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PRODUCTIVITY BOUNCE OR SQUEEZE

Employer responses to the National Living Wage

April 2020

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Contents

This report was written by Gerwyn Davies of the CIPD with contributions from Ben Willmott, Charles Cotton and Jon Boys of the CIPD. We are also grateful to the Low Pay Commission for part-funding this research.

1 Introduction

How has the National Living Wage (NLW) affected employers since its inception in 2016 and how have they adapted to its implementation? What effects have those adjustments had on the organisations, their workforce, and industry sectors? The CIPD launched an investigation in summer 2019 to find out. This report is the second of two reports which draws together the collected evidence and provides a combined analysis of the findings with recommendations for policy-makers. The evidence includes surveys of and interviews with employers.

This report draws on a companion report that provides further analysis of the *Labour Market Outlook* (LMO) survey data and company accounts.[1]

2 Key findings and implications

The findings of this report confirm that a significant share of firms have been affected by the NLW, including some employers from low-paying sectors who have seen large increases in their wage bill. Both the survey and the case study interviews show that, for most employers, cuts to employment levels are seen as either undesirable or impossible. Instead, the focus for many continues to be on absorbing the cost, raising prices or improving productivity.

Delivering productivity improvements proves challenging

Since the introduction of the NLW in 2016, the emphasis from many employers has been to improve productivity. However, the reality is that delivering on the sought productivity gains has proved very challenging, as reflected in the survey data by the falling share of employers who cite productivity improvements as a key response to the NLW.

In addition, our case study interviews paint a mixed picture about the success of their attempts to improve productivity. Some employers cited the NLW as one of a number of factors behind their initiatives to get more out of their business or employees. But there were no examples directly linking the NLW to anything specific, such as increased investment in training or automation.

Consistent with the survey data, some of the case study interviews point to work intensification as their main productivity response. This may not be sustainable in the medium to long term.

Others were less sure about how to improve productivity, while some pointed to reductions in skills investment as their main response to the NLW alongside workforce restructuring.

Rising proportion of employers turning to price increases

The survey data also underline that the share of employers who are passing the cost of the NLW on to consumers is rising modestly, in contrast with the falling proportion who had either planned to or had raised productivity. Given the relationship between stagnant productivity and lower profitability, it is no surprise that many organisations are faced with little or no alternative to raising prices.

While raising prices is still currently the third most popular response behind absorbing the cost and raising productivity, one can expect more employers to take this option if UK productivity growth remains weak.

[1] Forth, J, Paczos, M, Riley, R. and Davies, G. (2020) *The impact of the national living wage on businesses: evidence from new survey and linked datasets*. London: Low Pay Commission.

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Compressed pay differentials impacting some employers but some workers see pay gains

The reduction in pay differentials between NLW recipients and their supervisors or managers is another factor weighing on productivity growth in some organisations.

Virtually all of the case study employers interviewed reported giving smaller or no pay rises to staff above the NLW. And many of these employers said that the reduction in differentials is having a negative impact on progression. This is mainly because fewer employees who are paid the NLW are willing to take on more responsibilities for only a modest or no pay increase.

Further, some employers saw a decline in morale among those who don't receive the NLW on the basis of the perceived lack of recognition for qualifications and skills.

Survey data, however, suggests that some organisations have managed to maintain pay differentials between NLW recipients and other staff, raising pay for many employees further up the pay distribution. However, the most recent survey data reveal that a slightly higher proportion of employers have reduced pay differentials compared with the proportion that have maintained them compared with the 2018 survey data.

Merging adult NLW and youth NMW rates

Our research shows support for the idea of merging the 21–24 National Minimum Wage (NMW) youth rate and the NLW adult rate. The issues of fairness, recruitment and retention, and employee engagement were commonly cited as key reasons behind employers' decisions to pay the same hourly rate to 21–24-year-olds as those aged 25 and above. The research supports the Low Pay Commission's (LPC) recommendation, which has subsequently been accepted by the Government, to lower the threshold for eligibility for the NLW adult rate, first to 23 and eventually to 21.

Overall, the CIPD supports the policy objective to increase the pay of the lowest-paid employees and the ambitious target the Government has set itself for 2024. However, this needs to be accompanied by higher levels of productivity growth to succeed. This can only be brought about by more focus on workplace productivity. This report sets out some changes in government policy that can help employers achieve this.

3 National Living Wage in context

Introduced in 2015, the National Living Wage (NLW) came into force on 1 April 2016, establishing a new wage floor at an initial level of £7.20/hour for workers aged 25+. This amounted to a 7% rise in the adult minimum wage of £6.70/hour in October 2015, and an 11% rise on the rate of £6.50/hour that applied in April 2015.

At the time of its launch, the Government also committed to raising the level of the NLW from 52.5% of median hourly earnings (in 2015) for all workers aged 25 and over to 60% by 2020. This has been reflected in the relatively sharp up-ratings over the past five years (Table 1). More recently, the Government announced (in its response to the LPC's 2019 report) a more ambitious target to increase the NLW to two-thirds of median hourly earnings by 2024 with a new NLW adult rate of £8.72/hour from April 2020 – an increase of 6.2% from the current rate. It also announced that the NLW would cover those aged 23 and over from April 2021 and that it will cover those aged 21 and over by 2024.

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Table 1: UK NLW and NMW rates

Year	25 and up	21–24	18–20	Under 18	Apprentice
Apr 2020 to Mar 2021	£8.72	£8.20	£6.45	£4.55	£4.15
Apr 2019 to Mar 2020	£8.21	£7.70	£6.15	£4.35	£3.90
Apr 2018 to Mar 2019	£7.83	£7.38	£5.90	£4.20	£3.70
Apr 2017 to Mar 2018	£7.50	£7.05	£5.60	£4.05	£3.50
Oct 2016 to Mar 2017	£7.20	£6.95	£5.55	£4.00	£3.40
Apr 2016 to Sep 2016	£7.20	£6.70	£5.30	£3.87	£3.30

Source: Low Pay Commission

The NLW has helped to lift the wage floor and can be considered a success, especially given the strong employment growth during this period. However, NLW rate increases have outstripped inflation, average earnings growth and far outpaced productivity growth, which has been virtually flat over the past decade.

This has put more pressure on employers to adjust, such as by passing on the higher labour cost to the customer or simply absorbing it through a reduction in profits. Other ways employers have sought to offset the cost include cutting jobs or hours, or reducing overtime, bonuses and other aspects of the reward package, such as paid breaks or sick pay.

The CIPD has compiled and analysed employer data from 2015 to 2019 and conducted additional case studies to examine firms' responses to the NLW and to gauge its impact.

4 Research methodology

The research for this report comprises two parts.

The first is gathered evidence of employers' experiences of the NLW from the CIPD's quarterly *Labour Market Outlook* surveys of autumn 2015, summer 2018 and summer 2019. Each provides rich information on firms' exposure to the NLW and on their responses to increases in the rates. Responses in all three surveys have been weighted to be representative of the population of organisations with two or more employees in the UK.

The 2015 survey of 1,000 employers shows how organisations had planned to respond to the introduction of the NLW. The 2018 and 2019 surveys of more than 2,000 employers provide a view of employers' actual experiences and responses to the NLW alongside their productivity-related responses to the NLW. The evidence presented thus consists of a combined analysis of employers' responses over the three time points where appropriate.

There is, however, a heavier emphasis on the 2018 and 2019 surveys because the larger samples allow us to explore the role played by firm size and industry on employer reactions. Those also provide a more concrete picture, since the 2015 survey predates the NLW and looked only at anticipated responses. Further, the later surveys also explored responses to the recent NLW up-ratings.

Taken together, the three surveys overcome the limitations of existing research because they provide details of whether aspired productivity increases have been achieved or not, and how. While many studies lack a clear measure of those firms that are (or are not) affected by the wage floor, our research is able to provide new evidence based on a study of a sample of firms for whom exposure to the wage floor is known.

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The second part of our research consists of interviews with ten employers affected by the NLW, probing how and why they made their respective choices. These were done to develop a clearer picture of the trade-offs that employers have faced since the NLW's inception and the rationale for choosing their responses – especially in relation to productivity.

The respondents were mainly senior staff directly involved in the organisation's reward decision-making, primarily in industries that are set to be most affected by the NLW, such as social care, hospitality and retail. Most of the employers were small or medium-sized organisations. In addition, two of the participants already pay above the new wage floor.

As with any case study, these examples should not be treated as representative of all employers or even of those in similar industries, regions or of a similar size. Particularly, because we have focused on employers in the most affected sectors, it is important to note that the majority of firms and industries will find the implementation of NLW much more manageable. But the experiences of these employers do provide a timely and forward-looking insight into the options and barriers which employers see open to them in responding to the rising wage floor.

5 Breadth of exposure to the NLW

Over half of employers have been affected, but clear sectoral differences exist

In 2018 and 2019, around half (49–51%) of all organisations said that the NLW had affected their wage bill. Exposure to the NLW is fairly broadly spread across the public, private and voluntary sectors. In total, around half of private sector employers (49–50%) and public sector organisations (48–54%) say that their wage bill has increased as a result of the NLW, while this was slightly less with voluntary sector establishments (44–51%).

The industries most impacted, according to the share of organisations within them affected by the NLW, are hospitality (68–71%), retail (60–69%), education (50–65%), healthcare (53–57%) and manufacturing (50–53%). This contrasts with the information and communication (20–32%) and business services (21–23%) industries, where only a minority of organisations report that the NLW has had an impact.

The proportion of smaller organisations that have been affected (45%) is lower than the share of organisations with 250 employees or more (53–54%).

As Figure 1 on page 6 shows, 14–15% of employers said they had been affected to 'a large extent' by the NLW. However, that proportion rises to 26–31% for retail and 29–33% for hospitality employers. Around a fifth (19–21%) reported that they had been affected to 'some extent' and 16% to a 'small extent' in both 2018 and 2019.

At the same time, the surveys also confirmed that the NLW has not had an impact for a significant proportion of organisations. The NLW did not have an effect on the wage bill for 43–45%, with a small proportion (5–11%) answering 'don't know'.

Figure 1: Proportion of employers affected by the NLW (%)

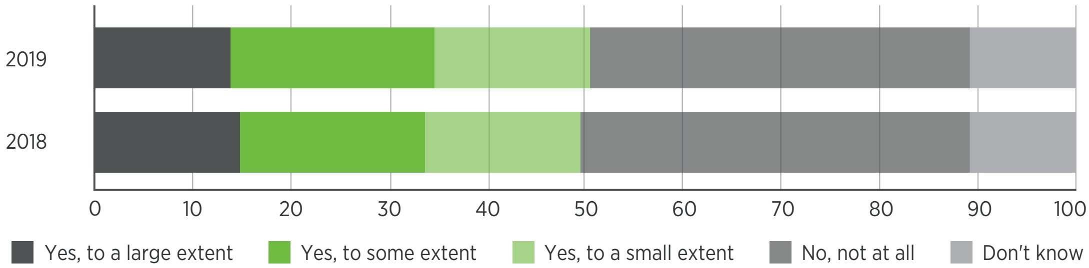
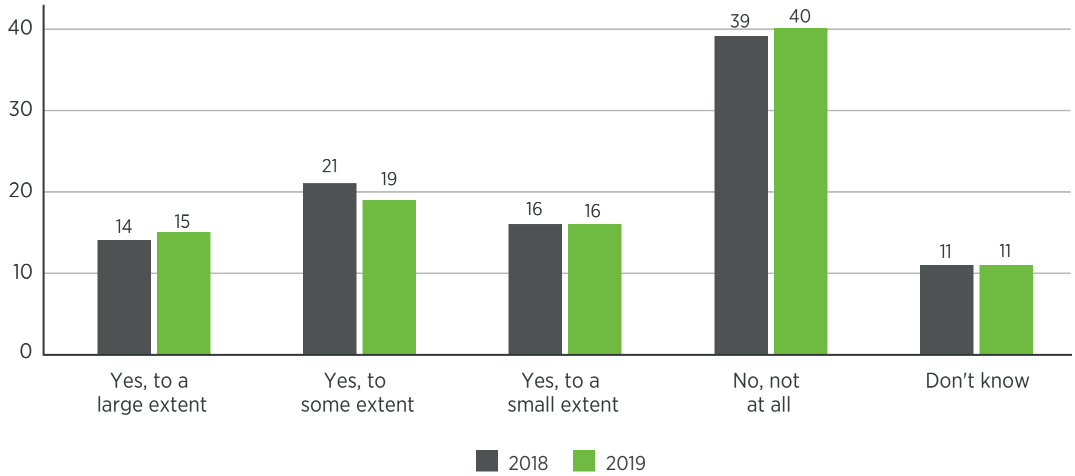
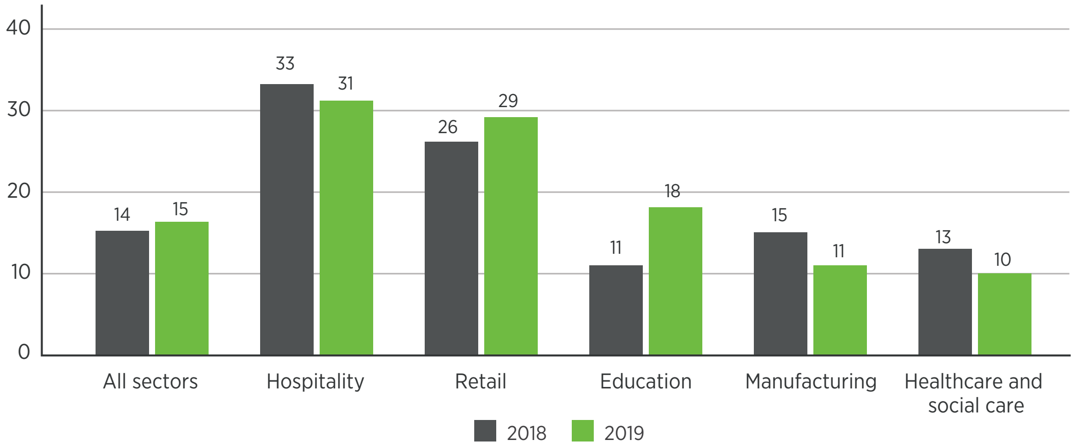


Figure 2: Exposure to the NLW adult rate, by year (%)



Base: organisations with two or more employees in the UK

Figure 3: Proportion of organisations affected by NLW to a 'large extent', by sector (%)



Base: employers that report that the NLW has increased their wage bill to a large extent

6 Employer responses to the NLW

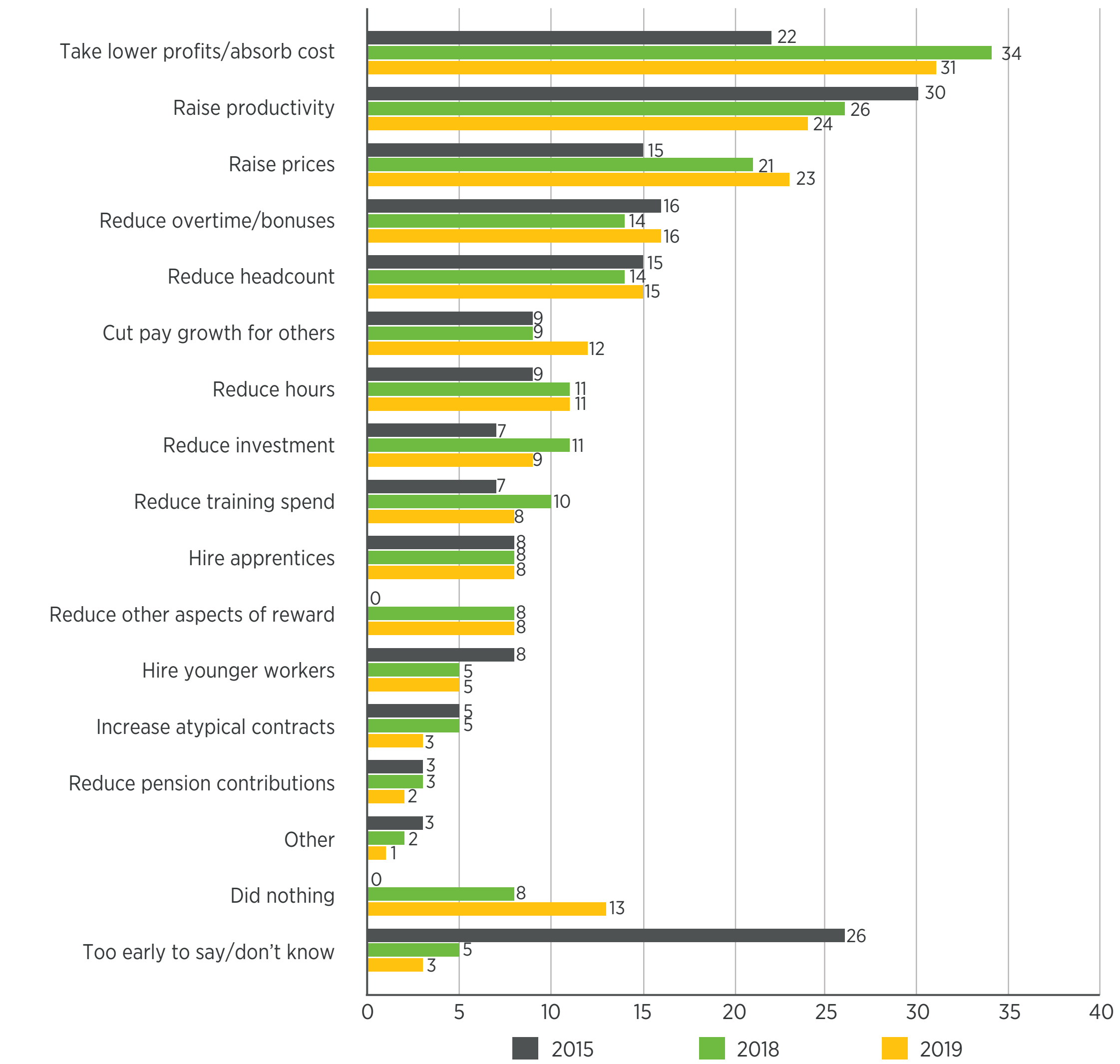
Planned actions versus actual actions

In 2015, we asked firms who anticipated an impact from the NLW what they planned to do in response, while in 2018 and 2019, we asked those who reported an impact what they did do. Respondents could choose up to three answers from a prescribed list, but also had the opportunity to mention actions not on the list.

Figure 4 shows that there has been a fair degree of consistency between 2018 and 2019. The most common employer response was to take lower profits (31–34%), followed by raising productivity (24–26%) and raising prices (21–23%). However, perhaps reflecting the challenges that organisations have faced in doing so, the share of employers citing productivity improvements as a response has fallen across the three intervals (from 30% in 2015 to 24% in 2019), while the proportion that cite absorbing the cost and raising prices has risen during the same period.

)Initial expectations that productivity improvements would make NLW increases more affordable and sustainable have proved to be too optimistic and are seemingly becoming out of reach for a growing proportion of employers.

Figure 4: Responses to the NLW, by year (%)



Base: organisations with some exposure to the NLW
Note: two new response codes were added in 2018 ('Reduce other aspects of reward' and 'Did nothing')

Absorbing the cost the most common option

After the NLW entered into force, the most common response among employers has been to absorb the costs or take lower profits as the result of a higher wage bill. Around a third (31–34%) of organisations responded in this way.

According to the 2019 data, this response was even more marked among health and social care employers, with 46% absorbing the added cost. When asked during case study sessions, social care employers interviewed felt that they had few choices other than to absorb the cost because of the inability of the sector to improve productivity without worsening the care provided to end users. As the HR director of a social care provider put it:

> *'There are some efficiencies to be had, but having worked in other business sectors, it's much easier in some to bring about process and efficiency improvements. We are heavily regulated, and we must prioritise care quality; you can't jeopardise that.'*

While passing the cost on to consumers was the third most common response to the NLW from the 2018 and 2019 surveys (Figure 4), this may be a risky option for many firms who do not feel they can raise their prices without losing customers.

For some private sector employers, absorbing the cost was preferable to raising prices to remain competitive. As the chief people officer of a large retailer explained:

> *'We already operate in a highly competitive market, with a very traditional customer base. If we squeeze the money we need for NLW directly from our customers, this would go against our values and runs the risk of switching customers to other offerings. We have to find another way to help fund the money needed, and still deliver a great customer experience.'*

Of all NLW-affected organisations in 2018 and 2019, 14–15% reported that they had reduced headcount either through redundancies or lower recruitment activity, and 10–11% had reduced hours. Reductions in headcount and hours were more common among organisations in which the NLW had raised the wage bill to 'a large extent'.

Different strokes for different folks

The research highlights some significant difference in responses depending on size of organisation. As per our previous report, larger organisations (27–32%) were more likely than smaller ones (16–19%) to opt for raising productivity to cover NLW costs. This is perhaps a reflection of the greater resources they have to improve productivity. Organisations with fewer than 250 employees are more likely instead to raise prices (23–29%) or simply absorb the cost (38–42% versus 25–31% in larger organisations).

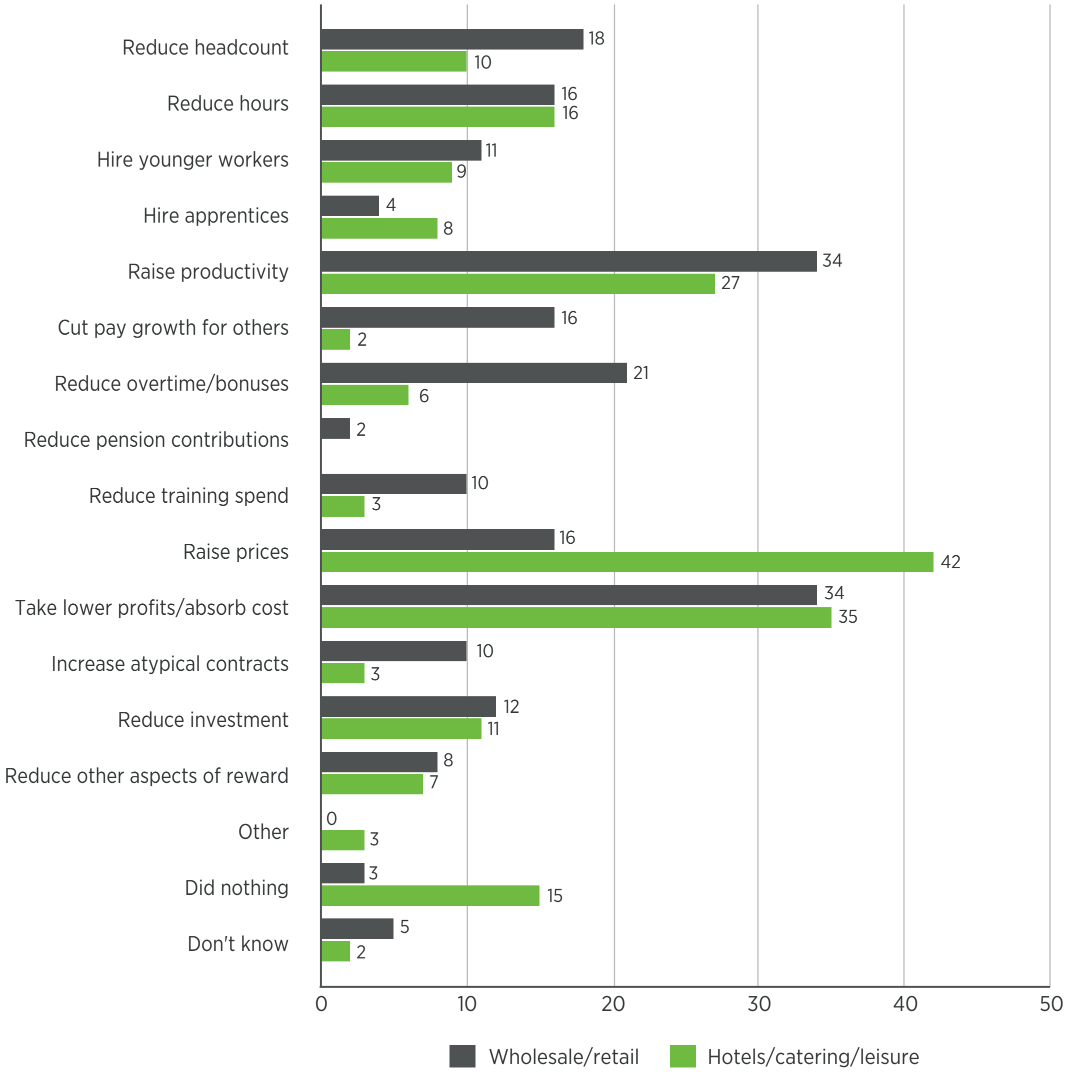
For the two main industries affected by the NLW, namely retail and hospitality, the survey data reveals a variation in approach between them (Figures 5 and 6). Hospitality employers were more likely to raise prices (42–44% versus 19–22%), while retail employers were more likely to reduce overtime and bonuses (21–26% versus 13%) and headcount (19% versus 10–13%). Retail employers were also much more likely to cut pay growth for others (11–14% versus 5–13%).

What is interesting to note are the changes to these responses between 2018 and 2019. Retail employers are now less keen to absorb costs, with greater numbers looking to raise prices. They are also less bullish about raising productivity as a means to cover the added wage bill.

For hospitality employers, the biggest change has been the tripled uptake of 'cutting pay growth for others' as a response to the NLW.

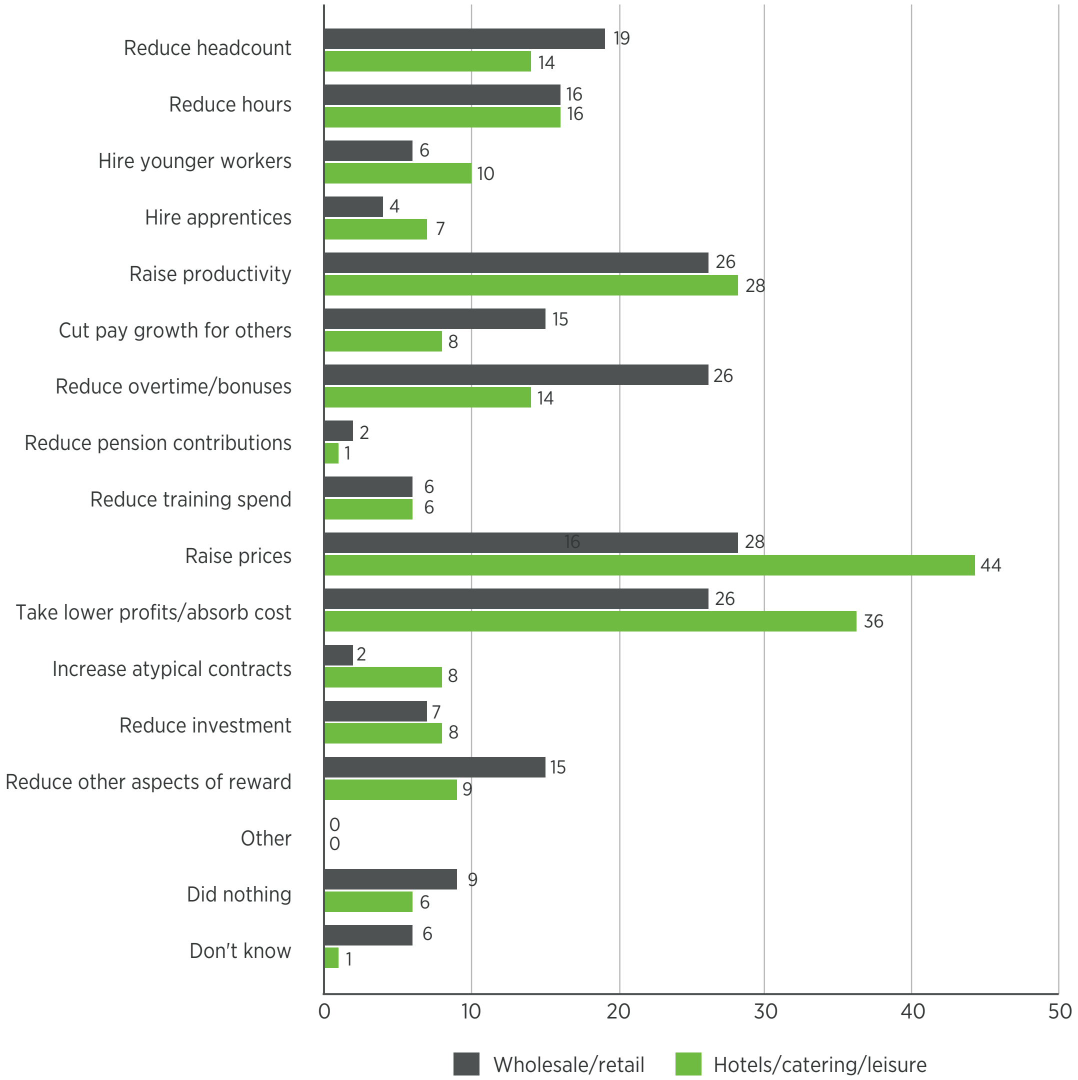
On the plus side, retail employers were less likely to reduce training spend or to rely on atypical contracts to alleviate wage bill pressures in 2019 compared with 2018.

Figure 5: Responses to the NLW in wholesale/retail and hotels/catering/leisure, 2018 (%)



Base: organisations in wholesale/retail and hotels/catering/leisure with some exposure to the NLW

Figure 6: Responses to the NLW in wholesale/retail and hotels/catering/leisure, 2019 (%)



Base: organisations in wholesale/retail and hotels/catering/leisure with some exposure to the NLW

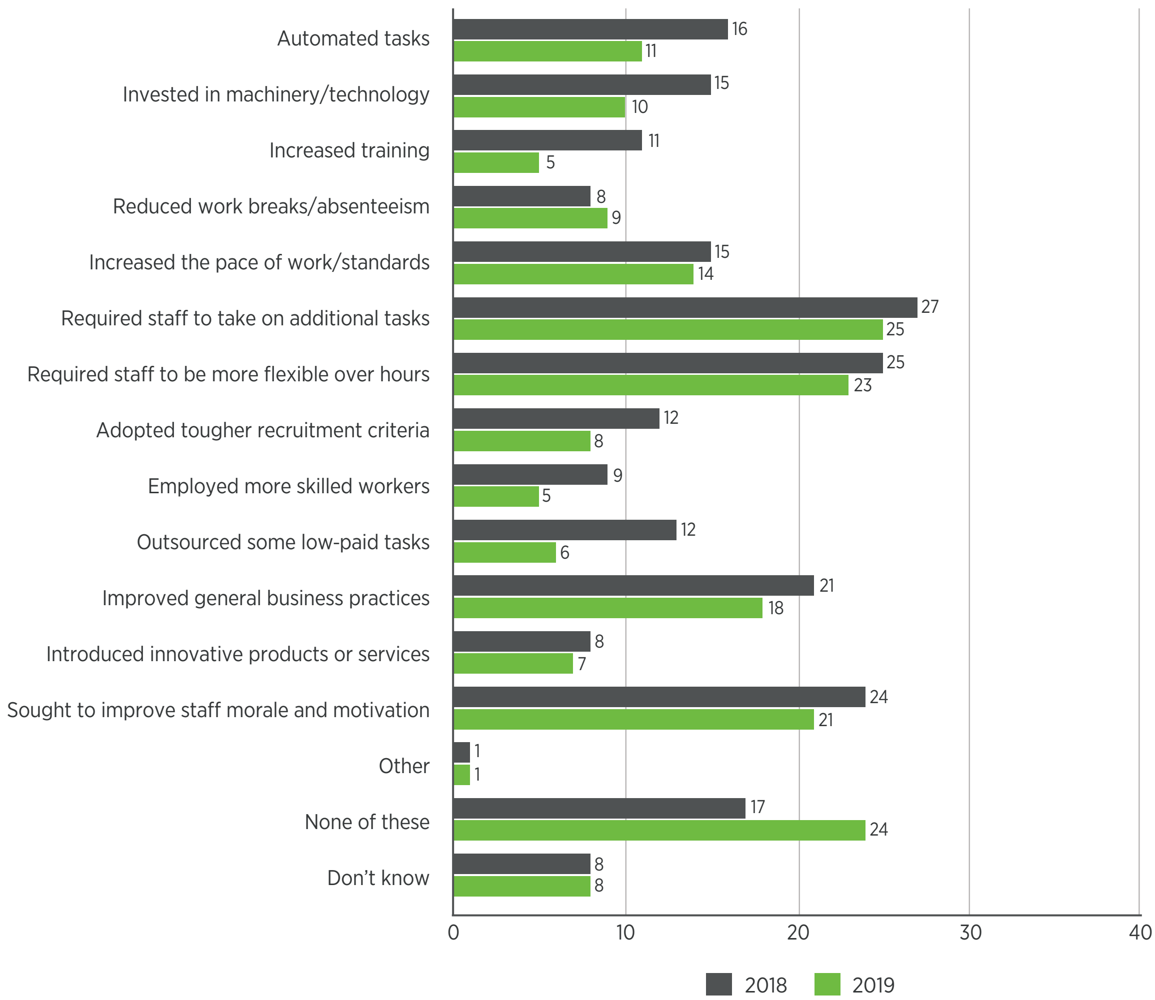
Strong productivity growth is easier said than done

As mentioned above and as can be seen from Figure 4, there are some discernible differences between how employers had planned to respond to the NLW in 2015 versus what was actually done in 2018 and 2019. One of the notable areas of difference was in raising productivity to offset the higher wage bill.

Reflecting the challenges organisations faced in improving productivity, the share of organisations expecting to do so fell from 30% in 2015 to 24–26% in the 2018 and 2019 surveys.

To overcome the varied ways employers understood or interpreted 'productivity', the 2018 and 2019 LMO surveys included an additional question about 'other ways' the organisation had responded to the NLW. In those surveys, all firms reporting exposure to the NLW were given an explicit list of actions through which an organisation might seek to raise output per worker and asked whether they had undertaken any of them. They were invited to choose any that their organisation had undertaken 'in direct response to the increase in [their] wage bill caused by the introduction of the National Living Wage'.

Figure 7: Productivity-related responses to the NLW, by year (%)



Base: organisations with some exposure to the NLW

The survey data here suggests that the response to the NLW from many employers has been to intensify work or reorganise hours. Around a quarter (25–27%) required staff to take on additional tasks, while a similar proportion (23–25%) required staff to be more flexible in their hours of work (Figure 7). Workplaces where the impact of the NLW has been larger were more likely than other workplaces to report these types of response. This is consistent with other research,[2] which showed that work intensification has increased in the UK in recent years.

Other common responses include attempts to improve staff morale and motivation (21–24%), improving general business practices, for example, quality control (18–21%) and increasing the pace of work or raising performance standards (14–15%). In addition, 11–16% of employers cite automating tasks previously done by staff and more investment in physical capital (10–15%). Looking at the most affected sectors, capital investment and automation were more prevalent in retail than in hospitality on average (Figures 8 and 9).

Some care should be taken not to over-interpret this data because the survey did not seek to explore how and the ways in which the NLW was having a negative impact on productivity, which was reflected in our case study interviews.

[2] Felstead, A, Gallie, D, Green, F. and Henseke, G. (2018) *Skills and Employment Survey 2017*. Cardiff: Cardiff University.

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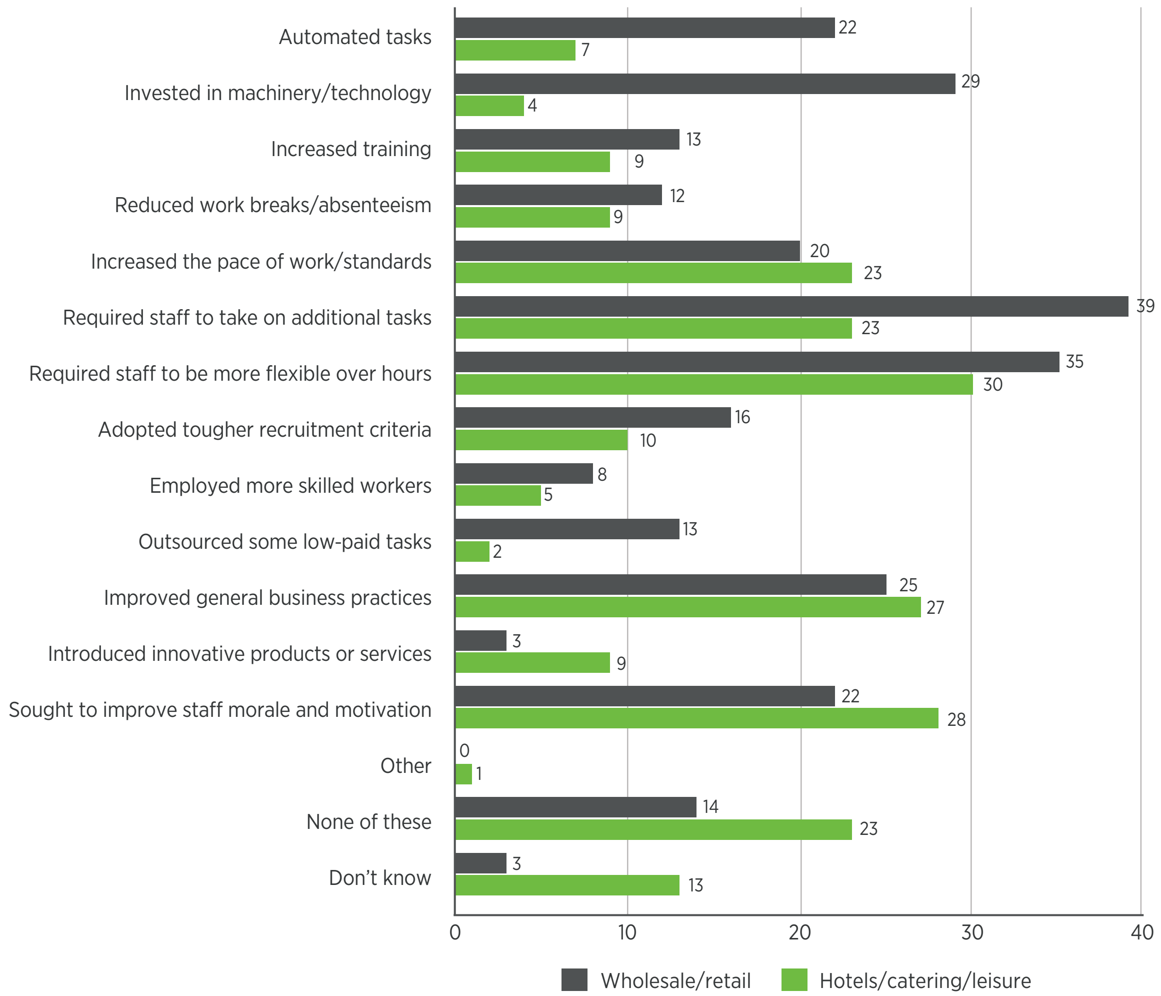
Figure 8: Productivity-related responses to the NLW in wholesale/retail and hotels/catering/leisure, 2018 (%)



Base: organisations in wholesale/retail and hotels/catering/leisure with some exposure to the NLW

Case study examples of organisations seeking to improve productivity

The first case study was with a GP surgery. It introduced a patient app to help cut the number of calls to it, hence reducing demand for clerical staff, who are all paid at the NLW. The surgery also sought to manage its increasing wage bill by replacing GPs with lower-skilled, allied health professionals, whose salaries are roughly half that of a GP. According to the surgery manager, such workforce restructuring has been a nationwide phenomenon.

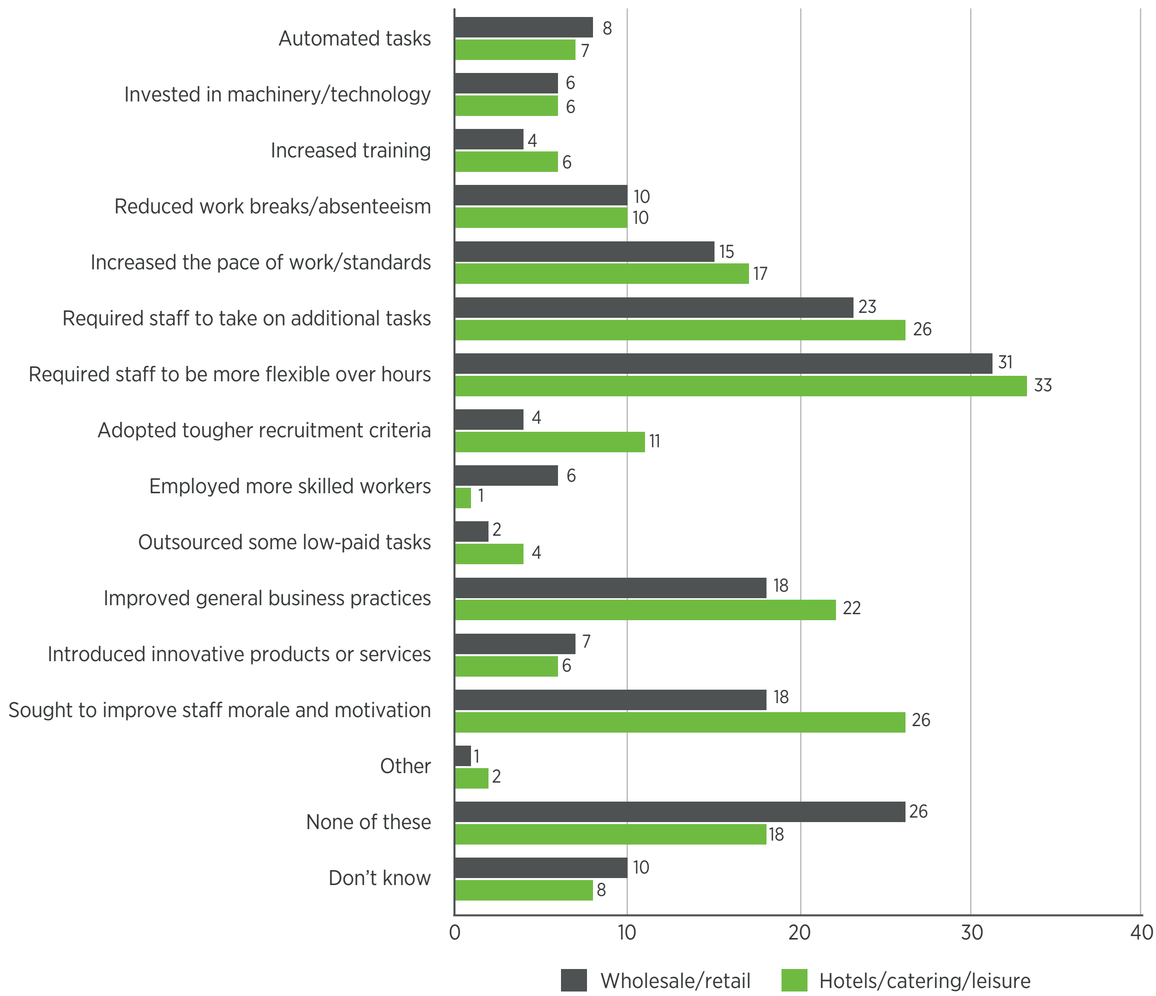
Meanwhile, a large retailer introduced a culture change initiative that has sought to empower staff to get more involved in decision-making on-site. According to the firm, this has succeeded in enabling them to exploit opportunities to increase revenue and decrease costs.

The third example was a call centre that looked to more coaching and training as a productivity-raising measure connected with the NLW.

The other two examples of NLW-affected organisations that have improved productivity focused on automation. However, the NLW was described as a small factor in both cases alongside other drivers.

One local authority, which introduced a voluntary Living Wage of £9/hour, saw Living Wage workers take on additional tasks that were previously performed by managers who were made redundant. This was a direct result of the increase in the wage bill.

Figure 9: Productivity-related responses to the NLW in wholesale/retail and hotels/catering/leisure, 2019 (%)



Base: organisations in wholesale/retail and hotels/catering/leisure with some exposure to the NLW

Meanwhile, others were less sure how to be more efficient or improve productivity, including one leisure employer in the north-west of England:

> *'Maybe we've missed a bit of a trick there, because while we're giving a decent pay increase, it's not linked to performance or anything. So, you could have an average leisure attendant who isn't really doing brilliantly, but yet they still get the 4% increase. The same as one who absolutely works their socks off and does a brilliant job and tries really hard. It is difficult though to see where we can improve productivity.'*

Taken together, the survey data and the case studies imply that employers' productivity efforts as a result of the NLW have been fairly modest. This is further offset by the number of organisations who report the rising wage floor as a barrier to productivity growth – whether that be through deskilling (GP surgery), training budget cuts (food processing, hospitality and social care employer) or staff motivation or in-work progression (leisure centre, GP surgery, social care).

This situation will concern policy-makers given the connection between wage increase affordability and productivity growth, which is already weak in the UK.

Price rises possible though difficult to implement

The third most common response to the 2018 and 2019 surveys is to pass the cost of the NLW on to consumers through higher prices, cited by 21–23% of employers (Figure 4). In the private sector, 25–28% of employers have responded in this way, including 39–42% of hospitality employers.

The case studies found only one example of an organisation raising prices as a key response to the NLW. A call centre said that it had been possible to pass the higher wage costs on to suppliers. However, many more firms do not feel they have the leeway to raise their prices without losing customers.

Only a modest impact on employment levels

Only 14–15% of employers across the 2018 and 2019 surveys say they have reduced the number of employees through redundancies and/or recruiting fewer workers as a result of the NLW. Reductions in headcount and hours were more common among organisations in which the NLW had raised the wage bill to ‘a large extent’.

Reductions in employment levels were most likely in public administration (24–26%), education (18–24%) and retail (12–19%). A sectoral gap also emerged, with 18–23% of public sector employers cutting their workforce compared with 13–14% of private sector employers.

Indeed, a local authority council interviewed for this report said that its main response to introducing the voluntary Living Wage of £9/hour had been to cut middle management roles, which could give us some indication of what might happen as the NLW increases.

Hours reduction and review of benefits for some

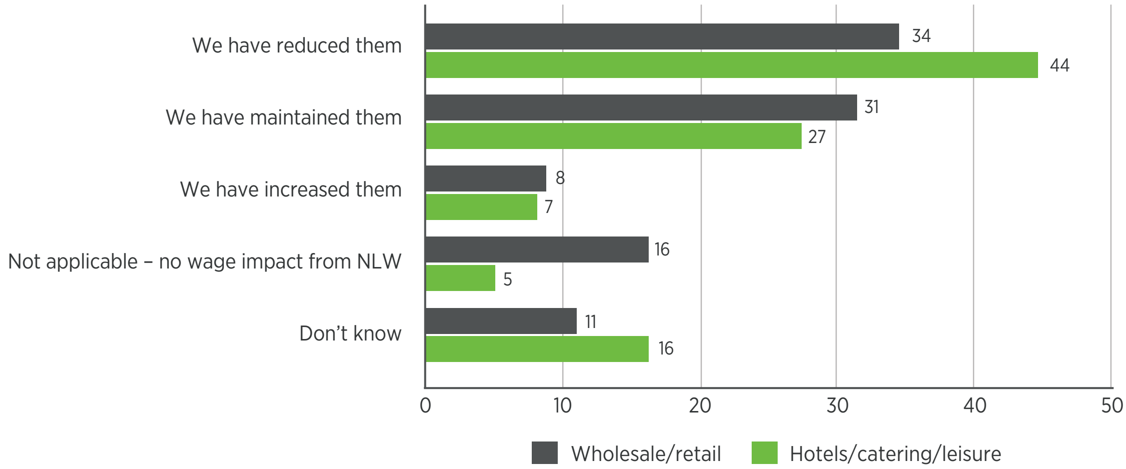
Among the other most common responses to the NLW were plans to look beyond the hourly pay rate to reduce overall labour costs. Around 10–11% of employers had reduced hours. Reducing overtime and bonuses was another measure (taken by 9–14% of employers), with a greater propensity to do so among retail employers (16–21%). Other responses among the case studies included cutting skills investment, reducing other aspects of the reward package, such as reducing maternity pay and sickness pay, and changing the composition of the workforce.

7 Impact on pay differentials and consequences

The NLW has made managing pay differentials between job levels more challenging for employers. Respondents were asked how salary levels in their organisation had changed for staff earning above the NLW since its introduction. Figure 10 shows that a significant portion of NLW-exposed organisations had reduced the pay differential between NLW-affected staff and their supervisors/managers (32% in 2018 and 37% in 2019), although 31% in 2018 and 30% in 2019 had been able to maintain them.

A challenge facing employers in responding to NLW increases is what happens to the pay of those paid higher than the NLW. Should firms aim to maintain the differences

Figure 10: Impact on pay differentials between NLW staff and their supervisors/managers (%)



Base: organisations with some exposure to the NLW

in pay between NLW workers and others, or should they accept that these differentials will be squeezed? Some employers in our case studies said they had no alternative to reducing the pay differential between their lowest-paid workers and those on higher pay as they could not afford to give higher-paid staff the same level of increase. For some organisations, the compression has seen a negative impact on in-work progression and staff motivation. This is illustrated by comments from different employers:

> *'If the National Living Wage continues to increase at this level, it will be quite difficult to maintain career ladders due to the cost of maintaining differentials at each level.'*

> *'The new policy has caused some angst for some employees as they feel you're literally paying an individual who has no/lower qualifications or experience the same as someone who maybe had an NVQ, who had some experience or who was doing a totally different job. In other cases, you now have individuals who are being paid exactly the same as the individuals they are managing, and this has caused some upset. We have managed to offset this to a degree by not altering the pay and grading structure and reviewing some roles to make sure they are reflective of the skills required to do the role. However, pay has remained static beyond those in receipt of the Living Wage, which for some managers and supervisors is not enough and they remain very unhappy.'*

> *'Actually, what we get reported back is people saying, "I'm taking on all this extra responsibility, and that person who has just joined us in a lower-skilled role is on the same pay scale as me. Why should I bother?"'*

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'Our pool attendants are unhappy because they are paid the same wage rates as other roles which do not require the same skill level. Pool attendants are required to have and maintain the appropriate qualification, to undertake a week-long intensive training course, have their level of swimming ability assessed and train two hours every month. In addition, when pool attendants are working as life guards, they have a lot of responsibility. However, these people are now paid the same hourly rate as cleaners.'

The last quoted employer also reported that the NLW had had an impact on the performance management system. Low-paid employees are now being given the same pay award increase, irrespective of how well they have performed over the previous year, due to the rising wage floor.

8 Employers' planned responses to 2020 NLW up-rating

Employers who are currently exposed to the NLW were also asked how they might respond to a new hypothetical NLW rate of £8.67/hour (representing a 3% increase) from April 2020.[3] The responses implied a business as usual approach to adjusting to a higher wage floor, albeit with modest changes. Raising prices (24%), raising productivity (23%) and absorbing the cost (23%) remain the three most common planned responses according to the data.

However, the proportion that plan to raise prices has grown compared with the survey data from 2018 and 2019 while the share of employers that plan to raise productivity and absorb the cost has declined. This suggests that a combination of lower productivity growth and lower profits may be forcing more organisations to pass on the NLW increase to the consumer.

In addition, the proportion of employers expecting to make job cuts has risen modestly to 17%. The proportion of employers expecting to make cuts is particularly high in the education (29%) and public administration (29%) industries. In addition, 16% of organisations expect to reduce overtime and bonuses, while 12% plan to cancel or scale down plans for investing in or expanding the business.

What's more, our case studies suggest that more employers will be seeking to raise prices than the survey data implies. Others said if the NLW continues to rise at the current pace, they would face financial challenges or at least have to scale down plans for the organisation. A GP surgery interviewed claimed it would not survive if the NLW were to continue with 'generous increases that would see it rise to, say, £10 an hour'. Meanwhile, a social care employer warned:

'Social care employers cannot [raise prices] and must therefore be listened to closely when setting the NLW. If this does not happen, I think we can expect to see more private sector employers in the care sector fall into financial difficulty.'

[3] More recently, the Government has since announced a more ambitious target of £8.72 from April 2020.

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9 Merging adult NLW and youth NMW rates

Our research gives support for the idea of merging the NLW adult rate and the 21–24 NMW youth rate. The issues of fairness, recruitment and retention, and employee engagement were commonly cited as key reasons behind employers' decisions to pay the same hourly rate to 21–24-year-olds as those aged 25 and above.

> *'Our decision to pay the same NLW rate for workers is about equity as well as the business imperative. We don't pay workers under 26 any less as long as they complete all the necessary training for their role. That's our choice. If you have a 23-year-old and a 29-year-old doing the same job to a similar standard, to take a view that one should get more than the other is unfair. The 23-year-old will have completed the same mandatory training and may even be more effective in their job. Another reason for having the same wage rates across the different age groups is related to the need to recruit and retain staff. The industry is very competitive from a staffing point of view.'*

> *'Paying the NLW adult rate for all workers is fairly common across the industry. We also know that employees in this industry will move jobs for relatively modest hourly wage increases, such as 5p or 10p, so it makes sense to remain competitive. As a result, very few firms in the industry would suffer if a flat adult rate were introduced. It is also a fairness issue; in my opinion, paying different wage rates to younger workers is discriminatory.'*

However, some employers differed in their view that these reasons were enough to counter the need to lower wage costs and maintain pay differentials. One HR director of a large leisure retail company suggested that introducing a youth rate was necessary to maintaining pay differentials and maintaining employee satisfaction:

> *'We'd much rather not have to pay the youth rate at all, but it is a catch-22 situation for us, and so we had to make the hard choice to use it. … We've had managers who have said, "There is no point me carrying on as a manager, I could earn more if I was a colleague, I'm going to step down." This has affected our junior management levels in particular, whose earnings had not risen (until recently) in line with the people they manage.'*

10 Conclusions and policy recommendations

Our research shows that nearly half of organisations are exposed to the NLW and must factor in an increased wage bill as a result. Although employers most commonly looked to raise productivity to offset the added cost prior to the NLW's introduction, this has been more difficult to effect in practice. 2018 and 2019 saw more organisations swallowing the cost themselves and a slightly higher number turning to price rises. Fewer organisations were as confident about productivity gains coming to the rescue.

For those that did adopt productivity-improving responses, there were some positive signs leading to increased revenue opportunities or discretionary effort. However, the NLW was reported to be one of many factors behind these initiatives in the vast majority of cases, which suggests that many of these improvements might have happened anyway. What's more, some organisations have adopted measures that are likely to restrict productivity growth in response to the NLW, such as cutting training budgets.

Add to the mix the difficulty the vast majority of case study employers are facing in maintaining sufficient pay differentials between job levels as the wage floor rises, and the demotivating effect this could have on some of the workforce, it becomes even more evident that raising productivity is an urgent business imperative.

Government policy can play a vital role in providing a policy framework to enable employers, and more crucially line managers, to overcome these challenges. The following recommendations are designed for this purpose, especially to equip line managers with the skills required to deal with the challenges many employers cite in this report.

Policy recommendations

Business support

Improve the quality and availability of business support to help firms, particularly small businesses, to boost their productivity.
Our research did find some limited examples of employers succeeding in raising productivity through investment in people management, skills development, and technology as a result of the NLW and other factors. However, these were matched by organisations that had not taken similar action, including employers that instead relied on getting their staff to work harder to increase output per worker, which is unlikely to prove sustainable over the longer term.

More business support is therefore needed, especially for smaller firms with limited resources and knowledge of people management, to help them improve how they manage and develop their staff. This type of support could boost job satisfaction and motivation, as well as reduce the cost and negative impact on operations of employee conflict, absence and high levels of staff turnover. This type of support could also encourage firms to invest in training that can help optimise the benefits of new technology in workplaces where it is introduced.

The CIPD has successfully piloted an approach to providing high-quality HR support at scale to small firms through its People Skills initiative. The evaluation found evidence indicating that the provision of a limited amount of expert people management support to small firms through key local stakeholders such as chambers of commerce, local councils and Growth Hubs was associated with improvements in workplace relations, labour productivity and improved financial outcomes for participating firms.

The CIPD has estimated that a People Skills type business support model could be rolled out across all Growth Hubs at a cost of £13 million a year.

Training and in-work progression

Reform the apprenticeship levy to create a broader training levy.
Another way organisations can boost productivity is through upskilling and reskilling the existing workforce. However, in three of the ten case studies, the NLW was reported to have had a negative impact in investment in skills or had led to deskilling.

This also reflects CIPD research published in 2019,[4] showing just 31% of firms reported the apprenticeship levy would lead them to boost investment in training, compared with 61% that said it would have no impact (49%) or mean they reduce investment in training (9%).

The same CIPD research showed broad employer support for reform of the apprenticeship levy to a broader, more flexible, training levy. This would prevent the increasingly common practice of rebadging and *'gold plating'* training courses as apprenticeships and give employers the flexibility to use levy funding to invest in the type of training and development most suited to their skills development requirements, while also funding apprenticeships.

Greater flexibility in how employers can use their levy funding to invest in different and more bespoke types of training would also support in-work progression. The report highlights a concern among some employers that reduced pay differentials is having a damaging impact on firms. On the one hand, the data suggests that there are significant wage benefits from the NLW for many workers who have benefitted from some employers' desire to maintain pay differentials between managers and workers. However, those employers who have seen a reduction in differentials between job grades as a result of the NLW say that it has had a negative effect on staff motivation, employee relations and in-work progression within firms. There is very little that government policy can do to help unblock this.

However, a broader, more flexible, training levy would help organisations support workers to develop skills and progress by enabling employers to use levy funding for a wider range of accredited skills training beyond simply apprenticeships. Apprenticeships are of course extremely valuable as a way of providing people – particularly younger workers – the means to develop the skills they need to develop a career in an occupation. However, they are also rigid and expensive forms of training that often don't meet employers' and learners' skills development needs at a time when public and private sector investment in skills needs to go further.

Pathway to reaching 66% of median earnings target

Ensure there is flexibility in meeting the 66% of median earnings target.
The CIPD believes that the Low Pay Commission's new 2024 target should be made more flexible to allow a longer path, especially given the continued weakness in productivity growth. The specific concern is that an increasing share of organisations will encounter a tipping point where they are forced to adjust to the higher minimum wage through job cuts or closure. A more flexible approach would help maintain the LPC's central role. The LPC has proved an excellent steward of the NMW and NLW since its introduction and remains the right body to make specific recommendations on the evolution of the NLW and to monitor its impact.

[4] Chartered Institute of Personnel and Development. (2019) *Addressing employer underinvestment in training: the case for a training levy.* London: CIPD.

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Merging adult NLW and NMW youth rates

Create a single adult National Living Wage rate.

The evidence in this report supports the LPC's recommendation that the age of eligibility for the NLW should be reduced from 25 to 23 from April 2021, along with a commitment to reduce the threshold to 21 at a later date. Overall, this report finds support for the idea of a single adult NLW rate from a fairness and simplicity perspective. Indeed, reducing the threshold to 21 from April 2021 might help avoid confusion among employers and National Living Wage recipients.

Industrial strategy

Create a more inclusive industrial strategy that places greater emphasis on the sectoral needs of the UK economy and addresses the chronic underinvestment in adult skills and lifelong learning.

To help the UK's broader efforts to improve productivity, the Government's industrial strategy should be modified to address the UK's chronic underinvestment in adult skills and lifelong learning. The focus is mainly on education policy and the supply of skilled labour for the future in niche sectors, such as high-tech and construction sectors, that together account for less than 15% of UK employment. As this report highlights, the strategies for dealing with the National Living Wage are very different in key sectors such as retail, hospitality and social care – and government policy needs to be more closely aligned to this.

As a result the CIPD believes that more money should be allocated to boosting investment in skills, particularly for lifelong learning. As the Government's own Industrial Strategy Council recently acknowledged, *'[a]n urgent shift to providing lifelong learning in the UK workforce is required to halt an increase in the number of workers without the right skills.'*[5]

In addition, as stated above, there is a need for the provision of more high-quality business support, particularly for small firms, to help them improve their people management capability and subsequently boost their investment in skills and enhance how existing skills are used in the workplace.

Post-Brexit immigration policy

Caution should be applied to setting the NLW rate for April 2021.

A couple of the case study interviews highlight the extent to which the NLW has interacted with other wage and non-wage costs such as the apprenticeship levy, the Government's auto-enrolment pensions scheme and business rates. In January 2021, employers who wish to recruit non-UK nationals from overseas will be faced with a range of additional costs, including visas and an Immigration Skills Charge. Further, a reduction in low-skill migration will undoubtedly put further wage pressure on employers, who are already struggling to fill vacancies while absorbing the NLW. This suggests that some caution should be applied in setting the NLW rate in 2021.

[5] *'20 per cent of workers could be under-skilled by 2030, new analysis finds'*, Industrial Strategy Council, 24 October 2019.

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11 Appendix: Employer case studies

A medium-sized call centre based in the south of England

Background

This call centre, based in the south of England, employs 200 workers who are all mainly employed in customer service occupations. Very few staff are paid the National Living Wage (NLW) adult rate because staff are paid the NLW until they have passed their probation period, when they receive £8.25 an hour. This rate rise is up-rated in line with the NLW. Those who are either NLW recipients or paid slightly above it are all paid the adult rate and are employed in sales, customer service and warehouse roles. In addition, many NLW recipients receive commission and bonuses in addition to their basic pay.

Response to recent NLW increases

The NLW is reported to have *'increased the wage bill considerably'* since its introduction in April 2016. The call centre has managed these additional wage costs primarily by raising prices, although the organisation also acknowledges that it has had a modest negative impact on profits. The organisation also said that it has improved productivity by linking the NLW increases with training spend and coaching. The overall objective of this activity is to offer a more efficient service, with a particular focus on minimising errors and *'being right first time'.*

In addition, the organisation has sought to control costs by reducing the pay differentials between staff and their line manager or supervisor. In some years, this has meant that some line managers or supervisors have had to accept a pay freeze. The organisation takes a philosophical attitude to the potential tensions this could cause in the workplace, pointing to its role as a good employer with a wide range of benefits. These include shop discounts, a subsidised canteen, gym membership, a relatively generous pension scheme and a basic pay award that at least keeps pace with inflation. As the HR manager of the firm puts it: *'You either like working somewhere or you don't.'*

Flat NLW rate for all workers

The tight labour market in the region and the need for simplification are two of the key factors behind the decision to have a flat rate for all workers. However, it also seems that fairness is a key underlying factor, which is reflected by the fact that apprentices also receive the NLW adult rate.

> *'The problem we have is that there are more jobs than there are people in this region. So you will see employers adopting the same policy as us because they want to attract the best talent they can themselves. It is rare when you see adverts that do not pay the highest [over 25] adult rate. ... Fairness also comes into it. If a young person is doing the same job and producing the same quality of work as an older colleague, why should they get a different rate of pay? In addition, the flat rate simplifies the whole situation for accountancy purposes.'*

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2020 and beyond

It seems that the organisation is broadly anticipating a business as usual approach to responding to similar up-ratings in the NLW. It expects to respond primarily through a continuation of raising prices and absorbing the additional cost. However, the firm expects to respond by focusing less on absorbing the cost and more on accepting lower profits, because *'we can't keep piling it on to consumers',* according to the HR manager of the firm.

However, it also says that future increases might galvanise them into '*finding more business*' and force them to look for efficiencies elsewhere, especially in the supply chain. It also rules out the option to introduce different wage rates for different age groups or cut back on benefits, pay and employment conditions because it *'wants to grow the business'* – even if the NLW were increased to £10/hour in a relatively short period.

Additionally, its only request of government is that it provides future guidance beyond a year, if possible.

A medium-sized social care provider in the voluntary sector

Background

The social care provider has been in existence for over 30 years. It has an annual turnover of just under £5 million and employs 250, mainly full-time, workers. A fifth of its employees are managers or in administrative roles. Meanwhile, around four-fifths of the workforce are either National Minimum Wage (NMW) or National Living Wage (NLW) recipients. This group comprises a fifth who earn the NMW youth rate and four-fifths who earn the NLW adult rate.

The organisation is currently experiencing severe recruitment and retention difficulties, despite a publicity campaign funded by the Government that aims to improve the attractiveness of the profession. The main reason for this is reported to be low pay, which, it is claimed, is partly due to the commissioning model that encourages *'getting the work done as cheaply as possible'.*

The organisation has found it increasingly challenging to finance the annual up-ratings because they are not keeping pace with annual funding increases. In addition, the organisation continues to be impacted by the *Whittlestone* judgment, which is when care workers who 'sleep over' became eligible for the NMW. Unfortunately, the organisation's request to the commissioners to meet this particular shortfall was rejected at the time. The organisation has paid £700,000 out of its reserves in order to remain compliant. The organisation is also eagerly awaiting the outcome of the *Mencap* judgment from the Supreme Court, which relates to social workers on 'sleep-in shifts', which could increase wage costs further.

Employer response to the NLW increases

Since its introduction in April 2016, the NLW has had a significant impact on the wage bill. In response, the organisation has employed a range of measures to help offset the increase. It has cut back on pay and conditions, including reductions in overtime rates and employer pension contributions. In addition, the organisation has made cuts to statutory maternity pay, paternity pay and statutory sick pay provisions. For example, whereas mothers used to receive six months' full pay maternity pay, they can now only get the statutory minimum. The organisation has also made a modest cut of 1% to its training budget. As the organisation points out, it is very reluctant to make any cuts to the training budget given the impact this would have on quality of care and the bottom line. This was in the main due to a lack of response by commissioners in responding to the NLW announcement.

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The decision to make cuts in these areas has been enforced because the employer cannot make job cuts due to the statutory minimum staffing that must be met, feels constrained from making productivity gains and cannot raise prices due to recruitment issues linked to pay.

As the director puts it:

> *'We are not in a position to reduce the number of employees through redundancies and/or recruiting fewer workers because they are unable to fill the vacancies that they have and are having to turn down business because they can't find enough people who want to enter the sector. We would like to employ more workers aged 25 and under and apprentices, but this is more to do with the talent pipeline than cutting costs.'*

Looking ahead, it expects to respond in a similar way if the path of future increases mirrors the recent up-ratings to the NLW. In addition, basic wage growth will continue to be pegged back.

Pay differentials

The organisation has also responded by reducing pay differentials. According to the organisation, there is a decreased differential between the hourly rate of NLW recipients and their managers and supervisors. As a result, the organisation has a current situation where a 24-year-old manager is earning less than a 25-year-old worker who earns the NLW hourly adult rate. Attempts are being made to keep pace with differentials. The organisation actively promotes from within; however, staff have been reluctant to develop and apply for management positions due to the differentials being eroded and the role being devalued in monetary terms against a backdrop of increased accountability and responsibility. *'Looking to the future, stagnation of internal talent development at middle management level could impact on succession planning.'*

Youth rates

The organisation pays the NLW adult rate and the NMW. All staff between the ages of 18 and 24 are paid the 21–24-year-old rate. The 18–20-year-old rate was disregarded in an attempt to attract workers into the sector. The organisation acknowledges that this has affected staff morale due to the perception among young workers that they should be paid the adult NLW rate because they have the same responsibilities and accountabilities.

2020 and beyond

If the NLW path were to continue at a similar rate compared with previous years, the organisation claims that it would be forced to reduce overheads and consider cutting jobs, particularly managerial roles.

A large social care provider

'If the National Living Wage continues to increase at this level, it will be quite difficult to maintain career ladders due to the cost of maintaining differentials at each level.'

Background

This social care provider has over 5,000 workers in approximately 150 locations. More than a third of the workforce are paid the National Living Wage (NLW). Recipients of the NLW are predominantly employed as care workers, or ancillary workers in hospitality and housekeeping.

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Impact on the wage bill

The NLW has had a significant impact on the wage bill since its introduction in 2016. However, another key factor behind the rise in the wage bill is the company's desire to maintain pay differentials between NLW recipients and their supervisors or managers. The NLW accounts for around two-thirds of the overall increase in wage costs since its introduction.

Pay differentials

The company has a large learning and development budget, together with designing, implementing and promoting career ladders to attract and retain staff. Despite efforts to protect pay differentials, there has been a degree of compression, which the company claims has affected employee engagement. According to the firm, more senior staff in particular have felt undervalued and dissatisfied.

Response to NLW

Absorbing the cost and/or generating other business efficiencies has been the main employer responses to the introduction of, and ongoing increases in, the NLW.

Given there is limited scope to raise levels of pay for staff above the NLW, a parallel focus has been on improving benefits wherever possible, focusing on recognition and long service awards to keep employee retention as high as possible.

The company does report that there has been an impact on profitability, especially for those sites that have a higher share of local authority payers. This is because the increase in what local authorities pay the provider often does not match the rate of NLW increases.

As the HR director of the organisation points out:

> *'There are some efficiencies to be had, but having worked in other business sectors it's much easier in some to bring about process and efficiency improvements. We are heavily regulated, and we must prioritise care quality; you can't jeopardise that.'*

Despite these challenges, the organisation has managed to find ways of making some process and efficiency improvements. The HR director continues:

> *'We have managed to improve efficiency by adopting new technology solutions in some areas. There are lots of investments now being made in technology, most of which also deliver qualitative improvements, support with training and consistency of care delivery. … The NLW is not the only driver as far as efficiency measures are concerned, but it is certainly one of the significant drivers for us.'*

Adult NLW and youth NMW rates

The company chooses to pay workers aged under 25 the higher NLW rate. As the HR director of the company explains:

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> *'Our decision to pay the same NLW rate for workers is about equity as well as the business imperative. We don't pay workers under 25 any less as long as they complete all the necessary training for their role. That's our choice. If you have a 23-year-old and a 29-year-old doing the same job to a similar standard, to take a view that one should get more than the other is unfair. The 23-year-old will have completed the same mandatory training and may even be more effective in their job. Another reason for having the same wage rates across the different age groups is related to the need to recruit and retain staff. The industry is very competitive from a staffing point of view. This is particularly true in the south of England.'*

2020 and beyond

The HR director of the firm is fearful of the consequences if the recent rate of increases to the NLW continue without the necessary levels of funding into the social care sector. The company understands and supports the NLW policy's aims in principle, but feels it is not being implemented appropriately with the care sector in mind. As the HR director points out, there can be very different implications from an affordability point of view for one business sector over another:

> *'There is a feeling that the policy is disjointed in its planning and implementation. The regulator, central government and local government do not appear to be co-ordinated in their approach. The regulator wants a continuous improvement on the quality front, local government is focused on trying to reduce costs and central government wants an increasing NLW. Some other industries have larger margins and employ a smaller proportion of NLW workers so can therefore absorb the increased costs more easily. Social care employers cannot and must therefore be listened to closely when setting the NLW. If this does not happen, I think we can expect to see more private sector employers in the care sector fall into financial difficulty.'*

The HR director also expresses concern that the single rate does not reflect cost of living differences across the country. In particular, he cites London weighting as a necessary measure, which is not reflected in the NLW's *'one size fits all'* rate approach. Additionally, in social care, recruitment challenges have been exacerbated by other policies and decisions which have impacted labour availability, such as migration restrictions.

A large retail leisure company

Background

This large retail leisure company has 3,400 employees across 119 retail sites and two corporate offices that employ 250 employees. The gender split in the organisation is 37% male and 63% female. Around 70% of the company's staff are paid either the higher

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National Living Wage (NLW) rate for those aged 25 and over or the lower National Minimum Wage (NMW) youth rates for those under 25. Recipients of the NLW or NMW are predominantly employed as chefs, presenters and hosts in retail outlets, and via the online offering. However, the composition of the workforce is changing due to the challenges being faced by declining admissions numbers currently being experienced across the industry and the move into an online gaming offer.

Response to recent NLW increases

The NLW increased the firm's wage bill when it was introduced in April 2016. The company's overall approach since 2016 has been to absorb the cost. However, the firm reports that the latest NLW up-rating in April 2019 forced it to reduce hours for some workers and introduce the lower NLW youth rate, which it had previously avoided doing, to help reduce wage costs.

One positive aspect to this approach is that it will ease tensions among more experienced workers, who have become frustrated by the narrowing of pay differentials between them and the colleagues they manage or work alongside. The firm reports that in-work progression has been more challenging as a result of the narrowing of the pay differentials because staff no longer feel that the marginal pay premium they gain is worth the additional responsibilities. As the chief people officer of the firm explains:

> *'Actually, what we get reported back is people saying, "I'm taking on all this extra responsibility, and that person who has just joined us in a lower-skilled role is on the same pay scale as me. Why should I bother?"'*

The company also identified that there is a higher rate of labour turnover among younger workers, which somewhat justifies the decision to apply a lower wage rate. However, to recognise those workers for whom this is a career, the lower wage rate will be supported by the forthcoming introduction of skills-based pay progression, giving all colleagues who take on additional skills and responsibilities the opportunity to increase their pay.

The introduction of the youth rate has led to some negative outcomes according to the firm. As the chief people officer points out:

> *'Managers are saying they can't recruit people at the under-25 level because we can't compete with other employers that pay the adult National Living Wage rate; we'd much rather not have to pay the youth rate at all, but it is a catch-22 situation for us, and so we had to make the hard choice to use it.'*

In addition, the business reports that the introduction of the youth rate has meant that it can now afford to give junior managers slightly more, which has helped to increase the pay gap between colleagues taking on some additional responsibilities and managers who are paid salaries. The chief people officer continues:

> *'We've had managers who have said, "There is no point me carrying on as a manager, I could earn more if I was a colleague, I'm going to step down." This has affected our junior management levels in particular, whose earnings had not risen (until recently) in line with the people they manage.'*

Raising productivity has also been a part of the organisation's response to the introduction and subsequent up-ratings in the NLW. The organisation has sought to improve, and been successful, by introducing a programme of culture change that has empowered colleagues to get more involved in making decisions on site. This has enabled them to exploit opportunities to increase revenue and decrease costs. The NLW was reported to be one of many factors behind the drive to improve productivity at the firm.

With so many staff members on the NLW or NMW, the business pointed out that their staff are missing out on salary sacrifice schemes such as cycle to work, pension payments, and buying back holidays. They suggest that the Government allows a 'reasonable amount' of salary sacrifice to those on the NMW so they can best utilise their tax bracket.

Merging the 21–24-year-old NMW rate with the NLW adult rate

The firm is also torn about merging the 21–24-year-old rate with the adult rate. While ethically and morally they believe it is entirely the right thing to do, it leaves them with a dilemma on how to pay for the skills and experience that come with people who have been with their business for longer, or who bring more life experience with them into the business.

According to the firm, raising prices is not a viable option. The chief people officer argues that:

> *'We already operate in a highly competitive market, with a very traditional customer base. If we squeeze the money we need for NLW directly from our customers, this would go against our values and runs the risk of switching customers to other leisure offerings. We have to find another way to help fund the money needed, and still deliver a great customer experience.'*

2020 and beyond

Looking ahead, the organisation plans to automate business processes to help offset similar increases in the NLW and NMW rates. They will be looking to make efficiencies by removing unnecessary processes and reviewing the organisational structure without having to reduce headcount. It hopes that these improvements can help pay for more generous increases, as summarised by the chief people officer:

> *'We believe that people should be paid a fair wage for the work they do, and that having a National Minimum / National Living Wage is one way to be assured of this, but sometimes the actions required impact on people in other ways. We'd much rather put ourselves into a position to be paying above NLW for all colleagues and are looking at all the different ways we can achieve this.'*

Overall, the firm believes that the introduction of the NLW has eliminated market forces that used to allow organisations to adjust pay rates according to the skills required and the demand for skills in each sector. By eliminating pay as a differentiator in the market, it has positively forced organisations to become more creative about what they can offer to differentiate themselves from others, but has also meant that generally prices have had to rise to afford it. The chief people officer concludes:

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> *'While we strongly believe everyone should be earning a National Living Wage, if this means prices are increased, this impacts the cost of living, leaving people with less in their pocket, not more. It is a flawed system, and there has to be a better way to bring people's pay to a reasonable level for them to live on.'*

A healthcare employer

Background

This private sector limited company owns two GP surgeries that are based in the south of England and employ 50 employees at two sites.

This is the first year this private sector limited company has run the GP, following last year's dissolving of the GP partnership. The sharp annual up-ratings in the National Living Wage (NLW) in recent years are reported to have contributed to this development. According to the firm, NLW up-ratings have helped increase the wage bill by 2% per annum, which lies above the annual funding increase of 1%.

The NLW did not have an immediate impact on the wage bill when it was introduced in 2016. However, the NLW started to bite in 2017 when it affected a small proportion of the workforce, and this share has grown gradually over the past couple of years in line with the annual up-ratings. Currently, around half of the workforce are paid the NLW and National Minimum Wage (NMW) youth rates, the vast majority of whom are employed in clerical roles.

Response to the NLW

The GP has sought to plug the gap between the amount of funding it receives from public authorities and higher wage bills by reducing the size and composition of its workforce and introducing more automation. The surgery has introduced a patient app to help cut the number of calls to the GP and reduce demand for clerical staff, who are NLW recipients. If the app is used to its full extent, it is estimated that the number of calls to the GP will decrease by 50%, which will reduce the demand for clerical staff.

It has also sought to reduce wage costs by halving the number of GPs it employs by replacing them with lower-skilled allied health professionals on lower salaries. This group includes paramedics and advanced nurse practitioners, who are all seeing patients as a GP would. According to the interviewee, this phenomenon is taking place across the UK. In addition, the GP has sought to take on more apprentices because they offer *'more value for money'*.

At the same time, improvements in technology and flexible working are being introduced alongside each other to reduce demand for labour and meet patient demand for a 12-hour service. The flexible working arrangements are being driven by the Government's new commitment to offering a service from 8am to 8pm, seven days a week, which has replaced the former 8am to 6:30pm arrangement. However, the potential for the organisation to adopt flexible working hours for receptionists, who are NLW recipients, is curbed by the need to have the reception desk manned during the evening. The technological improvements have therefore mainly benefitted more highly skilled staff, who have been able to work from home and carry out consultations through the mobile app.

Looking ahead, the company says that more generous increases in the NLW would be *'unsustainable'* unless funding is increased to the NHS and GPs.

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Different age rates and wage differentials

The company employs workers on the three different NMW and NLW rates. Indeed, the manager of the organisation says that the lower wage rates have influenced its decision to hire younger workers at the expense of older workers, which seems to have had an impact on overall quality of customer service. As the manager of the surgery puts it:

> *'Five or six years ago, when we were looking for a medical receptionist, we would want someone who was slightly older. They have a lot of life experience, they knew how to talk to people, and they understood when a patient was going through certain things like bereavement and so on. Now, actually, all of that is out the window. We're actually looking for younger people, people who are cheaper, people who we can mould and train. You see customer service, as it were, has actually decreased. We have had some more complaints about it. It's due to the freedom of being able to employ younger members of staff who are cheaper.'*

The company acknowledges that it would revert back to its original approach to recruiting more experienced workers if the number of age rates were reduced or eliminated. At the same time, it will seek to maintain its apprenticeship programme. Additionally, the employer has had no alternative but to reduce the pay differentials between NLW recipients and other staff, notably clinical staff.

2020 and beyond

The general manager of this GP surgery warns that 2020 will see the biggest impact on the wage bill. This is partly because the organisation is coming under increasing pressure from its clinical staff, who have not seen a pay rise for three years, to raise pay. As a result, wage costs are set to increase by 3–4% next year compared with an annual funding increase of 1%.

Despite this, the company hopes to break even this year following a loss last year as a result of the productivity improvements. However, it notes that if the NLW were to enjoy even more generous increases, such as £10/hour, it would not be able to survive.

Medium-sized leisure trust based in the north-west of England

Background

The organisation is a leisure trust based in the north-west of England, which has a contract to run such leisure facilities as running tracks, gyms and swimming pools across five main sites for the local council. The fee that it gets from the council for running its leisure amenities has fallen over the years. The trust has now been in existence for around 15 years.

It employs around 450 people, 300 of whom actively work for the organisation as employees, while 150 are employed on a casual basis and are called on as and when they are needed, such as covering for holidays or sickness absence. The gender split is 43% male and 57% female. The largest cohort of employees are aged between 18 and 24.

Twenty-nine per cent of the workforce have their pay set by the National Minimum Wage (NMW) (14%) and National Living Wage (NLW) (15%) rates. The occupational profile includes lifeguards, sales assistants, cleaners, swim teachers, café staff, admin assistants, gym instructors and receptionists. Higher hourly wage rates are given to those on the first level of management.

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Response to the NLW

The organisation claims that the NLW and NMW rates have impacted on affordability, which has forced it to look at making savings.

It seems that the new wage floor has led to some subtle employment effects. While no job cuts have been carried out, overall employment levels have been affected to a small extent among NLW recipients. As the HR manager of the trust comments:

> *'We do feel under more pressure to review the job roles and remove these where possible to make savings to meet the increased costs. It's usually managers who get the responsibilities shared amongst them rather than NLW individuals for higher-level posts, but where possible sessions can be reviewed and changed to reduce staffing in NLW roles, but they don't necessarily get more duties as we work to a very tight staffing structure for the centres we run.'*

Another key change has been to change its sickness policy by ending the arrangement where the organisation pays for the first three days of sickness absence. It has also replaced the six months' full pay arrangement with one that gives three months' full pay and three months' half pay. To offset the cutbacks, the firm tries to boost employee engagement through non-cash rewards, flexible working arrangements, generous annual leave arrangements and lots of training.

The impact of the NLW and NMW increases

The trust used to set wage rates according to job roles (a job evaluation scheme). However, following the recent increases in the NMW and the introduction of the NLW, the organisation has had to pay by age rather than job role due to affordability. This is because the new higher wage floor has captured occupations that were previously graded higher than other roles. As the HR manager of the leisure trust points out:

> *'Previously we paid by job role. But as the minimum wage crept up, and as the living wage came into force, we've had to pay by age, because we've not been able to afford to do both. For instance, a leisure attendant used to be band one, a gym instructor was band two. But now because the rates have increased so much, they're all paid the same, yet they were graded differently.'*

Another consequence of the NLW and NMW developments are that low-paid employees are paid the same irrespective of an employee's performance. This is due to the relatively sharp increase in annual up-ratings, which means that employees are given annual increases across the board. There is also a concern that the increases enjoyed by those on the NMW and NLW rates in the past may lead to certain expectations among NLW and NMW recipients. How these individuals might react in the future if similar mandatory increases are not as high may become a challenge for employers in terms of motivation.

The trust claims that it has lost its competitive advantage in the labour market as a result of the new wage floor. In the past, the trust was able to stand out as its minimum rates

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of pay were above the statutory minimum. However, the increase in the NMW rate and the introduction of the NLW mean that they can no longer advertise that they pay people above the legal minimums.

Pay differentials

There has been a gradual squeeze in pay differentials since the introduction of the NLW in April 2016 due to lack of affordability. Over the past three years, those who are not NMW or NLW recipients saw a pay freeze in 2017, an increase of 1% in 2018 and a 2% increase in 2019.

The overall impact of these limited pay increases on those paid above the NMW and NLW has been a fall in morale and challenges with in-work progression. For instance, the differential between leisure attendants and team leaders has fallen to around £1/hour, and this is resulting in recruitment issues for team leaders. For example, some attendants have been put off from applying for the team leader role. According to the HR manager of the trust, some employees are deterred from applying for the more senior role because they feel that an increase of £1/hour is not worth the extra responsibilities, which include health and safety, cash handling and opening and closing the building.

This phenomenon has also affected morale. For instance, pool attendants are reported to be unhappy because they are paid the same wage rates as other roles which do not require the same skill level. Pool attendants are required to have and maintain the appropriate qualification, to undertake a week-long intensive training course, have their level of swimming ability assessed and train two hours every month. In addition, when pool attendants are working as life guards, they have a lot of responsibility. However, these staff are now paid the same hourly rate as elementary occupations such as cleaners.

Alongside this, the pay differential between those covered by the NMW and NLW rates and the lowest paid supervisor grade has fallen from £1.82 in 2016 to £1.08 in 2019. In addition, while NLW and NMW recipients are delighted with their pay increases, managers are reported to be dissatisfied with relatively modest pay increases. HR has had to deal with complaints from team leaders about their pay and presented their complaints at the staff welfare meeting. To deal with team leaders' concerns, last year, in addition to the 2% pay rise, the employer increased the number of pay increments for this group from three to four to allow them to increase the differential between them and front-line staff. However, there is now a concern that other similar groups will use this as a precedent to restore the differentials between themselves and front-line staff.

Productivity response

The organisation reports that it has not sought to link higher pay with productivity, but the HR manager of the firm acknowledges that this might be an oversight:

> *'Maybe we've missed a bit of a trick there, because while we're giving a decent pay increase, it's not linked to performance or anything. So you could have an average leisure attendant who isn't really doing brilliantly, but yet they still get the 4% increase. The same as one who absolutely works their socks off and does a brilliant job and tries really hard. It is difficult, though, to see where we can improve productivity.'*

Looking ahead, the organisation does not plan to use the NLW as a means to improving productivity in the workplace, mainly because it does not see how it can.

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Use of NMW youth rates

The trust makes use of NMW rates for those aged 18–20 and those aged 21–24 alongside the NLW rate for those aged 25 and above. Employees either get the wage rate according to the organisation's job evaluation scheme, or the NMW or the NLW – depending on which rate is higher. It also uses the apprenticeship rate for its apprentices. However, while the use of age bands helps to reduce wage costs, it also increases the employer's administration costs. Every month, the payroll team must check whether someone will have a birthday and adjust their hourly rate accordingly. There is also the concern that an employee's birthday may be missed and the new rate won't be paid, opening the employer up to legal challenge.

2020 and beyond

The recent increases in the minimum rates have increased wage costs for the employer, in terms of how it can pay the increase for this group of people. If the age at which the NLW was paid were lowered from 25 years of age, this would increase labour costs and put additional pressure on wage differentials according to the establishment. However, the extent to which it would impact would depend on whether the adult rate would be payable at 21 or 18 and how quickly the change was introduced. At the same time, the HR manager acknowledges that having fewer rates would make it administratively less complex to operate.

If the NLW were to continue on its current pathway in the next few years, the organisation would likely respond through a combination of cutting back on the service provided, reducing opening hours, reducing activities and increasing prices. The establishment may even have to resort to closing sites and reducing headcount. Such a sharp increase would also mean that the differential between those on this wage and those supervising them would be just 20p. This could affect the desire of those on the new minimum rate to seek promotion when the differential is so small, while it could reduce the motivation among their supervisors, who don't see their contribution being adequately rewarded.

Large local authority in the north-east of England

Background

This local authority employs 3,500 employees who work across a variety of sites and services, ranging from staff employed in parks to those with back-office administrative duties. Partly influenced by the introduction of the National Living Wage (NLW), the organisation introduced a local living wage of £9/hour in April 2019. At the same time, the local authority has seen its budget cut in real terms during this period in common with councils across the country. Interestingly, when the same organisation was interviewed for a similar study in 2016, it reported that it had investigated the affordability of being a Living Wage employer, but ultimately decided it would not be affordable to do so.

Response to the living wage

The senior HR manager of the council reports that the organisation has not managed the increase in employment costs well following the introduction of a local living wage of £9/hour. The main response to the higher wage bill has been to cut jobs, especially middle management, and reduce overtime. On the upside, the organisation claims that the restructuring has brought about different ways of working and in some areas increased productivity. However, on the downside, the career progression has been negatively impacted because the job ladders no longer offer smooth progression routes.

As the senior HR manager explains:

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> *'Whereas in the past you might have had a director, an assistant director, a senior manager, a manager, a team leader and an individual who's delivering the services to the customer, some of those middle tiers have literally come out of the organisation. So, it's a much flatter organisation with more individuals delivering the service to the customers. As a result, the career pathways have been disrupted because in some cases the next tier is missing compared with two years ago.'*

On the upside, the organisation claims that the output of individuals has increased as a result of the job cuts because individuals are being asked to do more in their role, sometimes carrying out tasks that were formerly carried out by management. However, as the senior HR manager points out, while this has led to more opportunity, it has also led to some challenging conversations. This is because the workers have not been given a pay increase to perform the additional tasks because they come under the scope of the role.

As the senior HR manager points out:

> *'The changes have made us review the jobs on a flat level as opposed to hierarchical level. We have some individuals who possibly feel that they're doing more, but that's maybe because they weren't doing quite as much as they should've been in the first instance or were doing things that are no longer needed so the volume feels greater.'*

Productivity

The organisation claims that productivity gains are very difficult to achieve because it does not have the funds to invest in productivity initiatives or measures. Another reason is that many of its activities are people-centred, such as elder care and teaching, which cannot be substituted for automation.

However, the organisation claims that it has improved output by asking staff to take on additional tasks and by adopting more flexible working arrangements and agile working. Interestingly, the senior HR manager also claims that they have seen a one-off response because the higher pay has induced more effort from workers through higher satisfaction. As the senior HR manager explains:

> *'Individuals who in the past would have had a lower wage rate, they would have talked to you about also having to apply for benefits and how that made them feel as people. The fact that they can manage better without having to apply for them has given some individuals more self-esteem and a lot of satisfaction. … Having an employee who's happy and healthy at work and is actually being paid a wage that makes them happy and healthy leads to a reduction in other costs, like sickness absence, and greater effort.'*

Additionally, the local authority claims that productivity in the organisation has increased

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due to more investment in skills. However, it argues that the apprenticeship levy has been the key factor behind this.

Pay differentials

The local authority has also responded to the introduction of a voluntary living wage of £9/hour by reducing the pay differentials between workers and the smaller pool of line managers and supervisors.

In common with other employers that have been interviewed for this study, this has caused workplace conflict:

> *'The new policy has caused some angst for some employees as they feel you're literally paying an individual who has no/lower qualifications or experience the same as someone who maybe had an NVQ, who had some experience or who was doing a totally different job. In other cases, you now have individuals who are being paid exactly the same as the individuals they are managing, and this has caused some upset. We have managed to offset this to a degree by not altering the pay and grading structure and reviewing some roles to make sure they are reflective of the skills required to do the role. However, pay has remained static beyond those in receipt of the living wage, which for some managers and supervisors is not enough and they remain very unhappy.'*

Youth wage rates

The firm uses the voluntary hourly National Living Wage rate for all workers. It decided not to have youth rates because they regarded it as unfair and at odds with their equalities policy.

2020 and beyond

The firm is considering a review of the existing pay differentials and affordability of a living wage beyond £9 and considering the feedback from the Living Wage Foundation. They are aware that while a living wage beyond £10 may cause some budget pressures, the view remains that if a living wage is £10 or above and this supports individuals in their overall well-being, welfare and health, it is something that will be seriously considered, as the overall impact on well-being and mental health may override the budget challenges.

A medium-sized food processing company with multiple sites across the UK

Background

This food processing company employs 1,500 employees in the UK across 12 sites. Approximately 80% of the workforce are employed on the National Living Wage (NLW) hourly rate in roles such as fruit picking and meat processing. Around two-thirds of the workforce are male. In addition, a large proportion of the workers are aged under 25, with relatively few employed in supervisory or managerial roles. The company also runs an apprenticeship programme for various roles including factory supervisors and office vocations.

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Youth and adult rates

Employees aged under 25 are also paid the adult NLW wage rate. According to the group people director of the firm, there are many factors behind the decision to award a flat rate to all workers:

> *'Paying the NLW adult rate for all workers is fairly common across the industry. We also know that employees in this industry will move jobs for relatively modest hourly wage increases, such as 5p or 10p, so it makes sense to remain competitive. As a result, very few firms in the industry would suffer if a flat adult rate were introduced. It is also a fairness issue; in my opinion, paying different wage rates to younger workers [is] discriminatory.'*

Impact of the NLW

The initial introduction of the NLW had a modest impact because it represented a very small increase to the organisation's wage bill. However, subsequent up-ratings have had a dramatic impact alongside other employment costs, notably the apprenticeship levy and the Government's auto-enrolment pension scheme.

Organisation's response to the NLW

Lower profitability, smaller bonuses and lower investment in training have been the main responses to the NLW at the firm. In particular, the lower investment in training has led to challenging conversations with managers.

Looking ahead, the company is keen to explore automation as a substitute for labour, which it claims will have a significant impact on the skill requirements of workers, especially machine operators. In addition, the company is seeking to intensify work for NLW recipients by asking them to be more flexible in their working hours.

Pay differentials

Additionally, the pay differentials between NLW recipients and their supervisors or managers have come down, with managers and supervisors receiving comparatively modest pay increases. As in other case studies, the HR director of the firm claims that people no longer want to become a supervisor or manager because the extra responsibility is not accompanied by a proportionate pay increase. As a result, the supervisor/worker ratio has increased from 9 to 12. This in turn has affected succession planning and in-work progression.

2020 and beyond

The company is broadly supportive of the NLW policy. However, the HR director sounds a note of caution about the ambition of the NLW increases. Looking ahead, the firm predicts that the organisation will be forced to increase prices if the rate of increase continues to outpace inflation. In addition, the firm fears that they will have to make cost savings in other parts of the business, which would affect the quality of work and the working environment – *'and this should be taken into account when deciding future increases'*. Additionally, the firm is also supportive of a rate for London and the south-east of England and another for the rest of the UK.

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A large restaurant chain with branches across the UK

Background

The restaurant chain owns 129 establishments across the UK and has a workforce of approximately 15,500 people. There are a further 1,200 more restaurants that operate on a franchise basis which employ their own workers. The franchise owners are free to pay what they want, though the company does recommend what wage rates to use; most franchises do or pay more. Few franchisees rely on the legal minimums. This case study will focus on the company-owned operation.

In the company-owned restaurants, approximately 47% of workers are male and 53% are females. The average age of those working for the restaurant group is 24. Those aged 16–17 make up 20% of the workforce, which compares with 31% of the workforce that are aged 18–20. Eighteen per cent of the workforce is aged 21–24 and around three in ten are aged 25 and over. Typical roles include crew member, crew trainer, customer care, customer experience leader and shift leader. Sixty-six per cent of the restaurant-based staff are impacted by the National Minimum Wage (NMW) and National Living Wage (NLW) rates.

The organisation pays its employees aged 21 or over £8.31, which is 10p above the NLW and 61p above the NMW. It pays those aged 16–17 £6/hour (£1.65 higher than the NMW rate) and those aged 18–20 £6.85/hour (70p higher). The start rates are adjusted at the beginning of January each year.

Impact of the introduction of the NLW

The introduction of the NLW in 2016 has had an impact on the way the organisation manages pay, because previously it tracked the NMW. The organisation decided that all those aged 21 and over would be eligible for the new NLW, which increased its wage bill. In order to maintain a differential between the NLW and NMW wage floor and its own wage floor, the company has reduced the number of pay bands from four to three.

The increase in the hourly rates has narrowed the differential between the highest paid hourly ‘crew’ manager and the lowest-paid employees. In per centage terms, the differential has now fallen to around 20%. Because workers on hourly rates can increase their working hours, it is now feasible for those on the highest hourly rates to earn more than their salaried colleagues in supervisory roles. Despite this, the firm has not noticed a fall in the number of workers applying for promotions. Since the NLW’s introduction, there hasn’t been any change in the average age of workers.

Organisational response to higher wage bill

The organisation’s main response has been to accept higher overheads, rather than cutting labour costs or trying to increase employee productivity through smarter working or work intensification. However, the current approach may change if the legal pay minimums were to keep on increasing.

Merging the youth and adult rates

Currently, the ambition of the firm is to have two hourly start rates from January 2021, one for those aged 21 and over and another for those under 21. It has been increasing the under-21 rate both for reasons of fairness and to be competitive in the labour market for young workers, rather than following what others in their sector are doing, though affordability remains a key concern. Restaurant crew workers are offered a range of contract options, but the organisation guaranteed a minimum number of hours for crew members this year.

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If the NLW was extended to all employees, this would have a significant impact on cost. How significant would depend on how it was introduced – if it was phased in over time, the organisation would have more time to accommodate the additional labour costs. How it would respond to the additional cost, such as through job cuts or trying to increase productivity, would depend on the level of the new rate and the speed of introduction.

The future

The firm is supportive of the concept of having legal minimums to ensure that workers aren't exploited, and good employers undercut, though they question whether the NLW should have been called a living wage, because it's another legal minimum rather than a 'real' living wage and can cause some confusion among employees. It does not favour the idea of amending the NMW and NLW by region, preferring the administrative simplicity of national rates.

If the NLW and NMW were to keep on increasing as they have been, this would narrow the pay differentials between grades, which could have an impact on people wanting to take on extra responsibility and duties if the increase in pay did not reflect the additional effort.

A hospitality firm in Wales

Background

This hospitality firm in Wales employs around 2,000 employees, the majority of whom are employed in pubs. Sixty-two per cent of the company's staff are paid either the higher National Living Wage (NLW) rate for those aged 25 and over or the lower National Minimum Wage (NMW) youth rates. Most of these workers are aged under 25, who earn the lower NMW rates. These workers are employed as bar staff and waiters. The company pays a slightly higher premium for back-office functions such as chefs.

Response to the NLW

Absorbing the cost and improving productivity have been the organisation's main responses to the increase in the wage bill. It claims that the aim to improve productivity has been driven to a small extent by the NLW. Key initiatives in recent years have included a lean initiative and a labour management system that has made scheduling more effective and reduced demand for labour. It has also adopted more automation. The net result of these changes is less demand for labour, which has led to an overall reduction in hours. As the head of people reports:

> *'We've introduced different technologies ranging from apps that allow you to pay or order which you pull up at the table, etc, to try and, I guess, have fewer hours and more customers served.'*

Despite the higher levels of investment in technology, the organisation claims that it is lagging its competitors, who have been quicker to adopt labour-saving technology.

However, the organisation stresses that the NLW is one of many factors that have had a negative impact on profits. As the head of people points out:

> *'I think it would be hard to single it out as one thing, because I think across the last few years, there's been other things during that time that have probably impacted it just as much.*

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These include business rates, Brexit, especially the increase in price of food and energy. The industry is also undergoing significant structural change – especially the craft market, which is increasing competition in the sector.'

Additionally, the firm claims that the NLW may have had an impact on skills investment.

Different age rates

Sixty-two per cent of the company's staff are paid either the higher NLW rate for those aged 25 and over or the lower NMW youth rates. The company pays the NMW youth rates to younger workers, which make up 43% of the UK workforce. Faced with the prospect of merging the NLW adult rate with the lower NMW rate, the firm says that it would have a substantial impact on the wage bill. In response, the firm says that its main approach would be to substitute capital for labour.

2020 and beyond

Looking ahead to the future, the company anticipates placing greater emphasis on raising productivity at the organisation and raising prices, something it has not considered to date. It also says that it will take a closer look at the benefits it offers.

Additionally, it says that greater investment in skills will be required. The investment will be predominantly in on-the-job training. In addition, the company will invest in leadership and management initiatives to help strengthen career pathways, which it is hoped will attract more candidates to the organisation. Additionally, the company looks set to introduce a new apprenticeship programme. The key driver for the new apprenticeship programme will be to claim money back from the apprenticeship levy.

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