

Beyond CPI - Rethinking Supplier Price Increases



Procurement and Supply Chain Management Made Simple.

Foreword

Annual supplier price increases are often treated as an unavoidable feature of commercial life. A percentage is proposed, an inflation index is cited, and, unless challenged, the revised price becomes the new baseline. Yet that simplicity conceals a more complicated economic reality: labour, materials, energy, transport, finance and overheads rarely move together, and no single inflation measure can explain what has genuinely happened to every element of a supplier's cost base.

For procurement professionals, the central question is not whether inflation exists, but whether a requested increase reflects costs that have genuinely changed. A supplier may face legitimate pressure from wages, statutory employment costs, imported materials, fuel, interest rates or regulation. Equally, an automatic uplift applied across a whole contract can expand profit as well as recover cost, particularly where fixed or unaffected elements are swept into the calculation regardless.

The commercial stakes are considerable. UK public procurement spend exceeds £400 billion a year, and even a one-percentage-point difference on high-value contracts can translate into hundreds of thousands, or millions, of pounds once compounding is considered. The disciplined response combines contractual interpretation, weighted cost modelling, appropriate indices, open-book evidence, productivity challenge, benchmarking and market testing, so suppliers recover evidenced cost movement. At the same time, customers avoid paying for increases that bear little relation to genuine cost.

The Problem with Automatic Annual Price Increases

Automatic annual uplifts have become embedded in many long-term supply contracts because they simplify administration: both parties know when prices may change and can budget accordingly. Yet routine does not equal economic justification. UK public procurement spend exceeds £400 billion a year. In comparison, the Government Commercial Function directly manages roughly £90 billion of that total, so even modest percentage uplifts can transfer substantial value once applied mechanically across large contract portfolios.

The commercial distinction is fundamental. A supplier may be contractually entitled to an increase because an indexation clause says so, even where actual costs have risen by less. Conversely, genuine cost pressure does not automatically create a legal right to higher prices under a fixed-price contract. For contracting authorities, the Procurement Act 2023 also constrains post-award modifications, particularly where a change would materially shift the contract's economic balance towards the supplier.

The Government Commercial Agency's 2025/26 Annual Report, covering the activities of its predecessor Crown Commercial Service, illustrates the scale involved. Agreements supported roughly £42 billion of aggregated public-sector spend and generated around £5 billion of commercial benefits for customers. That does not prove every inflation claim is excessive; it demonstrates the value at stake in active commercial management. An unchallenged 3% uplift on a £10 million contract adds £300,000 annually before compounding, whether or not the supplier's underlying costs justify it.

Royal Mail illustrates a better approach than blanket indexation. From May 2026, its Fuel and Energy Surcharge on specified business parcel services rose from 11% to 16%, explicitly responding to fuel and energy pressure rather than applying one inflation rate to every charge. The mechanism remains commercially challengeable, but it demonstrates the underlying principle: identify the affected cost driver, isolate the relevant price component, and examine evidence before accepting recovery.

What Actually Drives a Supplier's Costs?

A supplier's price is normally a blend of labour, purchased materials, energy, transport, property, financing, technology, insurance, overhead and profit, and those elements rarely move together. In April to June 2026, ONS regular pay growth reached 3.5% overall, but public-sector regular pay rose 6.1% while private-sector pay rose 2.8%. A labour-intensive contract therefore faces a very different cost environment from a materials-heavy manufacturing or logistics contract operating over the same period.

Statutory labour costs create genuine pressure. From 1 April 2026, the National Living Wage for workers aged 21 and over rose from £12.21 to £12.71 an hour, a 4.1% increase. A service employing 100 full-time staff for 37.5 hours each week would see base annual wage cost rise by roughly £97,500 before employer National Insurance, pensions, holiday cover, overtime or supervisory differentials. That evidence is commercially relevant; headline CPI alone is not.

Energy, transport and financing can move in completely different directions. DESNZ recorded average non-domestic electricity prices of 24.3 pence per kWh in 2025, down from 26.3 pence in 2024, while gas averaged 5.3 pence, down from 5.7 pence. By July 2026, diesel averaged £1.676 a litre and petrol £1.522, while Bank Rate stood at 3.75%. Timing, category and a supplier's financing structure therefore matter greatly.

Construction offers another illustration. Department for Business and Trade statistics showed the all-work construction materials price index was 5.4% higher in May 2026 than a year earlier. That does not justify lifting every element of a construction contract by 5.4%: labour, plant, design, overhead, financing and margin may have moved differently. National Highways' Efficiency Programme Delivery Partner terms instead use a defined price-adjustment factor for specified maximum people rates, demonstrating targeted rather than indiscriminate indexation.

Compass Group demonstrates the same principle in private-sector contract management. Its 2026 investor material describes a portfolio split broadly between profit-and-loss, cost-plus and fixed-price arrangements, with indexation clauses for food and labour and operational mitigation through

menu flexibility, purchasing scale, data and technology. Sophisticated suppliers manage inflation by cost category, so buyers should expect an equally granular explanation whenever an annual price increase is formally proposed.

CPI, PPI and Other Indices – What Do They Really Measure?

CPI measures changes in prices paid by consumers for a representative basket of goods and services and underpins the Bank of England's 2% inflation target. In July 2026, UK CPI inflation stood at 2.9%. CPIH, which additionally includes owner-occupiers' housing costs and Council Tax, stood at 3.1%. ONS describes CPIH as its most comprehensive consumer measure, but neither index was designed to capture an individual supplier's production costs.

PPI asks a different question. The ONS input Producer Price Index measures prices of materials and fuels purchased by UK manufacturers, while output PPI measures factory-gate prices received by producers. In July 2026, input prices were 4.9% higher year on year and output prices 3.1% higher. Yet, input prices fell 1.7% during July alone, showing how an annual headline can conceal rapid swings in the direction and intensity of cost pressure.

Service contracts require another lens. ONS Services Producer Price Inflation reached 4.3% in the year to the second quarter of 2026, but underlying sectors varied sharply: transportation and storage rose 8.9%, professional, scientific and technical services 4.7%, information and communication 3.3%, and accommodation and food services only 1.1%. Applying one general index across such categories ignores real differences in the markets from which suppliers actually buy and sell.

Wage indices matter most where people dominate delivery costs. ONS reported private-sector regular earnings growth of 2.8% in April to June 2026, against 6.1% in the public sector, while minimum-wage exposure requires yet another benchmark given the National Living Wage's 4.1% rise. Procurement teams should identify whether a contract is driven by average earnings, statutory wage floors, specialist salaries or a negotiated workforce settlement before selecting an index.

Sector-specific measures improve precision. Construction buyers can use ONS or Department for Business and Trade materials and output indices; logistics buyers may examine fuel, freight and transportation series; manufacturers can use detailed PPI categories; and service buyers can draw on SPPI data. Cabinet Office guidance on risk allocation and pricing recommends selecting indices relevant to the cost being adjusted and using Variation of Price formulae that compare a defined base index with the index at delivery.

RPI deserves particular caution. ONS states that the Retail Prices Index does not meet the standard for accredited official statistics and strongly discourages new use, although legacy contracts still rely on it. The practical hierarchy is therefore not "CPI bad, PPI good", but "use the measure that best matches the cost exposure". A mixed-cost contract may legitimately need several indices, fixed portions and explicit weightings rather than one economy-wide percentage.

Why a Headline Inflation Rate Should Not Be Applied to the Whole Contract Price

Applying one headline rate to an entire contract price treats labour, materials, transport, fixed overhead and profit as though they all move identically, which they rarely do. Only the cost elements genuinely exposed to inflation should drive compensation, and each may require a different rate. Treating profit and genuinely fixed costs as automatically inflation-sensitive can enlarge margin without evidence. At the same time, a contract weighted mostly towards labour behaves differently from one weighted towards transport or energy.

The reverse also matters: CPI can understate, not just overstate, genuine cost pressure. In July 2026, CPI stood at 2.9% while producer input inflation was 4.9%, and transportation and storage service prices were 8.9% higher year on year in the second quarter. A responsible buyer should not suppress a demonstrably necessary adjustment simply because CPI is lower. The objective is economic neutrality, not an unintended windfall or an unsustainable loss.

Profit mechanics deserve equal scrutiny. A percentage-based margin legitimately generates a larger nominal return when allowable costs rise. In contrast, fixed-fee, target-cost-sharing and return-on-cost arrangements behave differently under the same cost movement. The Ministry of Defence's single-source regime keeps these concepts distinct: Single Source Regulations Office

guidance treats inflation within allowable costs, while the 2026/27 baseline profit rate is 9.10%. Reimbursing an evidenced input increase should restore economics, not enlarge the return on unaffected cost elements.

Public authorities must weigh legality alongside arithmetic. Under the Procurement Act 2023, a modification may be permitted where the contract as awarded and the tender or transparency notice for the award unambiguously provided for the possibility of that modification, provided the modification does not change the overall nature of the contract. A Contract Change Notice is generally required before modification, subject to statutory exemptions, including where the contract value increases or decreases by no more than 10% for goods or services, or 15% for works.

Building a Weighted Cost Model

A weighted cost model starts by breaking the contract price into economically distinct elements rather than treating the invoice total as one inflation-sensitive amount. A £10 million facilities contract might comprise 60% labour, 10% materials, 8% energy, 5% transport, 7% property and systems overhead, and 10% profit. Those proportions should come from tendered pricing, open-book data, audited accounts or a should-cost model, not from assumptions invented during negotiation.

Each cost line should then match the index that best reflects its exposure. Labour may follow an appropriate earnings series or statutory wage movement; manufactured goods may suit a sector-specific output PPI; transport can use an SPPI series; and energy may require an energy benchmark. Cabinet Office guidance expressly permits different indices for specific cost lines and recommends should-cost modelling to identify where indexation is genuinely required.

Weighting makes the calculation transparent. If 60% of a £10 million price is labour and the relevant labour measure rises 2.8%, that component contributes £168,000. If 10% is materials and its index rises 4.9%, the contribution is £49,000. An 8% energy component falling 3% would reduce the price by £24,000. The resulting net movement is £193,000, before transport or other indexed elements, rather than an automatic uplift across the whole £10 million.

Regulated utilities show the same discipline at national scale. Ofgem's RIIO-3 price controls for gas and electricity networks do not rely on a single inflation measure: the cost-of-debt allowance references market-based corporate bond indices. At the same time, CPIH is used to treat index-linked debt. Operating-cost allowances are assessed separately against efficiency and delivery evidence, demonstrating how different cost categories can be isolated and risks allocated without treating every pound of expenditure identically.

The advantage over blanket indexation is precision. A weighted model can move in either direction, reducing price where an indexed cost falls just as readily as raising it where a cost genuinely rises, and it exposes exactly which figures a supplier must evidence. That precision matters most once increases compound year on year, because a single unjustified percentage embedded early in the price base is repeated, and enlarged, at every subsequent review.

The Compounding Effect of Annual Uplifts

A modest annual percentage becomes materially larger once each increase becomes the base for the next. On a £10 million annual contract, a 3% uplift compounds to roughly £53.09 million over five years, about £3.09 million above a static price; at 5%, five-year spend reaches approximately £55.26 million, £5.26 million above static. At only 2%, cumulative spend is about £52.04 million, so the gap between 2% and 5% indexation exceeds £3.2 million within five years.

The bigger risk is not simply that prices rise; it is that an unjustified element becomes permanently embedded in the contractual baseline. Once a 4% increase has been accepted, the following year's 4% is normally calculated on 104% of the original price, not 100%. If part of an earlier uplift represented margin expansion rather than cost recovery, subsequent indexation compounds that margin expansion too, unless the clause or a renegotiation corrects the baseline.

Compounding becomes more significant across major public portfolios, where a single percentage point of unnecessary annual uplift on £1 billion of recurring expenditure adds £10 million in the first year alone, before further compounding. GCA's aggregated spend and commercial-benefit figures,

cited earlier, illustrate why: the arithmetic that looks trivial on one contract can become strategically material once repeated across an organisation's, or the public sector's, entire portfolio.

The practical lesson is straightforward: scrutinise the very first uplift most closely, because every later increase inherits its errors. A rigorous baseline review at the outset, supported by weighted cost evidence rather than a single headline figure, costs little in comparison with the value protected. Neglecting that first review is, in effect, agreeing to fund the same unjustified percentage indefinitely, compounded, for the remaining life of the contract.

When Supplier Price Increases Are Justified

Supplier increases can be entirely legitimate where identifiable inputs genuinely become more expensive, and the contract allocates that risk to the buyer. The National Living Wage rose from £12.21 to £12.71 an hour in April 2026, a 4.1% increase. Labour-intensive cleaning, security, catering and care contracts may therefore experience real cost growth, particularly where pay differentials above the statutory minimum must also be maintained to preserve supervision, skills and recruitment structures.

Employment costs extend beyond headline wages. Changes in employer National Insurance, pension contributions, holiday cover, statutory leave and recruitment costs affect service economics, while labour shortages can push market pay above general earnings growth. Mitie reported that its FY26 performance absorbed a material increase in employer costs, including National Insurance contributions and the National Living Wage. At the same time, 3% pricing contributed to organic growth: a practical illustration of cost pressure flowing through commercial pricing.

Commodity, energy and imported-input shocks can also justify adjustment. ONS reported that imported materials and fuels were 5.2% more expensive in July 2026 than a year earlier, with non-EU refined petroleum products the main contributor to the annual rise. Exchange-rate movement matters because sterling-priced imports can change independently of domestic inflation, so buyers should distinguish an evidenced exposure to imported fuel, metals or components from a general claim that inflation has risen.

Contract form matters during volatile conditions. At the end of 2025, 88% of Balfour Beatty's £8.9 billion UK Construction order book was on target-cost or cost-plus incentivised-fee arrangements, with the remaining 12% weighted towards two-stage fixed-price contracts, and its 2026 trading update said that mix provided strong protection from macroeconomic volatility and inflation. Sensible risk allocation can therefore protect both customer continuity and supplier viability without granting unrestricted price recovery.

A justified increase should nevertheless be proportionate, and temporary where the underlying shock is temporary. The Bank of England noted in July 2026 that crude and refined energy prices had become volatile and higher following Middle East events, while Bank Rate remained at 3.75%. Such shocks can legitimately raise fuel, financing and supply-chain costs, but later reversals should also be recognised: fair indexation works both ways, rather than converting exceptional inflation into a permanent entitlement.

How Procurement Should Challenge a Price Increase

The first question should be contractual, not economic: what precisely does the agreement permit? Procurement should identify the review date, eligible cost lines, specified index, base period, notice requirements, formula, evidence obligations and any discretion retained by the buyer. A supplier may present persuasive cost evidence yet still lack a contractual right to an uplift, just as a clearly drafted indexation clause may establish entitlement even where the outcome is unwelcome.

The second step is reconstructing the cost bridge from the current price to the requested figure. The supplier should identify which inputs changed, their percentage of contract value, the original baseline, the new cost, the timing of the movement and the evidence supporting it. Cabinet Office Open Book Contract Management guidance defines open book as scrutiny of supplier costs and margins through accounting data, providing a basis for reviewing performance and efficiency opportunities.

Procurement should then test the proposed index against the cost being claimed. Cabinet Office

guidance requires indexation to use official data and notes that output indices are often more suitable than input indices for contracts, because they incorporate production costs, productivity and profit. The baseline deserves attention too: an uplift calculated from an unusually high or low month can distort recovery, so guidance recommends twelve-month or four-quarter averages for both the base and uplift periods.

Test productivity and mitigation before accepting gross cost movements. A supplier facing higher wages may simultaneously reduce vacancies, improve scheduling, automate administration or increase output per employee, and evidence of such mitigation should offset part of any claimed increase. The commercial sequence matters: understand what a supplier has already absorbed or offset internally before determining what genuinely requires additional customer funding, rather than assuming every rising cost passes straight through unmodified.

Double recovery is another risk. A supplier may seek wage inflation through an annual CPI uplift while also requesting a separate National Living Wage adjustment, or recover fuel through both an indexed rate and a surcharge. Government guidance states that where indexation already transfers inflation risk to the contracting authority, an additional inflation risk premium is inappropriate. Procurement should map every recovery route, including change controls, pass-through costs and previous settlements, before agreeing another increase.

Finally, challenge must work downwards as well as upwards. If energy, commodities, freight or other indexed costs fall, procurement should test whether the contract permits, or requires, a corresponding reduction. Even where wording provides only for upward review, falling costs remain relevant to benchmarking, extensions and renegotiation. Effective contract management is disciplined verification of entitlement, causation, quantum and continuing value for money, not refusal by default.

Designing Better Price Review and Indexation Clauses

Good indexation begins before contract award. The clause should identify price elements subject to adjustment, the selected index or indices, their source, the base date, review frequency and calculation formula. Cabinet Office guidance recommends matching major cost lines to relevant industry indices and using published rather than forecast values. The Model Services Contract was deliberately amended so buyers could insert appropriate indices instead of defaulting automatically to CPI, reinforcing the need for tailored design.

Weightings should be fixed transparently where the underlying cost structure is sufficiently stable. A contract might state that 55% of price follows an employment-cost measure, 20% a sector output index, 10% an energy benchmark and 15% remains non-indexed, representing profit or costs already priced as fixed. For changing cost structures, open-book evidence and periodic rebasing may be preferable, provided the mechanism cannot be manipulated retrospectively once market movements are already known.

Caps and collars require care. They can protect budgets from extreme movements, but Cabinet Office guidance warns that restricting full indexation may cause suppliers to price an inflation risk premium into bids, reducing value for money. Better design may instead combine a firm initial period, relevant indexation thereafter and an exceptional-change mechanism for extraordinary events, while addressing negative index movements, discontinued or rebased indices, rounding and previously purchased inputs.

Legal drafting matters particularly for contracting authorities. Under the Procurement Act 2023, clear indexation specified in the original tender documents creates far greater certainty than improvised post-award relief, since any later modification must fit a permitted ground or risk being substantial. In private-sector contracts, the same discipline protects margin and cash flow without statutory constraint. However, well-drafted indexation clauses remain equally valuable for managing supplier relationships and avoiding disputed renegotiation.

Competition, Benchmarking and the Market Test

When an incumbent price no longer looks competitive, market evidence provides a powerful test. Benchmarking can compare unit rates, labour assumptions, margins, service levels and total cost against comparable contracts without automatically forcing a re-procurement. The Cabinet Office

Sourcing Playbook identifies benchmarking, appropriate indexation and pricing mechanisms as matters requiring deliberate design, and a credible benchmark must adjust for scope, geography, volume, risk transfer and performance requirements to avoid misleading comparisons.

Competition remains a clear external test where a contract nears expiry or a new procurement is appropriate. GovS 008, the government's commercial functional standard, states that commercial options should maximise competition unless there is clear justification for an alternative. Competition does more than reveal price: bidders expose productivity assumptions, technology choices, staffing models and risk premiums, testing an incumbent's economic assumptions more effectively than prolonged bilateral argument ever could.

Aggregation can outperform passive acceptance of inherited pricing. One GCA aggregation event involving significant participation from police forces delivered savings of 18%, on top of the billions in spend and benefits its agreements already generate each year. Those figures do not mean every re-tender saves money, but they demonstrate that purchasing scale, standardisation and genuine competition can materially outperform simply renewing a supplier's existing terms unchallenged.

Experience shows why price transparency matters. In its investigation of UK Trade & Investment's services contract with PA Consulting, the National Audit Office found weaknesses in pricing transparency and found that negotiation outside competition increased PA's revenue and profit; UKTI ultimately terminated the contract and settled. The case warns that poor visibility of overheads, margins and pricing mechanics makes it difficult for buyers to determine whether an increase reflects cost recovery or profit expansion.

Re-procurement should not become an automatic response to every disputed uplift, since transition expense, mobilisation, service continuity, data transfer and switching risk can exceed the prospective saving. HM Revenue & Customs' historic ASPIRE re-competition deliberately spent £8.6 million supporting bidding costs and £43.3 million on transition arrangements to secure effective competition for a £3 billion IT outsourcing contract. The correct market test therefore weighs whole-life value, not merely whether a new headline rate looks cheaper.

Private-sector procurement offers the same lesson from a different direction. Suppliers actively choose which risks they will price, accept or avoid within their contract mix, so customers should apply equal discipline when choosing suppliers and contract structures. Competition is healthiest when bidders understand the risk allocation clearly and can price it efficiently, rather than protecting themselves with opaque contingencies, indiscriminate inflation allowances or margin buried inside a single blended rate.

Summary – Pay for Genuine Cost Inflation, Not Automatic Margin Inflation

Annual price increases are not inherently unreasonable, and resisting every request would be as commercially unsound as accepting every request. Labour legislation, wage settlements, commodities, energy, foreign exchange, financing and supply disruption can all change the economics of delivery. The procurement objective is narrower and more disciplined: identify the cost that changed, establish who contractually carries that risk, measure the movement with appropriate evidence, and compensate only the portion of price genuinely affected.

That principle replaces the simplistic argument that CPI should always give way to PPI. Different contracts require different measures, and some require several. Cabinet Office guidance goes further, indicating that industry-specific output indices are generally preferable for many government contracts because they include production and delivery costs, productivity and profit. A strong model links each material cost exposure to the most relevant evidence, while preserving elements where inflation risk has already been priced or transferred.

Compounding makes accuracy important from the first review, because an unsupported percentage becomes embedded in the price base, and every subsequent increase then compounds both legitimate cost recovery and any unjustified margin expansion. Neither a high nor a low headline figure is automatically excessive or justified; what matters is whether the economics genuinely support it, as shown against the specific cost lines the contract actually exposes to inflation.

Strong commercial management combines contract interpretation, weighted cost modelling, official

indices, open-book evidence, productivity challenge, benchmarking and, when appropriate, competition. It also recognises supplier sustainability: government guidance warns that inappropriate indexation can cause under-recovery, weaker performance, market exit or insolvency, while over-recovery damages value for money and reputation. Balanced mechanisms protect buyers from windfalls and suppliers from unmanageable shocks, keeping the original commercial bargain economically credible throughout the contract term.

The practical rule is straightforward: pay for genuine inflation where the evidence, the contract and the allocated risk support it, but never confuse a general rise in consumer prices with proof that every pound of a supplier's cost has increased by the same percentage. A contract should reward efficiency, permit justified recovery, recognise falling costs and preserve competitive tension, protecting public money, private-sector margins and sustainable supplier relationships far better than an unquestioned annual uplift.

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Further Reading

- Office for National Statistics — Consumer Price Inflation, UK (CPI, CPIH and the status of RPI)
- Office for National Statistics — Producer Price Inflation, UK (input and output PPI)
- Office for National Statistics — Services Producer Price Inflation, UK
- Office for National Statistics — Average Weekly Earnings in Great Britain
- Office for National Statistics — UK Trade, imported materials and fuels price statistics
- Cabinet Office — Procurement Act 2023: guidance on contract modifications
- [legislation.gov.uk](#) — Procurement Act 2023, sections 74 to 77 and Schedule 8
- Cabinet Office — The Sourcing Playbook
- Cabinet Office — Open Book Contract Management: Guidance Note
- Cabinet Office / Government Commercial Function — Government Functional Standard GovS 008: Commercial
- Government Commercial Agency — Annual Report and Accounts 2025 to 2026
- Department for Energy Security and Net Zero — Prices of fuels purchased by non-domestic consumers
- Department for Business and Trade — Building materials and components statistics
- HM Treasury / Low Pay Commission — National Living Wage and National Minimum Wage rates from April 2026
- Single Source Regulations Office — Baseline profit rate and capital servicing rates recommendation, 2026/27
- Bank of England — Monetary Policy Report and Bank Rate announcements, 2026
- Office of Rail and Road — National Highways monitoring reports, Road Period 2
- National Audit Office — UK Trade & Investment's relationship with PA Consulting
- National Audit Office / HM Revenue & Customs — The ASPIRE contract
- Royal Mail Group — Business parcel services pricing and surcharge announcements, 2026
- Compass Group plc — Annual Report and investor materials, 2026
- Balfour Beatty plc — Full-year results and trading updates, 2025/2026

- *Mitie Group plc — Full-year results, FY26*
- *Ofgem — RIIO price control finance annexes, electricity and gas networks*