ABSTRACT

Using online reverse auctions to procure business services is a new and growing practice. Efficient use of such auctions, especially in maintaining procured service quality, is a major challenge. In this paper, using data from legal service procurement auctions, we study how online auctions can be used fairly and effectively in procuring business services, and demonstrate the roles supplier quality and incumbency play in this process. Supported by our theoretical results, and counter to some existing arguments, we empirically verify that online auctions can generate substantial savings to a buyer without significantly compromising quality. We provide evidence that with an open-ended auction format, introduction of non-incumbent suppliers to the process increases the average quality of winning incumbent suppliers, and show how this format can work to achieve high efficiency for the buyer. In addition, our data set allows us to quantify the buyer's quality assessments of suppliers' service, presenting a unique opportunity to control for quality in testing for potential incumbent bias. Utilizing this ability, we demonstrate that what may traditionally be perceived as incumbent bias can in fact be a revelation of preference for quality. We provide further support to this result by extracting buyer's revealed preferences, which significantly differ from her stated preferences in favor of quality over price.