

Scotland Excel

To: Executive Sub-Committee

On: 17 September 2021

**Report by:
Chief Executive of Scotland Excel**

Supply Chain Disruption and Price Volatility

1. Introduction

This report provides an update on the supply chain disruption and price variances that have occurred in recent months and the impact on the delivery of some of Scotland Excel's framework contracts and to highlight controls and actions that are being taken to mitigate these risks.

2. Background

Economies are growing fast as many countries ease coronavirus restrictions. This uptake in demand is coinciding with a global shortage of many key raw materials including construction materials, packaging, shipping containers and food amongst others. There was an early warning of this in May when the UN's Food and Agriculture Organisation reported a 40% monthly increase in their global food price index. This increase is the largest jump seen since 2011, driven by spikes in the cost of vegetable oils and cereals. Away from agricultural markets, energy, fuel, and packaging are also experiencing rapid inflation. In the last 12 months the price of crude oil has increased 50% while the average cost of packaging is up 70%. This commodity boom has led to speculation that we may be entering a "super cycle" which describes a period of unusually high demand which keeps prices high for an extended period. Additionally, changing global demand patterns have created a container shortage on East to West shipping routes with prices now up to 5 times higher than pre-pandemic. The resulting inflation is impacting all countries. In the USA, headline inflation is now 5.4% - a 13 year high, with fuel and food prices the key drivers.

The UK is partially insulated from this commodity pressure by the year on year strengthening of Sterling. But this only protects imported goods. As a result, overall UK inflation increased from 2.1% to 2.5% in June, and the consensus among economists and the Bank of England is that prices will continue to rise further as the year progresses. In their August Monetary Policy Committee meeting, the Bank of England forecasted that UK inflation would rise above 4% in the near-term causing speculation that they may respond by increasing the cost of borrowing.

Industry overall is also facing a well-publicised labour shortage. Estimates suggest there are currently around 100,000 delivery driver vacancies. This is a longer-term problem exacerbated by COVID restrictions and a changing immigration policy. As well as causing disruption, the subsequent wage inflation has materially increased business running costs across industry.

3. Key impacted areas

3.1 Construction Materials – Market Update

In June, Scotland Excel circulated a construction materials market update to its stakeholders reporting on the unprecedented disruption of our materials supply chains. This paper provided a summary of the causes and impacts of the current market conditions, outlined engagement with key suppliers and recommended appropriate mitigating action.

Over the course of the summer, and as predicted, conditions have deteriorated. Set out below is an update on the current market conditions, corresponding impacts for our members and suppliers and confirmation of collaborative work underway to advocate for the sector.

Of all the goods-based frameworks, the Building and Timber Materials framework is experiencing the greatest degree of disruption. The Timber Trade Federation (TTF)¹ have reported a record level of softwood imports in 2020 against previous years, with sales up 18% in Jan 2021 against Jan 2020. By April 2021 the value of construction projects on site (<£100m) was 30% higher than the same period in 2020.

Our suppliers are reporting the worst timber shortage the industry has faced in recent times. The Swedish sawmill industry, responsible for around 50% of the structural wood used in the UK, has reported the lowest stock levels for 20 years. The framework has been reclassified from a category D to a category B contract requiring frequent engagement with suppliers and councils. Our suppliers have reported an ongoing surge in demand over the Summer, as homeowners invested in upgrading their properties, during the favourable weather and as they were unable to travel as freely.

High demand from the retail sector and for European Whitewood is resulting in monthly price increases as well as driving up the price of Redwood. Medium Density Fibreboard (MDF) products have been impacted considerably by the scarcity of waxes and chemicals used in production. Given the high demand for MDF in the house building sector, many of those products are being priced on application. Demand from the US continues to be impactful with new homes 20% greater than estimated and with the US paying more than what has been paid in the UK. In evidence submitted by suppliers to justify price variance requests, increases are reported between c.20%-40% dependant on product groupings.

Where alternative sources of supply are available, supply chains are less mature and being impacted by difficulties in logistics including availability and price of containers, shortages of HGV drivers and shipping companies imposing surcharges due to delays at ports.

Holiday and maintenance periods in Scandinavia started at the end of June for two months resulting in reduced available timber to export.

As sawmills restarted in August, suppliers have advised (with caution), that it is hoped the deficit will be reduced, so that future increases for some product groupings will not be as high as previous. Scotland Excel is working with key suppliers to request market forecast data on how the market is anticipated to perform late 2021/early 2022.

¹ Timber demand and supply in the UK, May 2021

3.2 Building and Timber Impact - Price Variance and Indexation

The category team have been negotiating a higher volume of price variances and exceptional price increase requests in 2020-2021. Table 1 demonstrates the impact of the supply chain volatility on framework pricing, with the most recent uplift, for prices becoming effective on 1 September 2021 representative of a 23% increase, bringing the contract index to 142.04.

PRICE VARIANCE	VALUE PRIOR TO PV	VALUE FOLLOWING PV	TOTAL INCREASE	% INCREASE	COMPOUNDED INCREASE	CONTRACT INDEX	MARKET INDEX
OCTOBER 2019	£5,361,463.78	£5,361,838.96	£375.18	0.0%	100.0%	100.01	93.38
JULY 2020	£5,361,838.96	£5,409,277.97	£47,439.01	0.9%	100.9%	100.89	100.93
OCTOBER 2020	£5,409,277.97	£5,644,334.82	£235,056.85	4.3%	104.3%	105.25	104.84
APRIL 2021	£5,644,334.82	£6,045,499.71	£401,164.90	7.1%	107.1%	112.41	126.26
JULY 2021	£6,045,499.71	£6,397,722.51	£352,222.80	5.8%	105.8%	118.45	150.35
SEPTEMBER 2021	£6,397,722.51	£7,866,823.32	£1,469,100.81	23.0%	123.0%	142.04	150.35

Table 1: Building and Timber – Price Variance

Figure 1 displays the current indexation chart for the framework with the market index sitting at 150.35, a gap of c. 8%. August figures are yet to be published, but it is anticipated that the market index will be more than what is currently reflected on our indexation graph.

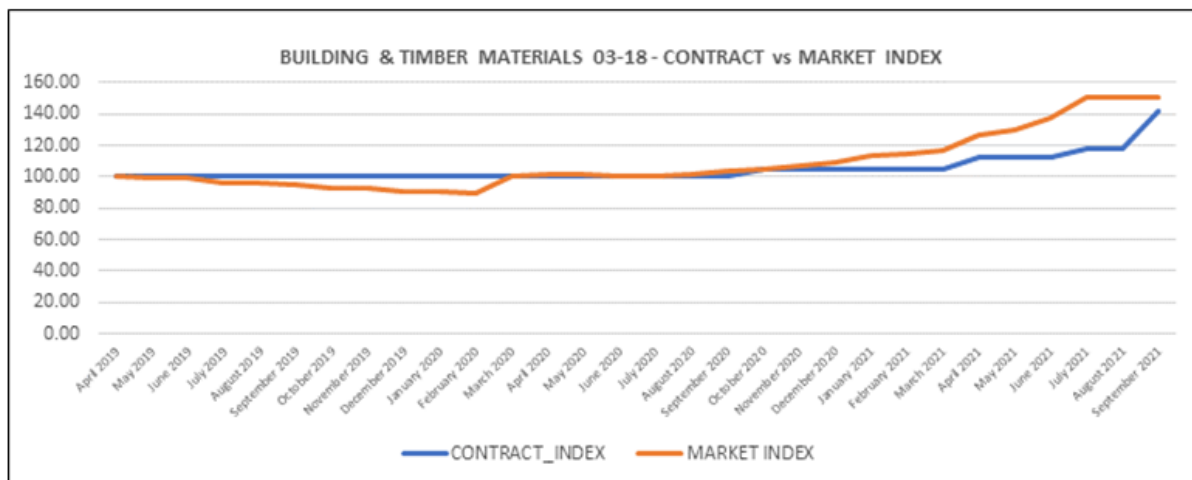


Figure 1: Building and Timber Indexation Graph Apr 2019 – Sept 21

3.3 Materials Short Life Working Group

Scotland Excel launched a short life working group (SLWG) with representatives from our established User Intelligence Group (UIG) to collaborate on our shared experiences of the current volatility. Key insights from this engagement are set out below.

- Our members are reporting extreme difficulty in launching procurement for larger projects given the lack of price certainty resulting in a focus on small, emergency repairs instead of capital programmes.
- There is concern that the current conditions will limit the ability to utilise available funding for construction projects impacting the construction-led recovery.

- Works which can be scheduled are significantly over budget due to materials costs.
- Direct award is becoming more prevalent as suppliers are unable to offer for mini competitions due to shortages and pricing volatility.
- Council departments are reporting a significant inefficiency/administrative burden of sourcing products with a range of suppliers in some cases on application or with fixed pricing reducing from months to weeks.
- There are constraints where grant funding timescale requirements are unable to be achieved because of prolonged material lead times.

4. Further Collaborative Activity

As part of enhanced contract management activities for the framework, members were provided with data and benchmarking to inform supplier engagement and purchasing decisions. Due to the number of lots/items affected, although demand planning was considered as part of the SLWG, it was decided that this should not be undertaken on a national basis.

Scotland Excel has been advocating on behalf of our members and suppliers with a range of public sector bodies including the Construction Scotland Innovation Centre (CSIC) on innovative and alternative products, Scottish Enterprise on the longer-term actions required to build supply chain resilience through Scottish manufacturing and has also joined the Ministerial Short Life Working Group (MSLWG) for construction materials chaired by Ivan McKee MSP. The issue of grant funding timescales has been raised at this forum to highlight the challenges, and to request that greater flexibility is introduced on such funding streams.

Other activities that will form part of our strategic procurement for materials include.

- Ongoing collaboration across the public sector on planning for alternative sources of supply, release of home-grown timber and changes to building regulations to accommodate sustainable alternatives.
- Data Analytics on historic line level data to inform forecasting/demand planning of materials requirements.
- Consideration of how tender pipeline should be influenced by ongoing disruption including, covid recovery, planning the backlog of works through and supplier's ability to tender for our revised contract delivery plan.
- Consideration of how to consult with and confirm impact on communities including delays to adaptations, fuel poor homes and housing programmes.
- Consideration of Net Zero implications how to support members to meet targets on retrofitting, reduction of embodied carbon and the opportunity for circular products.

5. Food and Drink

Supply chain issues continue to be well reported on in the media, but despite the challenges of a shortage of labour and haulage difficulties, Scotland Excel, working with key suppliers has had reassurance, that the key suppliers for schools and care homes have maintained an industry-leading level of product availability – as has been the case throughout the pandemic.

As suppliers have been able to continue to diversify and operate during the height of the pandemic, they advise that their supplier partners are working closely with them and

ensuring that Scotland Excel has been regularly updated on any challenges they may be encountering in getting goods into the supply chain. Whilst there are lower levels of availability in many areas of the supply base, with some challenges in specific categories, our key suppliers are pleased to report that they have seen only a **minimal impact on the top selling** lines.

The mitigation factors that key suppliers have undertaken are noted as follows: -

- Building up a **large stockholding of food and non-food** across their sites
- **Boosting inventory in advance of the peak requirements** to align with the reopening of schools after the summer term, with up to 4 weeks of stock of the most popular frozen and ambient product lines.
- **Broadening the range** so that they can identify and offer close alternatives for any products where there are issues, whilst ensuring that full allergen information is still provided so that customers can check for all products.
- **Using their own vehicles** to collect stock from suppliers who can't deliver to them, where this is practical.
- **Continually monitoring and tracking issues and risks**, so they can act early to mitigate product availability challenges.

We will continue to work with our suppliers to maintain availability, as the above factors have been, and are likely to remain, challenging. However, our supply base has provided reassurance that Education and Health sectors will be prioritised above retail requirements.

6. Fleet

In terms of vehicles and fleet, during the initial months of the pandemic last year, many vehicle manufacturing plants were closed completely or had severe restrictions placed on their manufacturing output for a significant period of time.

Although these plants are now back fully operational and have been for some time now, inevitably a backlog of their orderbooks has developed and this impact is still being felt in terms of vehicle delivery lead-times. Coupled with the well-publicised global scarcity of microchips affecting many industries, this has resulted in grossly extended delivery times from order placement until customer delivery.

Typically, where we would have previously seen car or vans delivered in a period of around 3-4 months from point of order placement, these are now around 6 months or more. For heavy duty vehicles lead times are up to 12 months, or even longer depending upon their specifications.

Vehicle manufacturers had expected an improvement in global microchip availability by the end of 2021, although the latest market analysis is still unclear when this situation will be fully resolved. As such, extended lead-times should be taken into consideration in any fleet replacement programmes that are being planned.

7. PPE and Future planning

In general PPE products (out with some key covid items) have healthy stock levels. Pricing has been affected by the factors below and some suppliers have approached Scotland Excel regarding potential price reviews, citing the following: -

- Labour costs have increased in both the UK and far east due to the impact of covid and worldwide demand for goods as well as a reduction in available resources.
- Freight costs remain at an all-time high and with no sign of this returning to normality for the remainder of 2021. Lack of available containers and vessels to sail from the Far East to the UK has been widely publicised across all sectors, regardless of industry. This has pushed normal lead times of 4-5 weeks being pushed out to 8-12 weeks. In addition, difficulties at the UK ports have forced some liners to take alternate routes into Europe, and for forwarders to transport via road into the UK.
- Raw material costs for nitrile gloves and plastics are still high, which is keeping the costs of items higher than pre covid with this expected to continue into 2022.

Work continues to develop a new tender for the provision of PPE with a focus on sustainability and where possible opening access to UK / Scottish marketplace to produce items for Scotland. Working alongside, Scottish Enterprise, it is hoped that the new tender activity will open a marketplace for production from Scottish Suppliers, and where it is not possible to source directly, will allow sub-contracting opportunities through tier one suppliers.

The challenge now will be in developing a longer-term approach to PPE supply and distribution, which includes both business as usual needs as well as preparing for future pandemics.

8. Conclusion

Members are invited to note the progress made to date, and endorse the ongoing activity outlined.