How contractors price risk in bids: theory and practice

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Abstract

Formal and analytical models that contractors can use to assess and price project risk at the tender stage have proliferated in recent years. However, they are rarely used in practice. Introducing more models would, therefore, not necessarily help. A better understanding is needed of how contractors arrive at a bid price in practice, and how, and in what circumstances, risk apportionment actually influences pricing levels. More than 60 proposed risk models for contractors that are published in journals were examined and classified. Then exploratory interviews with five UK contractors and documentary analyses on how contractors price work generally and risk specifically were carried out to help in comparing the propositions from the literature to what contractors actually do. No comprehensive literature on the real bidding processes used in practice was found, and there is no evidence that pricing is systematic. Hence, systematic risk and pricing models for contractors may have no justifiable basis. Contractors process their bids through certain tendering gateways. They acknowledge the risk that they should price. However, the final settlement depends on a set of complex, micro-economic factors. Hence, risk accountability may be smaller than its true cost to the contractor. Risk apportionment occurs at three stages of the whole bid-pricing process. However, analytical approaches tend not to incorporate this, although they could.

Keywords: Contractor; interview and documents; pricing; risk apportionment; tendering