and procedures. The buyer, therefore, has an interest in offering the specifications to the wider markets, leaving the original developer to find other ways to cover the R&D costs incurred, if the order is not taken home on the auction.

**DISCUSSION – POTENTIAL SOLUTIONS TO THE DILEMMA**

The e-market experiences of the case company gave rise to intensive discussions in the company both related to the dilemma itself and to possible solutions. In this section, we will discuss four possible solutions to the dilemma. Basically, the dilemma is one of transaction-marketing versus relationship-marketing. The producers want to build long-term relations based on high quality products and services for which the buyer is willing to pay a premium price. For the buyers, the dilemma reflects short- versus long-term orientation. The buyers may get the product at a cheaper price in the short run, but as they have a need for continuous improvements in the products, they may jeopardize the fulfilling of their own long-term needs if the supplier is forced to stop his R&D activities.

Even though the buyer is aware of this scenario, it will be difficult to change behaviour, as the competitors will thereby gain a short-term competitive advantage. A possible solution will have to be found in other types of dynamics of the market. We will look at four of them.

Before we do so, the first step for the supplier to take is to create an overview over the total magnitude of his offer, i.e. the composition of information, knowledge, product and service. The costs associated with each of these offers are normally not calculated and it is without a doubt a difficult task to calculate the costs and assess the value of each of these elements of his offer. However, the way the customer’s life value is calculated may be used as a foundation for assessing the elements. If this calculation shows that the supplier, as a result of e-markets, delivers unpaid knowledge to the customer, the supplier has to consider one or more of the following solutions:

1. Reduce knowledge transfer or rationalize the operations;
2. Build knowledge into the product;
3. Anchor knowledge in the relationship; and
4. Offer the knowledge as a product of its own, e.g. by creating a consultancy company.

**Reduce/eliminate knowledge transfer and rationalize**

The first possible solution is to reduce or even totally eliminate the ‘free’ knowledge. Maybe the knowledge has very little value to the customer and can thus be eliminated. It is a common observation that sellers often over-value their product and especially the know-how surrounding the product. In the specific case, the company is of the opinion that it does possess a high degree of what it calls ‘application know-how’ and ‘system’s knowledge’, but it has not tried to systematically assess its value, and confront the customer with the assessment.

Apart from cutting away knowledge, which the customer does not need or value, the supplier may use the idea of Porter’s value chain (Porter 1985) and map...
the knowledge and the knowledge transfer to customers, i.e., what are the activities vis-à-vis the customers, and to what extent do they imply knowledge transfer. Based on the map, the company must, for each activity, ask two questions: Can we do it cheaper by, for example, digitalizing the activity? Can we do it better, i.e., make the knowledge more valuable to the customer? A third and final question is how can we improve the coordination of the knowledge transfer activities, e.g., by studying the typical knowledge transfer process? Then optimize the transfer.

**Build knowledge into the product**

Including as much knowledge into the product as possible so that the buyer cannot avoid paying for it, seems to be the optimal way to resolve the dilemma – provided that the customer values the included knowledge and makes it part of his specifications, when launching an auction on the e-markets.

A product life cycle perspective may be useful in this respect. In general, more and more knowledge is included into the product during the life cycle. In the beginning, when the product is new on the market, it often has many flaws, which are handled by, for example, servicing staff. The flaws are gradually dealt with and solutions are found, reducing the need for servicing. Similarly, over the course of the life cycle, the customer gets more and more insight into a product’s technical features, but mainly into its application. The customer thereby becomes more aware of his needs, and the demand for extra-product knowledge transfer is reduced. Buyers and sellers may still have close relationships, but they do not need frequent and deep interactions to carry out the transactions. This situation is ripe for auction solutions. To avoid auctions, the supplier may move one step up and start offering systems into which the product is integrated, for example, compiling several products that the customer is usually buying from several suppliers and aligning these together to one module to fit the buyer’s needs and demands.

**Anchor knowledge in the relationship**

Instead of integrating the knowledge into the product (or service), the knowledge may be anchored in the relations with the customers, thereby creating inter-dependency. This anchoring may relate to the product itself (common product development projects) or to the organization as such, for example, various planning and administrative systems, which bring the companies closer together. Together, the anchoring creates value and increases the switching cost for both suppliers and customers. With reference to the previous distinction between product price and process cost, the issue of anchoring knowledge in the relation itself clearly requires a process orientation of the suppliers, i.e., the buyers have an advantage of collaborating with suppliers in order to bring down process cost between the two.

Outsourcing may also be part of anchoring knowledge in the relation. For example the supplier may take over the administration of the buyer’s stocks and in that way bring down the cost of buying and handling the products. In other words, the buyers are in general interested in higher efficiency and the generation of savings. If savings can be made related to the process of buying, the suppliers may maintain a premium price and thereby continue R&D, which benefits both buyer and seller in the long run.

**Offer the knowledge as a market based service**

It is seen before that markets are reorganized, if a certain market-offer is needed in the long term but cannot be provided in the short term under the present market conditions and structures. According to the transaction-cost theory, a dynamic market will always move toward an organizational form, which can provide the service in the cheapest way. By using the transaction-oriented reverse auction, the buyer has found a way to reduce transaction costs at the same time, as intensive competition will drive the prices down. In the process, various services are squeezed out, notably the services related to product adaptation and support to the application of the products. If this service is needed in the medium to long-term period, the buyer will have to pay for it either to the original supplier, who may now have established such services as a separate profit centre, or from other companies, which have seized the opportunity to enter the market.

Related to the use of reverse auctions it is obvious that the first solution, to ‘reduce/eliminate knowledge transfer and rationalize’, makes the company competitive and ready to handle the intense price pressure that the reverse auctions are creating. This will leave the company very competitive in the short run but what about the medium and long term?

Related to the second solution, to ‘build knowledge into the product’, the company will, if it succeeds, get paid for the knowledge that it possesses. The specifications in the reverse auctions will be in accordance with the products of the company and it will therefore be in a good position to win the auction. The ability to offer modules containing several individual products may also create a unique position for the company, as there will be relatively few competitors with a portfolio of products to offer the same modules.

In the case of the third solution, ‘anchor knowledge in the ongoing relationship’, the frequency of and intensity
in the interaction between buyer and supplier get very high. It is hard for the customer to specify all the different situations in which the supplier offers its competences and this makes the use of auctions almost impossible. This scenario requires many other competences of the supplier than the actual product and therefore this is not an easy position to obtain for the supplier.

In the case of the fourth solution, ‘offer the knowledge, as a market-based service’, the reverse auctions can be used for the basic product while the knowledge needed for including new features or adaptations of the product is handled on a separate market and, for example, dealt with before a reverse auction is launched. In this scenario, companies will focus on their core competences and long-term development and thereby fill the short- and long-term needs of the market.

CONCLUSION

Under the present conditions of intensified global competition, it is tempting for buyers to take advantage of the new transaction-oriented e-markets to lower the price of inputs and thus forego the advantages of long-term relations to individual suppliers. Observations from a large transnational company have shown that the attempts by the supplier to bind the buyers by means of services in the form of before- and after-sales knowledge available to the buyer ‘for free’ is not enough to make the buyers loyal and make them pay the premium price necessary for rendering the ‘free’ services. Thus, in the battle between the two marketing streams, transactional and relational marketing, it seems that the transactional stream comes out as the winner in industries where the e-markets are suitable solutions.

In this paper, we asked two fundamental questions: What happens to buyer-supplier relationships when reverse auctions are used? How do the supply companies adapt to these new market conditions?

On the basis of the theoretical discussion and the findings from our case company, we conclude that when reverse auctions, with their short-term orientation, are used as a tool for price negotiation, the long-term development-oriented relations between buyers and suppliers are easily jeopardized. In the situation where the suppliers are forced to take part in price competition-oriented e-markets such as the (reverse) auctions, they are brought into a new situation. Here they have to consider what to do with all the knowledge they have and the services they rendered for free to the buyer as part of their ongoing relations that made it possible to get a premium price in order to cover such services.

The first thing to do is to ask the question: Does the knowledge that the supplier believes he has, have any value to the customer or is it just a supplier self-believed position? It may be so, but it may also be that the buyer needs the knowledge, but for the sake of short-run competitiveness, he has to forego it. Another alternative for the suppliers is, if possible, to embed more of the knowledge into the product and thus get paid for it through the price, i.e. if the buyer will accept such an inclusion and adopt it in his specifications.

Alternatively, if the buyer needs the knowledge in the medium- to long-term period, market dynamics may create other solutions. According to transaction costs theory, markets tend to select the organizational forms with the minimum transaction costs. The ‘free’ knowledge can be considered extraordinary transaction costs in the short run and thus the market turns to e-markets to eliminate them. This, however, gives rise to the establishment of new markets, i.e., the market for the ‘free’ knowledge. The supplier himself may enter the market and thus find a new way to offer and price his previously free knowledge. It may also be that the knowledge, depending on its character, is taken over by others and thus constitutes a new but complementary business and industry.

At a more general level, the company case discussed in this paper is interesting as an example of the impact that the Internet has on conventional business. It is also an interesting example of the ‘battle’ between transactional and relational marketing. The literature generally holds that relational marketing is to the advantage of both buyers and sellers due to its focus on win–win solutions. However, it seems that this may not always be the case, at least not in the short term when e-markets are applied to cut prices for competitive reasons. Short-term oriented e-market exploitation is here to stay and will require new solutions to the classical dilemma of market economy between short-term optimization and long-term development.

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