

# Mitigating the risk of rising costs and fluctuating prices

Sept 28 2022 Dublin

**Eoin Lonergan FCIPS**

**Director - Tender Team**

**Chairman - Chartered Institute of Procurement & Supply (Ireland)**

**It's good to be back !**

**It's really good to be back –  
I don't blame Philip !**

***Speaker Profile:***

***Eoin Lonergan BBS Hons, MA, MSc, DipM, DipTHed, MCIM, FCIPS***

*Eoin is a recognized procurement and tendering expert with almost 30 years experience as educator, board level advisor, consultant, author and practitioner. Following 20 years working out of London, he returned to Dublin when appointed as the 1<sup>st</sup> Sourcing Director at the OGP in 2013. He has held consulting leadership roles for Deloitte, PwC and EY and currently is a Director with TenderTeam. He is the Chairman of the Chartered Institute of Procurement & Supply CIPS (RoI) and a CIPS Fellow. Over the past 3 years he has focused on supporting companies win business in the public sector in Ireland and the UK, while also running high value complex procurements for clients in both public and private sectors.*

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# Rising costs v Fluctuating Prices.... Not the same !

*Fluctuating prices offer opportunities for hedging, dodging and avoiding risk – inflation is different*

1. Introduction & Context
  2. Overview of tools available to procurement to attack and manage costs
  3. Cost Certainty and Fixed Price Contracts examined
  4. Fixed Price Contracts – can they really reduce risk?
  5. Using Contract Price Adjustment / Price Variation clauses in contracts
  6. Some Do's and Don't's..
- Q&A



# What's the fuss?

*Following decades of low inflation – high inflation is back, and we all need to plan for it..*



€2bn for 'rainy day' fund in cost of living Budget

Budget 2023



An Roinn Caiteachais  
Phoiblí agus Athchóirithe  
Department of Public  
Expenditure and Reform

The Department of Finance has updated its forecasts to headline inflation of 8½ per cent for 2022, and just over 7% for 2023, the Minister said.

**Euro zone inflation broadening and will continue to rise, ECB's Schnabel says**

Prices in Ireland are 9.6% higher than this time last year, new figures show

**Eurozone inflation nearing 10% will test European Central Bank**

**Irish rate of inflation set to 'peak' next quarter, analysts warn**

The Esri predicted a 'spike in prices' for the last quarter of 2021, driven by rising global energy costs and the swell of demand which continues to outpace supply

EVA SHORT | OCTOBER 6, 2021



**THE IRISH TIMES**

Economy

**Irish inflation moderates to 8.7% amid worst cost-of-living squeeze in decades**

Headline price growth drops for first time in seven months

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# inflation - Thursday 8 September, 2022

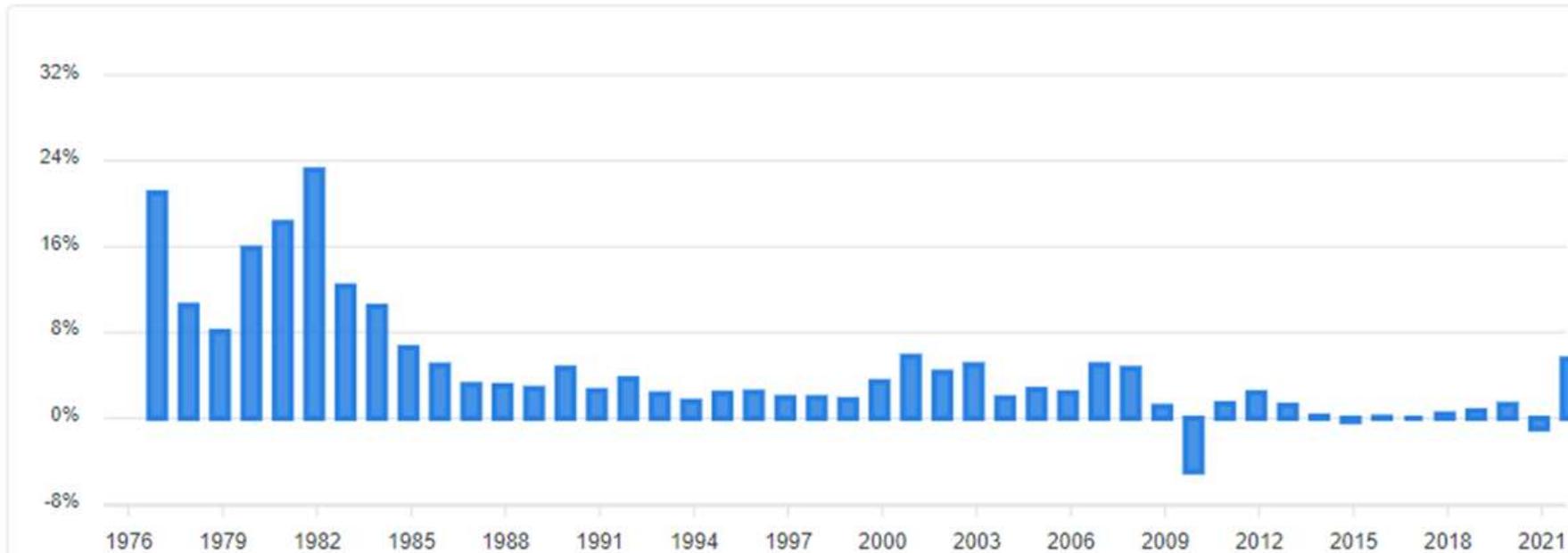
**# COST OF LIVING** Annual inflation eases slightly from last month's 38-year high  
 Sep 8th 2022, 2:48 PM 6,855 Views 1 Comments  
 Home heating oil hits up 72.5% in the year to August.

**# TRACKER MORTGAGES** Tracker mortgages set for increase as ECB hikes interest rates by record 0.75 percentage points  
 Sep 8th 2022, 2:04 PM 52,188 Views 38 Comments  
 The ECB is already playing catch-up with US and British central banks that started raising rates faster in response to inflation.

# No point in trying to forecast inflation rate... !

*Numbers vary but DPER forecasting 7% - 8% into 2023 – can't be ignored*

## Ireland Historical Inflation Rates



8% year on year inflation = almost 40% price increase in 4 years..  
=  
the life of many Public Sector Contracts / Frameworks

# Our focus in this session is on mitigation, but.....

*There are many tools available to procurement professionals to address and challenge costs*

1. **Demand management** – *Do we really need this ?*
2. **Negotiate with contractors** – *is there a win-win outcome?*
3. **Cost analysis** – *Identify exposure and seek substitutes*
4. **Value Engineering & Analysis** – *Can we Design out?*
5. **Standardisation** – *Variety is the enemy of cost reduction*
6. **Make or Buy analysis** – *should we bring "in-house"?*
7. **Target suppliers costs..** – *not their profits !*
8. **Becoming an more "attractive" customer..** *They pay less !*
9. **Early Supplier Involvement** – *Greatest opportunity at procurement / design stage to ask what will reduce costs?*

Done that?  
Mitigate

## 10. Contract Price Adjustment / Price Variation clauses



The screenshot shows the CIPS website interface. At the top, there's a navigation bar with the CIPS logo, a search bar, and a 'Join CIPS' button. The main content area features the title 'L4M5 Commercial Negotiation (CORE) - Study Guide' and a red book cover image. Below the cover, it says 'Edition 1 - 2018' and provides a brief description of the study guide. To the right, there's a 'Buy' section with a 'Details' button and a price table:

Category	Price
Members	£21.00
Non - Members	£21.00

Below the price table, there's a 'Join CIPS' button and an 'ADD TO BASKET' button. The quantity is set to 1.

# Inflation should not be ignored – particularly as a buyer

*You cannot fix costs – just prices - someone always pays...*

Fixed Cost Contracts were largely unquestioned in low inflation times when suppliers could absorb 2-3% and /or find efficiencies via technological or other innovations – even in extreme cases !

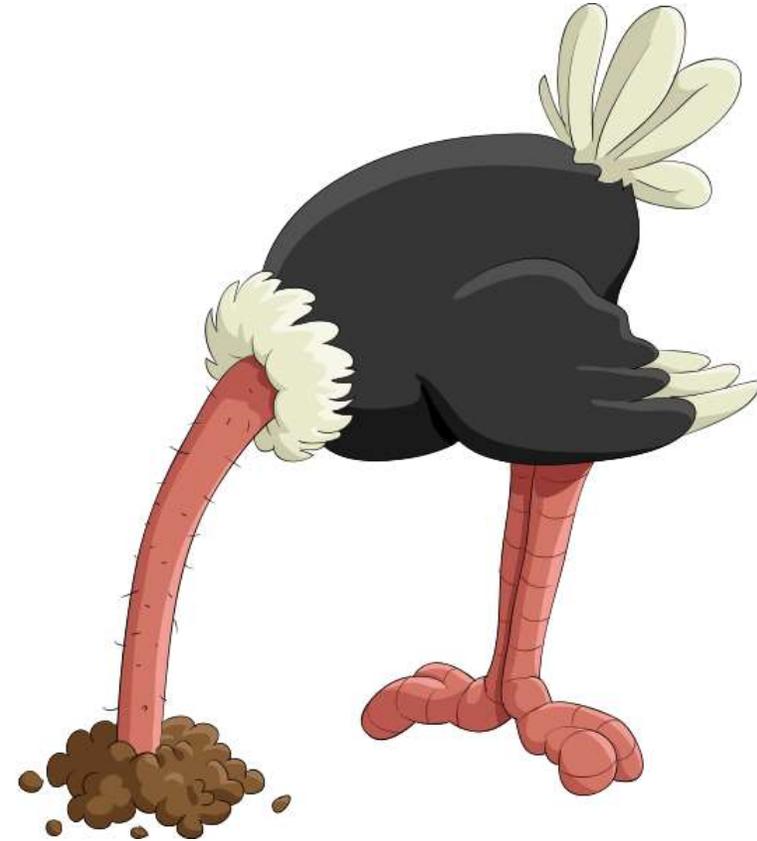
## Provision of Legal Services REQUEST FOR TENDER

### 6. APPENDIX A - FEE PRICING SCHEDULE

Tenderers to complete the pricing schedule below for all members of the proposed team using the role descriptions provided:

Fee Proposal			
Ref no.	Description	Tender Hourly Rate (€)	Tender Daily Rate (€) <sup>1</sup>
SR01	Trainee		
SR02	Assistant Solicitor or Junior Lawyer (i.e. up to four years qualified)		
SR03	Associate/Senior Lawyer/Consultant Solicitor (from 4 years post qualified up to partner/director level)		
SR04	Partner/Director or equivalent (includes salaried and equity partners)		
SR05	Other (please describe)		

All prices are to be held for 5 years and a further 2 years if contract is extended at discretion. Appropriate narrative should accompany the table describing any relevant assumptions in preparing the figures.



# Government now acknowledges ignoring does not work

*Announcement that Govt will reimburse construction suppliers for inflation in specific situations*



## Capital Works Management Framework

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Click [here](#) for details of the Inflation/ Supply Chain Delay Co-Operation Framework Agreement

CAPITAL WORKS  
MANAGEMENT FRAMEWORK

PILLAR 1: PUBLIC WORKS  
CONTRACTS

PILLAR 2: CONDITIONS OF  
ENGAGEMENT

PILLAR 3: COST PLANNING  
CONTROL AND SUITABILITY

### Details of Inflation/ Supply Chain Delay Co-operation Framework

[Guidance Note on Inflation/ Supply Chain Delay for use with: PW-CF1 – PW-CF5](#)

[Guidance Note on Inflation/ Supply Chain Delay for use with: PW-CF6](#)

[FAQs](#)

#### NB:

This presentation does not address the specifics of the CWMF – but wider cost mitigation approaches that can be considered in public sector contracts

# Cost certainty - so attractive yet so expensive..

*You cannot fix costs only prices – someone always pays and it's often the client*

## Fixed Price contracts work best when:

- there is little or no potential for variations in scope
- client can commit to a fixed schedule start / end dates
- external factors / shocks cannot affect project
- suppliers don't feel forced to bid on this basis

How often was / is this true in real life ?

**The drive for Cost Certainty driven by many including DPER and OGP seemed to ignore these basic premises in previous years..**

## Pattern of cost overruns on school and hospital buildings since 2010

**'Clear pattern of cost overruns in capital projects' as 35 out of 38 go over budget**

**Report into cost overruns at children's hospital identifies 'series of weaknesses'**

The report into cost overruns at the National Children's Hospital has been published by the government.



Irish Examiner + Follow View Profile

**Insolvencies climb 'substantially' as businesses struggle**

Cáit Cad **BUSINESS**

**Hundreds of businesses may fail before end of year, experts say**

Corporate insolvency practitioners claim factors including rising energy costs, the loss of government pandemic supports and inflation will wipe out weaker companies

**RTE** NEWS SPORT ENTERTAINMENT **BUSINESS** LIFESTYLE

NEWS > BUSINESS > Focus on Inflation Business of Climate Work & Great Water and Gasol Year Money

**Number of corporate insolvencies up over a third so far this year**

# Put yourself in tenderer's shoes..

*Insisting on fixed prices for long term commitments can reduce chance of optimum outcomes*

## **Vendor 1 – Fly by night Ltd**

*Ignore inflation risk - bid low to get the contract and worry about price / cost pressures later*

## **Vendor 2 – Risk Averse Ltd**

*Must build conservative (i.e. worst case) expectations into pricing so price will be at higher end*

## **Vendor 3 – Large Co/ Multinational**

*Won't bid as Deals Board/ will not take risk of Fixed Price contract in this situation or Bid very high price in hope of not winning*

## **Vendor 4 – Lean and Smart Ltd.**

*Bids mid range and plans methods to reduce costs during contract life if inflation goes above a target amount – (won't share benefit)*

How many of your vendors are Lean and Smart?

How will you deal with supplier insolvency if profitability becomes an issue after say year 1?

# The attractions and risks of Fixed pricing – Case Study

*In June 2022 OGP All Govt Framework for Consulting Services Awarded – 4 years*



**RFT 206674**

Request for Tenders dated 03/02/2022  
to establish a Multi Supplier Framework  
Agreement for the provision of  
Business, Management and ICT  
Consultancy Services (PAS122F)

**PAS122F**

The Term will not exceed four (4) years in aggregate.

Tender Deadline: 21/03/2022 12:00

For the avoidance of doubt, the rates provided in the Maximum Daily Rate Card for each Professional Grade under each Lot shall be the Maximum Daily Rates (SRFT) or Fixed Daily Rates (NASF) applicable to any call off contract over the term of the Framework Agreement(s), i.e. by way of drawdown by Mini-Competition or by Cascade respectively.

Eoin Lonergan FCIPS

**“Ceiling” rates for all grades fixed for duration (up to Q3 2026)**

**= Price Certainty achieved ? ... but at what cost?**

## Costs / risks

### Bid Stage

- Tenderers spending time 2<sup>nd</sup> guessing inflation rates over next 4 years and what others might bid
- Those who bid “low” more likely to get on FW but may not have sufficient margin to cope with inflation over FW life >x%
- Those who bid “high” in anticipation of higher inflation may not have won a place (dropped marks on pricing)

### FW Life

- FW rates not competitive – less bids received/ suppliers deprioritise seek higher margin work over time/ lose interest
- FW becomes unattractive all/ most bidders bid at ceiling rate
- Stronger Members may not bid leading to “off Framework” Procurement

# Good risk mgt places risk with those who can best manage it

*Typical public sector tenders seek to all inclusive prices that place risk with suppliers*

- 2.10 PRICING**
- 2.10.1 All Tenderers must complete the Pricing Schedule at Appendix 2 to this RFT.
- 2.10.2 All **prices** quoted must be all-inclusive (i.e. including but not being limited to shipping, packaging, delivery, ancillary costs and all other costs/expenses), be expressed in Euro only and exclusive of VAT. The VAT rate(s) where applicable should be indicated separately.
- 2.10.3 Tenderers must confirm that all **prices** quoted in the Tender will remain valid for six (6) months commencing from the Tender Deadline.
- 2.10.4 Any currency variations occurring over the term of the Services Contract shall be borne by the Tenderer.
- 2.10.5 Payments for Services provided pursuant to this RFT shall be subject to and made in accordance with the Services Contract at Appendix 6 to this RFT.
- 2.10.6 *Not Used*

Many of the costs Tenderers needed to absorb traditionally were assumed to be minor. Not True in 2022 !

In current environment this means risk averse bidders will charge more.

Tender Deadline is movable and Tender results may be many months later

Smart bidders will price in, while less mature bidders may not = trouble in future if Ex Rates move

**Many Companies particularly SMEs not well placed to manage these risks so "all inclusive" pricing may bias the larger companies who can shoulder the risks**

# Expect more focus on “2.10.6”

*s2.10.6 is where you can find (or not) find reference to CPA provisions in OGP type RFTs*

## 2.10 PRICING

- 2.10.1 All Tenderers must complete the Pricing Schedule at Appendix 2 to this RFT contained within Document C: Tender Response Document.
- 2.10.2 All prices quoted must be all-inclusive (i.e. including but not being limited to shipping, packaging, delivery, ancillary costs and all other costs/expenses), be expressed in Euro only and exclusive of VAT. The VAT rate(s) where applicable should be indicated separately.
- 2.10.3 Tenderers must confirm that all prices quoted in the Tender will remain valid for 180 days commencing from the Tender Deadline.
- 2.10.4 Any currency variations occurring over the term of the Client Contract shall be borne by the Tenderer.
- 2.10.5 Payments for Services provided pursuant to this RFT shall be made subject to and in accordance with the Framework Contract at Appendix 5 to this RFT.

## 2.10 PRICING

- 2.10.1 All Tenderers must complete the Pricing Schedule at Appendix 2 to this RFT.
- 2.10.2 All prices quoted must be all-inclusive (i.e. including but not being limited to shipping, packaging, delivery, ancillary costs and all other costs/expenses), be expressed in Euro only and exclusive of VAT. The VAT rate(s) where applicable should be indicated separately.
- 2.10.3 Tenderers must confirm that all prices quoted in the Tender will remain valid for one year commencing from the Tender Deadline.
- 2.10.4 Any currency variations occurring over the term of the Goods Contract shall be borne by the Tenderer.
- 2.10.5 Payments for Goods supplied under this RFT shall be made subject to and in accordance with the Goods Contract at Appendix 6 to this RFT.
- 2.10.6 “Not Used”

## 2.10.6

Tenderers should note that prices may be increased or decreased only on the first anniversary of the Effective Date of the Services Contract (as defined in the Services Contract) and on subsequent anniversaries of the Effective Date thereafter, and then only by the percentage by which the Annual Services Element of the Consumer Price Index has increased or decreased in the edition of that index published by the Central Statistics Office, Ireland most recently prior to that anniversary.

## 2.10 PRICING

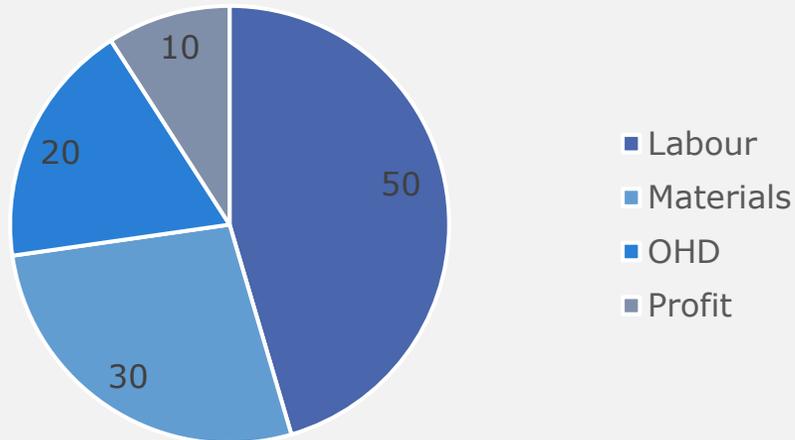
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- 2.10.2 All prices quoted must be all-inclusive (i.e. including but not being limited to shipping, packaging, delivery, ancillary costs and all other costs/expenses), be expressed in Euro only and exclusive of VAT. The VAT rate(s) where applicable should be indicated separately.
- 2.10.3 Tenderers must confirm that all prices quoted in the Tender will remain valid for twelve (12) months commencing from the Tender Deadline.
- 2.10.4 Any currency variations occurring over the term of the Goods Contract shall be borne by the Tenderer.
- 2.10.5 Payments for Goods supplied under this RFT shall be made subject to and in accordance with the Goods Contract at Appendix 5 to this RFT.
- 2.10.6 Not Used  
Tenderers should note that prices may be increased or decreased only on the first anniversary of the Effective Date of the Goods Contract (as defined in the Goods Contract) and on subsequent anniversaries of the Effective Date thereafter, and then only by the percentage by which the insert relevant price index has increased or decreased in the edition of that index published by the insert relevant authority most recently prior to that anniversary.

**CPA clauses are appearing more frequently now in Public Sector Contracts – but tend to use CPI as the base index**

# How Contract Price Adjustment clauses work

*CPA / PV Clauses are based on a simple concept but can have multiple layers added*

Price make-up – Widget X

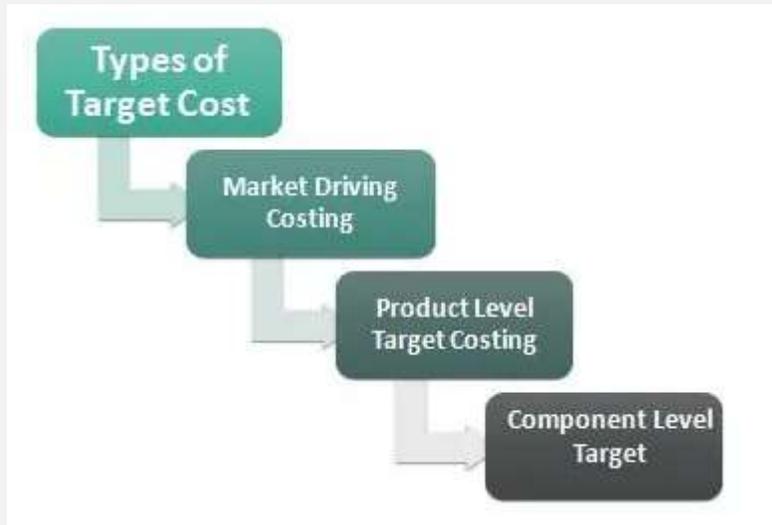


## Steps:

1. Agree which cost element is subject to variation e.g. Materials and what index will be used
2. Agree the proportion of Widget X price that is driven by the chosen element e.g. 30% in our example (evidence required).
3. Agree baseline price and date e.g. following competitive tender – in our example say €1,000 in Sept 2022
4. If materials price rises by 20% in year to Sept 2023 we pay Supplier €1,060  
 $€1,000 + (20\% \times € 300)$  from Sept 2023
5. Material price reductions also treated in same way.

# How Target Price Contract clauses work

*Both parties are incentivised to keep costs as low as possible through shared risk / reward*



## Simple Example - Steps:

1. Agree target cost of project with winning bidder e.g €5m and risk / reward parameters e.g. target profit €500k with 50% over / under run risk share

2. Agree open book costing method whereby CA can see input prices paid and rigorous audited costings

3.

If project comes in at €5m then no change to fee paid.

If €6m - Contractor gets €5.5m both parties share the "loss"

If €4m - Contractor gets €4.5m and both share the "gain"

- This approach can drive collaborative behaviour but requires more management time

# Choosing an Index - Beware of CPI or General Indices



*CPI and even SPI is an average and may have limited relevance to your spend category*



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YOU ARE HERE: [HOME](#) / [STATISTICS](#) / SERVICES PRODUCER PRICE INDEX QUARTER 2 2022

## Services Producer Price Index Quarter 2 2022

Services Producer Prices up 4% in the year to Quarter 2 2022

CSO statistical publication, 15 September 2022, 11am

Online ISS

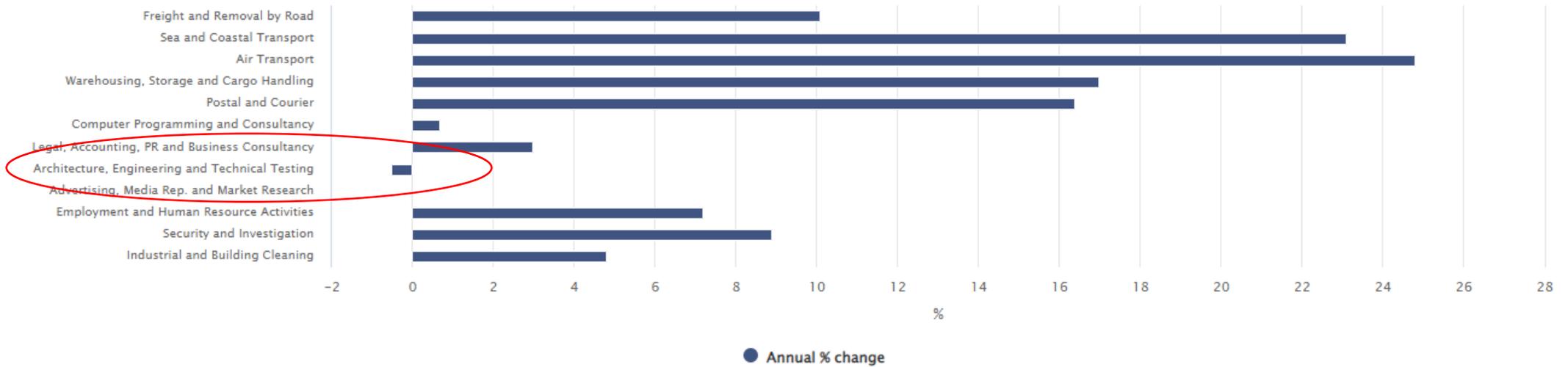
### Key Findings

- Services producer prices were on average 4% higher in Quarter 2 2022 compared with a year earlier.
- The most notable changes in the year were: Air Transport (+24.8%), Sea & Coastal Transport (+23.1%) and Warehousing, Storage & Cargo Handling (+17.0%).

# Sectoral Indices may be better guide

*Indices can work both ways.. Apologies to the Architects and Engineering Firms here !*

Figure 2 Comparison of the sectoral SPPI's to the overall SPPI annual % change – Q2 2022



Source: CSO Ireland

# Indices are also published by Professional Bodies

*CPI and even SPI is an average and may have limited relevance to your spend category*



## Further escalation of Tender Price Inflation for the first half of 2022

The Society of Chartered Surveyors Ireland (SCSI) Tender Price Index reveals that national construction tender prices increased by 7.5% in the first half of 2022 (1H2022).

The latest Tender Price Index shows that national construction tender prices are continuing to rise significantly. The index for the first half of 2022 is 195.7, an increase of 7.5% from the beginning of the year and an increase of 14% in 12 months (July 2021 to June 2022). The further increased level of tender price inflation can be largely attributed to the Russian invasion of Ukraine, coupled with material price volatility due to increased supply chain requirements, alongside labour shortages and energy cost inflation. These factors combined with pent-up demand for construction services have exacerbated tender price inflation from what was previously witnessed after the easing of Covid restrictions in 2021.

*The rates over a 12-month period (July 2021 to June 2022) for the provinces have witnessed a continuing and increasing upward trend.*

Table 1 highlights the median rate of tender price inflation for all provinces recorded in 1H2022. The rates over a 12-month period (July 2021 to June 2022) for the provinces have witnessed a continuing and increasing upward trend.

### National

The results confirm that nationally, the median rate of inflation in the first six months of 2022 stood at 7.5%. This significant continual increase resulted initially from the re-opening of the industry after Covid-19 restrictions, and was followed by the war in Ukraine and labour shortages, which have all caused inflation to continue as opposed to levelling off in the first half of the year, as some anticipated.

### Dublin

The results identify that in Dublin, the median rate of inflation in the first six months of 2022 was 7%.



***NB: Indices are based upon average data – that said, if your Tendered prices are coming at a wide variance to published indices – you should investigate for cause..***

# Mitigating the risk of cost increases: 5 do's and don'ts

*Remember - you cannot fix costs only prices – someone always pays and it's often the client*

## Do

- Validate your exposure to inflationary forces in your category – not all categories face same pressures
- Engage with suppliers through richer market consultation re cost pressures and how you can build mitigation strategies into your tendering strategy
- Consider incorporating target costing/ incentives into contracts
- Evaluate RFTs as quickly as possible and if delays consider confirming prices with bidders before final evaluation
- **2.10.6 Don't leave blank!** Remember many forecasts suggest inflation may decline substantially after 2023 so index linked CPA clauses will drive lower prices then

## Don't

- Ignore inflationary pressures even if you are not seeing them now
- Seek to shift all risk to suppliers
- Use Fixed Price contracts as a means to fight inflationary pressures - can have opposite effect
- Don't rely on contractual clauses – find out what is happening in your supply market before suppliers fail/ stop bidding
- Don't use CPI/ RPI/ SPI as index if a better one exists that better reflects your category

Thankyou...  
Questions

