Value delivered

Supply Chain Sentiment Report

Q3 2024

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Introduction

In our new look bi-annual sentiment report, we analyse the market mood, giving our customers a heads up on what to expect from their supply chain over coming months.

Dozens of manufacturers, merchants and contractors have shared their concerns and confidence levels so we can give you, our valued customers, an accurate measure of the market, its ups, downs and changes in direction.

We've divided our revamped report into three easy-to-digest sections:

1. **Market Summary**
   (Short on time? This is the section to read)
2. **Price Predictions for 2025**
3. **Market Sentiment**

We hope that by reading the mood of where the market is heading, public sector organisations can better prepare for the future.

Neil Butters
Head of Procurement,
Inprova

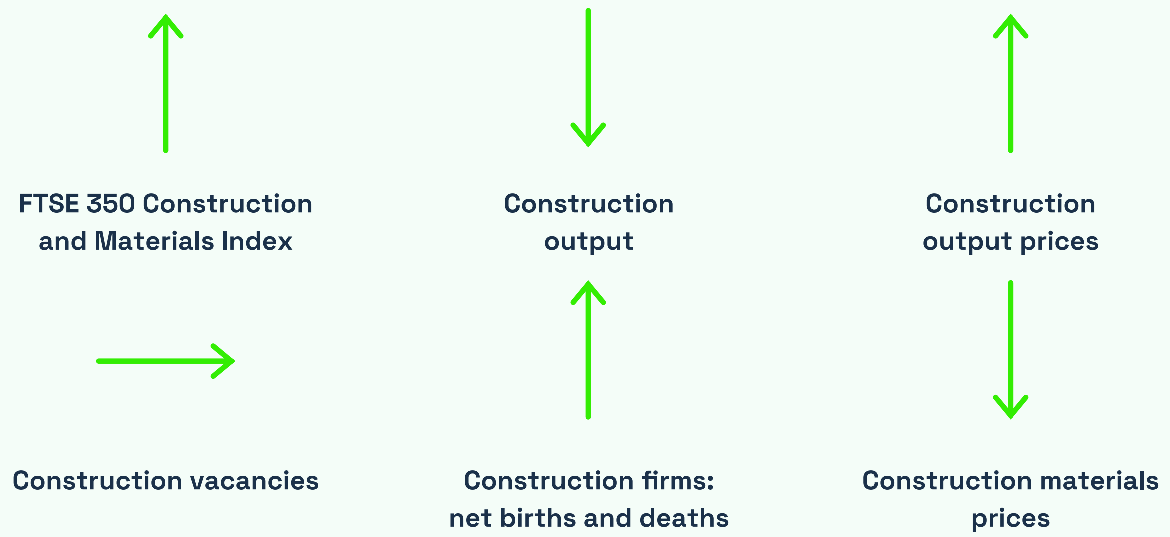
1 Market summary

Cautiously upbeat market in wait-and-see mode around Government policy, combative relationships with 'short-termist' customers and geo-political tensions

Survey results

- Suppliers predict 2025 prices will rise by 3.7%
- Business confidence is flat: 0.2 point rise from six months ago
- Confidence in construction growth is modest: just 6.96 out of 10
- Contractors rate strength of relationships with public sector organisations at just 7.64 out of 10
- Only 13.6% of contractors say they meet their public sector customer face to face, despite 86% wanting to
- 'Too much focus on cost' cited as main barrier to successful delivery of contracts

The macro-economic construction environment - six quarterly indicators:



ISG collapse

It was hard to miss news of construction giant ISG falling into administration. The collapse of the UK's sixth biggest construction company (by turnover) in September 24 was a huge blow, not just to the Government, with whom it had £1.84bn worth of contracts, but to its 2,400 employees and the multitude of smaller suppliers and contractors it worked with.

ISG is one of the largest construction firms to have ceased trading since Carillion's watershed failure in 2018, and the FTSE 350 Construction and Materials Index reacted with a sharp downturn. Crucially though, this was short lived, with a swift bounce back within two weeks.

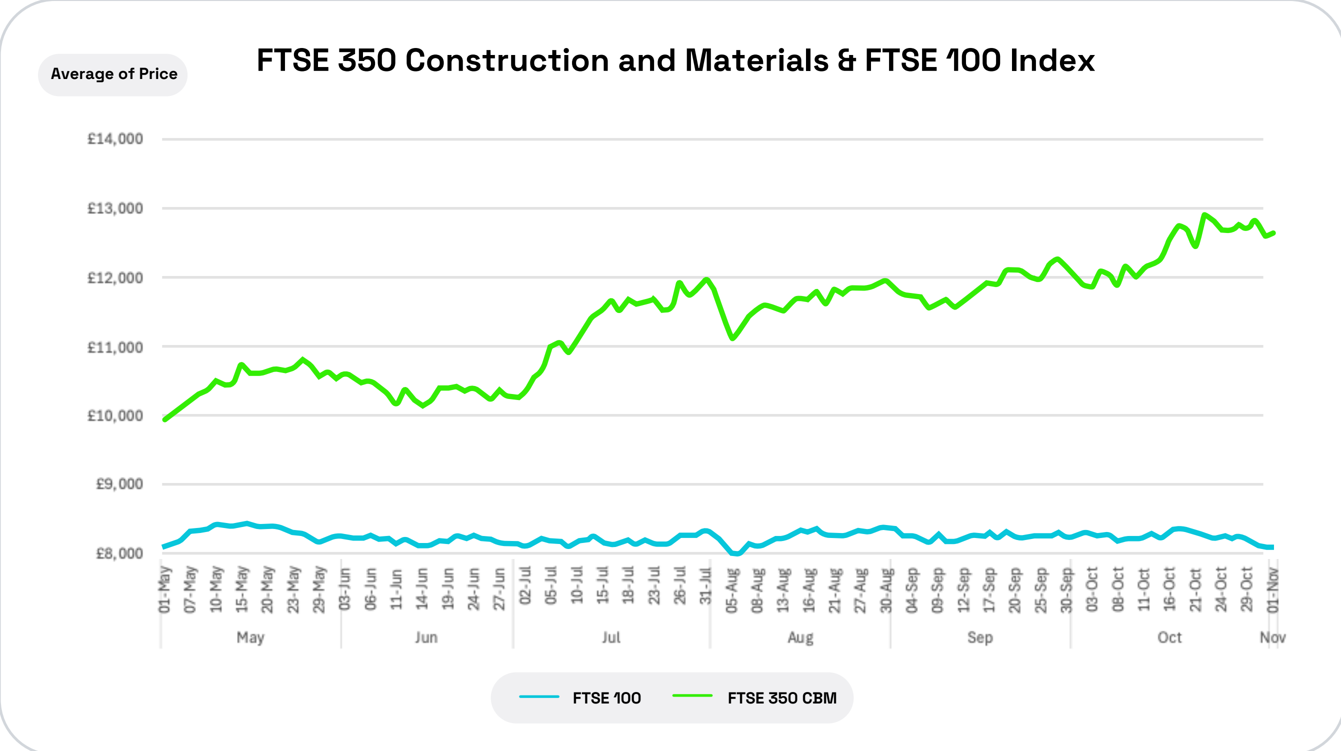
This is indicative of the restrained buoyancy and underlying resilience felt right now. After a roller coaster ride in recent years, construction companies are used to hunkering down, digging deep and building back. They accept that some challenges, like ISG's failure, remain, but overall, they have seen and navigated the worst.

Cautious optimism

I'm hearing talk of growth and renewal, buoyed by a new narrative from the Government – with housing being central to their economic strategy.

This cautious optimism in construction can be seen when comparing the FTSE 350 Construction and Materials Index with the FTSE 100 Index, made up of the largest 100 UK companies. Since the new Government took office, the FTSE 350 has significantly outperformed the FTSE 100, backing the feeling that construction will see a resurgence under Labour.

Graph 1 (Source: Inprova)



There are reservations, however. I'm hearing scepticism around whether Government will actually turn on the taps to get construction moving. Might they opt to loosen regulation instead, enabling the private sector to invest? And would this approach work without complementary Government funding? We're still waiting for many answers.

> **Biggest uncertainty is the new government not understanding housebuilding and manufacturing and planning and over promising and obviously tax implications"**
> - Supplier

This uncertainty is playing out in other ways. Despite an upsurge in the FTSE 350 Construction and Materials Index, other construction metrics are flat or beginning to dip.

'Wait and see'

Over the last quarter, output has dropped very slightly, net births and deaths of construction companies have fallen marginally, and construction vacancies remain largely flat. Construction companies are still in 'wait-and-see' mode and this chimes with the sentiment of a construction supplier I spoke to recently who told me he has 'bucket loads' of work going on in the business, but nothing happening externally yet.

The election of Labour in the summer didn't quite result in the sudden burst of growth many were expecting, and it will be interesting to see whether policies unveiled in the Autumn Budget (Labour's first for 14 years) change this.

The Chancellor announced measures that give social housing providers some certainty in the medium term: a five-year rent settlement and £500m investment in the Affordable Homes Programme until March 2026.

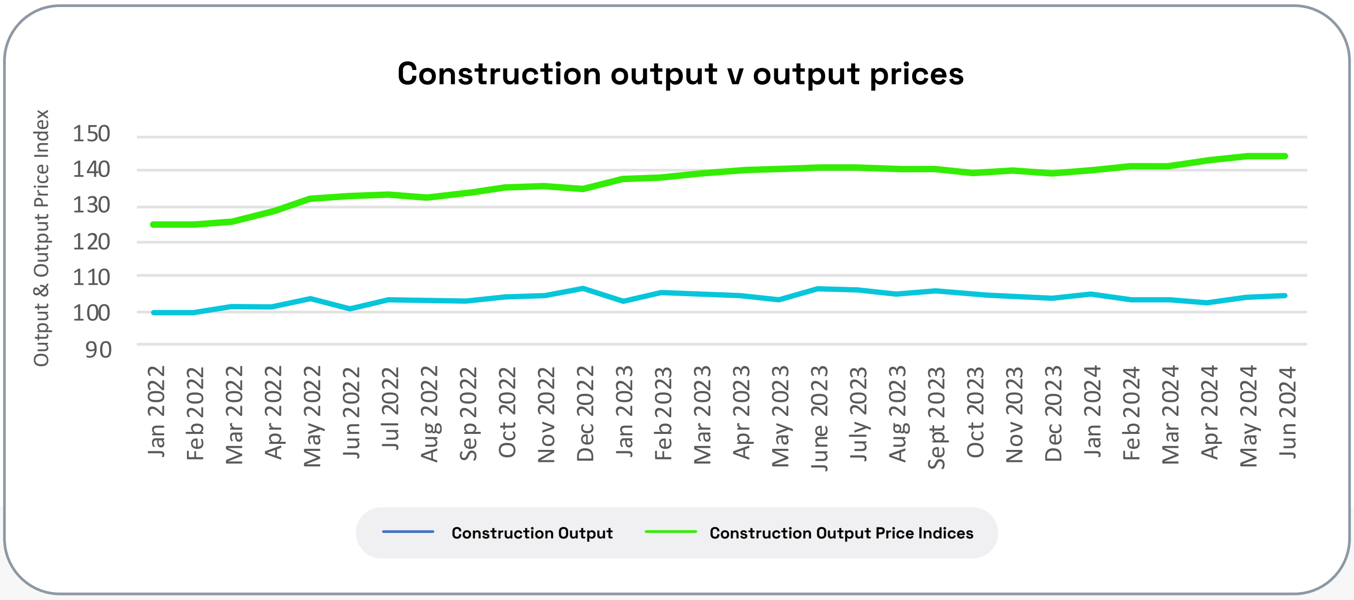
£3.4bn was also allocated to the Warm Homes Plan, although questions have been raised as to whether net zero spending has increased in total. Have funds actually been brought forward to pump prime activity, and in reality, will this create a peak in demand, adding cost to delivery?

There has also been a mixed reaction to the Budget from construction businesses, specifically SMEs, unhappy about increases to employers' National Insurance and the minimum wage. Will these measures stifle the recruitment drive so desperately needed to bridge the construction skills gap? There was little in the budget to show the Government are taking this labour shortage seriously.

Construction output prices

Although many market metrics remain flat – stuck in wait-and-see mode - there is one bucking the trend. Construction output prices have continued to increase since late last year and they don't show any signs of plateauing.

Graph 2 (Source: Office for National Statistics)



Output prices climb

This growing disparity between output and prices is worrying. If prices continue to rise when demand and vacancies are down, what happens when output finally picks up? Crucially, this imbalance points to structural issues, particularly around construction labour, that haven't yet been resolved.

Key advice

My advice to public sector organisations is to lock in suppliers now before that starting pistol is fired. We're likely to see mass migration of suppliers from the public to the private sector when funding and investment is confirmed, and this will push prices even higher and vacancies even lower. Now is the time to think ahead.

Construction materials prices

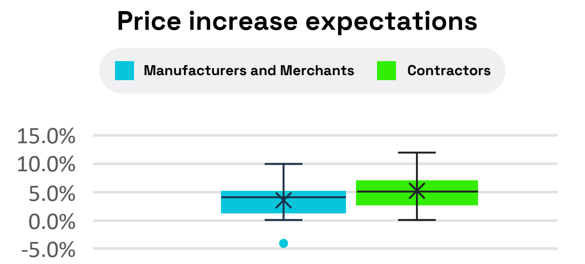
On a positive note, materials prices do appear to have reached their peak. Last quarter's data is still provisional and subject to revision, but in general, we are seeing a relatively flat picture.

Graph 3 (Source: Office for National Statistics)

2 Market price predictions for 2025

Interestingly, almost no one within the supply chain is predicting a fall in prices. Although we've seen the cost of materials stabilising over the last twelve months, manufacturers, merchants and contractors are all forecasting price rises for 2025.

They don't predict a huge jump, more of an inflationary increase, but the average price prediction is 3.7%. This is at the top end of what I expect will play out as a lot of pricing readjustment has already been made in the last 12-18 months.



Graph 4 (Source: Inprova)

Budget negotiations: what should you aim for?

What does that mean for asset management professionals negotiating with their finance directors to plan next year's budgets? It's likely that the first half of 2025 will be flat from a materials perspective, but things may well tail up again from the summer onwards.

Key advice

Begin your negotiations at 4% and if you can secure a 3% increase in your materials budget that will enable you to do the same as last year, if not more.

Overall, I expect that when we look back at 2025, materials prices will have risen by around 2 - 2.5%, subject to the unique circumstances and supply base of each material type. A 3% rise is likely to be the maximum.

Price predictions from contractors, compared to merchants and manufacturers seem to have more variety though. The box and whisker diagram (see graph 4) shows forecasts of between 0 - 12% from contractors, averaging a shade above 5%.

With ISG falling into administration, contractors are wary of thin margins, and they will try to gain long term stability.

The market's 'wait-and-see' mood may also be impacting price forecasts. If demand does shoot up once there is more certainty around construction investment, then inevitably, prices will rise.

Key advice

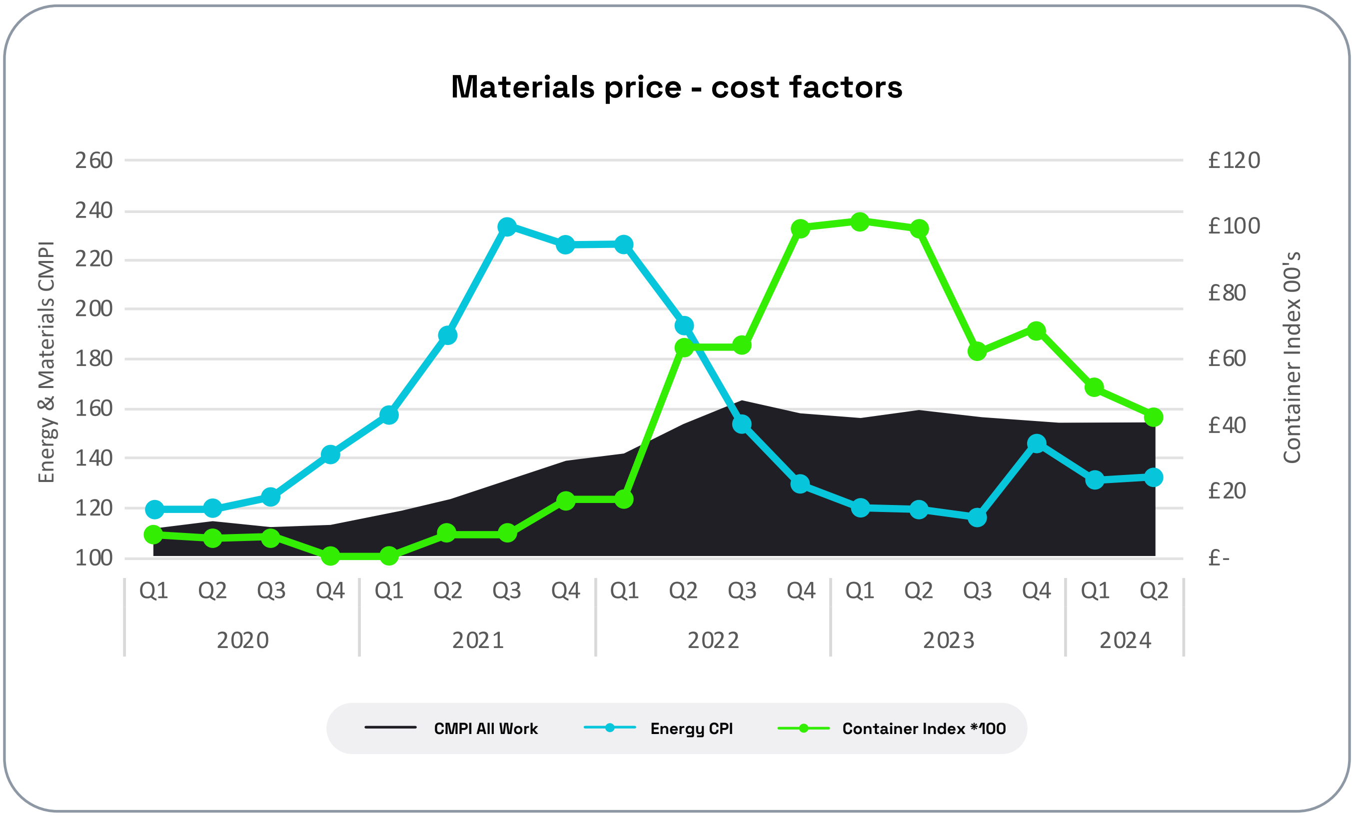
Asset directors looking to firm up budgets for 2025 should be aiming to secure a 5% minimum increase on the contractor side. It's also worth thinking about securing contracts for the next two years, whilst you still have the flexibility.

Materials cost factors stabilise

Graph 5 outlines a relatively settled picture around factors impacting the price of materials. The Construction Materials Price Index (CMPI) on all work has drifted down slightly over the past twelve months. Energy prices have had a sharper decline, along with the cost of shipping containers, which increased at the end of 2023, dropped again and have now stabilised.

All in all, the picture on materials cost factors is the steadiest it's been for around four years.

Graph 5 (Source: Freightos)



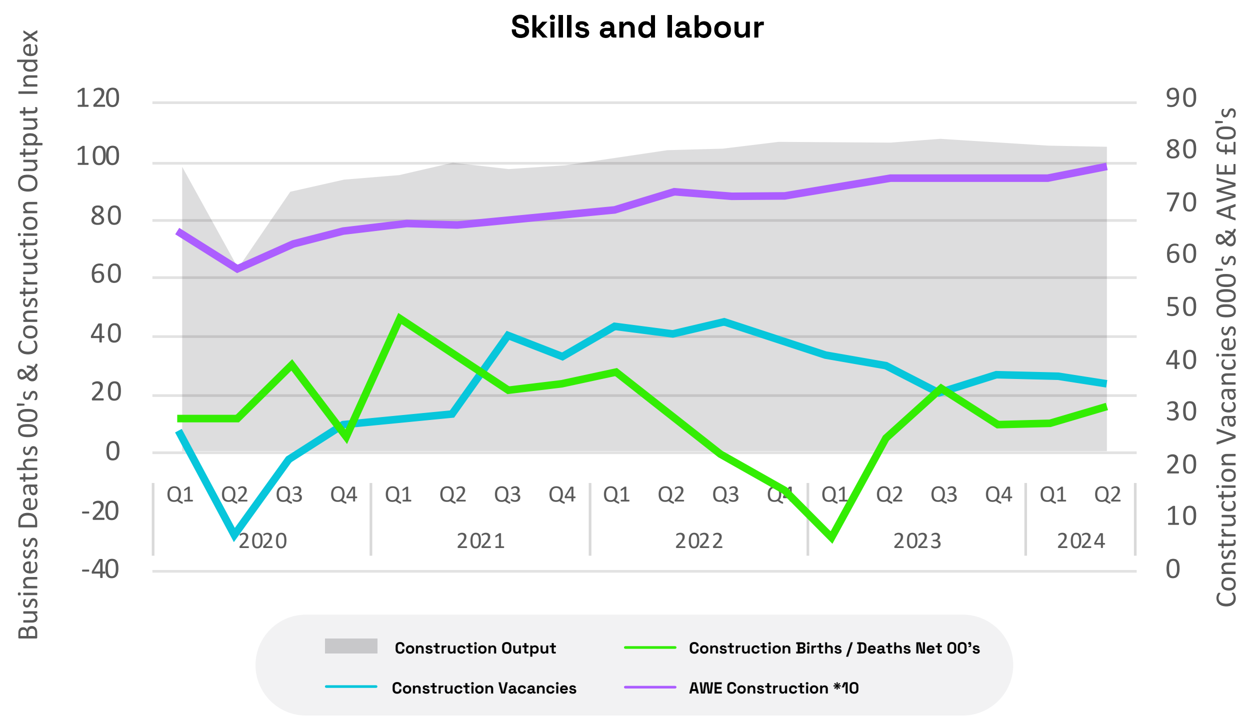
Weekly earnings increase

Looking at graph 6, we can see construction output has remained largely flat over the past two years, with a very slight tail off in 2024.

The net births and deaths of construction firms, along with vacancies in the sector, have also followed a steadier trajectory in 2024.

But it's average weekly earnings that are going the other way, continuing to climb this year and pointing to the country's fundamental skills shortage that is yet to be resolved.

Graph 6 (Source: Office for National Statistics)



Biggest worry is where are all the brickies, electricians, plumbers, etc. going to come from. The same worry we have had for a while"

- Supplier

My worry is that the births and deaths of building firms, along with job vacancies, may become a lot more volatile once the construction taps are turned back on.

Key advice

In anticipation of this changing macro-economic environment, it's vital that public sector organisations pay close attention to construction indicators, particularly construction output and tender rates over the next few months. Any signs of the market heating up must be spotted early.

3 Market sentiment

Contained confidence

Two key indicators of the overall market mood – skills concerns and business confidence - haven't moved much from our last supplier survey, six months ago. This backs up the mood we touched on earlier – one of restrained optimism.

When we asked manufacturers, merchants and contractors how concerned they were on a scale of 1-10 about the future skills shortage, their answer was 4.94 – so, 'not much'. With demand in stasis, this is understandable, but it's likely to be a different picture in six months' time, if the market does take off.

It is also surprising just how static business confidence is. Six months ago, that figure was 8.8 (on a scale of 1-10) but for this survey, there's only been + 0.2 points of movement. Interestingly, we surveyed the supply chain before the ISG news broke, so a feeling of hesitancy was already in place.

I had expected manufacturers, merchants and contractors to be more bullish about the next twelve months, but it's likely that uncertainty around new Government policy is containing that confidence.

Another question put to the market was how confident they feel about growth in construction over the next year. Again, I thought this would be a high 8, yet it came in at 6.96.

Being a 'good' customer

If the construction market does take off again, we will see the migration of suppliers from public sector projects back into the private sector. So, what can public sector organisations do to combat this exodus?

One approach is by being a good customer, something our sector is not always proficient at. That's why, for this report, we asked the supply chain about the strength of their relationships with public sector organisations.

On a scale of 1 -10, with 1 being very poor and 10 being very strong, merchants and manufacturers rated their relationships with public sector customers at 8.3. Contractors weren't so positive, with half a mark's difference at 7.64.

This links back to issues compounded by ISG's failure. The relationship between public bodies and building contractors has, in many cases, become attritional.

To meet increasingly tough savings targets, public sector organisations squeeze building firms, and in response, those firms try to protect their margins. The result is conflict, not collaboration. This doesn't bode well for public bodies in the coming months when investment is finally confirmed by government, demand increases and contractors become pickier.

Relationship management methods

We also asked suppliers about their main method of managing relationships with public body customers in a post-pandemic world. Only 33% said they currently meet face to face, and for contractors that figure is just 13.6%.

> **There is a reluctance [amongst public sector organisations] to get involved and too much responsibility is put on the contractor to resolve issues"** - Supplier

This supports the current picture of a friction based, combative environment focused on quick wins, rather than long term partnerships. Command-and-control procurement is easier to manage digitally rather than face to face.

> **We have found the digital age have limited the relationships between customer and contractors. Better relationships lead to better outputs"** - Supplier

Key advice

But it's clear from our survey that this is not what the market wants. When we asked suppliers about their preferred method of managing relationships, an overwhelming 86% said face to face. There is a gap here that the public sector must address, something that will become more important as demand grows. Look at where you can increase the number of in-person meetings with suppliers and ask staff to feed back on the impact of managing relationships this way. Don't let virtual calls become the default.

Short-term thinking on savings

Linked to this was our next question for suppliers: what do you see as they key challenges to successful delivery of contracts to customers? It was no surprise that 'too much focus on cost' was cited as the number one barrier, with 'lack of engagement' coming a close second. But interestingly, nearly one third of suppliers mentioned 'wrong skills in customer base' – something that is pertinent under the new procurement regime.

From February 2025 onwards, public sector organisations will have new responsibilities around contract transparency and KPI reporting, and they need the right skills to fulfil those duties.

Manufacturers, merchants and contractors were also asked where the greatest potential was to create value for money. Again, their answers aligned with previous findings. 'Better engagement with customer' came top, followed closely by 'more focus on efficiency over cost'.

> **Engagement with the client and their clients is vital to success. The earlier the engagement, the better as well"** - Supplier

There is an important theme here. Public sector organisations are under immense pressure with competing priorities, new regulation and depleted budgets. Managing suppliers in this environment can lead to a blinkered focus on cost cutting, here and now, and that creates a vicious circle of poor performance, escalation and attrition.

Key advice

There is another way, a longer-term approach, where value for money and efficiency are the focus. Equal, trusting relationships between suppliers and public sector organisations are key here, so you can reduce costs sustainably, together, without impacting quality. But these partnerships must be grown and nurtured, they don't happen overnight.

Open and honest communication with your supply chain is a first step on this journey. Find out about their cost base, listen to their pressures and industry observations. Having an empathetic dialogue will help you deepen relationships but also build your supply chain knowledge base, alongside your own market research.

What does value for money mean to you?

We asked the supply chain about their understanding of value for money and how they define it. Here's what our manufacturers and merchants said:

- Added value. It's not just about the cost of the item
- Delivering a high-quality product and sharing financial efficiencies based on higher production volumes
- Finding the right balance between service and cost. Providing the right product for the purpose it is designed. Also, a way of measuring the cost of something against the quality or benefit of that thing
- Supply of a product with no after sales issues
- Holistic approach from product quality and all-round service and support
- Improved efficiencies for organisations. Organisations should stop focussing on the bottom line but look at the whole life costings
- Paying a fair price for something that lasts and does what it's supposed to do efficiently and has as little impact on the environment as possible

What does value for money mean to you?

The contractors' view:

- Quality work for a quality product, with a decent profit margin
- Providing a quality service at a fair financial rate
- An ability to deliver works within costs and timeframe with added value through social value leaving a legacy within the communities we work in
- Price, service, client and resident satisfaction. Lifetime performance and saving. Innovation
- The most advantageous combination of cost, quality and sustainability to meet customer requirements
- Value for Money means the customer receives a good service with good quality goods at a reasonable cost…the supplier needs to be in a position to cover costs and also have enough profit to invest in the company & staff to enable long term growth & sustainability.
- It's not just about cutting costs but about managing them effectively while ensuring high standards and meeting project objectives
- Obtaining a quality product or service for a reasonable fee, hiring the cheapest provider is not a long term sustainable approach

Key advice

Be honest with board directors and use the intelligence you've gathered from suppliers, operatives and your own research to evidence current conditions and the need for an enduring approach. Make the argument to board members that creating long-term value, not just speedy savings, is key to achieving the right outcomes.

The findings of our survey and overall market sentiment point to a clear desire from suppliers to create sustainable, partnership-based relationships. Those public sector organisations that leverage this willingness to create long term value will also create competitive advantage and ultimately better outcomes for their residents.

Managing board expectations is also vital. The public sector operates on an annual budgeting cycle, with everything centred on in-year reporting and savings. Unless you have a particularly enlightened leadership team giving you space over a three, five or eight year period, it can be hard to shelve the short-sightedness and focus on longer-term outcomes.

Former Bank of England governor, Mark Carney describes this as 'breaking the tragedy of the horizon' and it can only be achieved when there is support from the top.

How we can help

We are Inprova, a technology-enabled procurement partner. We work with leading organisations to help manage spend better, drive sustainable value, and improve operational efficiency. At the heart of everything we do is our commitment to positively impact people's lives.

We provide procurement consultancy, compliant solutions such as frameworks and Dynamic Purchasing Systems (DPS), and procurement technology and analytics through our Quantum platform across the public and private sectors.

Get in touch to discuss your challenges or to find out more about how we can add value to your organisation.

Get in touch!

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