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ECA & BESA response to the consultation: Cash and digital payments in the new economy

Respond to: cashanddigitalpayments@HMTreasury.gsi.gov.uk

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ECA and the BESA welcome the opportunity to respond to this consultation. We jointly represent the interests of over 4,000 businesses covering a broad range of engineering, design, installation and facilities management activity, including electrical, heating, plumbing, energy management, micro-generation, ductwork, ventilation, fire and security, and wireless systems. These works not only form a key part of the UK construction, maintenance and facilities management services supply chain, but they form 40% of sector turnover (£10bn).

Our answers to this consultation tackle the issue of cash in construction and facilities management (FM) in two distinct areas: (a) B2C transactions and (b) B2B transactions. We have only answered those questions where we have a view to offer. Before turning to responding to the consultation questions, our key points are as follows:

Summary of main points:

- We expect that most commercial construction (B2B) and facilities management (FM) firms will operate on digital payment platforms. Industry is increasingly embracing the productivity benefits that digital payment platforms offer as a way of responding to legislation around prompt payment, improving supply chain relations, providing better analysis around payment performance, and reducing human resource and compliance risk through automation.
- Accelerating the spread of digital payment is very positive in that it potentially helps supply chains, which may be four to five levels deep, to get paid more quickly. Opportunities through (the appropriate use of), digital payment platforms, project bank accounts and blockchain technology offer ways to develop faster and more automatic payment flowing through the supply chain.
- This is important for the UK's economic performance because prompt and fair payment is one of the key issues that the Government can help drive up in order to boost productivity among our nation's SME base. (This is the subject of a concurrent Treasury review). If companies have more certainty of receiving money more quickly, they will exert less time chasing payment, and can invest in people, equipment and new markets to a greater extent. The Chancellor is right therefore to focus on the "scourge of late payment". Faster, secure and automatic means of payment provides less excuse for companies to delay or withhold monies.
- Some B2C transactions still clearly take place through cash and cheque, though we imagine this will decline in the years ahead due to generational shifts. Looking at the construction industry, this might be preferred by the customer where the tradesperson requires payment at the end of a job. Customers may more broadly prefer cash and cheque transactions, such as those who may be late adopters to digital.
- Such cash and (most) cheque payments are generally lower value transactions: in the hundreds of pounds. These should clearly be allowed to continue owing to customer preference. However, we suggest that for payments above £5,000, the Government considers requiring that only digital payments can be made. Similar limitations happen elsewhere, such as Norway. Limiting cash payments would also further promote digital payment innovation.
- In doing so, larger payments will be recorded meaning that payment by cash is less open to abuse and tax evasion. This creates a more level playing field and realises more money for the Exchequer.

¹ See page 7.

1 How do you expect digital payment methods, and the adoption of these by merchants and consumers, to change over the next 10 years? What are the drivers of this?

Global digital payment volumes are predicted to increase by an average more than 10% a year, reaching nearly 726 billion transactions by 2020/1. In the UK, as the Call for Evidence highlights, debit cards will overtake cash as the most frequently used form of payment in the UK, according to UK Finance.

As UK construction averages four to five levels within its supply chain and 70 sub-contract packages, it suffers from high fragmentation and disaggregation. This has a direct impact on its opaque, handling of British Sterling making the commercial eco-system in which the industry operates incredibly fragile.

The industry comprises 280,000 businesses of which 84% are SMEs (the bulk of which are involved in B2B transactions) – turnover is estimated by UK Government to be circa £225bn representing 10% of employment and enabling a further £540bn contribution to economic output.

Over the next ten years we expect that payment methods will become increasingly digital – over the last five years we have seen a significant move away from cash and cheques into the area of industry using digital payment methods.

The B2C market may still handle some element of residual cash and cheques due to the more unsophisticated nature of its client base, but an increasing number of market leading businesses operating in this area look for periodic payment systems to enshrine greater stability into their business models through cyclical cash-flow stability – this avoids the unnecessary use of cash and cheques.

In any event unless, businesses are deliberately seeking tax avoidance or hidden economy returns, or unless client demands dictate the nature of transactions through cash, businesses in this area who encounter high volumes of low value transactions will invariably operate on a debit/credit card payment system by phone or through the use of chip and pin machines in order to secure cash-flow and payment in advance. These businesses are likely to explore the use of intermediary payment systems such as Faster Payments, HSBC PayM, Android or Apple pay and systems linked to retailers or banks where loyalty schemes are in place for channeling payments through their facilities and technology.

The key drivers of this appear to be convenience, security and an increasing level of general acceptance. New methods of payment promoted by banks and card issuers have played a pivotal role in consumer awareness and take up given the obvious financial benefits for them in operating in the consumer space.

Merchants supplying into the construction and FM sectors for both B2B and B2C arrangements, already have digital card and banking facilities in place which allow them to closely monitor not only what, is being purchased, but how and on what credit facilities/limits.

With the evolution of Building Information Modeling in construction and FM in order to digitally transform the process around design, construction and operation of built-assets, and the need for goods and materials tracking from supplier to site, and through into asset life-cycle maintenance, the harmonisation of dynamic purchasing systems which digitally allow consumers from merchants to have visibility of not just price, but product specification and crucially, availability and delivery times, the need for fast and digitally enabled payment systems will be critical to the way in which merchants operate.

The drivers for change in this area are:

- **Compliance:**

There are a plethora of legislative and policy initiatives which are in place and which are designed to support fair, transparent and prompt payment. These include, the Housing Grants, Construction and Regeneration Act, Public Contracts Regulations, Prompt Payment Code, Construction Supply Chain Fair Payment Charter, duty to report on payment, project bank accounts etc. As many of these lead to increased compliance requirements, one of

the key drivers for change in the way payment and cash is handled is the driver to be able to demonstrate compliance through low-cost automated means which also ensures risk management of non-compliance. This in turn over the long-term improves CSR, integrity, corporate profile and trading risk.

- **Stability**

Intelligent and/or repeat consumers of construction and FM are increasingly conscious that the success of project delivery and value for money is directly linked to supply chain stability. The most destabilising issue for construction and FM is the fragility of the commercial ecosystem in which they operate caused by the lack of transparency within the fragmented and disaggregated supply chain.

It is acknowledged in construction and FM that consumers and tier 1 contractors are only as strong as their supply chains and that therefore one of the key measures of success is long term, commercially successful strategic alliancing relationships. It is further acknowledged that the way to ensure commercial strength is to ensure payments are quicker and more transparent. The requirement to be able to track the commercial success of a construction and/or FM project is therefore a key driver for change.

- **Value for money:**

As the public sector accounts for between 25-40% of demand in construction and FM, and it is a client who will invariably own the assets once built, it is under key policy requirements (Social Value Act 2012), to procure on a quality, not lowest price basis.

Private sector clients who will own assets during their lifetime or who have a direct commercial interest in the quality of the built-assets also recognise their need to procure, not simply on price, but also on quality as a reflection of their brand and their long term trading position.

The requirement to be able to demonstrate value for money therefore necessitates and increasingly needs to be able to provide granular data around payments and cash-flow disbursements through the design and construction phases of a projects which drives change in the area of payment.

- **Productivity**

The requirement to maintain competitive edge through digitisation of currently analogue processes which retain non-compliance risk and require substantial human resource cost also forms a driver for short term change in construction and FM. In an industry where profit margins are often as low as 2-3%, and Government mandates are in place for large clients to reduce both; waste and the cost of construction and FM, the industry is currently undergoing a process of digital transformation. Increased use of technology is expected to yield the productivity savings which will lead in turn, to profit. The modernisation agenda is therefore a key driver for change in this area.

We expect that (B2B) commercial construction and FM will operate on digital payment platforms. Industry has accepted the case for digital payment management platforms and is beginning to embrace the productivity benefits in order to maintain its competitive edge, namely:

- Compliance
- Risk management
- Transparency and granularity of payment data – big data analysis and improvement
- Increased low risk automated management
- Supply chain relations enhancement

There are already three major platforms in operation within UK construction that allow these benefits to lead to improved productivity, lower cost and in turn growth. The technology providers emerged in the UK three to four years ago and both the design of the solutions and the industry acceptance of smarter ways of managing commercial processes have taken time to mature.

Only 6% of UK construction firms export overseas and average profit margins are only 2-3%. This means that in itself UK construction is by its nature highly introverted and less inclined to utilise profit for research and development, or to re-invest working capital in order to innovate and/or modernise.

One of the main issues which has inhibited take-up of the technologies offering solutions is 'integration'. Some of the solutions are standalone products and consumers within the construction and FM sectors are striving to make the right choices when it comes to investment in technology, i.e. there is an inherent requirement for project payment platforms to integrate with enterprise resource management systems and accounting systems in order to achieve full productivity gains.

2 What further action could the government take to support greater adoption of digital payments by merchants and consumers (including civil society groups)?

Government accounts for nearly 40% of client demand in construction & FM. It therefore has a role to play as an intelligent client in the modernisation agenda for cash and digital payment systems.

It will need to harness its outputs from the Industrial strategy: AI sector deal and associated initiatives; digital catapult systems; and Construction Sector deal to accelerate the evolution of construction and FM as sectors by creating:

- Innovation and awareness programmes on payment and cash-handling systems in other sectors and other jurisdictions to ensure learning and adoption for acceleration of efficiency; and,
- Routine reduction of VAT thresholds and increases in the maximum limit for faster payments. Contactless payments to pragmatically allow migration of the consumer market to exclusively utilise digital payments.
- Incentivised use of innovation in this area through; fiscal incentives for technology solutions providers to enable investment in UK construction & FM, R&D tax credits, bonus payment systems for early adopters and procurement award criteria recognition of the use of innovative payment systems.
- Mandate the use of innovation in the cash management and payment systems within its role as client for its construction and FM projects

3 Are there international examples of countries supporting the adoption of digital payments that the government should look to?

Technology providers in the US and Australia have established and invested in payment systems and project payment management platforms in order to avoid the need for cash transactions.

Mobile phone bluetooth and bump technology has been experimented with in Africa to avoid the need for cash – this has been trialed in order to combat corruption.

Government should invite suppliers to innovation workshops in order to both capture the private sector innovation and highlight commercial opportunities for them to add value in the emerging UK economy.

We also believe that Sweden represents the world leader in migration to a cashless society and we would urge Government to look to Sweden for lessons learned.

4 Why does the cost of processing payments differ between cash and digital payments? How is it changing? And do you expect the change to continue?

The change is due to the expectations of individuals – due to their retail experience and generational churn – requiring that payments are expected to be facilitated via their wearable or mobile technology in a secure and immediate way.

Change is also due to investment based on critical mass, i.e. once the technology becomes 'normal' as opposed to innovative, there are increased opportunities for investment as the opportunity for scale is introduced, i.e. the opportunities to profit from investment in the provision of digital payment solutions becomes lower risk with increased certainty of return on investment.

5 Who uses cash as their main form of payment and why?

In construction and FM, this would most likely be a) those who deal with high volumes of low value transactions where the consumer client base due to demographics, demands to transact on a physical cash basis, and b) those consciously existing in the hidden economy, and c) those who seek avoidance of tax.

In some cases there may be a percentage of businesses operating in the B2C space that use cash to ensure payment is made because their trading methods are more often dictated by their consumers who are, due to their demographic late adopters of digital payment systems. For example, £3bn spent in the economy each month by non-UK residents.

6 How does cash usage and need vary by demographics, geography, and socio-economic status?

No answer offered.

7 How does the level of cash that you handled or used this year compare to what you handled or used five years ago? What are the drivers for that change (for example, change in customer preferences, currency modernisation programmes such as new polymer banknotes and £1 coin)?

No answer offered.

8 How do you think the level of cash you will handle or use in five years will compare to what you handled or used this year? What are the drivers for that change? And how will different sectors be impacted by this change?

The levels of cash handled will drastically reduce for two reasons:

- a) Businesses recognise that there is more commercial stability in aligning customers with cyclical relationships, i.e. annual homecare agreements where monthly direct debits are used for payment and price is aligned to annual service level requirements; and,
- b) Demand for cashless digital payment systems increases with consumer awareness and take-up of non cash based digital payment systems.

9 What impact has the change in demand had on industries that process cash?

No answer offered.

10 Does the current denominational mix (eight coins and four banknotes) meet your current and future needs? If not, how should it change?

No answer offered.

11 Have you made, or do you intend to make, any changes to the way that you accept cash due to the change in demand (for example, implemented rounding, restricted the use of certain denominations, or changed machines so that they no longer accept cash)?

No answer offered.

12 What measures can be taken to ensure that coins of denominations that are needed remain in active circulation and do not fall dormant, either with the public or at cash processors?

No answer offered.

13 In what circumstances is a £50 note used in routine transactions and why (rather than

multiple lower denomination notes)?

No answer offered.

14 How were counterfeit £1 coins able to enter circulation and circulate freely?

No answer offered.

15 When and how are / should coins be checked in the cash cycle, both now and in the future?

No answer offered.

16 Are there other international examples of countries managing decline in demand for cash that the government should look to? Should the UK follow a similar pathway as other countries in modernising the currency?

No answer offered.

17 In which sectors or circumstances is cash usage likely to increase tax evasion, hidden economy, and money laundering risks?

Sectors where a complex number of goods and workmanship/services are supplied as part of an overall commercial offering and/or labour-intensive services are most susceptible to providing ability to write-off and misrepresent the quantum of what is supplied with an intention of evading tax liabilities.

Construction and FM in the small scale consumer based markets, where cash is still a significant method of payment, is likely to be susceptible to those wishing to evade tax. Due to aspirations of growth and compliance issues the majority of businesses in our sectors would not operate in a way which either promotes or entertains tax evasion or hidden economy activities.

Those who do rely on cash to enable tax evasion would be limited in their scope through increased consumer demand to pay for goods and services through digital payment systems, limits on cash transactions and denominations of cash being kept at low levels to service the remaining cash transaction demands within society and commerce.

18 What further action should the government take to reduce tax evasion, hidden economy, and money laundering associated with cash to ensure a fair and level-playing field for tax compliant businesses?

We fully support the Government 'Making Tax Digital' policy/strategy, however, we would also welcome the ability of micro-businesses who are consumer-facing to continue to deal with those sectors of society who are inclined to use cash over digital payment methods, to ensure the ability of those businesses to trade is not inhibited.

Those businesses – which are forced by their client demographic to favour cash over digital payment – mostly operate in the high volume low value transaction space and therefore we could welcome a dialogue over what could be considered a suitable threshold for maximum cash transactions.

We understand that in the Norwegian model, there is no limit on cash payments for purchasing goods but purchasing services from the self-employed is limited to 10,000 Norwegian Krone or £920² after which a consumer is jointly and severally responsible with the trader if he or she does not pay the appropriate tax and VAT. Measures such as these may focus reduction of scope for evasion on the sectors which are at the highest risk.

19 The government knows that businesses and individuals still use large cash transactions, and wants to understand in which business practices or sectors are large cash transactions considered necessary or more acceptable? What are the barriers to using digital payments?

This is not necessarily an issue of what barriers are in place, rather what are the incentives to using

² According to an exchange rate conversion conducted on 30 May 2018.

cash over digital payment systems for British Sterling. There is a clear incentive to the black market economy in retaining a cash transaction system in order to ensure their transactions remain relatively untraceable so as to allow them to evade their tax liabilities.

20 How can the government use behavioural insights and nudge techniques to address cash related tax evasion, hidden economy and money laundering?

Government can require, or gain access to, large data analysis around those groups most likely to seek to evade tax liabilities through the use of predominantly cash transactions.

It should then seek to match data from merchants of materials, plant and goods with cash to highlight discrepancies in the movements of cash.

This would allow Government to focus its enforcement resources at those target sectors, businesses and individuals who are most likely to utilise cash to evade tax.

21 How can government encourage declarations of activity paid for by cash across the economy, including individuals, intermediaries and businesses (such as encouraging or mandating the use of receipts)?

No answer offered.

22 Are there other international examples of countries who have tackled tax evasion and money laundering associated with cash that the UK should look to?

No answer offered.

23 Should the UK follow a similar pathway to other countries and implement a cash transaction limit? If so, what would be an appropriate threshold?

Yes – we would estimate a cash transaction limit of circa £5,000 would be appropriate. Cash is used primarily because the physical nature of cash is that it is an asset where ownership falls with possession. It therefore enables simultaneous trading of goods/services for payment without a necessary trace of ownership of either.

Putting a cash limit in place would undoubtedly curb the ability of the criminal and evasion economy attempting to clean black market income by spending cash on large items or high value transactions.

We expect that payment in construction will embrace:

- a) the project payment platforms referred to above;
- b) which may later migrate to embracing blockchain technology in order to secure an immutable project ledger across the multiple layers of the supply chain as to how payments are managed and released;
- c) this will involve increase use of project bank accounts; and,
- d) until crypto currencies are mature and represent an acceptable level of risk, payments will be made in British Sterling

We are seeing the inception of blockchain products and groups, in order to explore the use of blockchain for payment in the construction and FM sectors. If blockchain represents an immutable ledge of payment across entire projects throughout the supply chain, this technology may lead to an indisputable record of payment throughout the life of a project and make the use of digital British Sterling less controversial.

However, since blockchain involves a pseudonymous transaction, i.e. there are not yet sufficient identification checks on users, until the residual security issues around the use of blockchain and crypto currencies are resolved we would only support the use of block chain with digital systems involving British Sterling.

Transactions that occur through the use and exchange of non-jurisdictional crypto currencies are independent from formal banking systems, and therefore can make tax evasion simpler for individuals. Also, whilst crypto currencies are thought to be virtual assets in their own right, unlike

cash as a physical bearer bond, there may be a requirement to tax the use of crypto currencies in due course if only to prevent devaluing of British Sterling.

Since charting taxable income is based upon what a recipient reports to the jurisdictional revenue service, it becomes extremely difficult to account for transactions made using existing crypto currencies, a mode of exchange that is complex and difficult to track.

Blockchain will mean each bearer bond cash element is trackable and linked so that banks will have no relevance unless they have wholesale permission to use money to lend or invest. If cash is digital, then British Sterling becomes crypto. Why do we need cash for any other reason?

The ECA and BESA – Working together to represent the engineering services sector

- *ECA and the BESA collaborate on a range of issues affecting the engineering services sector.*
- *The partnership brings together the two leading trade associations representing the interests of engineering services contractors, representing some 4,000 businesses with a combined annual turnover of almost £10bn.*
- *Together, ECA and the BESA cover a broad range of engineering, design, installation and facilities management activity, including electrical, heating, plumbing, energy management, micro-generation, ductwork, ventilation, fire and security, and wireless systems.*
- *Joint working includes representation and services in key areas such as contracts, procurement, payment and health and safety.*
- *Overall, the engineering services sector is estimated to account for some 40% of UK construction and maintenance turnover.*