Auctions essay sample

Business, Marketing

a).

In the introduction of the article, “ Counterspeculation, auctions, and competitive sealed tenders” William Vickrey (1961) mentions the study by A. P Lerner titled “ Economics of Control” which suggested a strategy known as “ counter speculation” that can be used by state agencies in imperfectly competitive markets to create conditions that facilitate the maintenance of marginal conditions for efficient resource allocation. Vickrey however mentions that the process of carrying out this strategy was not clearly laid out in this initial study. Vickrey then suggests that studies seem to indicate that most of the devices incorporated into this strategy often turns out to be very expensive in terms of the device’s demands of the state’s fiscal resources relative to the realizable net benefits. This is where the subject commodity is finely divisible.

In the second section of the article, Vickrey explores the relationship between divisibility of the resource and the optimum allocation of this resource. He mentions when a particular resource that is being allocated comprises of small divisible units rather than a single fungible commodity, then the chances of assuring optimum resource allocation are improved considerably since such an endeavor constitutes of a range of different prices that essentially lead to the same optimal allocation of the particular resources under trade. Vickrey contends that auctioning and bidding and auctioning procedures determines the price of a resource. He gives an example of a bidding procedure comprised of a progressive or ordinary auction whereby the auctioneer makes bids until no buyer wishes to make a bid that is higher than the one currently standing. In this case, the object is

purchased by the highest bidder, a result that Vickrey refers to as “ Pareto-optimal”.

He then introduces a new procedure referred to as a Dutch auction whereby the auctioneer basically announces the prices of a commodity in descending fashion, with the first and single big concluding this transaction. Each bidder in this scenario has to gauge the perfect time to make a bid which will ensure that he has the greatest gain expectation and in doing this, he or she must take onto account any information he has regarding the probable bids that might be made by other bidders. Bidding when a price comes down to the object’s full value increases the chances of acquiring the object, but at the same time guarantees zero gain from securing it. As the announce price progressively goes down, the chances of a gain arises but this gain that is being sought increases with lowering of the price to the point where a bid is made and this causes the probability of acquiring the gain to diminish. Consequently, Vickrey suggest that a bidder must take these two issues into consideration. Vickrey also extrapolates some data that seem to indicate that the Dutch auction may possess some disadvantageous characteristics than the progressive auction with main being the lack of optimum allocation especially where there is great variation in the intensity desires of the bidders.

The third section of the article explores the implication of the conclusions from the second section in regard to situation involving contracts of let and sales. Vickrey explores whether there exists a sealed-bid procedure that is logically isomorphic to a progressive auction given that it is the more advantageous of the two types of auctions. Vickrey suggests that the best

procedure in this scenario would involve asking for bids with the understanding that although the awarding to the object will be to the highest bidder, this will however be on the basis of the second highest bidder's price. The implementation of such a procedure means that each bidder's optimal strategy will be to make a put up a bid that is equal to the article's full value or alternatively to contract himself, that is the highest price that the bidder can afford without sustaining a net loss or the price whereby there would be no difference in terms of value, whether he gains the object or not.

In the conclusion, Vickrey suggest that counter speculation is a very dynamic strategy that may or may not work depending on the negotiation strategy adopted, whether Pareto-optimal or Dutch. Vickrey also suggest that it is quite hard to achieve optimum allocation resources in markets where the amounts that a given trader might sell or buy are in actual sense not predetermined but are ultimately determined by the procedure of negotiation accompanied by the amount that is going to be paid.

b)

The motivating idea behind Vickrey's study of auctions was the article " Economics of Control" by A. P Lerner that brought forward the " counter speculation" that could be used imperfectly competitive markets. The fact that this strategy had not been subjected to actual practice or even any critical examination of its contents prompted Vickrey to assess its applicability to an imperfectly competitive market such as an auction process.

c)

Ordinary or progressive auction- Absolute auction

Homogenous rectangular case- Regular homogenous

d)

The outcome of the progressive auction is Pareto optimal. Here, the bidder to whom the object has the highest value purchases the object. At this point, this is the only bidder who can reach the current asking price and in many instances, it is approximated that bidding usually stops at a level that is approximately equal; to the second highest value among the values placed by the purchasers on the item. The Pareto optimal emerges in that the value or profit of acquired by one bidder on an object cannot essentially be increased without decreasing the value on another bidder. This is why at the end of a progressive auction, only one bidder remains at the end, and this is usually the highest bidder. The outcome of the Dutch game is not Pareto optimal because the maximization of one's gains does not automatically mean the minimization of another.

e) Assumptions made in the analysis of the Dutch game

1. The knowledge that any player has on the probable behavior and motives of other layers is derivable from a singular probability distributions set. This means that all bidders have similar a similar conception in regard to the probability distribution from which any player derives a value that places of a particular object.

2. The bidder acts purposefully, maximizing either the expected utility to expected profit from being the winner of the auction

The elements ruled out from the start include side payments, collusion among the bidders, and signaling or any communication between the

bidders.

f.

Vickrey (1961, p. 20) suggest a new sealed bid method where he states that “ the required procedure is to ask for bids on the understanding that the award will be made to the highest bidder, but on the basis of the price set by the second highest bidder”. This method has an advantage in that it yields a significant increase in the aggregate profits that are shared between buyers and sellers. Problems might however arise if a “ shill” is used to jack or increase the price by putting up a late bid that exceeds the top bid. To overcome this problem, “ it would be desirable to have all the bids delivered to and certified by a trustworthy holder, who would then deliver all bids simultaneously to the seller” (Vickrey, 1961, p. 22). Vickrey (1961, p. 22) goes on to state that “ under these circumstance, the seller would have no incentive but to sell to the top bidder, showing him as him as his price the second best bid”.

References

Vickrey, W. (1961). Counterspeculation, auctions, and competitive sealed tenders. The Journal of finance, 16(1), 8-37.