ACTUATE UK
THE ENGINEERING SERVICES ALLIANCE

April 2023 - Summary of Actuate UK Consultation Response:

Payment and Cashflow Review: Reporting on Payment Practices and Performance Regulations 2017

Introduction

Actuate UK, the alliance of the engineering services sector, representing the interests of over 60,000 businesses and 350,000 individuals (with a combined annual turnover of almost £10bn) covering a broad range of engineering, design, installation, facilities management and data driven activity, including, but not limited to: steel, lifts and escalators, electrical, heating, plumbing, energy management, micro-generation, ductwork, ventilation, fire and security, and wireless systems (engineering).

In preparing this response we consulted widely with our member associations:

- BESA: Building Engineering Services Association
- BSRIA: Building Services Research and Information Association
- CIBSE: Chartered Institution of Building Services Engineers
- ECA, Excellence in Electrotechnical and Engineering Services
- FETA: Federation of Environmental Trade Associations
- LEIA: Lift and Escalator Industry Association

Some of our members (BESA, ECA, LEIA, FETA) are also submitting their own responses. We support their views; their responses include more specific feedback from their professional members. Our response represents our common points and thoughts for this review of the current Regulations.

According to the Construction Leadership Council, the construction industry comprises 405,000 businesses of which **99% are SMEs** (the bulk of which are involved in B2B transactions) – turnover is estimated by UK Government to be £100bn for construction, but circa £225bn for both construction and facilities management representing 10% of employment and enabling a further £540bn contribution to wider economic output.[1]

UK construction and facilities management averages four to five levels within its supply chain and 70 sub-contract packages across any one project[2]. It suffers from high fragmentation and disaggregation meaning that often the delivery level of the supply chain is highly divorced from the procurement level[3].

The public sector accounts for 30-40% of demand within the construction industry[4] and is a key client and driver of change/evolution – subject to its ability to leverage its demand across its 10,000+ procurement authorities.[5] This is because the public sector is a client who will own the built-asset and therefore has a vested interest in the asset whole-life-cycle and value proposition[6] – total public sector procurement spend is £292bn[7].

The engineering services sector not only forms a key part of the UK construction supply chain - forming between 40-60% of construction project value and sector turnover (capex/construction equates to 10% of asset whole-life cost) – but they also form an integral part of the facilities management service and maintenance sector (opex/operational cost equates to 80% of whole-life cost).[8] Our members' views are therefore based on a vested interest in driving whole-life value for money through built-asset life-cycle and not simply managing construction cost.

Economic background – why these regulations are important for our sector

It has widely been acknowledged from the Simon report, Banwell report, Latham report, Egan report, Wolstenholme report, Farmer Report, Hackitt report Procuring for Value and FIS report, that fair payment practices and behaviour are the key to unlocking a sustainable and resilient, safe, construction industry.

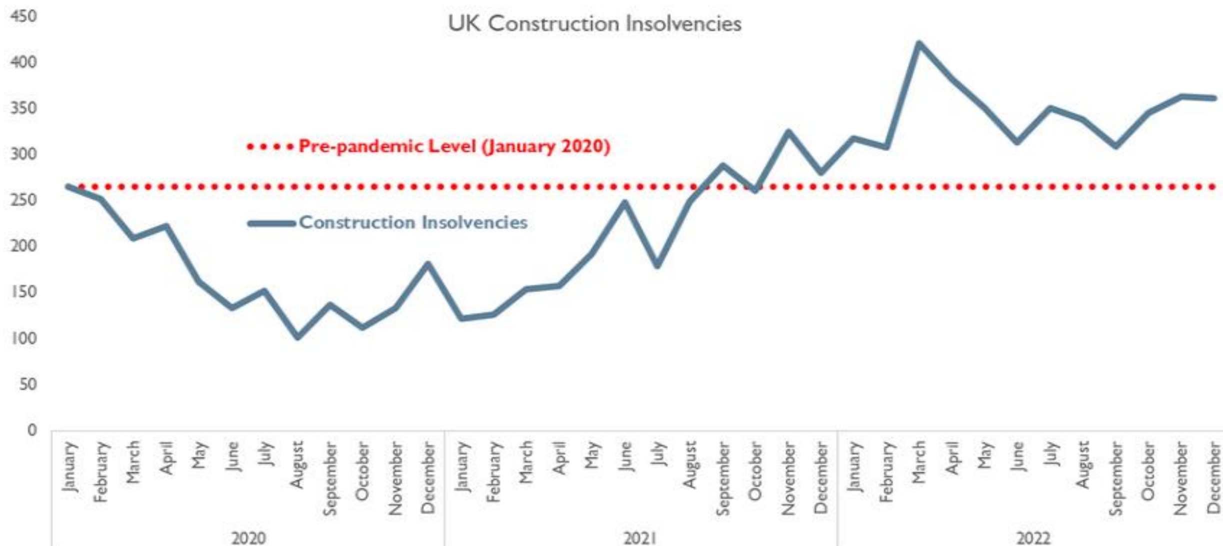
The Hackitt report, post-Grenfell, went as far as to note a direct correlation between the poor payment practices and safety/quality in construction.

Whilst league tables for construction[9] report payment performance has improved[10] (based on the BEIS payment reporting data measuring only the speed of invoice being paid not the speed of the value being paid), the reality for SMEs within

[1] CLC Roadmap to Recovery (2020): Recovery
[2] BIS: Construction: An economic analysis of the sector (2013)
[3] BIS Research Paper 145: Supply Chain Analysis into the Construction Industry (2013)
[4] BIS: Construction: An economic analysis of the sector (2013)
[5] House of Commons Library – Procurement Statistics
[6] Farmer: Modernise or Die (2016)
[7] Cabinet Office: Green Paper: Transforming Public Procurement (2021):
[8] Farmer: Modernise or Die (2016)
[9] Build UK Construction Sector Payment Performance
[10] Building Magazine 01.02.23

construction, according to rapidly rising insolvency statistics and feedback from trade-specific surveys such as the ECA/BEBS[11] and the CICV Scotland survey[12], is that commercial behaviour is hardening.

Incidence of late payment significantly increased in 2022 to almost 53 per cent – a rise of 13 per cent on 2021.[13]



From current data the **construction has the highest insolvency rate in UK commerce, and it is getting higher.**

Late payment as a means of finance

Construction contracting firms make between two and three times more use of trade credit than companies in the rest of the economy. Credit received from suppliers has a value equal to 32% of construction contractors' total assets (24% of construction SMEs' assets) compared to 11% for the rest of the economy. Trade credit given by construction contractors makes up 20% of total assets for construction contractors (21% for construction SMEs) compared with 8% for the rest of the economy. [14]

Looking at the differences between tier 1 (main contractor) and tier 2 contractors[98], shows that **tier 2 firms are net providers** of trade credit, that is they extend more trade credit to tier 1 firms than they receive from their own suppliers, while **tier 1 firms are net receivers** of trade credit, that is they receive more trade credit from suppliers (including tier 2 firms) than they offer to construction clients.

While (non-micro) tier 2 firms are large providers of trade credit to tier 1 firms, the price they obtain for this in terms of **higher margins appears to offset the cost** in terms of lower turnover per £ of capital employed.

Research shows that trade credit plays a vital role in the balance sheets of construction contractors, with lower tier contractors receiving trade credit from firms outside the industry, which then allows them to give trade credit to contractors further up the supply chain, and ultimately to the client. The **cascading nature** of this trade credit provision suggests that if contractors in the lower tiers experience problems accessing trade credit this could have implications throughout the supply chain.

Therefore, we know that delayed payment is baked into the economic structure of the construction industry.

The Regulations themselves have not provided incentives on business to improve payment practices. However, the Regulations are a catalyst and enabler of other initiatives in the payment landscape – e.g., Procurement Policy Note (PPN) 08/01,Prompt Payment Code (PPC), payment league tables, open source platforms (Good Business Pays), supply chain finance, statutory interest on late payment, grossly unfair payment terms etc.

[11] ECA Engineering Services Survey November 2022
[12] CICV Forum 2023 Survey - Payment
[13] Construction News Joshua Stein (2023).
[14] UCL for BIS (2013) *Trade credit in the UK construction industry*

ACTUATE UK RESPONSE

In the context and more widely our view dovetails with a number of key policy concepts raised elsewhere outside of this consultation.

We support:

- Extending the existing Regulations, subject to the **inclusion of metrics on the value of payment** being made within terms.
- Amending the Regulations to include points of ambiguity or non-binding best practice currently mentioned in the guidance.
- The introduction of a method of third party authentication of the data being reported (such as inclusion of the report on payment practices and performance being included in the directors' reports). As a lesson learned from Carillion, the requirement for third party verification by auditors at least introduces a duty of care for those verifying the contents of the director's reports.
- The introduction of a requirement to report on retentions in qualifying construction contracts. Because:
  - Cash retentions for construction, represent labour and materials already delivered and installed. They are often abused as the legal costs of recovery are not viable given the amounts involved.
  - Adding the standard retention payment terms to the reports would represent a significant metric to enable increased transparency and public scrutiny of large businesses' payment practices and performance; and provide SMEs with better information so SMEs can make informed decisions about who to trade with, negotiate fairer terms, and challenge late payments.
  - Feedback from trade bodies point that there is no such thing as standard retentions terms.
  - In a worst case scenario, requiring this information to be published would encourage large firms to standardise their approach and allow SMEs to benchmark their position.

Guidance should be amended:

The DUTY TO REPORT ON PAYMENT PRACTICES AND PERFORMANCE Guidance to reporting on payment practices and performance states:

> *This document has been prepared to provide general guidance* ***only****. The interpretation of the law on the duty to publish information on payment practices and performance is ultimately a* ***matter for the courts****. Users of this guidance should seek their own legal advice where appropriate.*

Unfortunately, the net impact of guidance is that it can be risk assessed and ignored. The reality is that SMEs seeking to rely on the payment performance data reports in a way envisaged by the consultation will not be in a position to fund any challenge to the reports as there would be little or no return on investment to funding a legal challenge.

Therefore, where the regulations are silent, vague or ambiguous, those reporting who wish to game the system can do so without impunity, because the guidance can be ignored.

We recommend that where we highlight specific areas of the guidance, it is at least amended as set out below:

- To present the true picture of trade credit payment performance being reported on, instantaneous transactions – such as those using debt or credit cards or digital wallets – should not be reported on.
- Disputed invoices/applications for payment should be reported on in an identical way to undisputed invoices/applications for payment.
- Systems where a payer uses a financier to pay the payee (supply chain finance), should report the period of time it takes the payer to pay the invoices/applications for payment as well as the period for the payee to get paid.
- Where payees do not invoice until after they are paid, payment periods should be measured from the first date on which the payer has notice of the amount the payee considers due.

Reporting Costs and Costs of not reporting

Most large firms have tackled compliance through digitisation. Industry has since 2015 worked with Government to create a blueprint for digital payment in construction which can eliminate risk, increase productivity and transparency to underpin trust and collaboration within supply chains – this has since been recognised in the Construction Playbook Ch.6.

In considering costs of compliance, cost can be broken down as follows:

- Costs of human capital deployed to operate an analogue manual process.
- Capex cost of digitisation.
- Cost savings of digitising the process resulting in an overall reduction of headcount.
- Cost redeployment in redeploying skilled roles to where they add most value rather than guarding against risk through carrying out manual compliance tasks.
- Ongoing opex cost of the digital process (subscription/usage fee + reduced headcount) which is usually a fraction previous cost of manual process.
- Ephemeral cost savings achieved through digitisation:
  - Increased granular MI – payment reporting.
  - De-risking the payment liability process from legal challenge and disputes.
  - Underpinning trust within supply chains to improve quality and growth.

There are a number of solutions in construction, each at different levels of maturity within the market. Each does something slightly different. On the whole, all of them provide automation of the compliance process under the Housing Grants, Construction and Regeneration Act and an ability to provide management information required in order to comply with the payment reporting Regulations.

When asked if they [companies offering such digital-based solutions] could measure value and volume, they all stated either yes, or yes if their system integrated into the incumbent finance/ERP system. In many cases, this is already done as part of good commercial management by those using the technology solutions and reporting under the Regulations.

Nearly all technology solutions operate on a sliding scale of user licence/subscriptions systems designed to eradicate human cost and risk. We estimate that on average the ongoing direct cost of using technology instead of a manual compliance process is one sixth of the manual cost.

The cost of chasing invoices to SMEs

A general outline of costs from SMEs point of view:

- 58 hrs a year for all team members at various levels of seniority.
- Which equates to £96,000 a year.
- In addition, £60,000 of external fees were incurred chasing late payment.
- 15-20% of working capital is tied up in late payment at any one time.

The human cost to SMEs due to late/abusive payment on SMEs:

- 72% of those paid late experienced stress as a result of late/abusive payment.
- Construction workers were nearly four times more likely to take their own life compared with other sectors last year.
- 15% of cases saw late/abusive payment lead to their own struggles to pay rent/mortgages.
- As a result of late/unfair payment, 59% of SMEs stopped or reduced paying themselves in order to mitigate the impact on their business.
- 25% of the time late/unfair payment leads to training cuts and struggles to pay business taxes, in over 20% of cases a lack of maintenance of office infrastructure, in 22% of cases this adversely impacted on creditor's personal credit rating and, further, a refusal of credit/finance facilities in 10% of cases.
- In over 30% of cases late/abusive payment led to struggles to retain and/or recruit personnel and had a 22% negative impact on staff productivity.
- In 17% of cases late or abusive payment as takes and SME business to the brink of insolvency.