



# The Way We Pay

Speed, efficiency and reliability in the way we pay are cornerstones of modern economies. Primitive economies rely on barter as a means of exchanging goods and services. The system is extremely inefficient, requiring each party in the transaction wanting what the other has to offer and for the value of the items to be similar. Long chains develop as someone with wool to exchange may have to go through several intermediate transactions to secure, say, coal, if the person with the coal only wants butter. Given the range of goods and services we consume today, bartering to acquire them would be a full time job in itself.

The invention of money around 5,000 years ago created a universal means of exchange, meaning goods and services could be sold at a price set by the market, and settled immediately. Much later, precious metal formed the basis of the first coinage, from around 2,600 years ago. Money itself has no intrinsic value in modern economies.

Cash dominated the world's payments history for centuries, but was not the only way to pay. A form of cheque has existed for around 2,500 years, used by Persians, Indians and Romans, although it was not until 353 years ago when cheques were used in the UK. But cash and cheque have been the main means of payment until as recently as forty years ago, when innovation in the way we pay really started to explode.

Real change started in the 1960s when the first credit card, first cash dispenser and first automated payments were introduced in the UK. New developments continue to bring about new and exciting services for customers. Someone currently in his thirties will arguably see a bigger change in his lifetime in how he can pay for things than in the previous five thousand years of human history.

The Way We Pay reviews the current trends in the UK and examines the latest round of the payments revolution, as even the internet yields to mobile banking.

# Executive Summary

## Getting Paid

- The shift from cash is gathering pace as firms, the state, and pension funds increasingly eliminate cash and cheques from their payments to individuals
- Now only 9% of adults do not have a current account, and only 4% have no sort of account at all. Use of branches has declined sharply but having an account is the key to accessing all the modern ways to pay

## Spending it

- Cash still makes up the largest proportion of our daily one-off transactions – three in five of our purchases – but they are very small in value
- Just ten years ago, three quarters of our shop purchases used cash. Now just over half do
- Debit cards are quickly taking over in the lower value transaction
- Contactless payment is poised to become ever more popular, and will push even more transactions onto plastic
- We use our credit cards for bigger purchases than debit cards, and we use them less than we used to
- Cheques are very niche nowadays with usage halving every five years, but remain popular with some groups of people and some organisations. Effectively gone from the high street, we mainly use them for financial transactions
- Supermarkets now account for over half of our retail spending, up from 46% in 2001 as they have added more and more products and opened stores rapidly
- Entertainment spending is the big winner. The economy may be gloomy, but we are spending more having fun, and doing more of it on plastic
- Spending abroad doubled in a decade

## Regular Payments

- Automatic payments (like Direct Debit) are now over three quarters of our regular commitments – up from half in 2001
- Housing costs have escalated, whether you own or rent
- Charities have shown great success in a decade of recruiting Direct Debit commitments
- Flashing less cash, but plastic may quickly lose its place in the sun to more innovative forms of payment, like mobile payments
- Number of cash machines doubles in decade, as people abandon the bank queue for the hole-in-the-wall
- But cash is becoming less important to us, particularly by value
- By value debit cards overtook cash in 2010, even before contactless took off
- Debit card holding is now 90%, up from 84% in 2001
- In 2001 debit card spending caught up with credit cards, but now far exceeds them
- Credit cards matured in the 2000s, and card holding even declined

## How businesses do it

- 98% of businesses are small, with fewer than 20 employees, so the payment needs of firms vary enormously according to their size and complexity
- Cheque usage is still popular with the smallest firms, but even so, cheque usage by business continues to fall sharply
- The smallest firms bank more like consumers, and often even use personal accounts
- Use of Direct Debit among businesses lags behind consumer use. Businesses prefer the flexibility on the timing of payments

## The future

- The use of contactless debit cards is set to increase. Many chains of stores already have point-of-sale devices to accept them, with more retailers planning to come onstream, this will continue to increase consumer awareness
- The debit card may have had its day. New technology means payment chips are now being embedded in phones, with more innovation to come
- New entrants may also appear. Smartphones are capable of scanning barcodes, a system which could easily be designed to take a payment from an account at a point-of-sale
- Paying a friend or business on your mobile as easily as sending a text is set to become a mainstream option in spring 2014, when the Payments Council launches the new mobile payments service. The service will be the first to link up every bank account in the country with a mobile number
- In future, the wallet may be obsolete altogether as more payments become electronic and our phones become the hub of our financial transactions

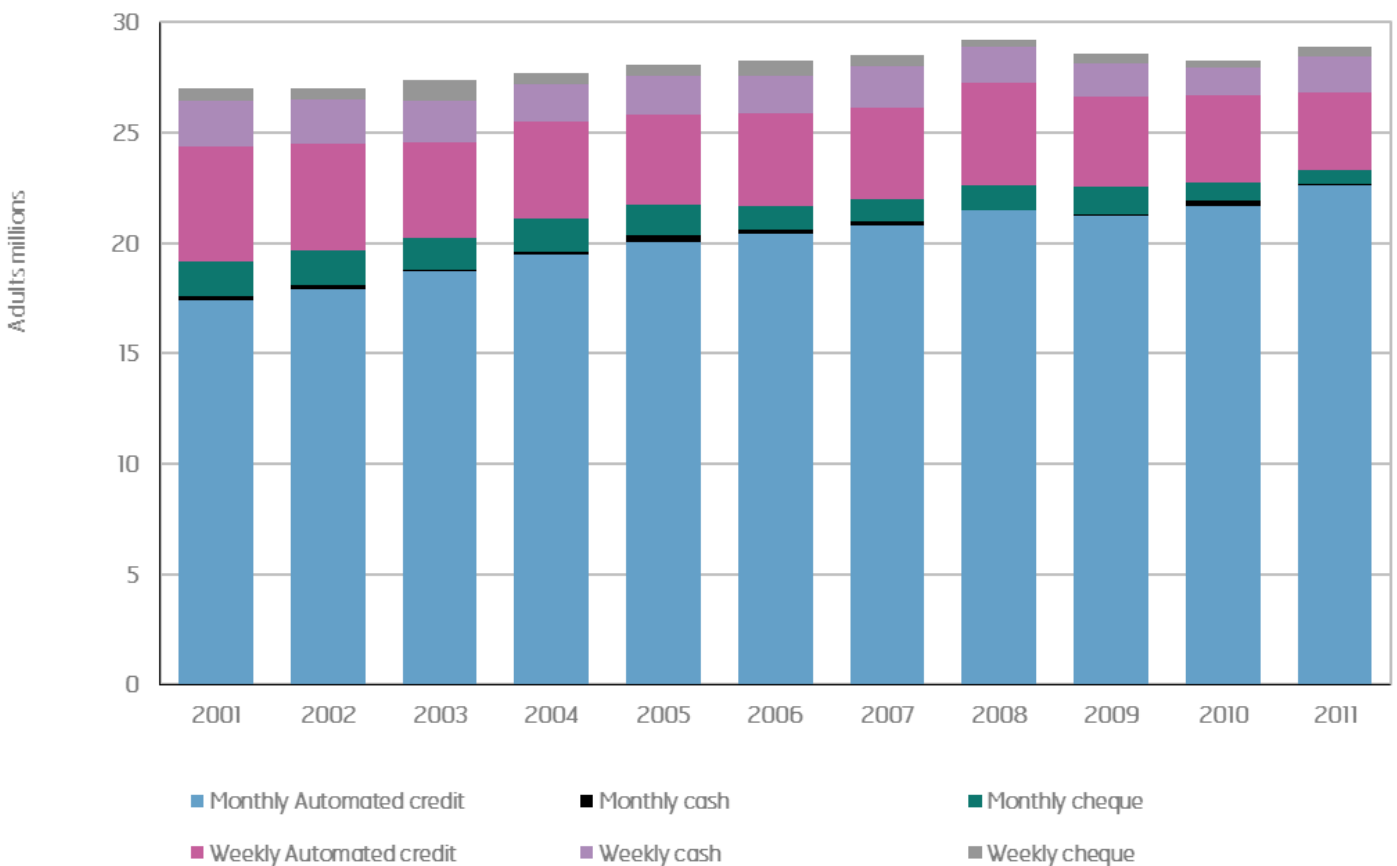
# How we get paid

In 2011, the state and businesses made 2.2 billion payments to individuals such as wages and pensions, around one a week to every adult in the country. How they make these payments has changed a lot.

## How firms do it

Fifty years ago, all workers received their wages or salary in cash or cheque. The reliance on these traditional ways to pay declined steadily, but even at the turn of the twenty-first century, cash and cheques were still relatively popular. In 2001, 175 million wage payments were paid by cash and cheque. In 2011, this figure dropped by 20%, with 141 million payments made that way. In 2011, 77% of all wages and salaries were paid using automated methods, and this is forecast to rise to 90% by 2021.

Chart 1. Payroll trends



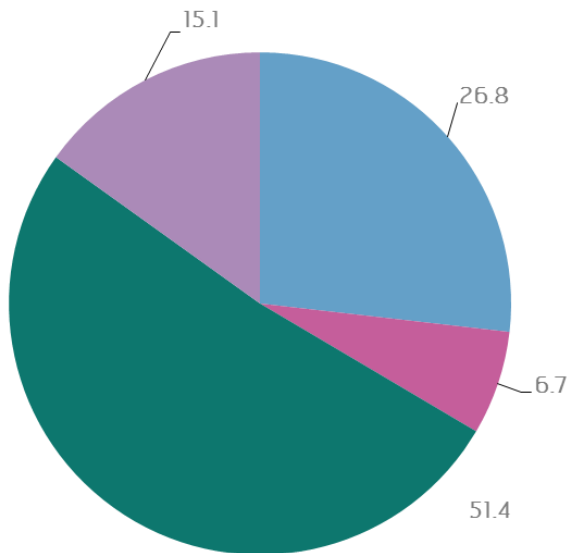
There are many reasons for the shift. It is more economical for businesses to make bulk automated payments for wages and salaries that are known in advance. More people are also paid on a regular monthly cycle now with the move from heavy industry into service industries. Bank account holding is also more widespread so people can use their accounts to receive automated payments.

## How private pensions do it

One in fourteen of all payments from businesses to individuals in 2011, were for private pensions. Private pension companies have largely abandoned cash and cheques to pay pensions and 98% of the 150 million yearly pension payments to 8.4 million adults were made by Bacs Direct Credit.

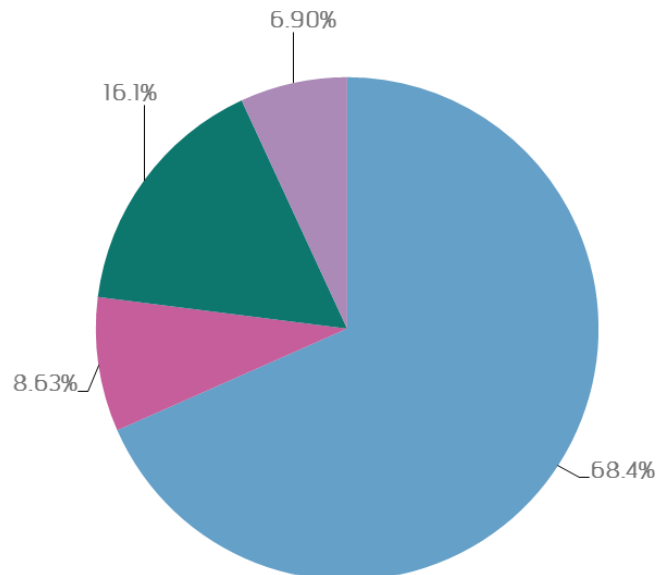
**Chart 2. Business-to-individual payments volumes 2011**

**Chart 3. Business-to-individual payments values 2011**



■ Wages/salaries      ■ Private pensions  
 ■ State benefits and pensions      ■ Other

Total volumes: 2.2 billion



■ Wages/salaries      ■ Private pensions  
 ■ State benefits and pensions      ■ Other

Total values: £1,078 billion

## How the state does it

The number of benefit and pension payments from the state to individuals over a year far outweighs those made by employers to employees. Although this may seem surprising, this is because of a number of factors. More people are in receipt of state benefits or pensions than are in employment, recipients may receive more than one benefit, each of which is paid separately, and many benefits are paid weekly or fortnightly. In 2011, over half of all automated payments (51%) were made by the state to individuals for benefits and pensions, and just over a quarter (27%) made from employers in the form of wages or salaries to their employees.

Although the state can be slower to adopt new payment methods than the private sector, they moved most of their payments for benefit and wages to automated payments between 2004 and 2007. It issued 12.2 million cheques to pay benefits and pensions in 2011, which was half the 2007 total. Cheques issued for benefits and pension payments now account for a tiny 1.1% of the total number of payments from businesses to individuals. Automated payments have dramatically simplified the administration of so many smaller value payments, helping to increase efficiency.

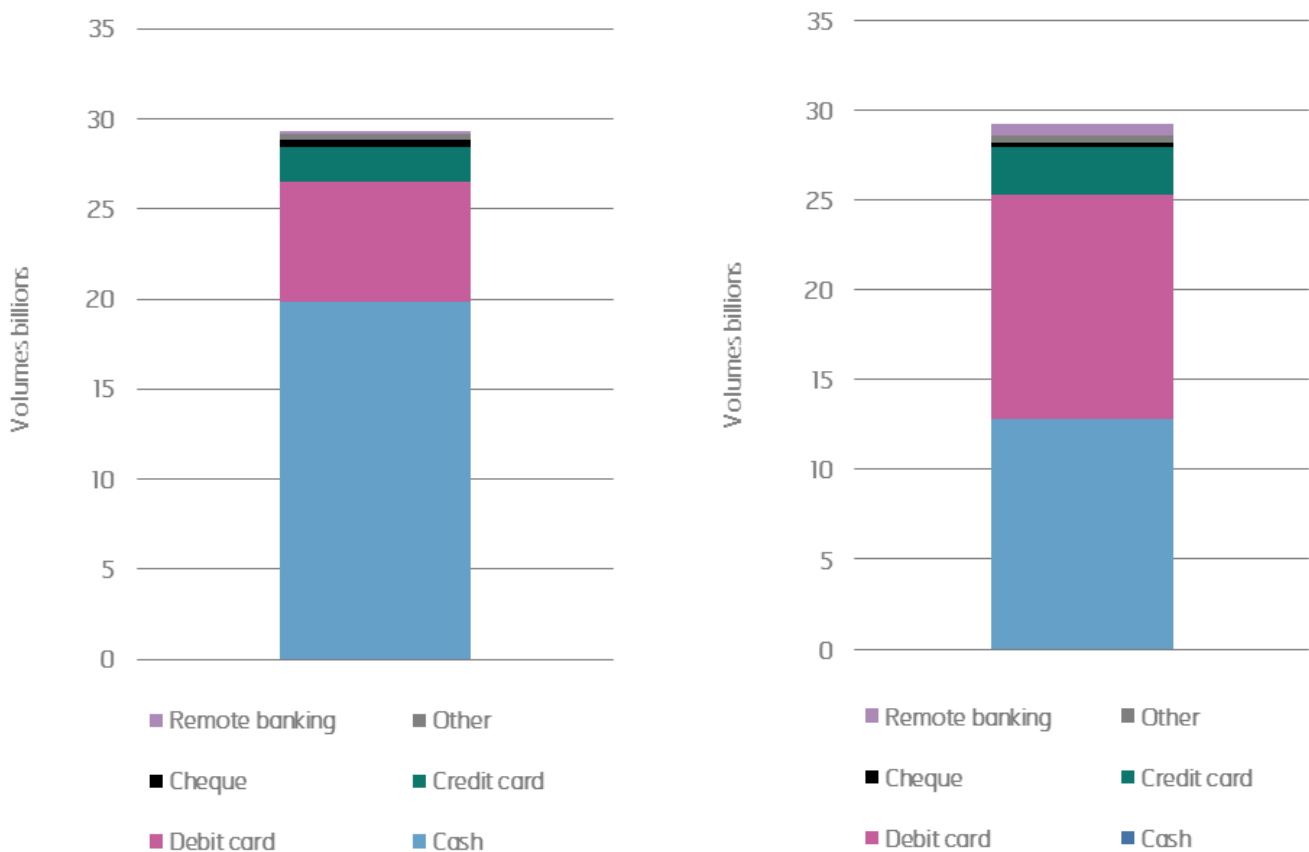
For most of the last decade, a strong economy meant the rise in state payments for benefits, and pensions has been driven by demographic changes such as population growth and ageing. Higher unemployment after the 2008 recession increased the number of people claiming Job Seekers Allowance. Planned changes in the benefits system, mainly the introduction of Universal Credit, will reduce the volume of certain benefits made by the state over the next decade. Some payments that are currently paid weekly or on a fortnightly basis will move to be paid monthly.

# The way we spend it

## One-off spending

Despite the big shift away from notes and coins, Payments Council statistics show that, as a payment method, though decreasing in its use, cash is still very important in our daily lives, and it continues to hold its grip on our frequent, low-value payments. It made up three out of five of our one-off payments in 2011, of which 44% were between £1 and £5. The average value of a one-off cash transaction was only £11. Some people are now using their debit card to pay for these small transactions, which stops them from having to rummage in their bags for notes or coins. Less than two thirds of our payments in shops are made in cash (56%), compared to 75% in 2001, demonstrating the reduction in cash usage.

**Chart 4a. Personal spontaneous payment volumes 2011**    **Chart 4b. Personal spontaneous payment volumes 2021**



There are marked differences in the ways different demographic groups pay. Young people, those on low incomes, and those in lower social classes make more of their payments by cash than those on higher incomes or in higher demographic groups. Those who are self-employed are four times as likely to rely on cash as those who are employed.

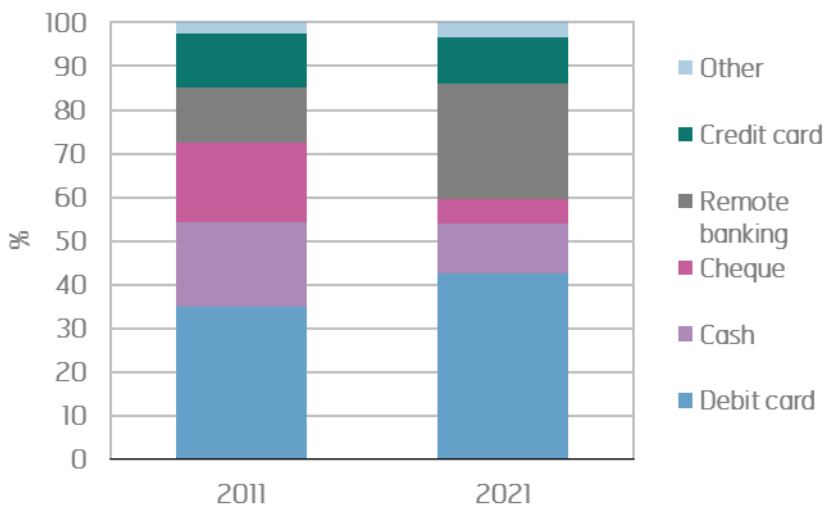
Debit cards are currently making gains in sectors previously dominated by cash and are likely to take a greater share as contactless cards reach mass adoption. More than one in four (28%) of our spontaneous transactions<sup>1</sup> are made on a debit card (a rise of 59% over the last five years), with the average transaction size at £42 and falling. Nearly three in five debit card purchases (56%) are between £10 and £50. 91% of all our one-off cash transactions were under £25, so the

contactless payment limit of £20 would allow many cash payments to potentially migrate onto cards. Debit card holding is widespread across all ages and socio-economic groups.

Credit cards, by contrast, are more commonly used by people drawing higher incomes or in higher social classes. This reflects the fact that they are more able to access credit and pass credit scoring criteria. They also have greater spending power and appetite to accumulate rewards such as Air Miles and cashback through their credit cards. Credit cards account for one in twelve of our spontaneous payments with an average value of £56 per transaction.

Cheques account for just 1% of spontaneous transactions, but have an average value of £375, as they are more likely to be used for high value payments such as financial transfers (see section on cheques for more detail). There is now a quite narrow demographic profile for cheque usage which reflects its diminishing status as a mass payment method. Cheques tend to be favoured by older people who are used to paying that way, the self-employed and families with children who have to pay for childcare and children’s activities.

**Chart 5 . Personal spontaneous payment values 2011 and 2021**



<sup>1</sup>Spontaneous transactions are defined as all non-regular payments. The majority of these are face-to-face transactions for goods and services at retail outlets.

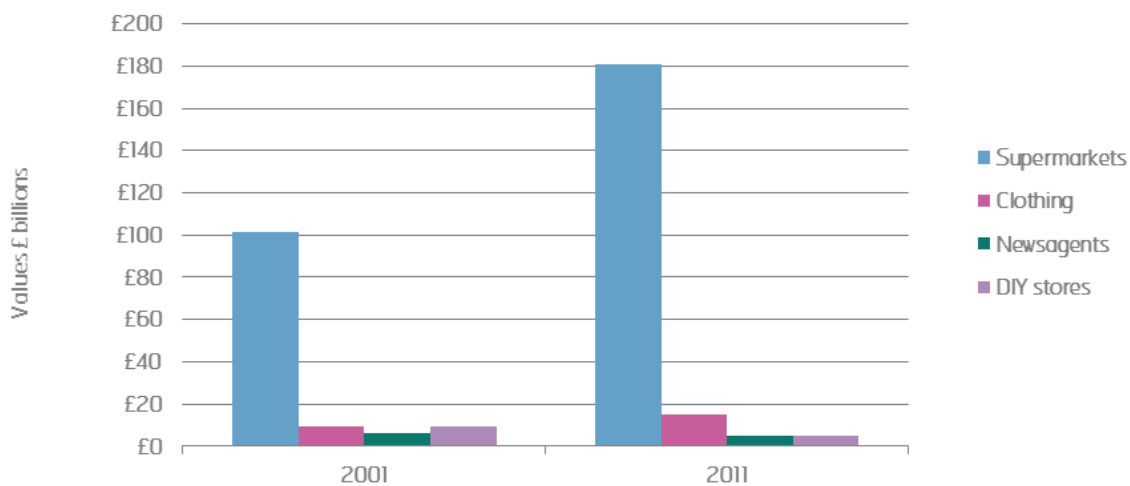


# What we buy

Supermarkets see more of our money than any other outlet grabbing share from up and down the high street. We spent £181 billion in supermarkets in 2011. Around 8.7 billion transactions were made in supermarkets, accounting for 58p of every pound we spend in retailers, up from 46p in 2001. They also took 33p of every pound spent on petrol; almost triple the amount taken over a decade ago. Some supermarkets entice customers with good petrol offers to encourage people to spend with them.

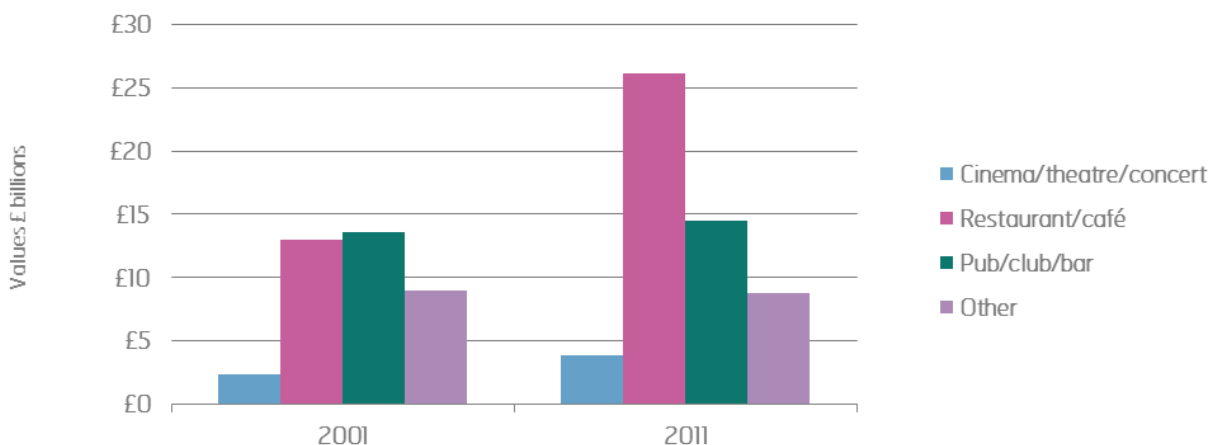
Some spending has moved from traditional retailers to supermarkets who sell more clothing, home and electrical goods and online retailers who can offer cheaper products without the overheads of having high street shops. Newsagents have lost nearly a quarter of their trade to supermarkets, and DIY stores are down by over a third. Clothing shops have bucked the retail trend and increased their share of our shopping spend, by more than a third, but they still only account for 8% of our purchases.

**Chart 6. Retail spending by outlet**



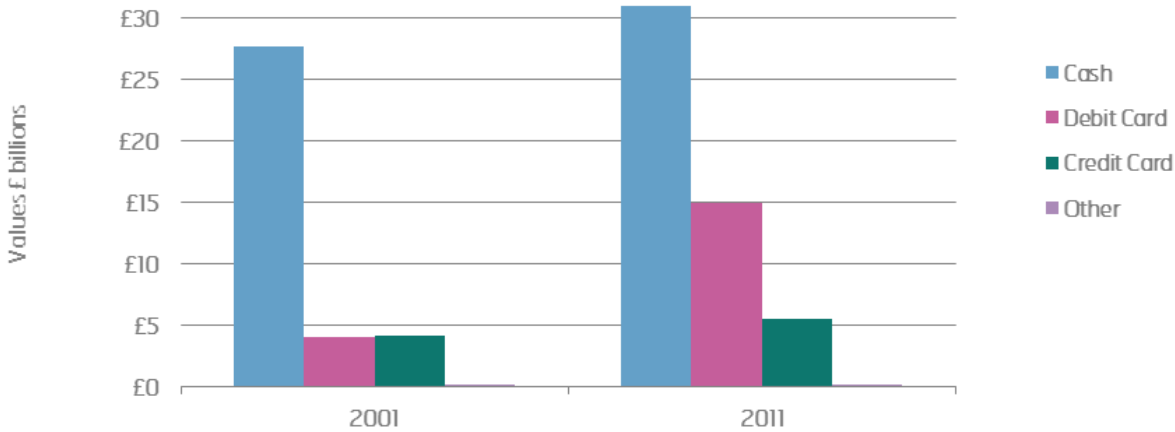
The cost of living may have shot up over the last decade, and we may be enduring the worst economic times in a century, but we are still having a lot more fun than in 2001. Spending on entertainment has increased from £37 billion in 2001 to £58 billion in 2011, at more than twice the pace of overall consumer spending. And we have changed the way we have fun too. Eating out in restaurants and the boom of UK restaurant and café society means we spend 100% more in these outlets nowadays. We also have been seeing more shows and visiting the cinema more often, as we have spent 63% more in those venues now than in 2001.

**Chart 7. Entertainment spending by category**



Over 3/4 of our entertainment tickets were bought in cash in 2001, but now just over half are paid for that way. Being able to buy and reserve tickets online with a card has spurred the huge change in the way we buy our tickets. Pubs and bars by contrast are struggling to compete for our time and money. We are spending less, in real terms, on going out for a drink though these outlets have caught on to the need to accept cards. As late as 2001, £90 in every £100 spent in a pub or bar was waved at the staff in cash while the customer waited to be served. Debit cards accounted for just £3. Thanks to chip and PIN, a piece of plastic is tapped impatiently instead, and £23 in every £100 now goes on a card.

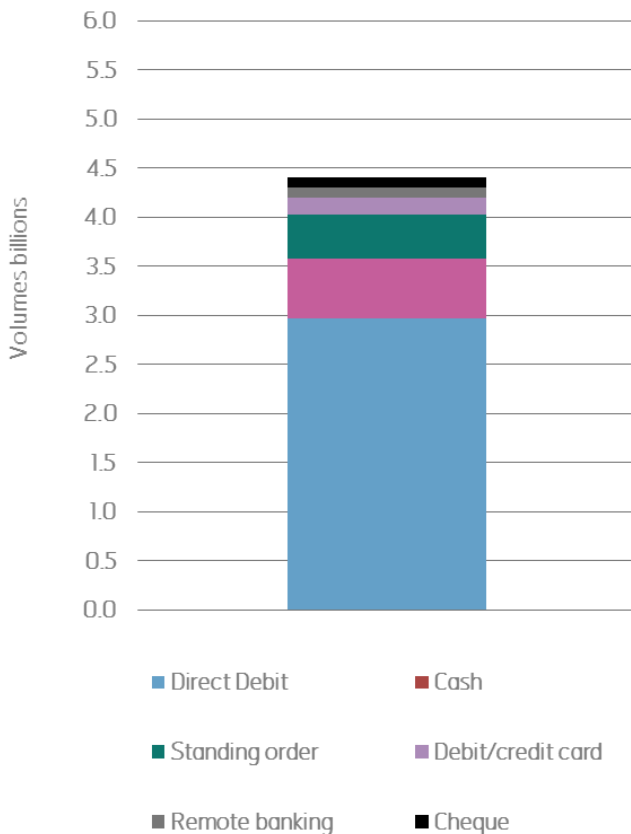
**Chart 8. Entertainment spending by payment method**



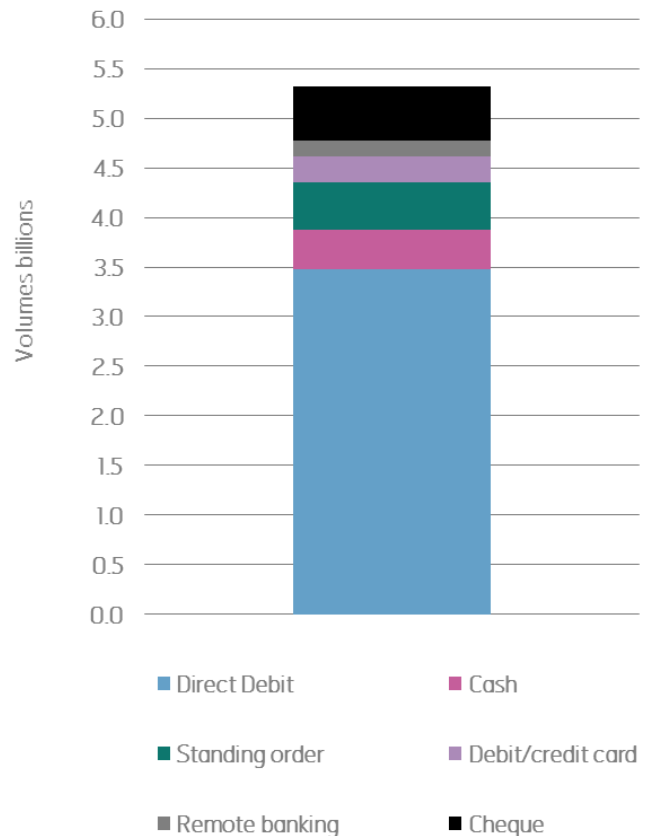
## Regular payments

Among our regular payments for household and other commitments like car insurance, mobile phones and donations to charity, Direct Debits and standing orders comprise three quarters of the total (76%) of which Direct Debits alone account for 66%. In 2001, cheques and cash accounted for 37% and Direct Debits only 50%.

**Chart 9. Regular payment volumes 2011**



**Chart 10. Regular payment volumes 2021**



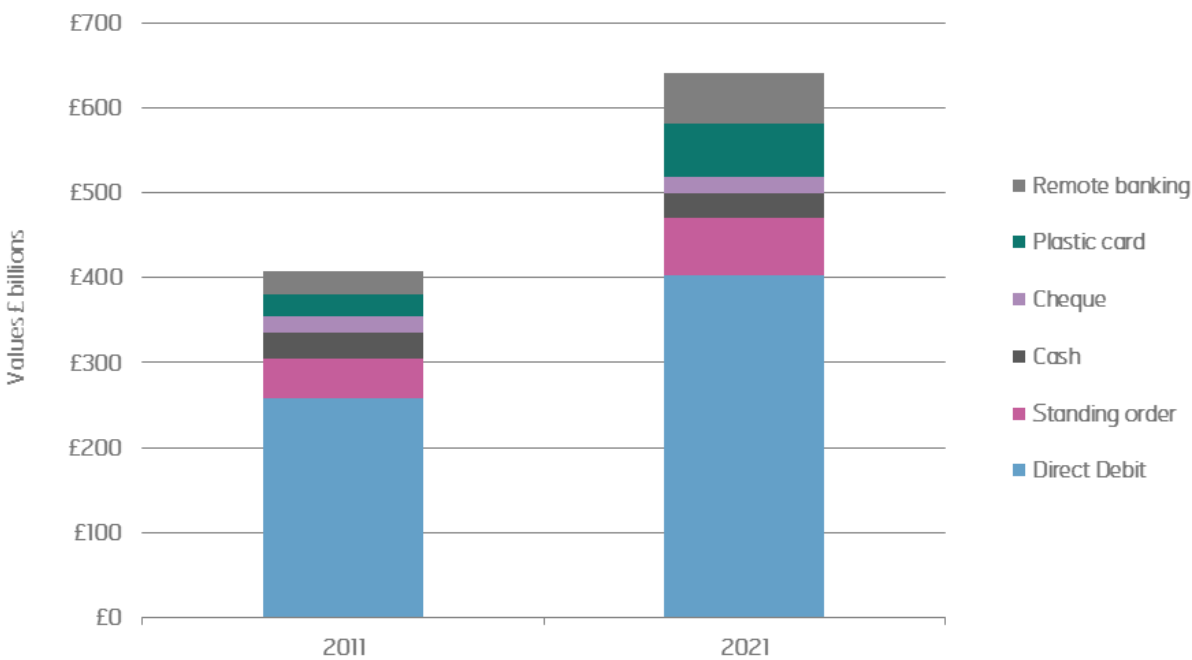
The cost of housing has shot up, whether you own or rent. The amount we collectively spend on rent has risen 104% since 2001, whilst spending on mortgages has increased by 99%. Councils, meanwhile, are taking over twice as much in local tax, at £41bn. A big change in the way we communicate means stand-alone spending on landlines is down 67%, as more people combine their telephone line with other services such as satellite TV, while we are paying over 18 times as much to internet service providers. Spending on mobile phone subscriptions is 183% higher than ten years ago.

In terms of what's changed amongst our regular payments, charities have done well in recruiting new donors. The volume of regular payments to charity has increased by 135% over the last decade, rising from 136 million to 261 million payments. The drive by street chuggers to recruit Direct Debit and standing order customers for charities has paid off too. The value of Direct Debits or standing orders to make charity donations has increased from £1.2 billion to £3.4 billion. They now comprise almost three quarters (70%) of the money we regularly pay to charity, up from 57% in 2001.

What's new?
• Gym Membership
• Childcare
• Student Loan repayments
• Opticians
• Internet subscription
• Mobile contracts
• Cable & Satellite TV subscriptions

What's on the way out?
• Rented tellies
• Catalogue/mail order shopping
• Trades union subscriptions
• Hire Purchase

**Chart 11. Personal regular payment values by method in 2011 and 2021**



# Doing it abroad

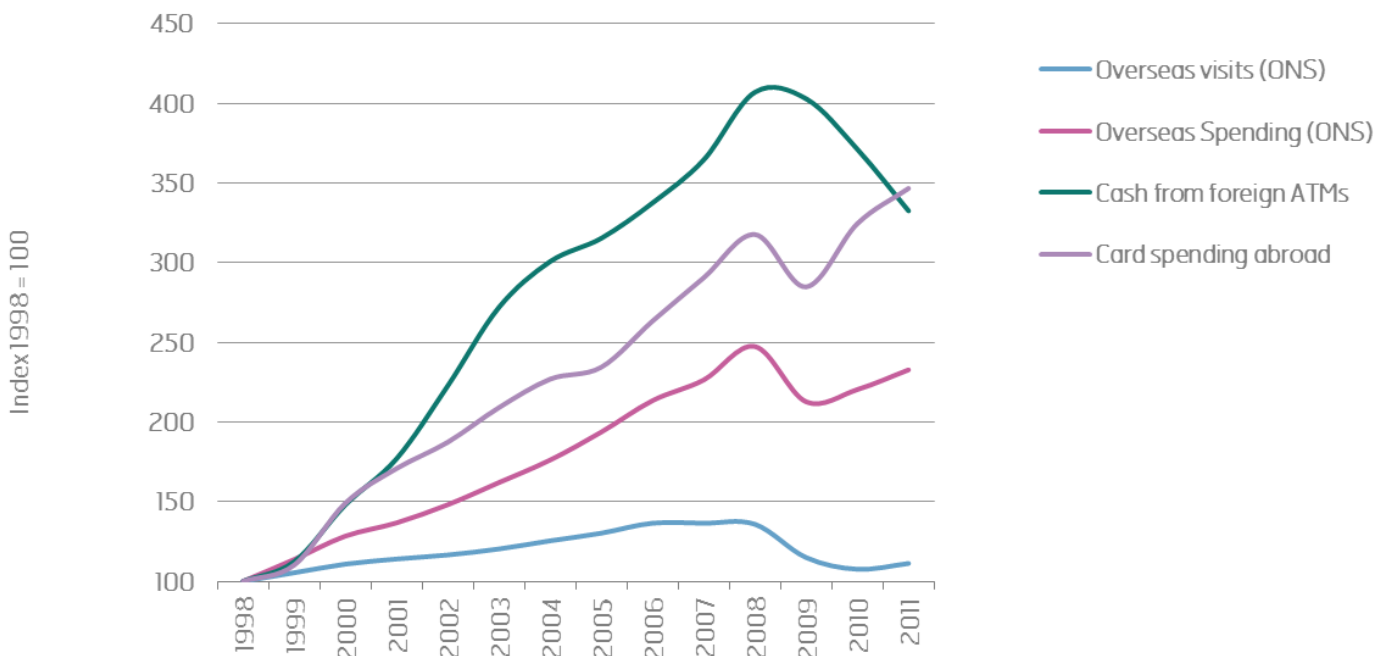
In total, spending abroad roughly doubled between 2000 and 2011 to £21.6 billion, but the way we spend when we're out of the country changed much faster. In the past travellers exchanged money in the UK and took traveller's cheques with them when they went abroad. As other countries increasingly accepted cards, and we had more cards of our own, so their use abroad exploded, almost tripling to 415 transactions between 2000 and 2011. Even more dramatic was the expansion in the use of ATMs.

Getting cash out of ATMs abroad increased by 130% between 2000 and 2008, when it peaked at £7.9 billion. This fell in each subsequent year to a total of £6.5 billion in 2011, in contrast to plastic card spending, which despite a fall in 2009 registered growth in 2010 and 2011. This is likely to have been driven by ever more widespread card acceptance abroad at hotels, restaurants and cafes, leaving travellers much less dependent on carrying foreign cash.

In 2001, debit card use abroad totalled £1.5 billion which was approximately 18% of credit card spending abroad. The growth in debit card ownership in the UK, coupled with wider acceptance of UK cards in foreign locations has driven some of the switch from credit card to debit card, with spending in 2011 amounting to £9.3 billion which was approximately 75% of credit card spending.

As in the UK, the traditional ways we pay abroad are falling by the wayside. In the next ten years it will be interesting to see whether other countries adopt contactless technology and develop the same mobile payment technologies as the UK.

Chart 12. Overseas spending



# How we pay for it

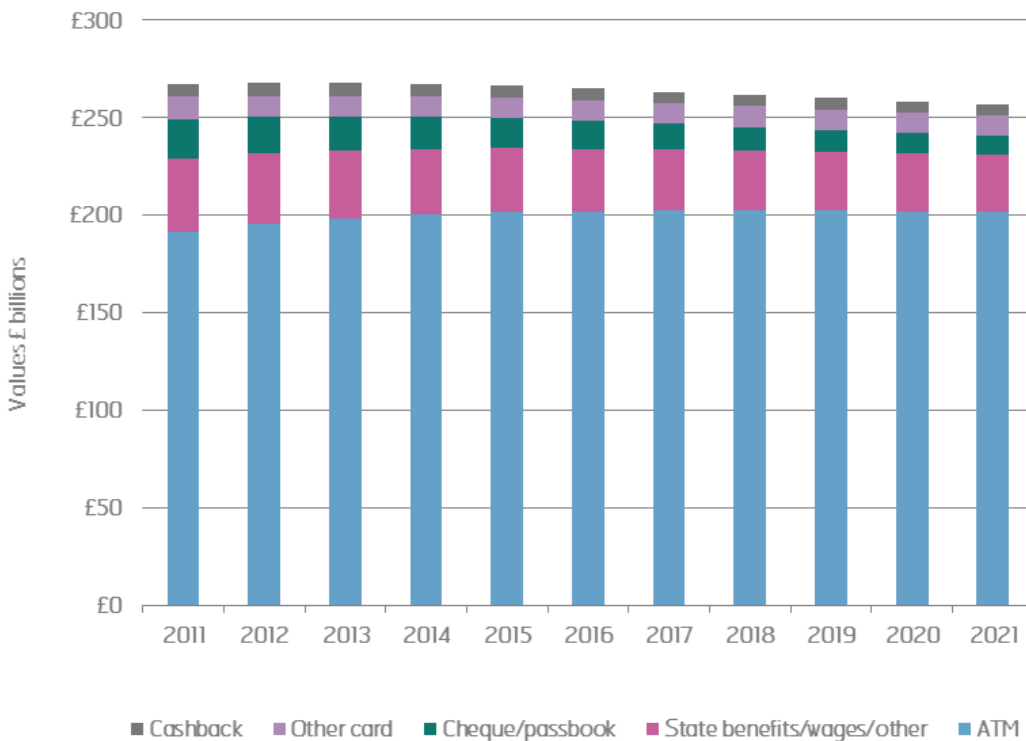
## Flashing less cash

Cash is becoming less important to us but it still has an important grip on the way we pay. And how easily we can get hold of cash is also changing.

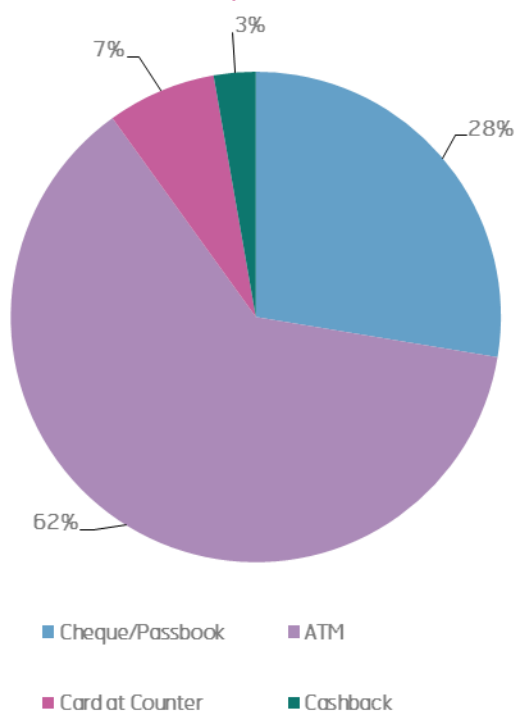
Cash machines are the most popular way for us to get our hands on ready money, and their presence continues to grow. The number has more than doubled since 2000 to 64,369, and there are more free-to-use machines, especially in locations such as high streets, shopping malls and rail stations, making it easier for us to get hold of the cash that we need when we need it.

In 2000, although three fifths (62%) of our cash came from a hole in the wall, many people still relied on cashing cheques and using passbooks in a branch, something most people would find hard to imagine today. In 2011 71% of cash withdrawn amounting to £191 billion was via ATMs. This proportion is projected to grow to 78% in 2021. In 2021 forecasts suggest that cheques and passbooks will shrink to a mere 40p in every £10 we take out, while ATMs will account for £9 of every £10. Even this overstates the importance of cheques and passbooks – only 1.3% of our visits to get cash will use this method. We get much bigger amounts out from counters – around £180 on average, which is around three times as much as the average ATM withdrawal.

Chart 13. Personal cash acquisition by channel

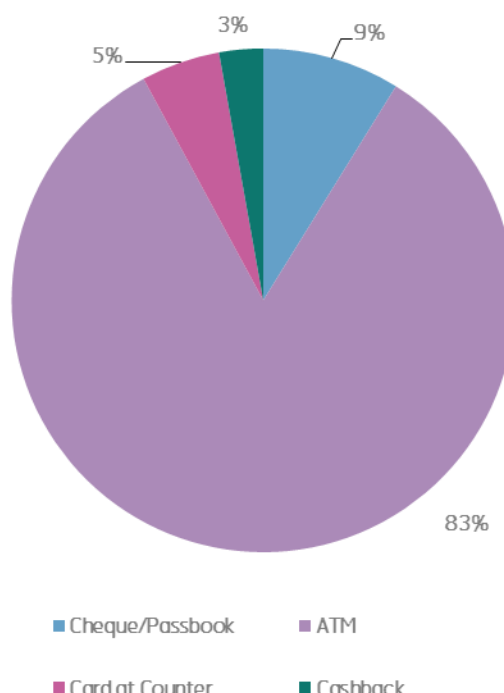


**Chart 14. Cash acquisition 2001**



**Total volumes: £181 billion**

**Chart 15. Cash acquisition 2011**



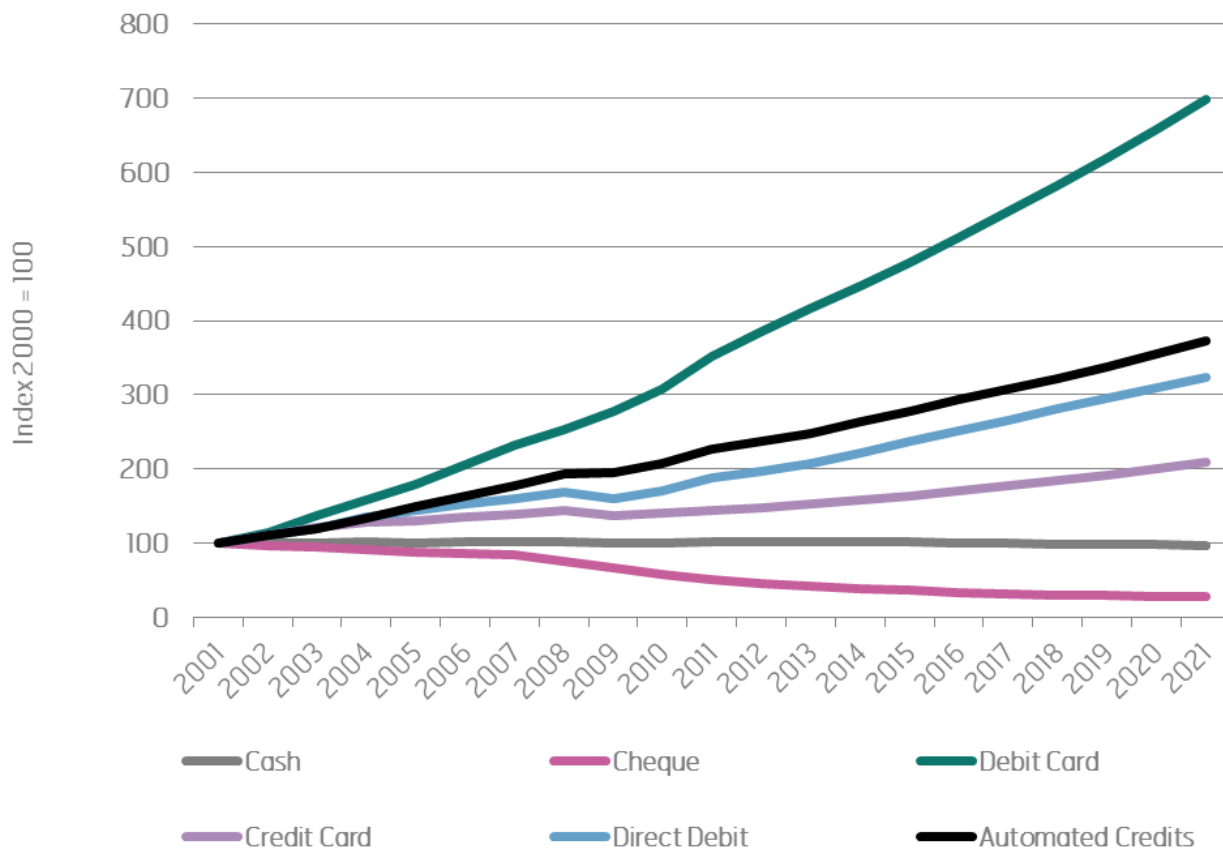
**Total values: £230 billion**

Younger people are the most frequent users of ATMs reflecting a lifestyle which sees them out and about more than older people and drawing money as they need it to manage their cash flow – a quarter of the 25–34 group use an ATM several times a week, while less than one tenth of over 55s make such a regular visit. The industry has made a concerted effort to stock more cash machines with £5 notes. At the end of 2011 there were 4,800 ATMs dispensing “fivers” compared to just 670 machines in 2009. This change is not only more convenient to consumers, but also helps people such as those on low incomes who use cash for their daily budgeting to be more in control of their finances.

The effect of the change in the way we pay is remarkable. We each took £4,501 of cash from our accounts in 2011, but that is forecast to drop to £4,178 by 2021, falling even faster than we previously thought due to the more rapid adoption of new payment technologies. If our choice of cash as a way to pay had kept pace with consumer spending, we would each have carried around an extra £1,090 in 2011, and would need yet another £2,018 (a total of £7,609) each in 2021, equivalent to an amazing extra £188 billion of paper and metal shuffling its way through our wallets each year.

More debit card holding has encouraged the switch from cash. Debit cards overtook cash for the first time, by value, in 2010. However, the next phase is potentially much more fast-moving. Contactless technology allows us to make transactions for less than £20 by waving a card or a smartphone fitted with a payment chip across a reader in a shop. This is far more convenient for consumers on the move and will eliminate the cost, hassle and security issues for businesses of handling cash. We won’t even need cash to pay a friend for a cinema ticket any more – a simple text message will do (see section ‘Keys, Phone, Wallet?’)

**Chart 16. Payments volumes from 2001 to 2021**

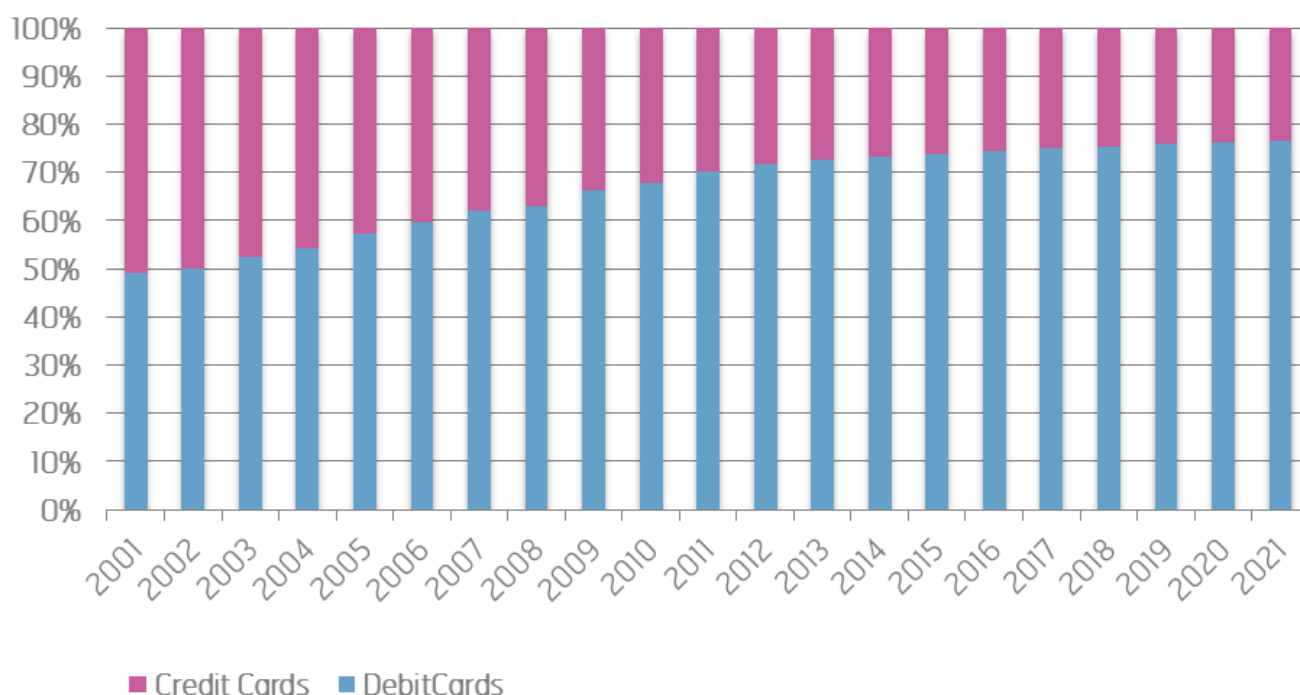


When we consider that cash still accounted for 55% of the volume of all transactions in 2011, it is clearly still an important way to pay. But most of these transactions are very small. Cash still dominates payments between individuals and tradesmen (like builders and plumbers), and the small one-off payments made to charities and schools. Over 70% of all payments to these groups are still in notes and coins. This will change more slowly than our shopping habits, but it will change. Cash is also more important to certain vulnerable groups. The disabled, job seekers, students and those on lowest incomes are most dependent on cash.

# The triumph of the debit card, but has it passed its peak?

The arrival of the debit card in the 1980s, which was billed as the consumers' alternative to the cheque, also provided customers with an alternative to the credit card. 84% of adults had a debit card in 2001, but they were less widely accepted, and many people still preferred cheques and cash. Spending was still just higher on credit cards (£93 billion) than debit cards (£77 billion) at the turn of the century. The balance tipped in favour of debit cards in 2001. As businesses like pubs, dentists and hairdressers began to accept the cards, thanks partly to the introduction of chip and PIN and to the rapid roll out of hand held point-of-sale devices, usage and card holding took off and the dominance of the debit card was secured.

**Chart 17. Credit gives way to debit - value of spending**



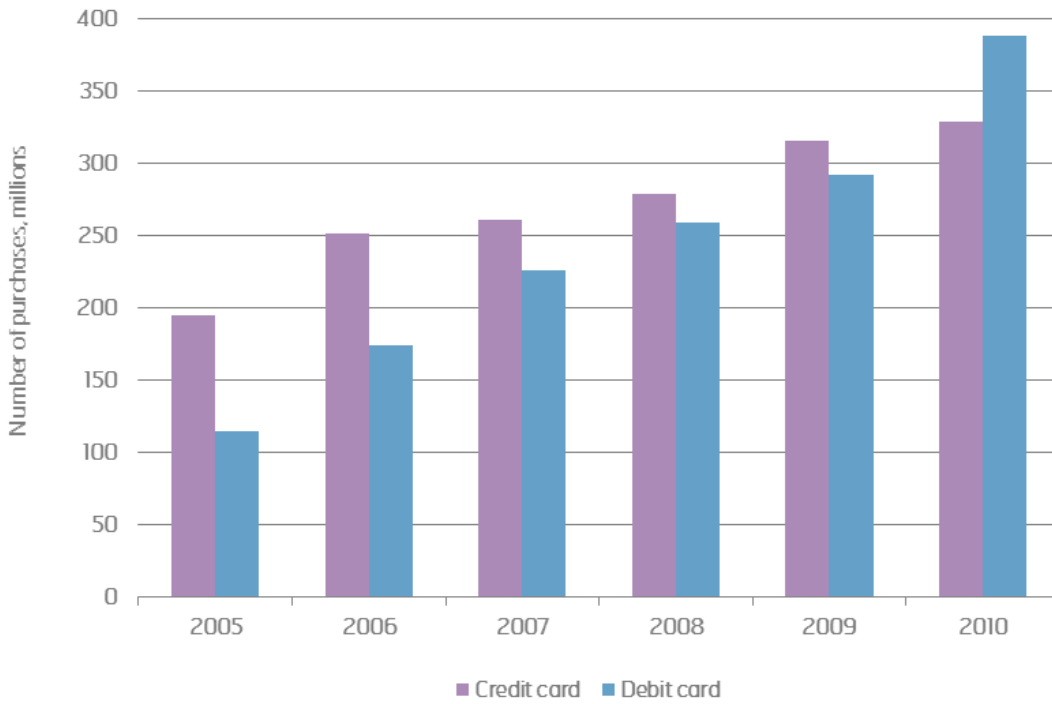
Between 2005 and 2011 the total value of plastic card spending increased by £179 billion. 91% of this growth was attributable to debit cards. In 2011, debit card spending in the UK amounted to £334 billion from 7.3 billion transactions. This was approximately two and half times the amount spent on credit cards of £140 billion from 2.1 billion transactions. This represented an increase of 252% on the corresponding amount spent in the year 2001, making this rate of growth three times higher than that recorded for consumer spending over the decade to 2011. In the next decade debit card spending in the UK could close to double – as we forecast £664 billion from 14 billion transactions, with credit card spending projected to be £204 billion from 3.1 billion transactions.

Debit card holding is much more widely spread across the social spectrum than credit cards, with 90% ownership across the adult population in 2011. 98% of AB adults held a debit card compared to 57% of E adults in 2011. For credit cards the figure is 77% v 26% respectively. The wide issuance of debit cards has positive social consequences as it means lower income consumers are able to access the world of e-commerce.

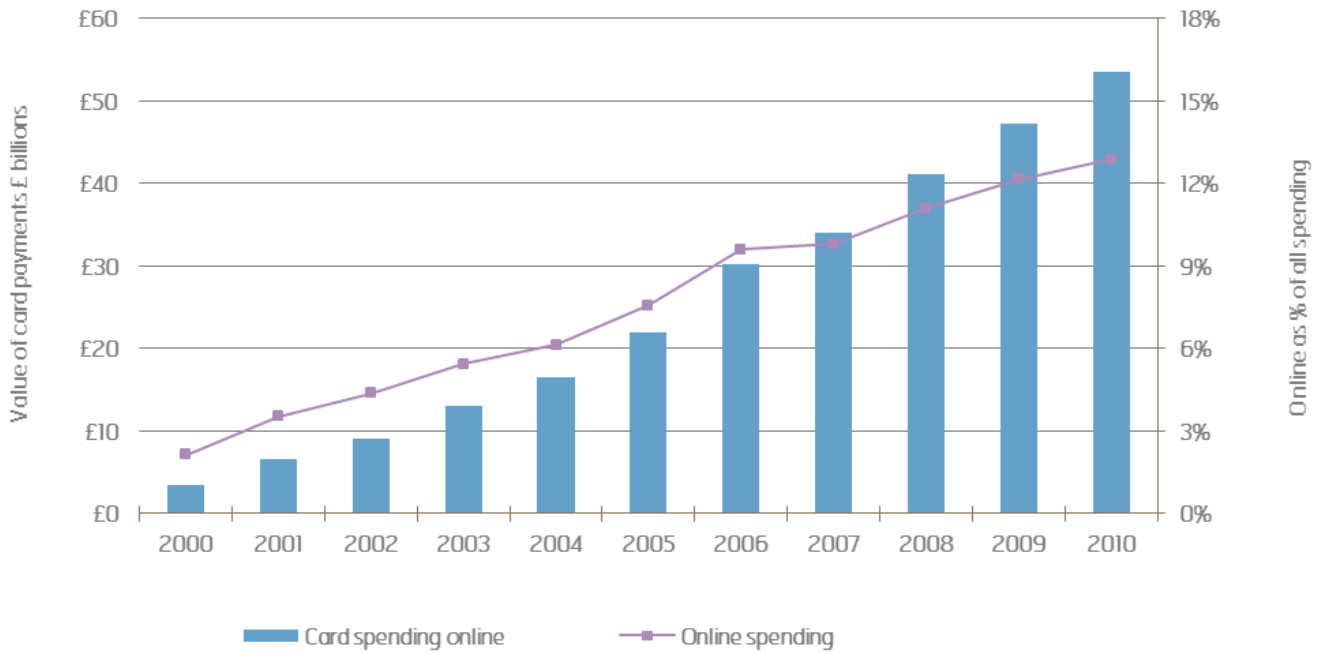
Indeed, without the mass adoption of cards the e-commerce industry could never have developed, and self-service in shops and filling stations would be non-existent. In 2001 online purchases took just 3.3p in every £1 spent on a card. By 2011, that had risen almost quadrupling to 12.8p in every £1, and the total continues to grow.



**Chart 18. Consumer internet card spending**



**Chart 19. Online card spending**



Contactless functionality means debit cards can continue to take a greater share of our spending, but in the longer term, the future of the piece of plastic could be impacted by the arrival of mobile payments. The huge success of the debit card has opened the door to new technologies that could even lead to its own demise, or at least heavily impact its use. In the next few years, if card technology gets incorporated into mobile payments – it could become possible to use the physical phone to make a debit card type payment instead of the physical card in a shop and if this happens the debit card as we know it today could become a thing of the past. (See section ‘Keys, Phone, Wallet?’, page 25).

# Credit cards reach maturity

The demise of the debit cards is still some way off, as despite having saturated the market, the use of debit cards will continue to grow for the time being. By contrast, the credit card market has already matured and usage has been subdued since 2009. Credit card issuance grew very strongly in the 1990s and 2000s as credit was more easily available.

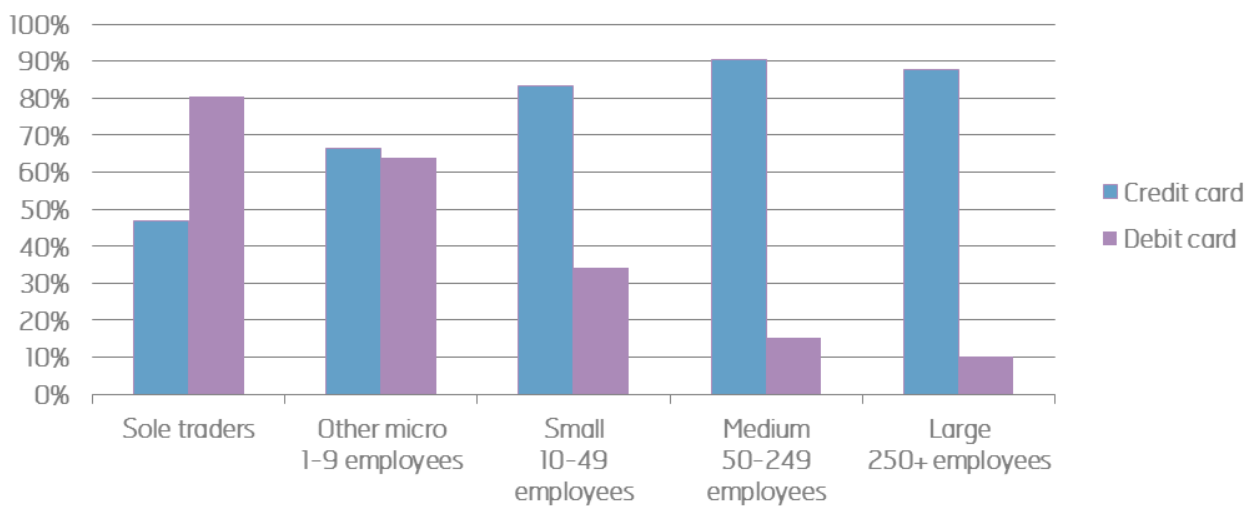
Credit cards are a very useful tool in our payments arsenal, but they are not the payments of choice for a lot of our day-to-day purchases. They are most useful where a large expense needs to be spread over a longer period, or for the protection offered under section 75 of the Consumer Credit Act 1974, or indeed because a credit card is ring-fenced away from a current account.

Rapid growth in consumer borrowing and the increase in credit card usage in the early 2000s meant that 69.9 million credit cards were in issue by 2005, along with 4.7 million charge cards. Two thirds of adults held a credit card. During the recession a greater focus on the need to borrow and lend responsibly saw consumer attitudes to credit card use change. By 2011, there were 15.4 million fewer credit cards in our wallets, compared to 2005.

Spending on credit cards has increased by just 7.7%, which was well below the cumulative rate of inflation over the period. Last year we spent £140 billion and made 2.1 billion purchases in the UK. During the recession, repayments increased and in 2011 around 60% of cardholders paid off their balance in full each month, up from 54% in 2003.

In terms of business-to-business payments, the trends stay true. Last year, spending on credit cards fell and cardholding was also down by 2.7% compared to 2010, resulting in a total of 1.9 million cards. Interestingly it is larger businesses that are most likely to use credit or charge cards, whereas smaller businesses use debit cards.

**Chart 20. Type of plastic cards used by businesses 2011**



**Basic: All businesses**

The final piece of the cards puzzle is the continued expansion in the usage of prepaid cards. They are already ubiquitous in replacing gift vouchers, but more sophisticated versions are available for example for business-to-person disbursements such as payments under reward, loyalty and incentive schemes. The insurance sector is also starting to issue prepaid cards to claimants, for use in a specific retail sector to cover a claim. Another area where these cards are starting to forge ahead is in the travel industry. They seem to have become a more attractive proposition compared with traveller's cheques as they can be used directly in shops or to withdraw cash, as well as offering competitive rates for fees and charges when used abroad. However, though this market continues to expand, it is still at a slower rate than in 2009. Ultimately it is hard to imagine prepaid cards developing beyond a small niche.

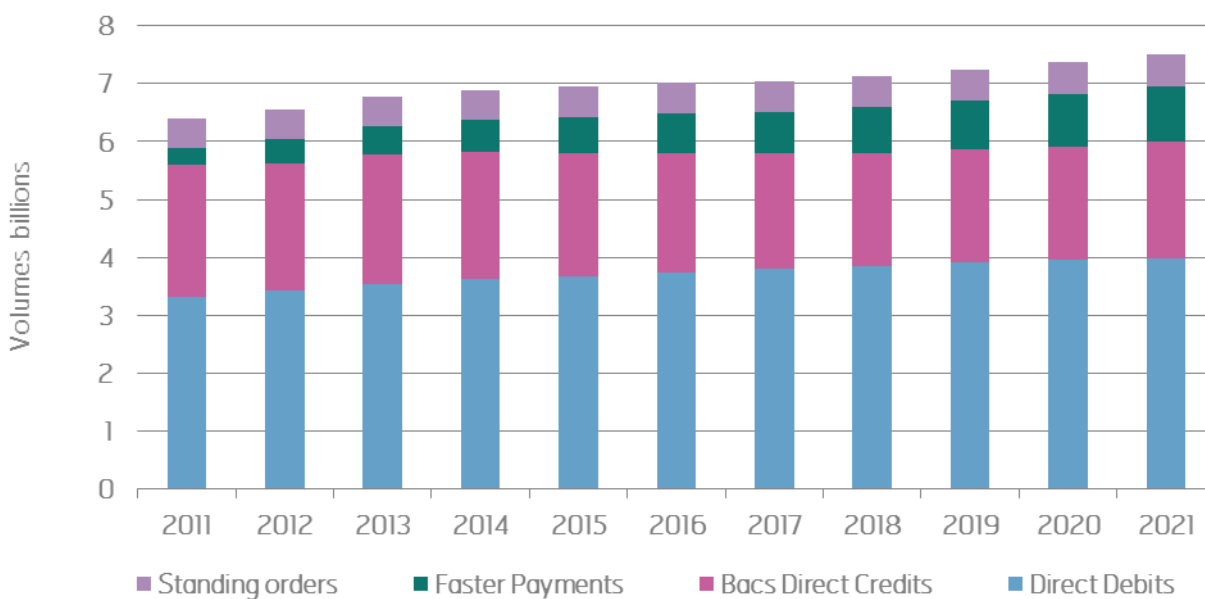
# Faster Payments lead the charge for automated payments

Bacs Direct Debit and Direct Credit, standing orders, CHAPS and Faster Payments make up the UK's automated payments systems. Faster Payments have grown enormously over the past couple of years, and have opened up new markets, business opportunities, and facilitated the adoption of new ways to pay.

There were more than half a billion Faster Payments in 2011, from a standing start in 2008, of which 237 million were standing orders. The adoption of internet and telephone banking has resulted in more people using Faster Payments to move their money, but it has also made it easier for making person-to-person payments or other transactions, such as paying credit card bills. Changes to the maximum timescale for electronic payments in 2011 - requiring payments across the EU to reach the recipient's account by the end of the next working day and known as D+1 - have also helped to bolster Faster Payment volumes. UK customers benefit from the best possible service as a Faster Payment typically lands in the recipient's account within two hours, exceeding the legal requirement.

The Faster Payments Service has also made it much easier for businesses to pay individuals, employment agencies, payday loan companies, car and mobile phone trade-in firms – all of whom enjoy the speed and reliability that it provides. Indeed payday loan firms who specialise in short-term and immediate loans rely on the speed of transfer into their customers' accounts for their business model to work.

**Chart 21. Automated payment volumes from 2011 to 2021**



When the Payments Council introduced the Faster Payments Service in 2008, it made very clear at that time that this cutting edge technology would not only ensure that the UK benefits from the world's fastest payment transfer service, but it would also pave the way for future payments innovation. These words ring true as the Council is currently building a central database that will facilitate a customer of any bank making a mobile payment – that is linked to their bank account – using just a mobile phone number. This new service that banks and other payment providers will be able to make available to customers will use Faster Payments and/or LINK to process the payments. The adoption of new technologies like mobile payments (bank account-to-bank account) will mean even bigger volume growth. Without the certainty of instant transfer, the appetite for mobile transfers amongst individuals and businesses would be limited.

Excluding standing orders, Faster Payment volumes are forecast to more than triple, rising to close to one billion by 2021.

Bacs Direct Credits are mainly used by businesses to pay each other and for tasks like making payroll and pension payments. Volumes have been fairly steady at around 2.3 billion over the last five years although they have been impacted by the

migration of standing order and telephone and online banking transactions to the Faster Payments Service. Precise predictions are hard to make but by 2021, volumes are likely to be around 10% lower than today.

Direct Debits are highly popular, comprising two thirds of regular household and individual bill payments in 2011. They are very widely used by utility and media providers. 91% of current account holders have the facility to make Direct Debits and standing orders using their account. Businesses are also using them more and more to pay each other, though their adoption has been slower than from consumers to businesses. Around half of businesses are using them to settle utilities and phone bills, but only one in ten are paying suppliers in this way for obvious reasons of cash flow management. Direct Debits made up a quarter of business to business payments by volume in 2011. Overall, Direct Credits are the most important method of making outgoing payments for businesses – accounting for 43% of total volumes. However, in practice it is clear that the use of Direct Credits generally increases with the size of the business, with the very large businesses being high users.

Direct Debits are a mature payment method among consumers. They are projected to grow to just over seven in ten regular payments by 2021, but will grow much more rapidly among businesses, reaching one third of all payments. By 2021, we estimate there will be almost four billion Direct Debits a year, up from 3.3 billion in 2011, as more small businesses migrate from cash and cheques to automated payments.

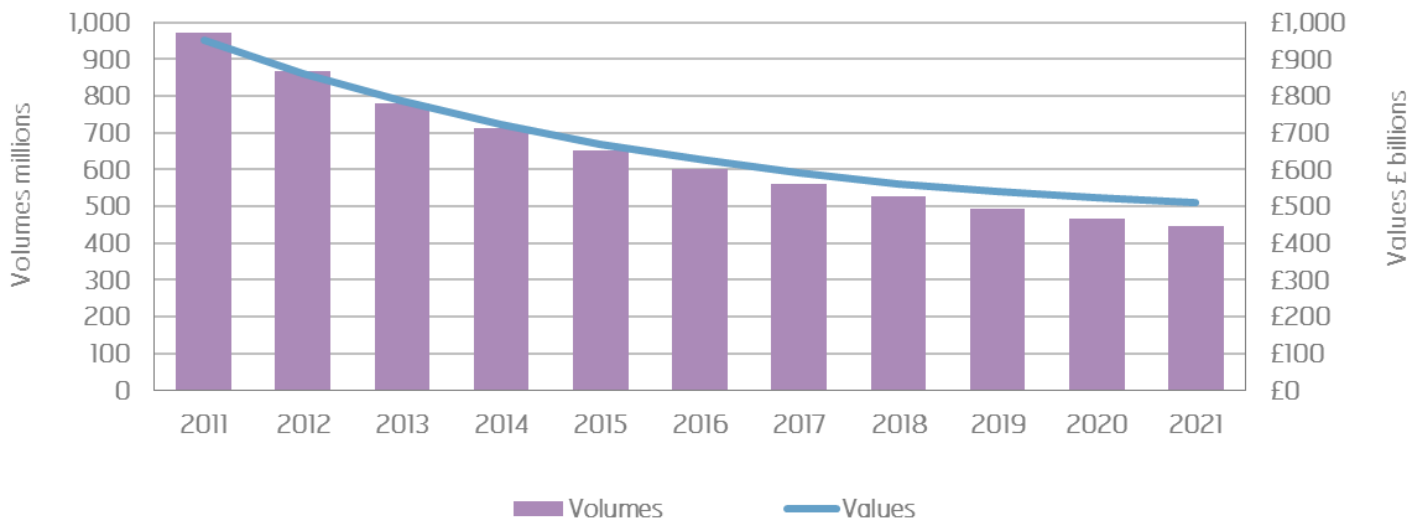
CHAPS is the UK's same-day high value automated payments system, and prior to the introduction of The Faster Payments Service in 2008 it was the only option for same-day payments. Though some low-value CHAPS payments are slowly migrating to Faster Payments, they are nevertheless still growing, owing to an increase in CHAPS membership and growth in cross border payments. We estimate there will be 42 million CHAPS payments in 2021 compared to 34 million in 2011. They tend to be used much more by larger organisations, but are also often used for urgent supplier payments, where a Direct Credit would take too long to deliver and clear.

Standing orders are a niche form of payment, preferred by those who perceive them providing greater control over their regular payments (such as rent, regular savings and charity donations) because they can decide when the money leaves their account. Just 509 million were made in 2011, a figure only likely to reach 552 million in a decade.

# Cheques drop further behind

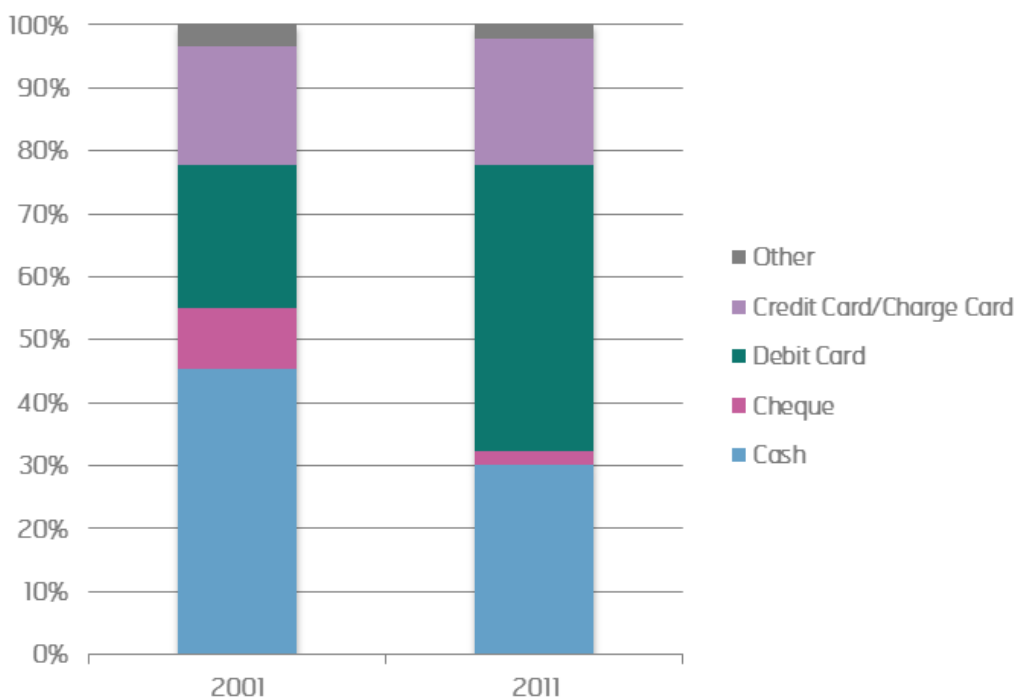
Cheque volumes continue to fall rapidly, dropping 12.1% in 2011, a rate of decline that halves their usage every five years. For many people, especially younger people, they are not considered as a payment option.

**Chart 22 . Cheque volumes and values from 2011-2021**



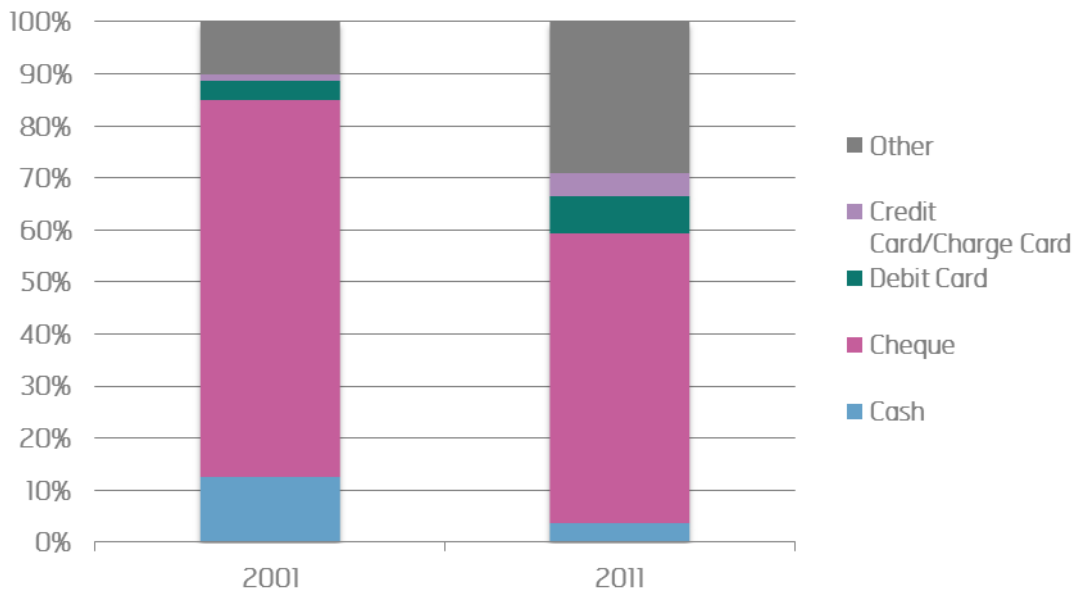
Consumers wrote about half of all cheques in 2011. They signed 545 million of them, 75 million fewer than in 2010. Less than one in five personal cheques written is used to make a regular bill payment. They comprise 12% of our regular transactions, with the biggest category by far being payments for childcare, making up nearly 20% of all regular cheque payments written in the UK by consumers. Over 100 million cheques were for regular payments in 2011 and over 400 million were used for one-off transactions. 400 million payments sounds like a lot, but is fewer than ten per adult per year.

**Chart 23 . Retail spending (value)**



Indeed, it's often quite hard to use a cheque at all. Many retailers no longer accept them, and stopped doing so long before the end of the Cheque Guarantee Card Scheme in 2011. Only 1 in 150 retail purchases was made by cheque in 2010. Cheques remain much more important in how we pay each other and how we move our money around. One in forty financial transactions (savings and investments, loan repayments etc.) were made by cheque, often for very large sums, while one in thirty payments to other individuals, and schools and organisations, like charities and clubs, were written and signed out of a cheque book. Even in these more popular categories though, they are a minority choice and declining.

**Chart 24. Financial transactions (value)**



Despite their rapid fall from favour cheques still remain an important payment method for some groups. Around 70% of the over 65's continue to use them – they are three times as likely to have written a cheque in the last month as someone under 35. Cheques are also a major source of income for the self-employed, charities, providers of childcare, school activities, and clubs and so on. They are also still widely used for paying tradespeople, and friends and family.

Charities, particularly small ones, tend to be the most reliant on cheques. Nearly a third of small charities receive around 75% or more of their income by cheque. Next most common is cash. Charities feel vulnerable to changes in the way we pay. While some charities have taken up alternatives to cheques, such as using cash or electronic payment methods, the appetite for these has been limited with concerns over security, cost, lack of control and the audit trail. Over time, and helped by innovation, charities may seek to collect and distribute funds more and more efficiently. The Payments Council is improving facilities for charities, such as by making sure banks offer all their customers including organisations, such as charities and small clubs and societies, the ability to dual authorise electronic payments online.

Businesses are cutting their use of cheques slightly faster than consumers but they are still slow to migrate away from paper and pen. The number of payments fell by 13.8% last year, and businesses only wrote 425 million cheques. Smaller businesses are much more likely to use them than big companies. Nevertheless the adoption of business debit cards and the increasing use of internet banking among businesses will keep downward pressure on cheque use by firms. The public sector still issues significant volumes of cheques for car tax refunds and as payment of premium bond winnings.

With the variety of new technologies becoming more widely available to consumers and organisations, and with a whole generation growing up never using them, the rate of decline in cheque use is likely to continue in the short term, though it will eventually slow as usage concentrates into those areas where other ways to pay are less easily available, or less willingly adopted, such as the charity sector or payments to schools, clubs and societies. The industry has committed to supporting the provision of cheque books for as long as there is demand.

# How we manage our money

## The way we bank now – how consumers do it

By 2011, only 4% of the adult population had no bank account at all. 91% had a current account, and 78% had a savings account. Current account penetration will continue to climb, though a small proportion of the population are likely to remain outside the net permanently. Just under a third of the E adults who tend to be in manual jobs and earn the lowest wages have no current account at present. From a regional perspective, those in Northern Ireland, East Anglia and Yorkshire and Humberside were also least likely to have one, compared to those living in the South East or South West. A number of adults have multiple accounts. Just over half of adults have more than one – a tenth have three or more.

It will be interesting to see if these trends are impacted, when the Payments Council introduces a new, free-to-use current account switching service – aimed at driving competition in the industry by making it easier for customers to switch bank accounts. The Payments Council will reduce the time it takes to switch an account from 18–30 days to just 7 days; ensure payments are automatically transferred to a customer's new account and provide a customer guarantee, should anything go wrong.

Branch banking has declined sharply. By 2011, 30.6 million adults were using telephone or internet banking and a total of 26.8 million were using online banking. Telephone banking use has plateaued while online banking continues to grow very strongly.

Even those who don't bank online are comfortably shopping online using a card. 37.6 million adults bought something online in 2011, with 6 out of 10 adults doing so at least once a month. This continues to grow sharply as the range of goods and services available on the internet is expanding dramatically.

Young people (25–34), those in higher social classes and those with higher incomes are much more likely to use telephone and/or internet banking. Online banking is now preferred over telephone banking by all groups. The next change is for internet banking to evolve into mobile banking and many financial providers are becoming increasingly active in this area.

**Table 25. Recent trends in users of remote banking (via telephone and internet) on main current account**

Adults (millions)	2006	2007	2008	2009	2010	2011
Telephone banking	13.8	13.1	12.3	13.4	13.5	13.5
Internet banking	17.0	19.2	21.5	22.4	25.1	26.8
Total remote banking users	23.0	24.2	25.8	26.5	29.1	30.6

## How businesses do it

98% of UK businesses are small, with fewer than 20 employees. Together they account for almost two fifths of private sector employment. The same proportion of employees work for big companies, (those with more than 250 employees), but these make up only one in five hundred firms. It's not hard to see why businesses need very varied ways to pay.

Big businesses obviously have the most sophisticated payment methods and are least likely for example to pay wages in cash or cheques. For the smallest businesses, convenience and simplicity are the most important, whereas for larger businesses the speed at which payment can be made is crucial.

Businesses have made a number of changes to the way they pay in recent years. Those changes included less use of cheques, more use of online payments and more use of Bacs Direct Credit. A fifth of businesses with internet access do not use online banking for example and have no intention to change. They give a number of reasons, but inertia and habit are the main underlying factors.

Smaller companies behave more like individual consumers in the way they bank 16% of companies use their personal accounts for their business banking, which is for many a way of avoiding more expensive business current accounts. Sole traders, which make up about three quarters of businesses, make only 15% of their payments using Direct Credits, with a greater proportion make using cheque (27%) or Direct Debit (23%). The importance of cheques declines as business size increases.



# How will we pay for it in the future? Keys, wallet, phone?

## Payments are changing faster than ever before

Contactless payment technology began in the UK in 2007, but those living in and around London would have been familiar with the principle, having had the contactless Oyster card since 2003 for using public transport. The London Olympics used its venues as a testing ground for contactless cards. In 2011, all the major UK card schemes (American Express, MasterCard and Visa) began processing contactless payments. By December 2011, six major UK issuers were issuing cards with contactless functionality and the number of these cards reached 23 million, an increase of 75% from the end of 2010. Adoption is still slow however, as retailers and consumers are yet to embrace the changes in a big way. This will change, but first requires more retailers to roll-out more terminals, and for banks to issue more cards.

Ironically contactless technology may eventually contribute to us becoming less reliant on a physical piece of plastic, as it can be incorporated into a mobile phone or any other popular item, rendering it a payment tool. Only ten years ago paying for items on your mobile was unthinkable, but now one wonders why it's not here in a bigger way already. The increasing demand for convenience and accessibility, along with the rising penetration of smartphones has driven the growth in mobile payment. The bold prediction made by PayPal<sup>2</sup> that by 2016 people will no longer need to take a wallet with them shopping may be premature but nevertheless at some point we may be leaving the house just asking ourselves 'keys, phone?' KPMG expect mobile payments to be mainstream within the next 2-4 years, while Visa, which recently released its digital wallet V.me in November 2012, expects half of all payments to be made through mobile devices by 2020<sup>3</sup>.

New entrants are muscling in to help us pay in shops. Google Wallet which launched in the US last year has already agreed deals with 25 national retailers to support the system through MasterCard's PayPass programme. Google's rival, Apple has yet to launch a competing system, but with such a huge, loyal customer base, well used to making many small transactions through iTunes all the time, it will surely not be far off. Microsoft has already announced that there will be a wallet feature on the Windows Mobile 8 operating system. Three of the big telecoms operators, Verizon, T-Mobile and AT&T are developing a service known as Iris.

For tradesmen on the move, new hardware is also on the market. Payment method Square, a mobile app and phone attachment which serves as its own cash register, has been created by one of the founders of Twitter and is in use in the US. This sort of kit will reduce the reliance among mobile tradesmen on cash and cheques. O2 UK also launched a new service that enables retailers to accept card payments on a smartphone or tablet by using a special keypad that connects via Bluetooth. A free app then manages the card transaction and sends a receipt.

For moving our money around, Barclays already offers a mobile payment service (Pingit). Anyone with a mobile phone can sign up with Barclays to receive payments though Pingit, but only Barclay's customers can send payments. A similar service has also been launched by phone provider O2, with customers able to transfer up to £500 via text message. Similarly, PayPal has also recently launched an app in the UK that allows users to pay for items with their mobile phones across a number.

In addition to all these competitive offerings in the collaborative space, the Payments Council is developing the industry-wide, central service that will make it possible to send or receive a payment using just a mobile number, no matter who you bank with. The new service could be a handy way to split a bill for dinner or pay a tradesman without needing to know their account details. Payments made using the service will be protected by a passcode or similar security feature, and arrive almost instantly.


Internationally, consumers have been quicker to take it up mobile payments in Asia than in the West. In France McDonalds is currently testing a mobile payments method arranged with PayPal. With over 30,000 restaurants worldwide, a McDonald's deal would represent a larger business and cultural footprint for PayPal than perhaps any other mobile payment system in operation. In Africa payments technology is leapfrogging the developed world. Starting with few branch networks, fixed line

<sup>2</sup><http://www.ft.com/cms/s/0/558fdb4-e7cd-11e1-8686-00144feab49a.html#axzz2CCkzst8q>

<sup>3</sup><http://www.computerweekly.com/news/2240173670/Half-of-UK-Visa-payments-will-be-mobile-by-2020>

telecoms and low card or bank account holding, banking is going straight to consumers' mobiles. Since 2007, Kenya has been using a system called M-Pesa which allows mobile money transfer through a text message, with over 50% of the population already using this service. The Payments Council's mobile payments database will make payment by mobile a possibility for the UK too, but it will be developed using existing payment systems, such as the Faster Payments Service or the Link network.

Worldwide the UK presents a key growth area in the uptake of mobile payment. Businesses should be planning now or risk falling behind consumer demand. From a consumer perspective in terms of making purchases using our phones, the amount of devices and potential new options, on offer at the moment can be confusing as people still grapple with all the commercial developments. Whilst the future may be unclear, it is exciting, and it will bring convenience and choice far greater than we have known until now. Ultimately only a handful of providers and products will create the winning proposition. Undeniably these new technologies will transform the way we manage our finances and the way we pay over the next decade.



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