The Essence of Competition

A professional bidder carefully researches the coin for sale, keeping in mind its value to future buyers.

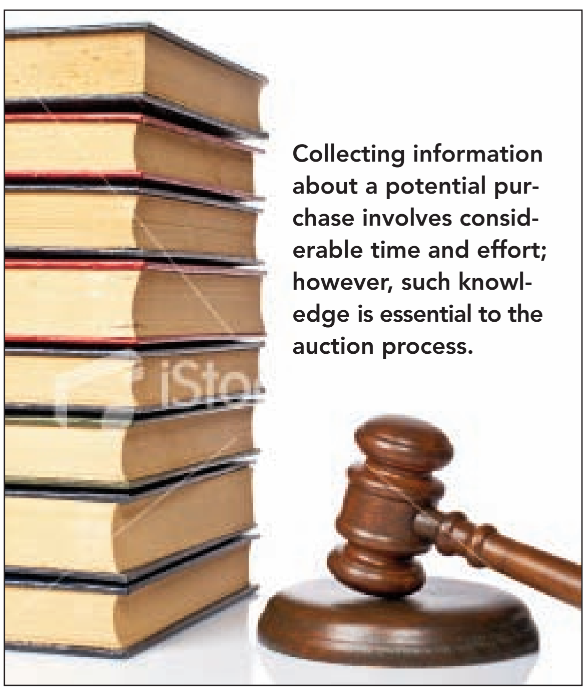
DECEPTIVELY SIMPLE on the outside, the auction process actually is fairly complicated. Before we discuss the most popular type of auction, we should talk about the homework a bidder must do to participate.

When an individual, such as a coin collector or house-hunter, wants to acquire property for his personal use, he privately values the commodity he intends to buy. He might come up with this information on his own or hire an expert to do so.

Collecting such data can be costly and, if done correctly, can involve a lot of time and effort. Understandably, after working hard to get that information, the individual generally keeps what he's learned to himself. Bidders who want to become buyers also tend to keep their identities a secret to prevent bidding wars. If the seller already knew what his property was worth, who the potential bidders were, and just what the highest bidder was willing to pay, there would be no need for an auction, because he simply would sell the item directly at the best price.

One reason for bidding in an auction is to acquire products for commercial use or, in the rare-coin business, resale. In the case of resale, the bid is based not only on the buyer's private valuation, but also on his estimate of its future value to buyers, to whom he will resell his product. Therefore, each commercial buyer has to make an educated guess, using some universal measurement, as to what each buyer down the road will be willing to pay . . . all the way to the ultimate buyer, in this case, an investor, retail consumer or collector.

The professional bidder takes into account a variety of factors, including his opinion of the grade and value of the coin he is buying, and the nature of his customer, the next buyer. Each professional bidder in the auction almost certainly has a different buyer in mind. And who knows how many buyers fall in between the original buyer at the auction and the ultimate buyer? The original buyer may not even know the buyer at the end of the line, and how he will value the very product he is purchasing at auction.



Collecting information about a potential purchase involves considerable time and effort; however, such knowledge is essential to the auction process.

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Somewhere within these considerations and varying opinions lies the essence of the competition between bidders at a public auction.

The "English" style of auction (otherwise known as the "open outcry" or "price ascending" auction) is the most common and popular today, particularly among dealers of coins, art and antiques. Typically, it is conducted in a room filled with potential buyers or bidders, with phones, fax machines and Internet sites serving absent bidders.

The auctioneer sometimes begins the bidding at the seller's lowest, acceptable price (called the "reserve" price). Occasionally, the reserve is kept secret, and the auctioneer starts with the highest price he has received through the mail, from a customer prior to the sale (called a "book bid") or from a customer on the telephone. He then solicits progressively higher bids until no one in the room, or on the phone, is willing to bid higher.

At that point, the item is "knocked down," or sold to the highest bidder (i.e., the buyer). It is called a "knock down" because the auctioneer actually hits the podium with a pencil, his hand or, at a fancy auction house, a gavel (essentially a wooden hammer). The final price is called the "hammer price" for obvious reasons. The auction house adds its commission to the hammer price, then gives the buyer the final tally.

Next month, we'll explore live auctions and the "auction fever" that causes many to overpay.

berman@money.org