

**Service Supply Management and Tendering Solutions in
Increasing the Performance of Purchasing Procedures: Case Kon-
Tiki Tours**

Palveluiden hankinnan ja kilpailuttamisen keinot ostotoiminnan
tehostamisessa: Case Kon-Tiki Tours

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Tämän kandidaatintutkielman tavoitteena on luoda katsaus palveluiden hankinnan erityispiirteisiin, ja yhdistää siihen perinteisesti fyysisten hyödykkeiden hankinnan kilpailuttamiseen liittyviä keinoja, pääasiassa käänteistä huutokauppaa. Tutkimuksessa selvitetään, miten palveluiden hankinnan erityispiirteet vaikuttavat ostotoimintaan, ja miten kilpailuttaminen voitaisiin toteuttaa käänteisen huutokaupan avulla. Näiden keinojen kautta pohditaan, kuinka case-yrityksen palveluiden hankintaa voitaisiin tehostaa, ja etenkin kustannuksia laskea tehokkaan kilpailuttamisen kautta.

Tutkielmassa esitellään kvalitatiivinen tapaustutkimus, joka pohjautuu case-yritys Kon-Tiki Toursin toiminnanjohtajan haastatteluun. Puolistrukturoidun teemahaastattelun avulla kerätyn aineiston analyysin tavoitteena oli selvittää, miten palveluiden hankinnan erityispiirteet vaikuttavat yrityksen ostotoimintaan, ja miten käänteisen huutokaupan keinoja voisi implementoida osaksi päivittäistä toimintaa.

Tutkimuksen tulokset osoittavat, kuinka palveluiden hankinnan erityispiirteet luovat tarpeen mahdollisimman tarkkaan kysynnän ennustamiseen, sekä vaikeuttavat hankinnan kohteen laadun arviointia. Jos palveluiden hankinnassa käytetään apuna sähköisesti toteutettua käänteistä huutokauppaa, on toimittajien arviointi etukäteen ensiarvoisen tärkeää hyvän lopputuloksen aikaansaamiseksi. Oikein toteutettuna käänteinen huutokauppa voisi merkittävästi auttaa case-yritystä parantamaan kannattavuuttaan laskevien kustannusten kautta.

ABSTRACT

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The goal for this thesis is to address the characteristics of service supply management and combine it with tendering policies that are traditionally linked to the purchasing of physical goods, mainly reverse auction. The research examines how the characteristics of service supply affect the purchasing procedures, and how tendering could be conducted with a reverse auction. These solutions are used in researching how the performance of the purchasing procedures could be increased in the case company.

This thesis present a qualitative case study based on an interview with the managing director of Kon-Tiki Tours. The data is collected through a half-structured theme interview and the analysis on the data thrives to examine how the characteristics of service supply management affect the daily purchasing activities of the company, and how the reverse auction method could be implemented as a part of the tendering procedures.

The results of this study show that the characteristics of service supply management create a need for accurate demand management, and makes the evaluating of quality of service providers significantly more difficult. If an online reverse auction is used as a tool purchasing services, the evaluation of suppliers is extremely important in order to achieve satisfying results. If used correctly, reverse auctions could help the case company to achieve better profitability by lowering the costs.

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Attachment 1: Interview questions

1 Introduction

When you think about supply and purchasing, first thing that comes to mind is the simple, traditional act of giving away money in exchange of a material product you receive. On a larger scale, companies buy massive amounts of one product they need in their business activities. But when you start to think about the modern western world, purchasing of only material products is no longer a valid way of defining the word. For example Finland has moved from an industry-focused economy more and more towards a service economy in the past decades. By 2014, public and private services contributed 70% of the cross domestic product, and have been a major growing factors in the GDP's growth during the last few years.(EK.fi, 2015) The same development can be seen all around the world, as a result of growing economic wellbeing and income.

Development towards a service economy forces supply management to focus on services, which are becoming a more and more important part of organizations purchasing portfolio. As a result of growing use of outsourcing organizational activities, services provided by outside suppliers have a huge impact on how customers see the company itself, and how happy they are with the results. (Van Weele, 2014a, p. 77) All this makes the comparing and choosing between service providers a crucial task for organizations that wish to succeed in the modern service economy. An effective service supply management can give important leverage to a single company and can help it to better its profitability, competitive stand and customer satisfaction. Nevertheless, the service perspective has been overlooked in supply management, until recent years. (Wang, Wallace, Shen, Choi, 2015) The research field is relatively new and doesn't yet have the same kind of coverage as some more traditional fields of study in the business sciences, which gives an interesting starting point for this research on service supply management.

Despite the fact that service supply management has been a growing academic research field in recent years, most of the studies focus on the supply of health and nursing services, and overall public services. As stated before, service supply management is important to a major portion of all companies, throughout all branches. This is the gap in research this thesis aims to fill.

1.1 Research problems and objectives

This thesis addresses the characteristics of service supply management, focusing on different approaches to tendering and the use of different competitive solutions in purchasing services in business-to-business environment. Research is based on one main research question and two sub-questions. Sub-questions aim to differentiate the problems behind the main research question, and help find solutions for it. The main research question is:

“How could reverse auctions be implemented into the purchasing of services in a travel agency’s business-to-business environment?”

The question describes the problem concerning the implementation of reverse auction procedures to service supply management in an efficient, profitable and productive way. The two sub-questions divide the main research problems into two different points of view. The goal is to find solutions for the sub-questions, and to conduct an answer to the main research problem by analyzing these findings. The sub-questions are:

“How does the service supply management differ from the supply management of physical goods, and what affects do these difference have in practice?”

“What issues and benefits the implementing of reverse auction can bring to the buying organization?”

The first sub-question addresses the differences service supply management and traditional supply management have, and how these differences affect the daily purchasing procedures. The second sub-question focuses on the reverse auction, and the possible benefits and issues the procedure can bring, and what aspects should be considered when the buying organization starts to plan a reverse auction. These two different views are combined in the main research question.

The goal for this thesis is to urge forward the research on service supply management, and combine it with theories that are traditionally viewed as a part of purchasing physical goods rather than abstract services. This is the problem the main research problem aims to give answers

to. This thesis includes an empiric research on one travel agency, Kon-Tiki Tours, with the goal of implementing the theoretic background to daily activities of the company and hopefully help to develop their service supply management towards a more up-to-date and effective procedures. The case company and its business model is presented in chapter 4. The objective of this thesis's empiric research is to study how the theories and theoretic approaches to purchasing and tendering can be implemented to the daily activities of the company in case, and how they could possibly help them to choose the best suppliers of the services they need for their clients. These services include for example accommodation and transportation.

According to researcher's previous knowledge about the subject and knowing that the case company is a rather small business with limited resources to purchasing, the case company is not expected to be using many of the solutions described in the theory section of this thesis. That's why the focus is also on how they feel they could start implementing the solutions to their purchasing activities in the future. The main restriction to taking full advantage of the methods can be the resources at hand. This has to be taken into consideration when selecting the purchasing and tendering policies that are addressed in this thesis.

Nevertheless, the theoretic parts and the results for the sub-questions can be implemented to many different companies, not just the company in case. The research subject is somehow important to almost every company, because few companies these days can manage without the need to buy some services from outside suppliers. An advanced service supply management might not be needed in all cases, but the need for that as well rises as the service industry becomes more and more important.

1.2 Theoretic Framework and the Structure of the Study

Theory parts of this thesis are based on supply management and it's specifications on service supply management, and different approaches to tendering. Purchasing is a part of supply management: supply management can be seen as the more strategic activity, whereas purchasing is more practical and commercial activity. (Lysons & Farrington, 2006; p. 7-8) First part of the theory base of this thesis addresses the characteristics that differ service supply management from traditional supply management. These characteristics have multiple different impacts on how successful service supply management should be conducted, and what aspects

should be taken into consideration when purchasing services in a business-to-business environment. (Van Weele, 2014)

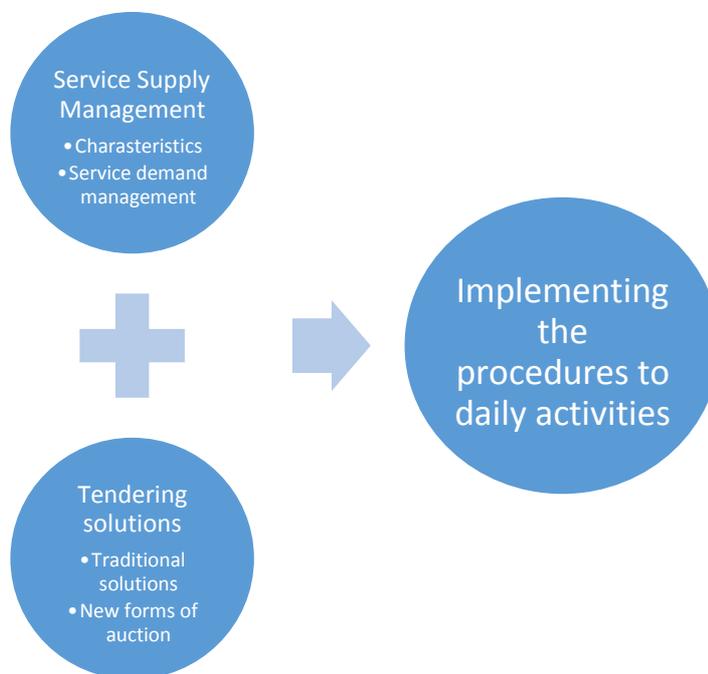


Figure 1: Theoretic framework

Another important factor concerning service supply management that is addressed in this thesis is supply demand management. Demand management is also crucial for the supply management of manufactured goods, but its impact on service supply management is even more important, due to some of services characteristics. Service demand management can be defined as all the actions companies must take in order to anticipate and get ready for future demand of the services. This includes strategic methods of forecasting the future as well as taking actions, so that the company can handle for example an increase in the demand. (Wang et. al., 2015)

The second part of the theory focuses on more practical side of supply management, which is purchasing. The focus is on tendering, and specially in using different purchasing procedures, both traditional and new internet-based activities, to help choose the best supplier. Reverse auctions is one of the main theoretic procedures addressed in this thesis. Goal of a reverse auction is to simply find the supplier that can offer the best price for the item or service in question. (Lysons et.al. 2006, p. 199) This second part of the thesis can be easily adapted to

purchasing of material goods, because of the nature of practical methods being based on the traditional supply management. All of these theories are used in the latter part of the research to analyze the data from the case company.

The second and the third chapters of this thesis address the theoretic framework, and the two chapters that follow focus on the empiric research. The first part of the empiric research present the case company more thoroughly, and the current situation of the supply management procedures in use. The second chapter of the empiric research (chapter 5) analyzes the data from the case company more carefully, and thrives to find solutions to the possible implementing of reverse auction to the case company's daily purchasing activities by analyzing the possible objects of the auctions and the aspects that have to be taken into notice.

1.3 Research method

Qualitative research is based on real life situation, that is described as broadly and comprehensive as possible, and the goal is to find and reveal facts from the basis of the data, rather than proving already existing claims. Even though no official hypothesis for this research is made, it is often recommended to make some sort of "work hypothesis" that helps to keep the research focused on the right goal. In qualitative research, the data is in written format, and the text can be born independently without the researcher, or as a result of interaction between the researcher and the object. (Eskola & Suoranta, 2008, p. 19-20)

This thesis is based on a qualitative case-study on one relatively small travel agency, Kon-Tiki Tours. The material will be collected through interviews with the company's representative. The method used to collect the data is a half-structured theme interview: the questions are written beforehand, and the interview is conducted via phone conversation. Even though the questions are written beforehand, and the interview is based on these questions, the interviewer can ask further questions and specify something in the interviewees answers. The interview questions create the frame for the interview, but don't limit the interviewer. (Eskola et.al. 2008, p. 86)

The interviewee will answer the open questions in his own words. The interview is recorded and transcribed. If needed, it's possible for the researcher to keep an open dialogue with the

representative of the company after the interview and specify or ask explanations for the answers given. As starters, the managing director of the company will answer the interview questions, but another employee can also be interviewed if needed. For this research, the chosen method is suitable due to the fact that it's easy to fit into the company's schedule. Open communication with the company can help to increase the validity of the information: possibility to ask further questions diminishes the risk for misinterpretation. The interview questions are presented at attachment 1.

Due to the qualitative method, the result may not be valid for other companies. The research only deals with the data from one company that offers specific kind of services to its customers. Nevertheless, the goal of qualitative research is to find generalized results from small data: therefore, as the results of this research may not be suited for every company as they are, the results can help other companies to better understand their own situation.

1.4 Literary review

The theory base for this study is built on a number of different articles that have studied the field and give new insights to the subject. Some textbooks have also been used to help narrow the subject and to define some of the basic concept used in the study. These books include the book "Bids, Tenders & Proposals" by H. Lewis (2005) that addressed the basic element on tendering from a very practical point of view. K. Lysons' and B. Farrington's (2006) book "Purchasing and supply chain management" addresses the traditional supply chain management theory extensively, and gives a good view on the practical purchasing side as well. Third fundamental book used is van Weele's (2014) "Purchasing & Supply management: Analysis, Strategy, Planning and Practice". As stated before, these textbooks are used as an assistant in defining the theory basics, not to conduct the actual theory.

The following articles presented are the ones that are most influential to this study and its theoretic framework. Some other articles that are not presented here have also been cited, but only the most important ones are mentioned here. They give a good overlook on the base of the theory of this study.

Y. Wang (2015) studies the operational models of service supply chain management. The article reviews the definitions of service supply management and service demand management, and provides insight into the current state of research and the future of the field of study. This article is more of a view into this field of study, and it tries to give a wide perspective of the subject rather than creating any new theories or models.

McDougal and Snetsinger (1990) focus on a narrower subject in their article on the intangibility of services, measuring it and reviewing how it affects the marketing and purchasing of services. The article shows how a new scale to measuring the degree of tangibility of services is developed, based on three different empirical studies. The implementation to practice in organizations is also addressed. Another article on the subject of service's intangibility by Bebko (2000) the problem of customers' expectations of quality across the range of services with different levels of intangibility. The most significant result of this study is that when the level of intangibility of the service increases, expectations of the level of quality also increases. At the same time, the risk in the purchase of the service also increases.

The service demand management theory is mostly based on the article by Coshall (2015) addressing the different models used to forecasting the future demand for international tourism. The article states that goal programming gives an alternative approach to demand management. Different points of views on demand management are also presented, as well as the demand management process and possible problems.

Most important article considering the tendering theory is by Szymanski and Wilkins (1993), and it presents a study on competitive tendering procedures and outcomes. The study shows that tendering can reduce costs by around 20 per cent, but the impact varies a lot between different situations. Some of the savings that seem to follow tendering may also be identified with productivity improvement.

The theory on reverse auctions, that is a part of the whole tendering chapter, is based on two articles on the subject. The first one is by Emiliani and Stec (2002) and it addresses the possible savings that result from reverse auctions, and defines some of the basic concepts needed to understand the reverse auction process, such as gross and net savings. The study shows that the actual savings can be a lot under what the online reverse auction suppliers report in their

marketing material, and that the main reason for managers to choose to conduct a reverse auction is local optimizing of the business systems. Another article also by Emiliani (2000) focuses on the online reverse auction process, especially in the business-to-business environment. Improvement on the process, issues and interpretation of the results are addressed, as well as comparison between online auctions and more traditional ways on tendering.

2 Service supply management

To be able to differentiate service supply management from the traditional supply management, it's important to define what services mean, and how broadly we understand the term in this research's content. The suitable way of approaching service supply management varies depending on the chosen definition. In some cases, services are only the procedures that no physical goods are needed for or used during the service, and that the procedure is in no ways tangible. These kind of services are for example many consulting and expert services, such as legal counseling or financial guidance. In this research, however, the term 'service' is defined as a broader vision of services which can have some physical aspects to them as well. For example accommodation services, that are fundamental for the case company in this research, have physical attributes that are absolutely necessary for providing the service in question, such as a bed, a room and a building.

As Giannakis (2010) states in their article on the subject, the supply management was born in the field of industrial production and logistics that usually handle only manufactured and very tangible goods. That's why the service point of view to supply management has not been as well studied in literature as one might expect in the modern service-driven economy. This is a major gap in literature that many articles in the past few years have been addressing to.

2.1 *Characteristics of service supply management*

There are many differences between buying services and buying goods, and in this thesis, we focus on basic characteristics that differentiate the two different approaches to supply management. As cited before, service supply management is undermined by the supply management of manufactured goods, and for that reason most of the theories concerning supply management can't be adapted to this research. When managing the supply of services, the company must take in consideration the many special qualities that affect the purchasing of services.

According to Van Weele (2014), the main distinctive features of services can be divided into four characteristics: intangibility, heterogeneity, perishability and simultaneity. These characteristics all have different kinds of impacts on the supply of services, and have to all be

taken into consideration when building effective service supply management procedures. In the literature and articles about the field of study, the intangibility factor is most commonly mentioned, and provides the best starting point to understanding the biggest difference buying organizations face when purchasing services instead of tangible goods.

2.1.1 Intangibility of services

Intangibility is perhaps the most influential characteristic of service. Figure 2 (below) shows how services and goods can be categorized according to their level on tangibility or intangibility. As mentioned before, ‘services’ can be defined in many different ways, and the chosen definition for this research would include the last three from the continuum shown below. The continuum is based on the idea that even salt can be defined as a service: it provides the service of seasoning food, as well as clothes provide the service of keeping people warm. Eventually, practically everything can be categorized under the term “service”, if you stretch the definition wide enough. It all depend on how much intangibility the use of the term ‘service’ requires. Therefore, the level of intangibility determines whether the offering is a service or a product. (McDougall & Snetsinger, 1990; Bebko, 2000)



Figure 2: The continuum of intangibility (McDougall & Snetsinger, 1990)

As the level on intangibility increases, it’s much harder for the customers to evaluate the service quality; they can’t see, touch or feel the good they are paying for. This affects how customers choose the provider of services. When buying intangible services, customers rely more and more on the reputation, brand name and marketing of the service, compared to when the same customer is buying, for example, an apple at the market square: they can see, feel and maybe even taste the difference between two seller’s apples, but when buying services, they can’t really know in advance what the service quality will be this time. The same goes for business-to-business buyers, and the B2B market for services. (Brewer, Button & Hensher, 2001, p. 277)

The level of intangibility can also be seen as the level which physical evidences the service

requires. Physical evidence includes the environment, products, tools and other physical element needed to produce the service. The more physical evidence there is of the service, the easier it is for the customer or the business that purchases the service to evaluate the quality. Physical evidence can be used by the supplier to communicate the quality of the service, but it doesn't guarantee it. Also, there is a difference between the level of intangibility of the service itself, and the level of intangibility of the production of the service: from the buyer's point of view, only the level of intangibility of the service itself matters. (Bebko, 2000)

The intangible nature of services cause a higher risk in purchasing compared to purchasing physical products: as the level of intangibility increases, the amount and quality of information of the offering decreases. Perception of the quality of the service is based on the physical evidences and the price of the service, not so much on the core service itself. This is especially true when the result of the service is in no way tangible: it may be impossible to know what to expect when buying the service in question. All this increases the risk in purchasing services. Still, as the level of intangibility in both the procedure and the outcome of the service increases, the expectations of quality also increases. (Bebko, 2000)

2.2 Service demand management

Because of the nature of purchasing services, service demand management also plays a crucial role in successful service supply management in whole. Service demand management addresses the different ways a company can manage its future demand for services: forecasting the need and making plans on how to deal with demand's uncertainty in the future. (Wang, 2015) In his article about on managing the demand for international tourism, Coshall (2015) states that increasingly competitive tourism industry is a major contributor to nations' economies around the world, and managing the demand as efficiently as possible is vital for profitable business operations. Forecasting future trends is very important for all travel agencies, and doing this effectively and continuously can help decision making and planning future strategies become much more accurate and successful.

Demand management can be divided into two very different points of view, depending the time range and width of the forecast. Usually the different views go hand in hand, and demand management is seen as a coherent process including different points of view. Demand

management can focus on short-term or long-term forecasts, and both can be equally important to company's future success, but the focus points are very different. (Coshall, 2015)

2.2.1 Difference between long- and short-term demand management

Long-term demand management has a wider horizon and a longer time range: travel agencies and other organizations try to forecast future trends, for example which destinations are going to grow in popularity during the next five years, and what will the tourist flows be at various times of the year. Long-term forecasting thrives to see the “bigger picture”, and predict the flows of tourism at a scale that includes the whole world. If successful, this can help the travel agencies to prepare in advance, by for example getting a local agent and getting familiar with the destinations environment, business culture and possible suppliers of needed services. Getting a head start to a new, upcoming destination before competitors gives the company important leverage, and can be of major assistance in developing a profitable business in the destination. (Coshall, 2015)

Short-term forecasting focuses on the more near future and is more local than the global longterm forecasting, but the challenges are still inevitable. This point of view focuses on forecasting the need during the next few months or the following year, and on already existing destinations, in tourism business' case. The goal is to predict as accurately as possible how many people would like to get on trip that is being planned, so the agency can purchase a fitting amounts of, for example, hotel rooms or seats on a plane in advance. The short-term demand management is a much more practical and down-to-earth procedure, whereas long term forecasting is more strategic and abstract. (Wang, 2015; Coshall, 2015)

3 Tendering theory

Purchasing is a part of supply management, and supply management can be seen as the more strategic activity, whereas purchasing is more practical and commercial activity. (Lysons & Farrington, 2006, p. 7-8) That being said, tendering can be seen as more of a part of purchasing process, not so much as part of supply management. The traditional, practical term of tendering is familiar to everyone from basic consumers who need a new car insurance or a new electricity supplier, to large corporate buyers.

The tendering models used in big organizations aren't really that different from the ones consumers use, in smaller scale of course: the buyer collects a group of possible suppliers, asks for offers on the goods in case and chooses the best offer. In real life, the situation is much more complex than this, and that's why tendering can be an interesting subject for academic research. During the last few years, new approaches to tendering have grown in popularity amongst organizations: for example online and reverse auction are relatively new methods.

3.1 *Traditional ways of comparing suppliers*

This theory part of the thesis addresses the important focuses organizations must have when conducting tendering procedures at any chosen method. As stated previously, traditional tendering in its most simple form refers to the process, in which the buying organization asks the possible suppliers offers on the price and the terms on which they would be willing to sell the goods in case. As seen on many researches, tendering has a major impact on cost reduction. For example a study set in the years 1984, tendering caused a 20-per-cent reduction in prices at the companies that took part in the study. (Szymanski & Wilkins, 1993)

When receiving offers, the company must take into consideration multiple different factors that affect the quality of the offer: price is only one factor, and in many cases, not even the most important one. Choosing a supplier means choosing a future business partner too. These different factors can be divided and presented in many different ways, and the focuses between factors vary between different branches. Harold Lewis (2005) addresses these factors that the company should take into consideration, and they are presented below (Figure 3). These factors are extremely essential also in the reverse auction process that will be addressed in the later part of this chapter. The factors don't have to do with the product or service itself, but more with the suitability of the company to be a new business companion.

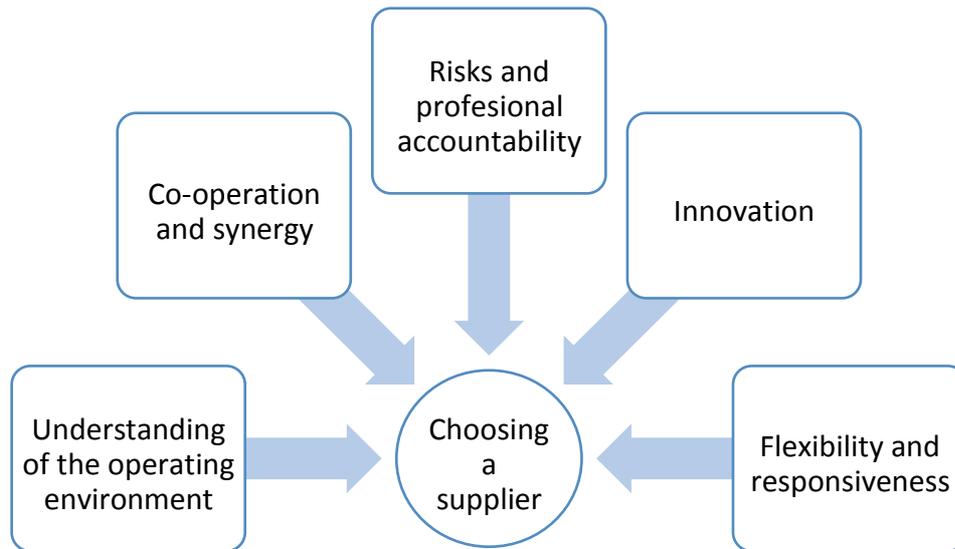


Figure 3: Factors to be taken into consideration when choosing a supplier (Lewis, 2005)

It's important that the possible future supplier has a sufficiently broad understanding and insight of the field the buying organization operates in. Supplier should have a vision of the variables that may affect the profitability and the environment of the branch. If the product or service in case belongs to the main operative area of the possible supplier, one can assume that the supplier has a better vision of the field comparing to a supplier that is mostly focused on some other field. The buying organization can trust that the supplier is well aware on the common practices and the price level of the field.

Especially in business-to-business-environment, developing co-operation and synergy between business partners is an essential part of a successful trade. When evaluating the tenders from possible suppliers, one has to consider the suppliers suitability to be a profitable partner. This can be a hard factor to measure, and such things as the relationships between the companies workers can have a huge impact on how they are seen as the potential partner. Co-operation relies on the relationships of the workers. For example different values and views on future can be major problems when building a co-operative procedures.

When choosing a new supplier and business partner, there is an inevitable financial risk that has to be minimized. When conducting a deal with the supplier, the buying organization should be able to trust that the supplier can follow the terms and the price of the contract. Measuring

financial stability of the potential suppliers can be easy comparing to less quantitative factors, but processing the information can take a lot of time and work power.

Innovations are vital for a company that seeks growth and development in the future. They also benefit the partnering companies. Potential for creating innovations, that benefit the company itself, can be a major decisive factor when choosing suppliers. Implementing innovations is also risky: not every innovation is successful, and the funds invested in them don't always generate positive cash flow in the future. Choosing an innovative partner, that is also financially balanced, can be a major advantage for a company, especially in the co-operative business-tobusiness environment.

Last factor presented in this theory is the flexibility and responsiveness of the supplier. Ability to adapt to your business partners needs in possible changing situations and make compromises can be a major benefit in suppliers for the buying organization. If the supplier cannot answer to for example a rapid growth or spikes in demand, the buying organization loses profits because of the supplier. Flexibility is becoming more and more important factor in the modern, rapidly changing business environment, and it's a major factor the buyer must consider when choosing the best supplier.

Evaluating and comparing suppliers is not as easy as it looks, and the quality and price are not the only factors to be considered, as presented previously. Measuring all the different factors can be time-consuming and can generate surprisingly large amount of costs to the buying organization. Company must choose the most important factors for every situation individually, and try to make the best possible decision based on the information that is at hand.

3.2 *Online reverse auction*

Reverse auctions is one of the main theoretic procedures addressed in this thesis. Goal of a reverse auction is to simply find the supplier that can offer the best price for the item or service in question. (Lysons, K. et.al. 2006; p. 199) In some cases, online auctions and reverse auctions are addressed as two different options, but this view can be outdated in the modern world where practically everything revolves around online-based platforms. In this thesis, it is a basic

assumption that the reverse auctions are conducted on some kind of online platform, and the difference between online and reverse auctions isn't essential.

Reverse auctions are basically a tool to help better the efficiency of tendering. Compared to for example growing the business altogether, an efficient tendering is a relatively easy way to increase profitability: if a company's margin of profit is for example 20 percent, one dollar saving in costs is the equivalent of a five dollar rise in sales, regarding the growth of profits. Lowering the costs as much as possible is therefore an important part of organizations financial success. (Emiliani, Stec, 2002) As this chapter shows, reverse auction can be a very powerful tool to achieve just that.

Figure 1 Example of a bid record generated from an online auction for "Lot X" of buyer-designed machined parts

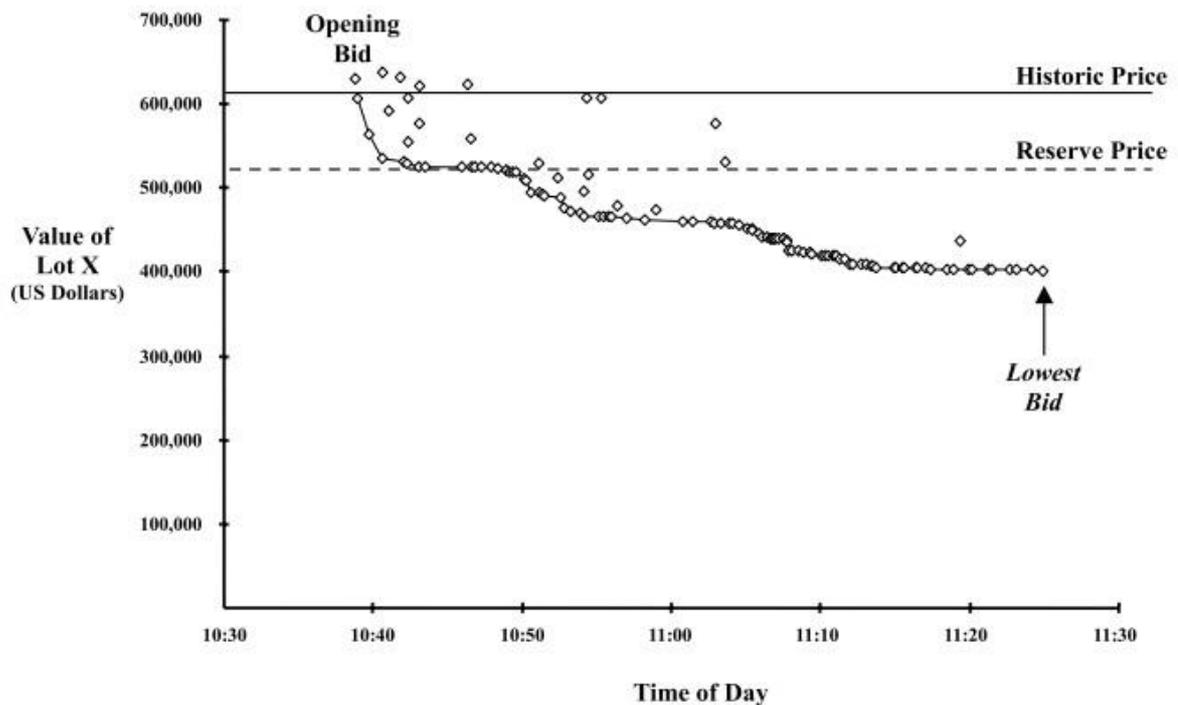


Figure 4: Example case of the effect a successful reverse auction has on the price of a single purchase (Emiliani et. al. 2002)

In the figure above (Figure 4) the price development during a reverse auction. "Historic price" refers to the price the buying organization has last purchased the product, and the "reserve price" means the level at which the buying organization is ready to switch to new supplier. The development seen in the graphic happened during one hour from the start of the auction.

3.2.1 Preconditions

The factors concerning supplier evaluation, as presented previously in figure 3, are also relevant when a company prepares to hold a reverse auction. Evaluating the suppliers is important part of the process: goal is to narrow down the supplier base that can take part in the auction. There is one simple basic idea that is crucial and in many cases, the most important precondition of a successful reverse auction. When the auction starts, it shouldn't matter to the buying organization which of the partaking supplier options wins the auction. All the suppliers must be evaluated beforehand and chosen as an actual prospective future business partner. (Emiliani et. al. 2002) This ensures that the auction is fair, and the result is actually useful for the buying organization. If only one or two suitable suppliers are found in this part of the reverse auction process, there is no point in continuing to the reverse auction itself.

The number of possible suppliers is also a major factor when planning on a successful reverse auction. According to basic principles of conducting a reverse auction, the more suppliers take part in the auction, the more likely it is to get the price down to the wanted price level. A common rule on the sufficient amount of suppliers can't be made, but it's not likely that a reverse auction with less than five partaking suppliers will provide useful information for the company, that can't be researched without the help of a reverse auction. (Emiliani et. al. 2002)

If these two preconditions are met, the reverse auction can be conducted with a good chance of a fulfilling result that can help the buying organization to massively decrease the costs on the good or service in question. As stated before, exact limits on the amount of suppliers has to be evaluated on each case separately, and studies on the matter don't even try to present any exact, common guidelines on the matter.

Contrary to all the other previous preconditions, the possibility to conduct a reverse auction on a limited amount of suppliers has also been studied, and it seems that the possibility of a successful outcome can be achieved with only a few partaking suppliers. This requires a whole new kind of approach to the process of the auction, new aspects to evaluating suppliers, and a totally different view on how to choose the "winner" of the auction to achieve the overall best situation for the buying organization. The subject has only been studied on a few articles, and is a totally new approach to reverse auction. Nevertheless, it is proven that a successful reverse auction can happen with only two or three supplier options. This can widen the possibilities of

reverse auctions and bring the possibility closer to many more organizations that wish better the efficiency of the purchasing procedures and increase profitability. (Ray, 2011)

3.2.2 Benefits and issues

M.L. Emiliani (2000) addresses the possible benefits and issues that may occur when taking online reverse auctions as a part of the company's purchasing process. Firstly, the auction process is highly disciplined compared to a traditional, one-by-one tendering, and by disciplined process it helps the buying organization to stay focused on the results, that being the lowest possible price. On the other hand, choosing the best supplier for each product separately can lead to a scattered supplier base, where the amounts that are bought from one supplier stay small. Over time, this can lead to higher total costs through the expenses wasted to maintaining a large supplier base.

The involvement of a third party, an intermediate who provides the online platform on which the auction is held, can bring valuable experience to the tendering project. The online reverse auction providers have held numerous auctions, and are the best possible partners to gain information and knowledge of the auction process, possible problems and attention-worthy issues. (Emiliani, 2000) This can be a major benefit especially for a company that is performing its first auction, and need help in the process.

The reverse auction process forces the company to consider multiple new suppliers, which they wouldn't have even thought about without the auction. To be as successful as possible, the company must involve as many potential suppliers as possible. This can help the buying organization to discover suppliers that would have otherwise gone unnoticed. Process also shortens the negotiation process significantly, at best from months to mere hours, saving time and lowering the risk on changes during the process. (Emiliani, 2000)

Issues that might follow from moving from negotiation-based traditional competitive tendering to automatized online auctions include reduce of value of the buyers who work for the organization. The amount of people needed to conduct a single purchase is likely to reduce. This can affect the workforce's motivations towards implementing such procedures. The buyer must also be prepared for the cost of switching suppliers. The change from previous practices to online auctions should also be well informed to the existing suppliers, to ensure a smooth

transfer and a good possibility to continue businesses with the old suppliers, if it's financially supported. (Emiliani, 2000)

As the example on figure 4 shows, the most important benefit a company can achieve from reverse auction is the decrease in costs. This is obviously the main goal of conducting a reverse auction, and to achieve this the company must take into consideration the preconditions needed for a successful auction and possible issues that may occur during and after the process. When used in the right situation and right circumstances, using reverse auctions can be a major factor in bettering the profitability and economic stand of the company. As the theory shows, a company considering reverse auction must carefully evaluate the risks and issues, choose the right object that would be suitable for reverse auction, and conduct the auction according to strict guidelines, to be able to achieve the best possible outcome. The possibilities reverse auction offers are tempting, but implementing the procedure is not as simple and should be carefully thought through.

4 Case company: Kon-Tiki Tours

This chapter presents the case company more closely, focusing on the services they provide, focus segments and client base. Knowledge of the company's rather unique range of travel services and current situation of supply management is vital for understanding the research material and results of this study. First, the case company is presented at a general level, and the second part of this chapter focuses on describing the current situation of the supply management in the company.



Picture 1: Kon-Tiki Tour's logo

4.1 Introduction of the case company

This research is based on the interview with the managing director Timo Saranpää. Saranpää works for every department of the company, and is responsible for general administration, marketing and finance. Saranpää says that most importantly, his role is to make sure the staff has enough resources to fulfill their duties. The company employs 9 salespersons, that all have their own area of specification. The business idea of Kon Tiki is to provide tailor-made trips for different kind of organizations, not to individual consumers as most traditional travel agencies do. Saranpää describes the company as follows:

“Kon tiki provides tailor-made travel for groups and network companies that include clients, group collectors, and agents all over the globe, tour leaders, guides, personnel, good pricequality-ratio and environmental responsibility”

As a travel agency Kon Tiki differs from most others by its client base: all of their customers are organizational, and they don't sell any individual trips. All of their trips are sold to different organizations, and they are tailor-made for each occasion separately. Due to the nature of their supply, marketing is targeted to associations, clubs and companies. Good examples of their organizational clients are different senior associations and magazines that organize reader trips. Kon Tiki organizes a lot of trips with special themes, such as bird watching, history, wine and food, and art and opera. Typically, the minimum amount for their trips is 20 people.

The strategy of Kon Tiki is to provide great price-value-ratio to its customers through unique, tailor-made trips. Kon Tiki has got a wide global partner network: every destination country has a local agency that Kon Tiki works in co-operation with. Saranpää sees the company as a network company, and it's crucial for the company's procedures to find a good, trust-worthy agencies that understands the quality. Kon Tiki is seen as a “challenger” in the market, and its strength is in its flexibility and professional attitude.

4.2 Current situation of supply management

Most of the case company's purchases go through the local agent. This makes Kon-Tiki's operations in the destination country easier, but it can also be a major problem considering the

costs and profitability of the company. When planning a trip, Kon-Tiki's employee contacts the local agent and asks for an offer, usually on the whole portfolio of the services their customer needs for the trip, including the accommodation and transportation. The local agent then puts together a proposal and Kon-Tiki approves it. This is the process in its most simple form. At some locations, Kon-Tiki has two or three different agents, and they ask for offers from all of them and then decide which one they most rather want to do business with.

Kon-Tiki does some service purchases itself, and at these cases they usually ask for a few different offers from possible suppliers and choose the best one. The process is very simple and fast to conduct, but doesn't give the best possible results in terms of lowering the costs efficiently. The company hasn't used any tendering tools before, such as reverse auctions.

When planning a trip, Kon-Tiki tries to evaluate the number of people that will take part in the trip in co-operation with the client. As Saranpää states, the best scenario is when the client can make an accurate prediction on how many people will be joining: that is a huge benefit considering the financial risk of organizing such trips.

“The size of the group has an enormous effect on the profit margins and profitability of our business activities”

As Saranpää states in the previous quote, ideal group size is a lot bigger than the minimum of 20 people. The difference in the amount of work when organizing a trip for 50 people isn't that much bigger than the amount needed to organize a trip for 25 people, but the profit margins are a lot better.

Regarding the demand management, when it comes to financial risk, the non-traditional business model does not protect Kon-Tiki. They have strict timelines on when they have to confirm the amounts to the suppliers in the destination, and they also have to pay for them, often before they have a final number from the customers on how many people will be participating the trip. The terms on which they can cancel for example reserved hotel rooms or seats on a plane vary. After a certain deadline, if the customers cancel some of the reserved seats, they still have to pay some part or even the whole sum of money, depending on the deadlines determined in the contract.

“From a commercial point of view, the financial risk is on us, but the group size is planned in co-operation with the customer. Usually the customer organization has a better clue on how many of for example their member would possibly be interested in such trip.”

This co-operation lowers the financial risk Kon-Tiki takes when starting to organize a trip, and helps with the demand management process. The tailor-made nature of the trips increases the challenges supply management faces: every trip organized is different, and the need of local agents that do most of the purchasing of services is inevitable. As Saranpää says, the need for purchasing procedures renewal has been on the table for quite a while, but there hasn't yet been any actions towards it. He says that they should be able to give up the use of agents and do more effective tendering in the destinations themselves. Losing one link from the chain would also help to better the profitability.

5 Empirical research

The empiric research focuses on the problems presented in the research questions: effective service supply management in a travel agency's business to business environment, and how different approaches and procedures may help to make it more effective, both cost- and timewise. The research is based on the interview with the case company's managing director Timo Saranpää. First, the research focuses on how the characteristics of service supply affect the current situation and how they are being taken into notice. The second part of the research addresses the possibility of implementing reverse auction into the purchasing process of the company. Tendering and especially using reverse auctions is not widely studied in the supply management field, and this research thrives to combine the two different views.

5.1 Purchasing services

The case company doesn't make any other kind of purchases for their main business procedures other than services. The range of different kinds of services needed on the trips Kon-Tiki organizes vary greatly, but most important types of services, that make most of the costs, are

accommodation and transportation services. The problem with this kind of buying portfolio can be the fact that you have to be careful in forecasting the demand beforehand: if Kon-Tiki buys seats on a plane for 50 people but only 40 people take part in the trip, they can't store the remaining ones and use them later. This is one of the most important ways the service characteristics affect the company: need for short-term demand management is plays a major role in minimizing the financial risk.

Kon-Tiki relays on their customers when it comes to forecasting the demand on their trips. The decision on how many seats they will reserve is made in co-operation with the client. Considering how great the financial risk is every time they start to organize a trip, more effective demand management would help the company to lower the risk of losing profits due to cancelations or the customer's inability to fill all the seats reserved for the trip.

After analyzing the data from the case company, the demand management methods used in the company are suitable for their business model and the situation they're in. Usually the customers can provide a pretty good prediction on how many people would be interested in taking part on the trip, and this helps to lower the risk on Kon-Tiki's behalf. The intangibility of services also surface the problem of evaluating the quality. This is more accurately analyzed in the next part of the research, when the tendering policies and the problem with evaluating suppliers is addressed.

5.2 Tendering policies

When evaluating possible service suppliers, the case company must take into consideration the characteristics of service supply management, and how they affect the daily procedures of purchasing services used on the trips. Just like on other supply management fields, tendering services can be very different from traditional supply managements tendering policies. Evaluating the quality of a service beforehand is a lot harder than checking the quality of physical goods. This is especially true when the service providers can be located at the far side of the globe: it may seem simple to check if a hotel matches the quality standards by walking in and taking a tour around the lobby, but traveling abroad to do this is not cost or time efficient in any way. This is where the local agents that Kon Tiki uses in its destinations abroad are important: the local agents have experience and knowledge of the possible suppliers.

“Operating in, for example, South-East Asia, would be much more difficult without a trustworthy local agent that meets with suppliers and can give a good image of the quality of the service in question for us.”

The use of same agents for years is also the biggest issue the company has in bettering its profitability and lowering the costs of the services they purchase. In order to conduct more effective tendering, the company should move more and more from using the local agents to purchasing the services themselves. This would allow the company to conduct proper tendering methods and would allow them to get a proper view of the actual price level in the destination, rather than settling with whatever the agent is offering. Saranpää sees it important that the company could in the future use the agents less, also getting rid of one intermediary that takes up part of the profits. Development towards a more independent way of purchasing would also allow the company to use more tendering procedures, and that way lower the costs.

As stated before, the company is well aware of the need to lower their costs and better their profitability. According to Saranpää, one of their competitors has repeatedly better margin profits, by a few percent's. This is due to the fact that they have continuously used tendering when purchasing, and the use of agencies is significantly smaller. The use of reverse auctions sounds very tempting to the case company, but there are many possible issues and problems as well. These issues, as well as practical implementation of the auction, are addressed in the following chapter.

5.3 Possible use of reverse auctions

As stated before, the company has not used any reverse auction methods in the past. The tendering policies in use are relatively simple: asking for tenders from a few possible suppliers, and choosing the best one from these options. This is done when the destination is new and there are no previously used suppliers. The supplier options are usually presented by the local agents. When asked about the subject, reverse auctions did sound tempting, and possibly an easy way of making the tendering process faster and more effective. The biggest concerns that rose from the interview concerning the use of reverse auction was the resources needed to conduct such process, and the possible negative effects on relationships with some current, long-term business partners. As presented previously, when addressing the theory behind

reverse auctions, these are all common problems and can be determining obstacles that keep a company from trying the procedure.

The portfolio of services the case company must purchase varies, from accommodation to transportation, and the services needed for every individual trip organized can be very different from each other. That's why it's also important to try to choose carefully which of these services would be the best candidates to try a reverse auction for. The possible negative outcomes must also be taken into consideration. These are the main focuses that are studied in the research concerning the use of reverse auction.

5.3.1 Choosing the objects of the auction

When implementing the reverse auction process, which is traditionally much more commonly used in the purchases of tangible goods rather than services, the buying organization must carefully choose the services it could be easiest to use on. The buyer must remember the characteristics of service supply, and of course the basic factors behind tendering and reverse auctions.

Biggest factor when narrowing down the possible services suitable for reverse auction is the quality differences of the suppliers. The quality of the service is seen by the customer as the quality of the company itself, and that makes it of paramount importance. Case company thrives to provide its customers as high-quality services in all parts of the trip as possible, given the funds in use. If reverse auctions were implemented into the purchasing procedures, the quality of the services must remain at a sufficient level. The services on which it could be implemented on should be chosen accordingly: a service that has multiple optional suppliers that would also fulfill the quality standards. All the suppliers that would take part in the auction would have to be good enough to be chosen: that's why it's important that there is enough suppliers in the field to start with.

After analyzing the information on the services Kon Tiki purchases the most, the best option for reverse auctions seems to be the transportation services. Company often gets one company from the destination that handles all the transportations needed during the trip: in practice, this often means one bus and one driver that travels with the group the whole trip. The impact these

services have on the overall costs is significant, and tendering them as efficiently as possible could have a major impact on the profitability of the company.

Transportation would be suitable to be a reverse auction object for a few different reasons. There are multiple suppliers in practically every destination that provide transportation services: the possibility to find a large enough supplier base to choose from is vital when planning a reverse auction. The more the options, the better chance there is to find a supplier that has the best price-quality-ratio. This increases the chance that the overall outcome of the auction is profitable and suitable for the buying organization Kon Tiki.

Transportation is also relatively standardized service: the quality doesn't differ from one supplier to another as much as for example it would if accommodation services are in question. Getting the travel group from the airport to the hotel with a tourist-class bus is a simple and straightforward service, and the variations between different companies isn't that large, but if you compare cheap hostels to a five star hotel, the differences are much more substantial. This is why the transportation services are a better fit to use reverse auctions for: the difference between suppliers isn't as determining for the overall experience of the trip.

5.3.2 Possible problems with current suppliers

Another big issue concerning the use of reverse auctions was the strain it might cause on the current relationships with frequently used suppliers. Kon-Tiki has organized numerous trips to same destinations, and the relationships with the suppliers has been built on mutual respect. The company feels that risking some of these relationships and the stability and low risk connected to using same suppliers over and over again can't be measured in money. The balance between possible savings in costs and the attitude the suppliers have towards the buyer can be too easily disturbed by new procedures in tendering. Each situation should be considered individually, and a common rule can't be set.

Nevertheless, staying in business with the same partner year after year can be a problem too, and this is well acknowledged in the company. Without the pressure of competition that tendering procedures bring onto the suppliers, the cost can easily rise above the market price. The company admits that staying with the same suppliers is "a kind of lazy choice, and it has its pros and cons".

5.3.3 Resource limitations

The main reason the case company in most cases still stays in business with the agencies is the resources that would be needed to conduct a proper amount of tendering. Kon-Tiki is a fairly small travel agency, but it has a lot of growing potential, and it seeks growth in the future.

“I would definitely want to develop out actions towards that we would use more effective tendering methods on service suppliers without any intermediates, but at this point, we don't have enough resources for that.”

Saranpää sees that the lack of time their salespersons have organizing a single trip is the main reason the use of agents is still so common. The problem is to keep the balance between developing the business and keeping the result positive.

Nevertheless, even if using reverse auction as a way to lower the costs is not possible for the company at this point, the plan is that it will be in a few years time. Saranpää feels that the reverse auction would be suitable for them, because in most of the destinations, there are multiple supplier options on the types of services they need. Using online platforms to conduct such procedures would also be a perfect fit for the case, given that the suppliers can be anywhere in the world.

6 Conclusions

The goal for this thesis was to combine the theoretic background of service supply management with tendering theory and find ways to implement efficient tendering solutions, such as reverse auction, into the purchasing of services. First the research concentrates on the theory of service supply management and the definition of services and characteristics that cause the purchasing of services to differ from the supply of tangible goods. The intangibility of services also makes the service demand management vital for conducting strategically and financially profitable purchasing.

The second part of the theoretic framework presets the theory behind tendering. Evaluating the suppliers efficiently and taking different factors into notice is an important part of tendering process. The same background applies to the reverse auction as well. Reverse auction is addressed broadly, presenting the preconditions, benefits and issues of conducting a reverse auction.

The case company is a travel agency with a business model that differs from what is traditionally viewed as travel agencies way of working in the tourism business. Kon-Tiki Tours operates in the business-to-business environment, providing unique, tailor-made trips for customer organizations. The current situation of the supply management in the company is presented: it's important to understand the nature of their activities in order to try to improve the performance of their purchasing procedures.

The empirical research focuses mostly on the implementation of reverse auction. The auction process requires a thorough evaluation of service suppliers, and the intangible nature of services makes the evaluation of quality of the service much more difficult. Whether the reverse auction is an option worth considering, the issues and possible benefits have to be weighed carefully. The research also addresses the possible choice of service that would be optimal for reverse auction process. The results of the research are presented in the following chapter.

6.1 Results

To be able to conclude the results of this study and find an answer to the main research question, first the sub-questions are reviewed and answered. The results are based on the theoretic framework and basis on the research subject and the empirical research on the case company Kon-Tiki Tours.

The first sub-question was about how the service supply management differs from the supply management of physical goods, and what effects do these differences have in practice for a company whose buying portfolio consist mainly of services. According to the theory of service supply management, the most influential characteristic is the intangibility of services. The level of intangibility is also the trait that defines whether an offering can be categorized as a service. For the case company, the biggest effect of service supply's intangibility has on their business activities is the need for careful demand management, especially the short-term forecasting of demand. Another big issue for Kon-Tiki is the evaluating of suppliers based on their quality of service, and the intangible nature of their purchasing portfolio makes this crucial task a challenging one.

The second sub-question addressed the issues and benefits the implementing of a reverse auction can bring to the buying organization. The biggest and most important benefit would be the reduction of costs. For the case company, the need for lowering the costs of their purchases is a problem that should be addressed if they want to better their profitability.

The main research question can be answered with the help of the results of the sub-questions. The main research question, as presented in the introduction, is as follows:

“How could reverse auctions be implemented into the purchasing of services in a travel agency's business-to-business environment?”

To be able to conduct a successful reverse auction, the company must evaluate the suppliers and narrow down the possible suppliers to the ones that would be totally suitable to be a future business partner. Evaluating the quality of services can be difficult, but if Kon-Tiki wants to use reverse auction as a tool in tendering and achieve lower costs, they have to be able to find

a way to do that. Choosing the right target is the first step. A suitable option for reverse auction would be the transportation services that Kon-Tiki must purchase in practically every location. The suppliers are relatively homogenous in quality, and there are usually many options in every destination. The company must also take into notice the possible issues with current agents that they have built close relationships with. Whether the reverse auction is financially or strategically profitable or not, depends on the value they put on current relationships, possible lowering of costs and the resources they have to use into the procedure. Right now, the company doesn't have the resources to develop their purchasing, but in the future as the company grows, the reverse auction process in a tempting tool that could help them reduce the costs and in the long run better their profitability.

6.2 Possibilities for further studies

One very interesting research area that this thesis touches slightly, is the supplier evaluation methods. Different factors that have to be considered when choosing suppliers are addressed in this thesis, but a more throughout look into the different ways of evaluating suppliers and how a proper supplier evaluation would help to get better results from tendering would be an interesting issue to study further. Especially in the business-to-business environment, where the case company purchases services, evaluating suppliers plays a major role in conducting efficient tendering. Supplier evaluations role in a successful reverse auction would be an interesting starting point for a study.

Another interesting theoretic issue is the demand management and its implications on service supply management. Forecasting the future is impossible, but there are many different models on how to efficiently predict future trends and demand. For the case company, it would be interesting to study how they could take the upcoming trends in tourism into notice and develop their trip selection accordingly.

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Attachment 1

Interview questions

1. What is your role in the daily activities of the company?
2. How important is a successful supply management for your company from your point of view?
3. What are the basic traits of purchasing currently is use in the company?
4. What kind of tendering policies are in use?
5. What are the main restrictions on developing the tendering in the company?
6. How would you feel the reverse auction process would fit into the daily activities of your company?
7. How do you feel the characteristics of purchasing services affects the ways purchasing is conducted in the company?
8. When planning a trip, who carries most of the risk concerning possible cancelations etc.?
9. How are the decisions on how many seats are reserved when starting to organize a trip made?
10. How do you see the possible benefits on implementing reverse auction?
11. How do you see the possible issues on implementing reverse auction?