Competitive Bidding

Sound market information can improve your success

By Jon Vencil

Bidding Strategies

The decision of how much to bid for a contract often is a source of consternation for many businesses. Bidding strategy, like so many other decisions, is driven by the objectives. Is your objective to maximize profit, preserve cash flow, retain a client, or generate new business?

Once you have estimated your costs to complete a job (and the bid), you must decide how much profit to build in. Like pricing strategies, your approach should be to sell “value” to the customer. Be sure, however, you understand the criteria used for judging the bid. For example, in many government contracts there is no opportunity to sell value since the contract is awarded to the bidder with the lowest price and/or required business designations.

Bidding situations can add additional uncertainty, and therefore risk, to the pricing process because you may not know why the bid has been issued. The growing use of online “marketplaces” makes this especially tricky since most often the company issuing the request is not known.

- Is it to find out what the possibilities are?
- Is it intended to drive price down?
- Will the bid results be used to set an internal budget?
- Is the request simply a requirement even though a vendor has already been selected?
- Could it be a combination of many of these?

If the firm intends to bid on contracts frequently, one way to begin to reduce the risk of an unprofitable bid and increase the chances to maximize profits is by applying the concept of expected value to your bidding strategy?

Expected Value

Expected Value is calculated by multiplying the profit from the bid with the subjective probability of winning the bid. Typically, the higher the bid price, the lower the probability of winning the bid. Once internal costs for the job have been calculated profit can be determined from the amount of the bid. The probability of winning is subjective but should be based on current and historical industry information.

An example bidding strategy with expected value applied.

Proposed Bid Amount (1)	Profit from Bid (2)	Probability of Winning (3)	Expected Profit (2 x 3)
$19,000	**$200**	**0.81**	**$162**
$20,000	**$1,200**	**0.36**	**$432**
$21,000	**$2,200**	**0.15**	**$330**
$22,000	**$3,200**	**0.10**	**$320**

In this example the bid to submit would be the one for $20,000 because expected profit of $432 is maximized.

Firms that bid on only a few contracts or desperately want a certain contract probably should not use expected value in their bidding strategy. However, for firms that bid on many contracts, using the expected value approach intelligently will maximize long term profits

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Conclusion

Bidding on contracts is inherently risky. Customer motivations for issuing the bid are typically unknown. Internal profits contributions can be difficult to discern. Assigning probabilities with limited information is often more art than science.

Firms that know their internal cost structure, profit objectives and what motivates their clients are on the path to profitability. Understanding the bidding process and bidding new jobs or contracts strategically will pave the way for sustained profitability and growth.

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