Bidding When Cost Is Uncertain: Evidence From Fresh Produce Procurement Auctions *

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Abstract

This paper empirically analyzes procurement auctions in which suppliers must decide their bid based on expectations about how future market conditions will affect their costs. While previous literature has focused on the uncertainty about winning or losing the auction, I examine the risk that is intrinsic to the contract. I use data from government procurement auctions in the State of Sao Paulo in Brazil for fresh produce to study the effect of contract risk on auction outcomes. I find that suppliers are risk averse and therefore include a risk premium in the prices they bid, which can reach 38% of the price for some goods. In addition, I show that a simple change in the payment scheme, in which the government pays a fixed amount plus 40% of the reference index of wholesale prices, could reduce the risk premium to less than 1% of the bid price for all goods analyzed.

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