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Policy report

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Weighing up the wage floor: Employer *responses* to the National Living Wage

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Weighing up the wage floor: Employer responses to the National Living Wage

Policy report

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Acknowledgements

This report was written by Gerwyn Davies of the CIPD and Conor D'Arcy of the Resolution Foundation, with contributions from colleagues at both organisations.

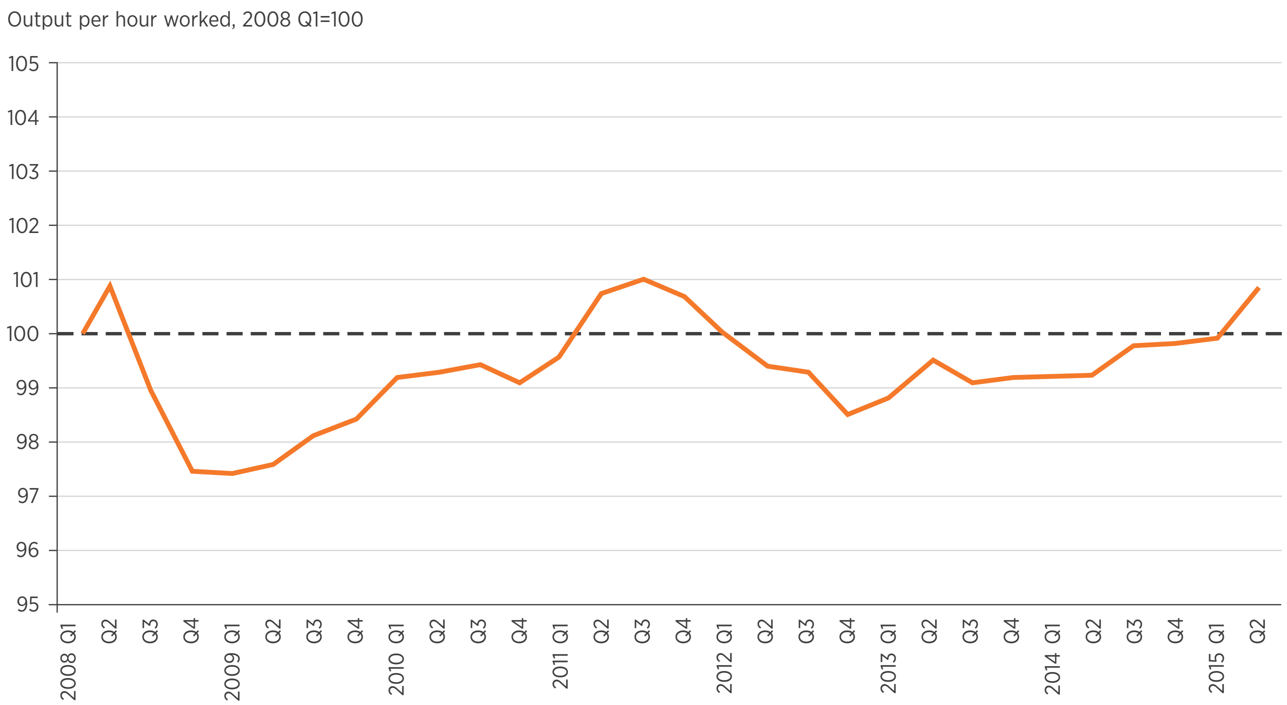
The context for the National Living Wage

George Osborne's announcement of the National Living Wage (NLW) was the *coup de theatre* of last July's Budget. Yet, in hindsight, perhaps we should have seen it coming. Low pay and a lack of opportunities for progression featured prominently in the General Election campaign, with Labour promising to promote the spread of the Living Wage through procurement policy and other such indirect means. Shortly after the election, the Prime Minister spoke about ending the 'ridiculous merry-go-round' of people on low wages being taxed and then claiming in-work benefits, arguing that the focus should be on *'... helping to create well paid jobs in the first place'*.[1] An increase in minimum wages also makes a direct contribution to reducing the welfare budget by reducing the cost of in-work tax credits (in time to be replaced by Universal Credit) – provided there is no negative effect on employment.

The previous Coalition Government explored the possibility of moving to a higher National Minimum Wage (in terms of its position in the earnings distribution) by asking the Low Pay Commission (LPC) to consider the conditions that would need to be in place for a real increase in the value of the National Minimum Wage (NMW) The LPC response, included in its 2015 report, highlighted some of the economic barriers to achieving this: low earnings growth that had, for several years, fallen behind consumer price inflation and, in particular, the lack of productivity growth.[2]

Labour productivity has hardly increased in the seven years since the start of the last recession, something unprecedented in the statistical record (see Figure 1).

Figure 1: The problem is lack of productivity growth



GDP is chained volume measure, seasonally adjusted. Source: Office for National Statistics

[1] Prime Minister's speech on opportunity. Available at: https://www.gov.uk/government/speeches/pm-speech-on-opportunity

[2] LOW PAY COMMISSION. (2015) *National Minimum Wage: Low Pay Commission report 2015*. London: Low Pay Commission and Department for Business, Innovation and Skills. Available at: https://www.gov.uk/government/publications/national-minimum-wage-low-pay-commission-report-2015 [Accessed 19 February 2016].

While labour productivity did increase in the second and third quarters of 2015, strong employment growth and an easing in output growth in the second half of 2015 means we have not yet reached a point where sustained productivity growth appears likely. There are many potential explanations for the so-called 'productivity puzzle', but recent CIPD research has highlighted the impact of weak investment in both people, capital equipment and technology during the past few years and the extent to which the last recession has continued to affect the mindset and behaviour of many firms.[3] When surveyed in June 2015, two-fifths of private employers described their approach in the previous two years as focusing on surviving on a day-to-day basis or cost-cutting, making themselves leaner and fitter. When asked to think about the years ahead, many of these firms saw themselves similarly constrained.

The continued weakness of productivity growth makes it difficult for an evidence- and consensus-based body such as the LPC to recommend increases in the NMW sufficient to substantially raise its relative value. This point was recognised by the Resolution Foundation's review of the minimum wage, chaired by Sir George Bain, which suggested that the government should *'...make it an explicit long-term ambition of economic policy to reduce the incidence of low pay, setting out a plan to reduce the share of employees who earn below two-thirds of the hourly median wage'.*[4]

Enter the Chancellor and the new National Living Wage. The new higher wage floor for those aged 25 and over makes the need for improved productivity growth, especially within the low-paying sectors that are set to be most-affected, all the more pressing. A comprehensive body of evidence on the National Minimum Wage's effect since 1999 is a useful guide to the impact the NLW will have, and there is some evidence that firms, specifically larger organisations, did raise their productivity in response. But because the Government's ambition for the NLW represents a rate of around £9 per hour by 2020, this is takes us beyond the current evidence base. How employers will react therefore remains uncertain, but vital.

Indeed, building an evidence base on how employers may react goes beyond the obvious importance for Britain's businesses. First, the National Living Wage is set to boost the family budgets of millions of low-paid workers but by exactly how much will depend on how employers adapt. If, for example, employers react by cutting employment – a fear that hasn't materialised since the NMW's introduction – the gain to employees is less clear. Second, how organisations adjust will also be important for the national budget given the implications it will have for inflation, tax receipts and benefit payments and the overall national budget. The stage is thus set for employers to play a key role in determining how this bold policy initiative will unfold.

'When surveyed in June 2015, two-fifths of private employers described their approach in the previous two years as focusing on surviving on a day-to-day basis or cost-cutting, making themselves leaner and fitter.'

[3] CIPD. (2015) *Investing in productivity: unlocking ambition*. London: Chartered Institute of Personnel and Development. Available at: https://www.cipd.co.uk/publicpolicy/policy-reports/investing-productivity-unlocking-ambition.aspx [Accessed 19 February 2016].

[4] RESOLUTION FOUNDATION. (2014) *More than a minimum: the Resolution Foundation review of the National Minimum Wage: the final report*. London: Resolution Foundation. Available at: http://www.resolutionfoundation.org/wp-content/uploads/2014/03/More_than_a_minimum.pdf [Accessed 19 February 2016].

The research

In September 2015, the CIPD and the Resolution Foundation launched a joint investigation into how employers planned to adapt to the National Living Wage (NLW). The research comprises two parts. The first – a representative survey of 1,037 employers – offers an overview of how employers across the economy are likely to be affected and how they plan to respond. In particular, the survey allows us to explore the role played by firm size and industry on employer reactions.

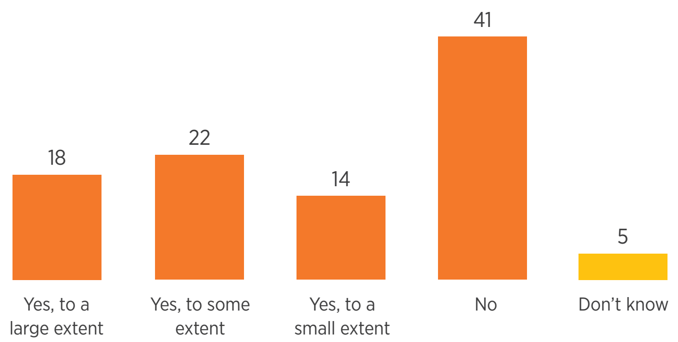
The survey was followed up by 14 interviews with organisations in December 2015 in order to better understand why employers are opting to react in their chosen way. Interviews were carried out to develop a clearer picture of the trade-offs that employers are weighing in the months before the NLW is introduced and the rationale for choosing their path. The respondents were mainly senior staff directly involved in the organisation's decision-making on this topic, primarily in industries that are set to be most affected by the NLW, but also some firms that already pay above the level of the new wage floor.

As with any case studies, these examples should not be treated as representative of all employers or of those in similar industries, regions or of a similar size. In particular, because we have focused on employers in the most affected sectors, it is important to remember that the majority of firms and industries will find the NLW's introduction much more manageable. But the experiences of these employers do provide a timely insight into the options and barriers which employers see open to them in responding to the NLW's introduction.

Over half of employers set to be affected, but clear sectoral differences

The survey reinforces the scope of the NLW. In total, just over half of all employers (54%) said the NLW will have an effect on their wage bill. When asked how large the impact would be, and as Figure 2 shows, 18% expect to be affected to 'a large extent' by the NLW, with 22% predicting they would be affected to 'some extent' and 14% to a 'small extent'. But at the same time, the survey also confirms that for a significant proportion of firms, the NLW will not have an impact. Two in five employers (41%) say that the NLW will not have an effect on their wage bill, with a remaining 5% answering 'don't know'.

Figure 2: Proportion of employers that report that the National Living Wage will increase their wage bill (%)



Base: All employers (n=1,037), private sector (n=754), public sector (n=217), voluntary sector (n=66)

It is perhaps surprising given past Resolution Foundation research[5] that the proportion of smaller organisations that are likely to be affected (44%) is lower than the share of organisations with 250 employees or more (62%). However, and as discussed below, the lower level of awareness of the NLW that was shown by smaller organisations in the case studies may partly explain this.

Consistent with previous research (Resolution Foundation), the survey finds that the NLW is likely to disproportionately affect the wages of those in hospitality, retail and other low-paid sectors.[6] More than three-quarters of employers in the retail (79%), hospitality (77%) and health and social care (68%) sectors reported that the higher wage floor will have an impact on them. Additionally, while almost one in five employers (18%) say they will be affected to a large extent by the NLW, that proportion rises to around one in three in retail (33%) and hospitality (32%) and one in four in health and social care (25%), as Figure 3 illustrates. This contrasts with the professional (3%), education (4%) and information and communication (6%) sectors, where only a small minority of organisations expect the NLW to have a large impact.

The survey then asked employers who responded that they would be affected by the NLW, how they planned to cope with the higher wage bill. Recognising the evidence of the National Minimum Wage's (NMW) introduction,[7] which showed that a variety of responses can be used, employers were given a list of potential responses and permitted to pick up to three which constituted their main reactions. The following sections discuss the most popular responses in depth, using insights from case studies to help illuminate employer perspectives and thinking.

Figure 3: Proportion of organisations that report that the National Living Wage will increase their wage bill to 'a large extent' (by sector) (%)

Base: All employers that report that the NLW will increase their wage bill to a large extent (n=187), private sector (n=158), public sector (n=17), voluntary sector (n=11)

[5] D'ARCY, C. and CORLETT, A. (2015) *Taking up the floor: exploring the impact of the National Living Wage on employers.* London: Resolution Foundation. Available at: http://www.resolutionfoundation.org/publications/taking-up-the-floor-exploring-the-impact-of-the-national-living-wage-on-employers/ [Accessed 10 February 2016].

[6] D'ARCY, C. and CORLETT, A. (2015) *Taking up the floor: exploring the impact of the National Living Wage on employers.* London: Resolution Foundation. Available at: http://www.resolutionfoundation.org/publications/taking-up-the-floor-exploring-the-impact-of-the-national-living-wage-on-employers/ [Accessed 10 February 2016].

[7] METCALF, D. (2006) *On the impact of the British National Minimum Wage on pay and employment.* London: LSE. Available at: http://cep.lse.ac.uk/research/labour/minimumwage/wp1481c.pdf [Accessed 15 February 2016].

Raising productivity a common goal but easier said than done

Three in ten (30%) of those organisations that will be affected by the new higher wage floor plan to raise productivity in response to the introduction of the NLW – the most common response across the survey. However, as per previous evidence and perhaps reflecting the greater resources and expertise they have to seek to make productivity improvements or efficiencies, larger organisations (32%) were more likely to report this than smaller organisations (25%). Figure 4 highlights how responses vary by firm size.

The question this raises is how exactly organisations plan on achieving greater efficiency and productivity. These are, of course, different concepts, and the interviews highlighted that firms' interpretations vary. In common with the survey findings, many of the employers interviewed intend to first try to make their businesses more efficient or their workforce more productive as a way of mitigating the costs of the NLW. The path to achieving this goal looks very different across the case studies, however.

For some, being more efficient means using their staff time better. One nationwide retailer had recently conducted a time and motion study, examining how employees spent their time at work and where there were opportunities to streamline processes. They intend to repeat this exercise, partially in response to the greater premium the NLW will place on wages and therefore staff time. Crucially, though, any time 'savings' identified through the process would not result in a reduction in staffing levels but rather be re-invested elsewhere, shifting staff time onto other tasks designed to improve the customer service experience. Meanwhile, another small healthcare charity is currently looking at work organisation, but this is not in response to the NLW announcement:

We are looking at ways to increase productivity by examining: how it can streamline administration; ways of automating what it does; what it can stop doing because it doesn't add value; and expanding people's roles, so that they can do more. We are also hoping to improve productivity by leveraging economies of scale because the organisation is now a lot larger than it once was.

Some employers have decided to use their more highly skilled staff to a greater extent with less reliance on employees who are seen as less productive, thereby raising their measured productivity. A hotel group that provides extensive training to staff had no plans to cut back on their training expenditure as they see it as fundamental to the customer experience. But in order to maximise that expertise, the group explained how they would rely more on their permanent staff:

Figure 4: Employers' response to the National Living Wage (by firm size) (%)

Base: All employers that report that the NLW will affect them (n=561), private sector (n=420), public sector (n=109), voluntary sector (n=32)

We will more strictly enforce the casual contracts. A casual should be there to be called up to say, 'Look, we've got a big function on the Saturday night, could you do a couple of hours?' And that's what a casual should be there for. We should be able to manage our business with our part-time and full-time employees. ... If someone's a casual or people are in and out of the business, they tend to be less skilled, so if we can focus more on the skilled people, that won't impact our service levels at all.

Rather than any explicit change to practices or training, some employers made the case for their pay and reward strategy as a tool both to boost employee morale, performance and, as a result, productivity. An academy provided an example of how the NLW has served as an opportunity for reflection on its pay structure and the motivating effect it has on employees:

We are slowly moving towards a much more output-oriented organisation. ... Rather than not reward somebody for underperformance, we will reward people for exceptional performance. ... Once you get to that point, you can make the reward bigger and more attractive but fewer people get it. So the budget may not be overly affected by it, but what it does do is it drives performance amongst the workforce to really perform.

Thus, by raising the bonus for excellent staff performance and reducing the amount paid out for average performance, the academy believes it can motivate its staff sufficiently to improve the quality of the work done. This echoed with the experiences of the minority of firms interviewed that already pay above the voluntary Living Wage. One explained that they pay the higher wage rate in order to improve morale and reduce labour turnover: *'The Living Wage Foundation rate might cost more in the short term, but in the longer term it should generate more benefit in terms of lower staff turnover and help us win more contracts'* (support services employer).

At the same time, some organisations can only see marginal productivity gains from such improvements. While somewhat pessimistic about the overall ability of the sector to continue with its current level of funding, one social care provider sees development ladders – making clear the training and competencies needed in order for a small proportion of staff to progress onto higher wages – as one way to motivate staff and improve their performance for a limited number of hard-to-fill roles while coping with increased labour costs. Indeed, both social care providers interviewed expressed a desire to boost productivity and efficiency but without a clear sense of how to achieve it.

For others, however, improving their efficiency or productivity to a large enough extent so as to offset the cost of the NLW seemed unlikely. Indeed, recent CIPD evidence suggests that just one in ten employers have taken the opportunity to review working practices and job design in order to help pay for the higher labour costs from the Government's auto-enrolment pensions scheme through increased performance.[8]

'Rather than any explicit change to practices or training, some employers made the case for their pay and reward strategy as a tool both to boost employee morale, performance and, as a result, productivity.'

[8] CIPD. (2016) *Employee outlook: focus on employee attitudes to pay and pensions: winter 2015–16.* London: Chartered Institute of Personnel and Development. Available at: http://www.cipd.co.uk/hr-resources/survey-reports/employee-outlook-focus-attitudes-pay-pensions-2015-16.aspx [Accessed 10 February 2016].

'Overall, it is encouraging that raising productivity is the most common response among employers, with it being among the most popular reactions across industries.'

For some, such as the owner of a small hotel, decisions taken in years since the recession mean that they would find it difficult to achieve this:

We've done all that before. In order to keep staff, we said, 'We're going through a recession … we need you to do more things.' … I don't think I can get any more out of them to be honest. Most firms, if they've survived the recession, they've already cut back. … Cleanliness is god in a hotel. I'd much prefer that the job gets done properly rather than saying, 'You've got 20 minutes to clean a room.' If I was to do that, I'd increase my customer complaints.

Overall, it is encouraging that raising productivity is the most common response among employers, with it being among the most popular reactions across industries. While gains can certainly be made, and some of the approaches outlined by interviewees align with best practice, the mismatch between the survey responses and the interviews suggests improvements may be modest in the short term. As will be discussed in the next section – and as has been the case with the National Minimum Wage (NMW) – it may be that in the short term firms choose to pay the higher wages required without any notable changes to their operations. As the NLW rises, government and sectoral bodies have a role to play in spreading best practice and helping those firms who are keen to adapt their business model to do so. Interestingly, despite popular fears over robots displacing more and more workers, making greater use of labour-saving technology is not a major focus for almost all of our interviewees. Again, though, as the NLW moves towards its target, we may see firms begin to slowly adapt in such ways.

Taking lower profits as the default option in the short term

According to the survey data, the second most popular response among employers is to absorb the costs or take lower profits. One-quarter of smaller organisations (26%) said they expect to simply absorb the cost, compared with one-fifth of large organisations (20%). While this difference between small and larger employers in the survey is not stark, it is a contrast which re-emerged in the interviews. The smaller organisations contacted tend to be less well informed about the NLW, have a narrower sense of what responses are available to them and are more pessimistic about the possibility of boosting efficiency. Given that in smaller employers the owners or directors tend to fill many roles, including finance and HR, it is perhaps unsurprising that they have had less time to research the issue compared with dedicated departments in larger organisations.

Absorbing the added costs of the NLW was portrayed by many respondents as the default option. In social care, the employers interviewed feel that they have few choices other than to absorb the cost because of the inability of the sector to improve productivity without worsening the care provided to service users. In addition, they report that lower profits or budget squeezes and a squeezing of differentials, with the exception of hard-to-fill vacancies, may be inevitable.

This lack of viable alternatives was also expressed by the director of a small food retail firm. In her view, their scope to increase productivity, reduce staffing levels or raise prices is limited because of the highly competitive nature of the industry and the firm's focus on quality. Therefore, her expectation is that around 80% of the additional cost of the NLW will come from reduced profits.

Similarly, one nationwide retailer interviewed will absorb 100% of the additional costs, largely because of the strong performance of the business over the past 12 months:

Our financial year runs from January to December, so we have budgeted for next year and we have taken the hit. Because our sales are performing very well, we will be taking less profit than what we would have done had this not happened. … Our managing director is determined not to raise prices.

Reviewing other benefits to staff a necessary compromise for some

Among the other most common responses to the survey are plans to reduce an organisation's labour costs beyond the hourly rate paid to staff. Sixteen per cent of employers said they plan to reduce overtime and bonuses, with that propensity greater among services firms (21%). While some employers interviewed have plans to do so, for many it is not among the main responses currently under consideration.

Another common concern raised by the employers in this sample is the focus the NLW will place on the hourly rate of pay rather than the total reward package. This is particularly the case in the hotel sector, with many employers offering discounted accommodation and meals and making use of the accommodation offset under the National Minimum Wage Act. This allows employers to deduct some money from an employee's wage in order to recognise the value of food and board:

I don't think any of this is set up for hospitality to be honest. We offer live-in accommodation for our lower-paid members of staff. Basically it's discounted rent. You can only deduct about £5 a day. I'm sure you'd like to pay £160 a month for all your accommodation and bills. We need to look at what can and can't be included. (mid-sized hotel group)

The hotel group in question had not yet decided how to proceed, as currently only some of their staff live in and benefit from this deduction. Others are considering how to rebalance benefit packages between annual leave, pension contributions and sick pay. For one large retailer which had cut back on its non-wage benefits in response to the recession, the NLW now means it is unlikely to see these restored to pre-crisis levels.

Price rises possible though risky

A lower share of employers (15%) plan to pass the cost of the NLW on to consumers through higher prices. Around one-quarter of smaller organisations (24%) are considering this option, compared with one in ten (10%) large organisations.

This is partly reflected in the case studies, where one smaller employer identified the potential to gain competitive advantage over its lower-cost rivals. For this retailer, the degree to which they can increase prices is directly linked to their business model:

The type of businesses we are competing with online, and particularly other sellers on eBay and Amazon, are low-margin businesses. We have efficient processes which allow us to afford to pay premium wage rates. It may be harder for these types of businesses to absorb the cost of the NLW without putting their prices up, which could be to our advantage. On the other hand, smaller-scale self-traders are more likely to carry on as before and absorb any increased costs themselves.

The experience of recent years is another important factor in determining whether or not firms feel they have sufficient leeway to raise their prices without damaging customer numbers. Another hotelier, who was planning to increase their room rates in order to afford the NLW, feels that, despite this danger, because they are relatively low-cost compared with other similar hotels in the area, they have scope to charge that bit more:

It is a risk but our room rates, when we had the recession, they dropped back to where they were in 2003. And that's where they were until January 2015 and now they've gone up so we can start making a profit. But I think when we compare ourselves with other hotels, we're more affordable. We've borne the additional cost for five years. It's one of those things where you can't absorb any more costs without it hitting the customers. (small hotel)

A focus on how competitors would react is, unsurprisingly, common across many interviewees. For some, this means that they do not intend to raise their prices immediately in response to the NLW but are instead watching closely how other firms in their sector will respond:

In terms of our industry, we have to be careful because people do shop around on price. If we put our prices up, we then might just price ourselves out of the market and none of us would have a job. So we have to be careful in bumping up our prices to cover

'In the private sector, few employers predict job losses in the near to medium term as a result of the National Living Wage.'

[the NLW] because then you're in that downward spiral where we go, 'Okay, we're not that busy so we have to lay off staff anyway.' (hotel group)

This reinforces the fact that employer responses will develop over time, with a number of interviewees making clear that their strategy for April's NLW rise will not necessarily continue to be their approach through to 2020.

This mindset was summed up by a small childcare company who intends to *'follow what is standard in the market'*. This benchmarking against competitors will be an important factor across all the various potential responses, but is likely to be especially key on prices given it is easier to track and is central to performance. For employers in the public sector, the scope to raise prices is limited or non-existent.

Job losses unlikely, at least in the short term

Consistent with other evidence and in line with the UK's experience of the introduction of the NMW in 1999, the survey data suggest that the new rate will have only a modest impact on employment levels. Fifteen per cent of organisations say that they plan to reduce the number of employees through redundancies and/or recruiting fewer workers. Reductions in employment levels are more likely in large organisations (17%) than smaller organisations (10%) and among services firms (21%) compared with manufacturing and production companies (14%).

Something of a sectoral gap emerges, with 21% of public sector employers likely to cut the size of their workforce because of the NLW compared with 13% of private sector employers. The councils interviewed for this report are clear that the NLW is not the only or even the main pressure which could contribute to job losses. Separating out the impact of recent and ongoing consolidation – the 1% cap on annual pay bills placed on the public sector for the next four years, alongside cuts to local government funding – from the NLW is difficult at best. In either case, while there are no short-term plans for job losses within the councils contacted, it is viewed as a greater possibility as the NLW rises higher. The need to cut back on non-essential services offered by councils is seen as likely to have an impact on employment levels:

A local authority might have 27 libraries. Politically, the organisation is going to have a decision to make about whether or not those things are maintained. Because you have a statutory requirement and then there's your optional [services]. So your statutory requirement might be you have to have 20 libraries and they'll have to make a decision about the ones that are over and above. I think that's something that most businesses, not just the public sector, will be looking at. We'll say, 'Right, what do we absolutely have to deliver, what do we need to deliver, and what's nice to deliver?' and then you have to work back from that. (council)

In the private sector, few employers predict job losses in the near to medium term as a result of the National Living Wage. A number of employers described their businesses as already operating with optimal efficiency without negatively affecting efficiency or customer service:

Our business is labour-intensive. So if you start cutting staff, as in making people redundant, that could impact on the guest *experience. So [we'll be] focusing more on our business functionality and ratios and things like that.* (small hotel group)

This is another issue where, rather than resulting in immediate job losses, it may have an impact on recruitment and the pace of employment growth than in a counterfactual world without the NLW.

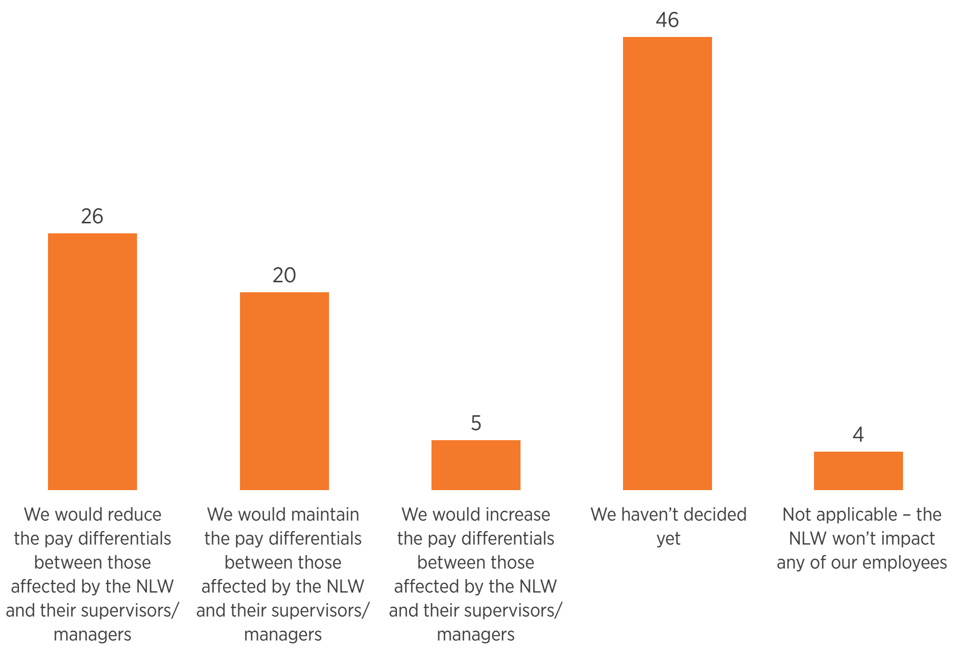
NLW will make managing differentials more challenging

Almost one in ten employers (9%) plan to reduce the basic pay growth rate for the rest of the workforce. This suggests that the modest upward pressure that the NLW will have on wages may be offset by the downward pressure it may place on total and basic pay growth; that is, while it may boost the pay of the lowest earners, it could be slightly lower for those on higher wages. This is broadly consistent with the Bank of England's recent estimate that the National Living Wage will increase average annual wage growth by less than 0.1 percentage points, and may not boost wage growth at all, especially against the backdrop of other higher labour costs such as the Government's auto-enrolment pension scheme and the apprenticeship levy. However, wage growth inflation will also depend on the extent employers will seek to maintain the differentials of those already earning above the new wage floor with those who stand to benefit from it (see Figure 5).

In calculating the costs of the NLW, some firms may consider more than just those staff who currently earn less than the new wage floor. Because of the size of the increase this April, a question for firms is whether to offer a similar pay rise to staff earning a little more than £7.20 per hour. The survey data indicate that the NLW could increase the wages of many employees already earning more than the NLW. Around one-fifth (20%) of employers who expect to be affected by the NLW report that they wish to maintain pay differentials among employees. On the other hand, the survey finds that more than a quarter (26%) say that it will reduce pay differentials between those affected and their supervisors or managers.

It is perhaps no surprise that almost half (46%) of employers who expect to be affected by the National Living Wage do not yet know what impact it will have on pay differentials within their organisation, so there is still considerable uncertainty over what the effects will be. Again, evidence on the NMW's impact is a useful tool, showing that employers adapted slowly to the introduction of the wage floor.[9]

Figure 5: Pay differential changes between those directly affected by the NLW and their supervisors/managers (%)



Base: All LMO employers who said the higher minimum wage will increase their organisation's wage bill (n=461)

[9] RESOLUTION FOUNDATION. (2014) *More than a minimum: the Resolution Foundation review of the National Minimum Wage: the final report*. London: Resolution Foundation. Available at: http://www.resolutionfoundation.org/wp-content/uploads/2014/03/More_than_a_minimum.pdf [Accessed 19 February 2016].

Most employers in our case studies said that there would be a narrowing of the pay gap or differential between their lowest-paid workers and those on slightly higher pay. This is because it is seen as unaffordable to pass the full NLW increase onto higher-paid staff, or even coming close to the 7.5% increase it represents.

For some employers, this is a continuation of a long-term trend that began with the introduction of the National Minimum Wage. The HR director of a hotel group explained how the introduction of a legal wage floor had affected their differentials:

We've only really done what we needed to do in terms of the National Minimum Wage increases. That means that now our wage structure is not so much a structure, more of a wage.

Meanwhile, for those employers that are looking to pass on at least some of the NLW increase to higher-paid staff, deciding exactly how much to pass on is a difficult process. In addition, finding an acceptable balance between affordability and staff satisfaction presents risks on both sides. In the case of an academy, it is consulting with affected staff and sees three options available:

The first option is we don't worry about the compression and we let it happen. We say to people, 'As long as you're being paid fairly for the job that you do, why would you worry about what somebody who is less-skilled than you is paid?' So it's about your personal desires, as in: 'Ask yourself, is what we're paying you the right amount of money for the job that you do?' ... The real issue for us is maintaining a level of differential such that the people that are more highly skilled feel that they are being properly recognised for those skills and qualifications but without making that differentiation unaffordable.

The other options are to pass on some of the increase, either by adding a nominal percentage, for example 1% above the NLW to £7.27, or alternatively, a nominal cash figure, for example 5p or 10p. In the case of the academy, they were about to enter into consultation with staff at the time of the interview, but the expectation is that some gap will be maintained.

For employers with more highly unionised workforces, the decision around differentials has to be taken in negotiation with unions. The employers who are in this situation had yet to enter into official talks with the unions representing their employees, but there is an optimism that an acceptable middle ground between entirely eroding differentials and passing the full increase on can be found.

Among those organisations that are looking to increase pay for those employees paid above the NLW, there are some exceptions to the squeezing of differentials. One online retailer that already pays above the NLW explained that the policy would cause them to boost their pay in order to retain their position as an above-average employer, thereby capable of attracting the best staff. Similarly, in the case of low-paid but hard-to-fill positions, some interviewees feel they have no option but to pass on almost the entirety of the NLW increase to higher-paid staff. These examples will be discussed in greater detail in the section on additional issues faced by employers.

However, there are other organisations that see the NLW eroding their competitive advantage over their rivals from a recruitment and retention perspective.

We always try and pay more than other employers pay for equivalent jobs, and unless we keep pace, the gap between what we offer and [what] other organisations offer will narrow and we could have more difficulty recruiting and retaining staff. Two and a half years ago we received 1,500 applications for two picking and packing roles in our warehouse. We recently advertised to fill similar roles and received between 60 and 70 applications, suggesting that the jobs market is getting tighter. (online retailer)

We are competitive with our rates of pay at the distribution centres compared with our competitors, but the NLW will erode this advantage to some extent. (large retailer)

Beyond attracting and keeping staff, the necessary squeezing of differential resulting from the NLW also struck some employers as making progression more of a challenge:

Everybody who's in housekeeping will have a pay rise up to the NLW, but then I've also got a couple of supervisors who might say, 'Oh well, for the difference between our pay I might as well go back to being in housekeeping and not have the responsibility and have a pay rise as well.' (small hotel)

This experience reflects the finding of Resolution Foundation analysis of progression among low-paid workers that small pay increases between roles acts as a disincentive to progress.[10]

[10] D'ARCY, C. and HURRELL, A. (2014) *Escape plan: understanding who progresses from low pay and who gets stuck.* London: Resolution Foundation. Available at: http://www.resolutionfoundation.org/wp-content/uploads/2014/11/Escape-Plan.pdf [Accessed 10 February 2016].

Hiring under-25s not seen as a sustainable answer for most

One of the major shifts in the move from the NMW to the NLW is the changing of the age threshold. Whereas the adult NMW applies to those aged 21 and over, the NLW sees that rise to those aged 25 and over. The fear that some employers may prefer younger, cheaper workers over their older counterparts is not reflected in the survey findings or the case studies, although there are concerns that rival firms might be tempted to hire younger workers. Fewer than one in ten said they would do this (8%), while a similar proportion of employers say they will hire more apprentices (8%). The key reasons for this are meritocracy and the need to fill roles with experienced staff, according to the interviews with employers. As one small healthcare charity explained, *'Because of the need for experienced staff, it would be difficult to employ more people aged 25 and under.'*

From a productivity perspective, one hotel group sees hiring younger people as a short-sighted perspective:

The way we recruit is if they've got the skills and they can do the job, we're going to take them on. Because we find it so hard anyway, there's not a specific strategy because that could damage our business – then we might have to employ two under-25s to do the job of one over-25. So basically it's a case of we're just going to recruit to fill the position.

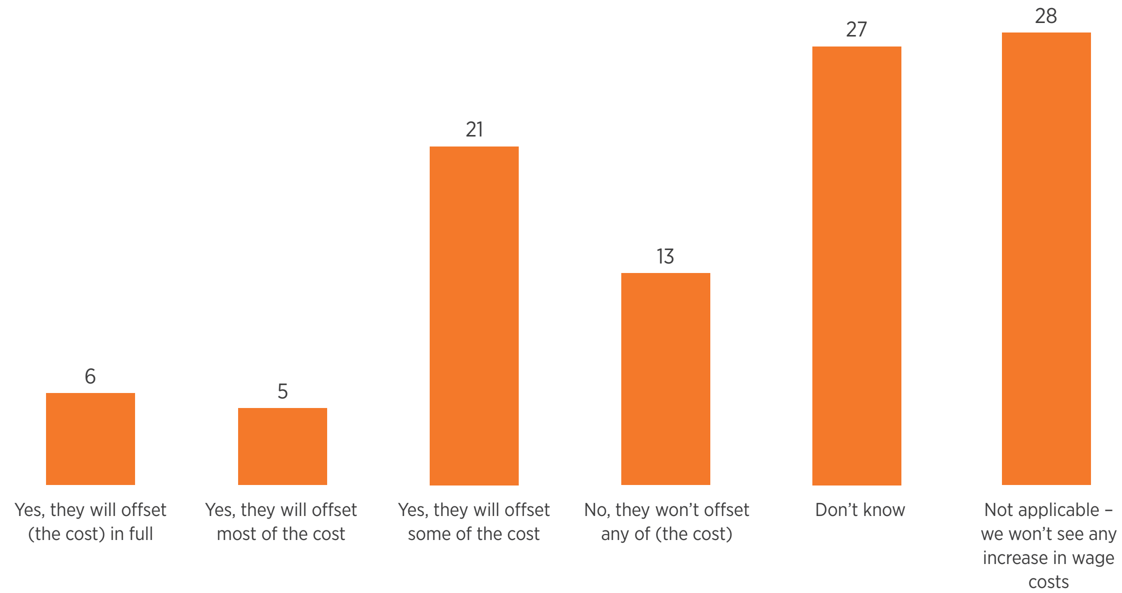
Despite this overall view, the group intend to operate two pay levels once the NLW is introduced: £6 per hour to those aged under 18 and £7.20 per hour to those aged 18 and over. Although many already pay workers aged 20 and over the age-appropriate rates, the application of the NMW solely to workers aged 21–24 proves more controversial.

However, many employers acknowledge that as the NLW edges towards £9.00 an hour by the end of the decade, they may be forced to re-assess their approach. But even for those who are more open to this possibility, the same concerns expressed above regarding the long-term wisdom of such a strategy were shared. This supports the evidence since the NMW's introduction, with the employment rate of younger workers not dramatically affected. Although international evidence highlights the potential for some effect on workers just over the threshold,[11] together these employer preferences and past experience suggest that there will not be an upsurge in firms hiring young workers.

Policy changes perceived as providing some relief

The data suggest that a section of firms see a connection between the NLW and other changes to taxes and National Insurance

Figure 6: The extent to which the proposed cuts to corporation tax and National Insurance will offset the National Living Wage (private sector only) (%)



Base: All private sector employers (n=754)

[11] KABÁTEK, J. (2015) *Happy birthday, you're fired! The effects of age-dependent minimum wage on youth employment flows in the Netherlands.* IZA DP No. 9528. November. Bonn, Germany: IZA. Available at: http://ftp.iza.org/dp9528.pdf [Accessed 16 February 2016].

'Around a third of employers (32%) think that cuts to corporation tax and National Insurance will offset at least some of the extra wage costs.'

contributions. Around a third of employers (32%) think that cuts to corporation tax and National Insurance will offset at least some of the extra wage costs, though only around one in ten say the tax cuts will offset most or all of the increased costs. However, reflecting the fact that many employers have yet to fully assess the impact of the range of taxation changes, just over a quarter of employers (27%) were unable to give a response. Additionally, very few, if any, of the employers interviewed have factored these changes into their budgets for the financial year ahead. Indeed, when discussing other policy changes, the most commonly cited were those which add to wage bills, including auto-enrolment into workplace pensions and the apprenticeship levy, although the latter is set to affect only larger firms.

Lack of clarity makes forward planning more challenging

A consistent source of concern among the respondents is the lack of information about the pace of the increases in the NLW, its relationship to the NMW and whether additional support would be forthcoming in order to help firms adapt to the higher-paying model. This varied from a lack of knowledge around whether the legal rate would actually be uprated annually between £7.20 and £9 to a more general lack of clarity around the trajectory and how fixed it is. A comment made by almost all respondents regards the confusion surrounding several different rates with similar names: the National Minimum Wage, the National Living Wage and the Living Wage. Subsequent to the interviews conducted for this report, the Government launched a campaign to raise awareness of the NLW, which should help employers.

Concerns on non-compliance

Despite this terminological confusion, all the interviewees are clear they will be paying the NLW themselves. That said, there are doubts for some about how widespread compliance will be. In the opinion of the director of a childcare company, there are currently a high number of workers in the sector who are already being paid below the NMW. In their view, this is being driven from both the demand side – for example, client requests for nannies that do 65 hours per week for 'as little money as possible' – as well as the supply side – some workers are 'willingly' signing employment contracts that state a gross hourly rate of around £6 per hour.

A specific loophole in the childcare sector that the owner felt should be addressed is the classification of nannies as au pairs – a class of worker to whom the NMW does not legally apply – in order to avoid having to pay the legal minimum, despite the fact that the au pairs are often not involved in education or training and are working well in excess of the recommended 30 hours per week set out in legal guidance on the distinction. The firm's view is that enforcement should be more stringent with better communication, especially to raise the low levels of awareness of the new laws among foreign nationals that employ domestic workers.

Conclusion and recommendations

The findings of this report confirm that a significant share of firms will not be affected by the NLW, or will face only a small increase in their wage bill. At the same time, it is clear that for some employers, particularly those in low-paying sectors, the NLW will raise their labour costs considerably. Both the survey and the case study interviews show that, for most employers, cuts to employment levels are seen as either undesirable or impossible. The emphasis from many is on improving productivity. Yet the employer interviews suggest that delivering these productivity gains will prove challenging. While a number of employers had clear plans on how to get more out of their business or employees, others were less sure how to be more efficient, while some questioned the potential for any gains. For many, absorbing the added costs of the NLW was seen as the default approach in the short term with more meaningful adjustments to their business model being seen as possible and more necessary as the NLW increases.

Improving workplace productivity, particularly in low-paying sectors, has rarely had any prominence in the many government strategies and plans published to boost national productivity, growth or competitiveness. Much the same can be said about the Government's productivity plan published just after the Summer Budget. Including these low-paying sectors in discussions and thinking on raising productivity will be crucial in light of the NLW. While there is no 'magic lever' for government to pull, the fact that other advanced economies achieve higher productivity in these low-paying sectors suggests that some gains are possible.[12] Government focus has long been on increasing the supply of skills and levels of qualifications, but much less attention has been given to how effectively those skills are used in the workplace. There needs to be a coherent strategy on improving workplace productivity, which includes a focus on providing more support for SMEs to encourage and enable them to invest in building their people management capability (see Box 1 for one approach to this issue).

In terms of predicting how employers will adapt to the NLW, though certain trends do emerge between different industries and firm sizes, there is still much variation. The data suggest that SMEs are more likely to simply absorb the cost and reduce the pay differentials between employees than large organisations. On the other hand, large employers are more likely to

Box 1: CIPD pilots

SMEs are responsible for 60% of private sector employment in the UK but most will never have been involved in any government skills initiative and will lie outside formal supply chains and existing SME networks. At a local level there needs to be much greater emphasis on the provision of high-quality HR support, advice and guidance, driven by clear leadership from bodies such as Local Enterprise Partnerships, Business Growth Hubs and local authorities. More local business support hubs need to be created to provide hard-to-reach SMEs with cost-effective and easy-to-find advice and support to improve their people management capability, as well as to access available public skills funding and high-quality training to get the most from their people and grow. The CIPD has, with funding from J.P. Morgan, been piloting schemes in Hackney, Stoke and Glasgow providing high-quality HR advice and support for small businesses using a combination of face-to-face, telephone and online support. It is important that insights from schemes such as this inform thinking about what support might be sustainable longer term to enable small businesses to raise their ambition and productivity levels.

[12] See the discussion of retail sector productivity on pages 11 and 12 of: CIPD. (2015) *Productivity: getting the best out of people.* London: Chartered Institute of Personnel and Development. Available at: https://www.cipd.co.uk/publicpolicy/policy-reports/productivity-getting-best-out-of-people.aspx [Accessed 19 February 2016].

seek productivity improvements and make efficiencies. An important if obvious factor determining employers' responses is their recent performance, with those reporting growth in the past year tending to require a less comprehensive range of responses.

Government as a source of information

- **Continue to engage with employers to improve awareness.** Surveys of employers show mixed awareness of different minimum wages and the timetable for rises. More importantly, most firms appear still to be in the process of deciding how to deal with those rises. As much information as possible at this stage could help employers make better-informed decisions. Building on the evidence base developed by the Low Pay Commission, the CIPD, the Resolution Foundation and others, the Government should therefore develop a picture of the areas and sectors in which the NLW is likely to prove more challenging, publish this and use it as a basis for dialogue with stakeholders.
- **Help firms, particularly SMEs, who are keen to boost productivity.** This report has underlined that employers are keen to be more productive and efficient but are often unclear on how to achieve that goal. The CIPD has been piloting schemes providing high-quality HR advice and support for small businesses using a combination of face-to-face, telephone and online support. It is important that insights from schemes such as this inform thinking about what support might be sustainable to enable small businesses to raise their ambition and productivity levels.

Government implementation, enforcement and funding

- **Boost enforcement.** With a higher wage floor, the incentive not to comply with the NLW grows. This government and the previous administration have increased the fines payable and naming-and-shaming of non-compliant employers, but our report has highlighted that concerns remain in specific sectors including childcare.
- **Increase funding of social care.** The social care sector has long been highlighted as a potential source of non-payment of the minimum wage. The Autumn Statement introduced some potential additional funding into the sector by giving local authorities an option to increase their council tax by up to 2%, provided the proceeds were used to fund additional social care. Feedback from local authorities suggests this may not be enough on its own to meet funding gaps and provide for better pay and working conditions in the sector.
- Align the timing of the annual uprating announcements of the National Living Wage and the National Minimum Wage to the same month each year.
- Ensure that the current business rates review takes account of the impact on the retail sector at a local level.

Focus on progression

- **Making the most of Universal Credit.** The introduction of in-work conditionality in Universal Credit could potentially be used to help low-paid workers into better-paying positions. As it currently stands, however, it would appear to be a missed opportunity: the in-work conditionality element is only set to encourage UC recipients into full-time positions at the NLW, and is likely to focus efforts on expanding claimants' working hours rather than their potential to earn more each hour. With a greater focus on skills, training and development, it may be that the UC can help workers progress onto higher wages.

A focus on local labour markets

- **Explicitly making this the focus of new devolved economic leadership.** This process should not wait for new mayors to be elected in 2017, but should receive a boost at that point. It should also benefit from the involvement of local businesses through LEPs at the city level.
- **Focus on productivity.** City leaders should be using existing and new devolved powers to encourage firms to change how they do things rather than just coping with higher wage bills. That means supporting firms to invest in new equipment, training and ways of working.

Continued importance of the Low Pay Commission

- **Maintain the Low Pay Commission's central role.** The LPC has proved an excellent steward of the NMW since its introduction and remains the right body to make specific recommendations on the evolution of the NLW and to monitor its impact. Government should ensure that its remit includes an explicit requirement to consider the impact of the NLW on different regions and industries as the NLW rises over the course of this Parliament.

Appendix: Employer case studies

Recent evidence suggests that the National Living Wage is likely to disproportionately affect the wages of those in certain sectors, such as hospitality, retail and social care (Resolution Foundation).[13] In order to better understand the overall impact of the National Living Wage on employers that are likely to see a significant impact, and why they are opting to react in their chosen way, 14 semi-structured interviews were conducted with organisations between 1 and 18 December 2015.

The respondents were in the main senior staff directly involved in the organisation's decision-making on this topic, primarily in industries that are set to be most affected by the NLW, but also some firms that already pay above the level of the new wage floor. The summaries set out in this section are anonymous in accordance with the wishes of the employers we interviewed for this study.

As with any case studies, these 14 examples should not be treated as representative of all employers or of those in similar industries, regions or of a similar size. In addition, it is important to remember that the majority of firms and industries will find the NLW's introduction a much smaller challenge compared with the employers we have focused on in this study, who are all drawn from the most affected sectors. However, the experiences of these employers do provide a timely insight into the options and barriers which employers see open to them in responding to the NLW's introduction and subsequent annual increases.

[13] RESOLUTION FOUNDATION. (2015). *Taking up the floor: exploring the impact of the National Living Wage on employers.* London: Resolution Foundation. Available at: http://www.resolutionfoundation.org/publications/taking-up-thefloor-exploring-the-impact-ofthe-national-living-wage-onemployers/ [Accessed: 19 February 2016]

Social care/healthcare

The challenges in meeting the increase in labour costs are arguably greatest in the social care sector given the high proportion of staff that will be affected by the increase and the budget constraints in the sector.

The Resolution Foundation has estimated that between 51% and 64% of front-line care workers will be directly affected by the NLW, equivalent to a pay rise for between 850,000 and 1 million workers. The average annual wage rise for those directly affected is projected to be £1,250. Based on that analysis, the NLW is expected to increase payroll costs (wages, employer National Insurance and pension costs) across adult social care by £2.3 billion by 2020. The social care precept announced at the Autumn Statement 2015 is expected to cover only a small percentage of these additional costs, with higher funding not always being possible in the areas it is most needed because of the relative prosperity of the area. The Low Pay Commission has repeatedly flagged the risk of non-compliance with the NMW that social care presents, with the NLW set to only exacerbate this situation.

In addition, the *Whittlestone v BJP Home Support* judgment, which established the right of care workers to be paid for 'sleepover' shifts, looks set to increase labour costs further. It is perhaps no surprise that some of the social care providers in this study offer a particularly bleak outlook for the future of the sector, with the aim being to survive until 2017 and hope that the Government boosts funding.

A medium-sized social care provider in the voluntary sector

'The extra labour costs mean that providers are gradually going bankrupt, though some may go bust faster than others.'

Background

The social care provider has been in existence for over a quarter of a century. It has an annual turnover of just under £5 million and employs 290, mainly full-time, workers. Two-thirds of its employees (predominantly female across all age groups) are care staff working directly with service users, such as the elderly with care needs, who can have a wide range of requirements.

Up until July 2013, the organisation was financially stable. By careful management, the charity had been able to absorb the increases caused by the recent uprating of the National Minimum Wage and the Government's automatic pension enrolment scheme. However, the impact of the *Whittlestone* judgment, when care workers who 'sleep over' became eligible for the National Minimum Wage, has meant that sleep-in employment costs have almost doubled, adding £200,000 to the pay bill.

The new National Living Wage (NLW) will increase costs further, and there is now very little left to cut. The employer thinks that the NLW is a good idea; it just needs the money to pay for it. Overall, 85% of total costs are payroll costs. The provider reports that other providers face similar challenges. According to the director of this organisation: *'The extra labour costs mean that providers are gradually going bankrupt, though some may go bust faster than others.'*

The NLW has been discussed both at board and senior management team levels. The impact of the NLW is to add another £177,000 on payroll. However, by already finding savings, it has reduced the annual impact to £120,000 from April 2016. Against the backdrop of other higher labour costs, such as the Government's auto-enrolment pension scheme and the *Whittlestone* judgment, the new National Living Wage will mean that the organisation will lose money.

Looking ahead, the plan is to reduce costs to a minimum in an attempt to reduce the speed at which the employer goes out of business. By making the cost reductions that it has, it believes that it can survive until 2017, when, hopefully, the Government will have found enough money to ensure the financial sustainability of the social care sector.

Options

Because of previous economy drives, there is little potential to further improve productivity; nor is it able to increase its prices to local government (though if local councils raise their council tax in order to pay more for social care, that will help providers). Investment (such as in training) and expansion plans have also been cut.

In addition, it is 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. While the organisation would like to employ more workers aged 24 and under and apprentices, this is more to do with the talent pipeline than a deliberate policy to cut costs.

Pay and conditions have already been cut back: the organisation now pays only basic overtime rates and pays only the minimum pension contribution. It is not possible to restrict the amount of overtime as that is client driven. Future wage growth will therefore be reduced as will pay differentials. The organisation has adopted this approach because it hopes that by 2017 the Government will intervene before the sector collapses.

A small social care provider in the voluntary sector

'We are looking at ways to increase productivity by examining how we can streamline administration, looking at ways of automating what we do and stopping what doesn't add value. We are also looking to expand people's roles, so that they can do more. We also hope to improve productivity by leveraging economies of scale because the organisation is now a lot larger than it once was.'

Background

Since being set up just four years ago, this children's hospice has grown from six employees to just under 100. Half of these employees are care workers (such as qualified and part-qualified nurses, therapists and counsellors) whose pay and conditions follow that of the NHS, which is their main competitor for these kinds of employees. The rest of its staff work predominantly in fundraising and in the retail shops, with a few in central service functions, such as HR, marketing and finance. In addition, there are around 300 volunteers who help in the hospice and its shops. The people who'll see their pay increase with the introduction of the National Living Wage (NLW) will be assistant shop managers, housekeepers and cleaners.

Overall, the hospice raises £3.8 million from donations, 60% of which comes from the Government. Around 94% of all operating costs come from fundraising. In business performance terms, because the organisation is relatively new, it is difficult to judge its performance against other longer established hospices. It also competes and has to mirror its pay and conditions with the NHS for employees. The charity sees itself as focusing on quality. However, it acknowledges that in the past it has under-invested in capital and that it now plans to move from being a people-focused investor to more of a capital-focused investor as it invests in new technology and processes.

The organisation forecasts that the NLW will increase its payroll costs by £25,000 a year on top of a payroll bill of £2.5 million, or 0.1%. While the cost increase is relatively small, the extra money still has to be found.

Response to the National Living Wage

In order to respond, it is drawing up a plan that will allow the charity to pay the new rates. While the issue has so far not been discussed at trustee-board level, it has been at senior management team level and an action plan agreed. The action plan will look at how the impact of the NLW on the cost base can be mitigated.

At the moment, the plan is to put more effort into fundraising to grow income, increasing the number of volunteers and looking for cost savings. Currently, it has not determined where these costs savings will be found, but the charity anticipates they'll be efficiencies that can be achieved in support services.

Options

The organisation is looking to reduce pay growth and productivity to offset the higher cost of the National Living Wage.

As the HR director of the organisation explains, it is looking at a variety of ways to improve productivity levels: *'We are looking at ways to increase productivity by examining how we can streamline administration, looking at ways of automating what we do and stopping what doesn't add value. We are also looking to expand people's roles, so that they can do more. We also hope to improve productivity by leveraging economies of scale because the organisation is now a lot larger than it once was.'*

In addition, it is looking at reducing the rate of basic pay growth for its support staff and the pay differentials between those affected by the NLW and their supervisors/managers.

In common with other social care providers from the voluntary or public sector, the organisation reports that it is hard to cut operating costs further because these have been kept to a minimum and it has no profits to reduce or prices to raise.

Price rises are not an option because the charity doesn't charge for its services. Furthermore, as it is growing, it is not able to cancel or scale back its expansion plans. Reducing the amount of overtime is also difficult because the operations are small and what little overtime there is is reactive and depends on the nature of the care required. While employer pension contributions are a significant cost, it is not possible to reduce them because they have to offer the NHS pension in order to attract and retain care staff.

Overall, the organisation has little room for manoeuvre because it does not want to lower its standards or its levels of care. Other options, such as reducing the number of workers, employing cheaper, younger workers or cutting back on training expenditure are therefore discounted.

A medium-sized social care provider in the private sector

'Everyone in the sector is surprised by how quickly it has come in. A lot of people think that it is the right thing to do in principle, but it clearly has a different impact on different sectors, and in different geographies; having one living wage for Newcastle and London, for example, where the circumstances are completely different, is difficult to understand.'

Background

This social care provider employs staff across the UK in elderly and dementia care and care for those with learning disabilities. The company frequently compares its pay rates with its competitors and has already carried out detailed analysis of the future impact of the NLW. The analysis suggests that the National Living Wage will have 'a significant impact' as far as costs are concerned within its front-line staff population. The company will consider how and whether to take account of the impact on differentials between those that will be affected directly by the NLW and the rest of the workforce.

Response to the National Living Wage

'Speaking to colleagues in the [social care] sector, the National Living Wage could mean the difference between some operators achieving small margins or not making any money at all.'

The company says its capacity to respond to the wage bill increase is severely limited by the fixed income it receives from local authorities. Local authority fee increases over the last ten years have already fallen well short of the cost of doing business within the sector. Given the statutory obligations of the sector, the HR director of the firm believes that the firm has no option other than to accept lower profits. He also warns that the impact of the National Living Wage may reduce any profits in some social care organisations further to a point where this will not be sustainable in some cases.

Attitude towards government policy

'It is the right thing to do. But it is the pace of change, and the one-size-fits-all approach, which are the biggest challenges. A further example here relates to the over-25 stipulation for the NLW to apply. If we approach a 24-year-old who is one of our star performers, and we assess them on knowledge and competencies, why would we pay them less than a 25-year-old who is an average performer? … It [age] is such an arbitrary criterion.'

The company has reservations about the speed with which the NLW has been introduced, the limited range of options available to social care providers in seeking to fund the National Living Wage and the performance management implications of the change. It is also unsure about the number of local authorities that will introduce a 2% levy on council tax to fund social care, a policy that was announced in the Government's 2015 Spending Review.

On the upside, it recognises that the policy may have 'attraction and retention benefits' in the sector and it will be partly offset by the changes to corporation tax and National Insurance contributions. However, these will *'not come close to mitigating the cost of the National Living Wage overall if implemented in this way and within the planned timescales'.*

Retail

A small food shop

Background

This small food shop that caters to the higher end of the market employs four full-time staff members and two weekend employees (both under 20) in addition to the owner. Over the busy Christmas period, one additional member of staff is added on a zero-hours contract. The business is doing 'exceptionally well', with 10% growth in sales in 2015. All staff members are currently paid above the NMW, with those staff who have worked in the shop longer paid more to recognise their length of service as well as their expertise. However, the business currently pays one of its employees at a lower rate than it otherwise would because any pay rise would be counter-productive as it would lead to the employee receiving a lower tax credit award.

Response to the National Living Wage

The owner didn't feel well informed as to the impact of the NLW, recalling that she remembers *'lots of political nonsense around it'.* On a personal level, the owner was supportive of the idea of a higher minimum wage. The impact of the NLW on the business will be relatively insignificant in 2016, but will be very significant by 2020. Currently, the business makes a profit of around £1,000 a month. This constitutes the owner's salary, with the business described as 'lean'. The owner estimated that the NLW will all but wipe out this profit by adding around £10,000 to the business's annual wage bill. As well as the direct impact on the wage bill, auto-enrolment will also mean the business pays towards its staff's pensions this year.

The owner thinks that the scope for increasing productivity, reducing the amount of overtime worked or raising prices in response to the NLW is limited. The food retail sector is highly competitive and the shop's customers are incredibly knowledgeable of the value of the products that they buy. Therefore, her expectation is that around 80% of the additional cost of the NLW will come from reduced profits.

The owner felt that the impact of the NLW may even lead to the sale of the business, potentially representing the *'straw that breaks the camel's back'.* One potential solution to the much-reduced profits could be to hire more staff aged under 25, although the owner doubted whether this would be possible, or prove sustainable in the long run.

Squeezed differentials harming pay progression

An important consequence of the NLW from the perspective of the shop is that maintaining pay differentials will be a challenge. Currently, the highest-paid member of staff earns £1.25 more per hour than the lowest-paid member of staff. In the owner's opinion, this allows them to recognise the added value their best employees bring and is valued by staff members. The ability to increase someone's pay over time is seen as a key part of the employee–employer relationship.

However, the owner expects that the NLW will mean they are unable to maintain any differentials between staff members as it will be unaffordable. They fear that 'something will be lost' in not being able to offer this in future.

'We are in wait-and-see mode. We would be foolish to think this will not have far-reaching implications. We will react as we need to when they appear.'

A small online retailer

Background

The Bermondsey-based business already pays above the current London Living Wage, but the finance and business development manager thinks the business could face pressure to increase pay rates if the introduction of the National Living Wage undermines its premium position in the jobs market.

The firm employs 13 people on permanent contracts and will take on about seven temporary staff in the run-up to Christmas, its busiest time. It has a number of roles in business development management, customer services, marketing and sales, with the remaining jobs in operational roles within its warehouse, for example picking and packing. It currently pays its warehouse operations staff about £18,000 a year for 37.5 hours and its temporary staff £9.15 per hour.

The company, which is managed by friends and has a family ethos to it, currently pitches its lowest pay rates at above the London Living Wage and has quite a flat structure – where the difference between the bottom and the top is much less than in other firms.

Response to the National Living Wage

The business does not envisage increasing its focus on employing younger workers as it already employs a number of staff aged under 25. These are recruited on merit for the role advertised.

However, the finance and business development manager does think the NLW, together with the Government's auto-enrolment pension scheme, could increase the employment premium for younger workers in the labour market by making them significantly cheaper to take on. He is concerned that people aged 25 and slightly older could lose out because they are expensive but many won't have a lot of experience:

'These financial incentives fly in the face of diversity. People who are slightly over the age threshold will probably lose out because they will be more expensive (than younger workers) to employ and many won't have much work experience,' he said.

Looking ahead the business has ambitious growth plans. The finance and business development manager expects the business to realise revenue growth of between 40% and 50% for the 'next few years', which will require it to recruit more people, particularly into operational roles in its warehouse. The business is also exploring the potential of creating pop-up shops in the high street, where the finance and business development manager thinks its business model will enable it to pay above-average wage rates for staff. To underpin its growth plan, the company is planning to continue its investment in staff training and formalise this so that it becomes more structured. The finance and business development manager believes that paying staff competitive rates of pay means that the company gets better return on any training investment as people stay longer.

He said the business will remain vigilant to any knock-on effects of the National Living Wage. *'We are in wait-and-see mode. We would be foolish to think this will not have far-reaching implications. We will react as we need to when they appear.'*

Maintaining pay differentials

This online retailer believes the introduction of the new National Living Wage could force it to raise pay rates to maintain its advantage in the jobs market and recruit and retain quality staff:

'We were aware of the proposed change as soon as it was announced by the chancellor and our initial reaction was that it would have little effect on us as we pay higher than the new National Living Wage anyway. However, I've since had a chance to reflect and I think this could well have a knock-on impact in the longer term.

'We always try and pay more than other employers pay for equivalent jobs and, unless we keep pace, the gap between what we offer and what other organisations offer will narrow and we could have more difficulty recruiting and retaining staff. We have already seen a change over the last two years in the jobs market with fewer applicants per role. Two and a half years ago we received 1,500 applications for two picking and packing roles in our warehouse. We recently advertised to fill similar roles and received between 60 and 70 applications, suggesting that the jobs market is getting tighter.

'We will carry on as we have in terms of what we pay for the time being and we will react to the introduction of the NLW if it is making it harder for us to recruit and retain staff, if the cost of living soars, or if we see changes to selling patterns across our own websites as a result of how our competitors respond, which is difficult to predict.

'The type of businesses we are competing with online, and particularly other sellers on eBay and Amazon, are low-margin businesses. We have efficient processes which allow us to afford to pay premium wage rates. It may be harder for these types of businesses to absorb the cost of the NLW without putting their prices up, which could be to our advantage. On the other hand, smaller-scale self-traders are more likely to carry on as before and absorb any increased costs themselves.'

A nationwide retailer

'Our financial year runs from January to December, so we have budgeted for next year and we have taken the hit. Because our sales are performing very well, we will be taking less profit than what we would have done had this not happened.'

Background

This major retailer comprises two brands and employs around 16,000 people in the UK. The smaller of the two brands has a discount pricing strategy, while the other brand has a value strategy. The majority of employees are employed in the retail stores, with the remainder employed either at the company's two distribution centres or at the company's head office.

The firm describes itself as a 'balanced investor'. On the one hand, the need to maintain strict control over costs is the most important priority for the firm. For example, the company has not reversed the cuts to sick pay and annual leave arrangements that were made in 2009 in response to the recession. The decision not to restore these cuts is due, in part, to the recent annual increases in the National Minimum Wage. On the other hand, the firm continues to make a 'substantial investment' in key strategic projects, such as the website. Both businesses are doing 'incredibly well', according to the two measures the organisation uses to assess performance: sales and profits.

Employees are employed under a variety of employment contracts in different parts of the organisation, including some atypical employment contracts. Around 40% of workers at the distribution centre are agency workers. At the same time, a very small proportion of people are employed under short-hours contracts that guarantee workers four hours a week. However, in order to improve its labour turnover rate, the firm is now looking to increase the minimum number of hours it guarantees its staff to more than 12 hours. The remainder of the workforce are employed under a permanent contract.

Impact of the National Living Wage

The National Living Wage will have a disproportionately large impact at the 350 stores of this discount chain, where 90% of workers are employed at the current National Minimum Wage rate. The only exceptions are 18–20-year-olds and apprentices, who are paid above their respective National Minimum Wage rates. Consistent with the rest of the workforce, the salaries of managers are in the lowest quartile for the sector.

Meanwhile, the larger brand has three 'location rates' for the lowest-paid workers, the lowest of which is the National Minimum Wage. The other two rates are at stores in big city centres, where the lowest-paid workers are paid just above the National Minimum Wage rate, and in Central London, where the lowest-paid workers are paid an hourly rate between the NMW and the NLW. Both brands offer good bonuses.

Additionally, it reports that it is competitive with its rates of pay at the distribution centres that serve both chains, but the NLW will erode this advantage to some extent. It also considers itself in a minority in the sector because the majority of firms pay one flat National Minimum Wage rate across all the different age groups.

Response to the National Living Wage

The decision to absorb the cost has been taken because the managing director is 'determined' that the National Living Wage will not impact on prices. The company's potential response to the NLW in April 2016 is thus limited 'compared with other firms' because of its pricing strategy. As a result, the company will simply absorb the 6.5% increase to the pay bill for 2016.

In addition, the firm plans to introduce a time and motion study next year to make productivity gains; this will build on an exercise conducted earlier this year that sought to redistribute hours across the retail stores. As a result, the company feels that they are *'operating on the lowest number of hours possible ... and even if we find some efficiencies, we will aim to re-invest it in customer services as opposed to stripping costs out.'*

Additionally, the firm does not envisage the NLW placing downward pressure on basic pay growth. However, it will erode the differentials between staff up to assistant manager level in some cases, especially in lower turnover stores in locations where hourly paid colleagues are closer to the manager rates, such as those based in city centres. There is a degree of uncertainty about what impact the National Living Wage will have on wages and wage differentials because the company is keen to see how the rest of the sector responds.

Attitudes towards government policy

The Living Wage is reported to be 'a good idea'. However, the company is keen to merge the timing of the National Living Wage and National Minimum Wage increases into April (currently April and October respectively).

In addition, the firm cites the apprenticeship levy as *'an additional tax of more than £1 million'* and the auto-enrolment pension scheme as imposing significant costs to the business. The firm has set a target of 500 apprentices for this year to get maximum value from the levy. In addition, the firm describes the Government's decision to postpone the minimum total employer contribution of 3% of an employee's earnings under automatic enrolment to 2018 as 'helpful'.

Hospitality

A small independent hotel

'We've done all that before. In order to keep staff, we said, "We're going through a recession, you know what the bookings are like, we've hardly had anyone coming through the door, we need you to do more things." They're a bit more universal throughout the hotel now. I don't think I can get any more out of them to be honest. Most firms, if they've survived the recession, they've already cut back.'

Background

This small, three-star hotel employs 20 staff, all of whom will be affected by the NLW, some of whom are at the NMW with a few more just above that. The business has been performing well, although the recession did require the firm to hold their rates down for a longer period to the extent that they are now at 2003 levels. The owner does not feel well informed on the NLW beyond knowing it meant a rise in the minimum wage. They are, however, generally supportive of a higher minimum wage.

Response to the National Living Wage

The firm is one of a minority of firms in this study that plans to raise prices to offset the cost of the NLW. The owners had not estimated the total cost of the NLW to the business as the number of hours worked in any week fluctuates depending on demand, with many of the staff employed on zero-hours contracts. The owners expect to continue to make use of zero-hours contract workers in the future, with staff employed under these contracts tending to be women in their fifties or sixties looking for some extra income, or students with Saturday jobs.

As a result of keeping their room rates relatively low throughout the recession, the owners believe there is more scope to raise prices without greatly affecting the competitiveness of the hotel. They expect there will be higher rates and fewer weekend deals across the sector. Raising rates will be the primary response they make to the NLW, both in 2016 and beyond.

Limits to productivity gains

The owners feel they are already at the limits of what they can do to improve productivity, especially following the recession, which saw employees trained across multiple roles within the hotel. Referring to the possibility of seeking greater efficiency or higher productivity, the owner said:

'We've done all that before. In order to keep staff, we said, "We're going through a recession, you know what the bookings are like, we've hardly had anyone coming through the door, we need you to do more things." They're a bit more universal throughout the hotel now. I don't think I can get any more out of them to be honest. Most firms, if they've survived the recession, they've already cut back.'

Another area where savings are expected to be made is from less regular investment in refurbishing the rooms. Prior to the recession, they believed the average time between renovations of the rooms was five or six years, but that has now risen to ten. They are, however, pressing ahead with improving the rooms one by one.

They don't expect the Employment Allowance or corporation tax changes to offset the costs to any degree. As a result of having many staff on zero-hours contracts, auto-enrolment presents a smaller challenge to the hotel's finances.

Wage differentials

Maintaining differentials is important for the hotel. Those with jobs with less responsibility are now likely to be paid at the same level as supervisory staff: *'For the difference between the roles, I might as well go back to being in housekeeping and not have the responsibility of having a pay rise as well.'* The hotel does not intend to differentiate by age. Reducing staffing levels is not seen as an option as it may lead to a drop-off in the quality of the service provided to customers. The hotel intends to look at where else savings could be made within the business, for instance reducing utilities bills through installing more insulation, although this process had been ongoing anyway regardless of the NLW.

A mid-size hotel group

Background

This hotel group employs 530 staff across several hotels and two associated businesses. The hotels range from budget to luxury. The business has performed averagely in recent years. The National Minimum Wage had always presented something of a challenge to the business, though they had always tried to pay above it in order to attract better-quality staff. From 2008, however, that became unaffordable: *'Our wage structure is not so much a structure anymore, more of a wage.'*

The group consider themselves very well informed about the NLW. In order to assess the impact on the business, they had undertaken a detailed analysis of the number of employees affected and the size of the wage bill increase. On a subsection of those properties for which figures were available (employing 365 staff), as of April 2016, 121 would be on the National Living Wage, 70 would be on the National Minimum Wage and the remaining 74 were above the NLW. Across all these staff, 20–30 work fewer than 30 hours per week, with the rest (excluding those employed on zero-hours contracts) working more than 30 hours per week. They expect the NLW to be approximately twice the size of the increase in their wage bill they experienced in October as a result of the NMW rising from £6.50 to £6.70.

Their initial intention had been to adopt a three-point strategy for pay increases:

1 Staff aged under 18 would earn £6 per hour rather than using the lower youth rates (£5.30 for those aged 18–20 and £3.87 for those aged 16–17).
2 Staff aged 18 and over currently earning less than £7.20 would be brought up to that level.
3 Staff earning more than £7.20 would receive a 3% rise.

While the group will proceed with steps one and two, a 3% rise was deemed to be too expensive. As such, those earning more than the NLW will receive a 1.5% pay increase.

Response to the National Living Wage

The two main responses to the NLW are to reduce basic pay growth for the rest of the workforce and reduce the number of hours worked through efficiencies. This will include reassessing ratios (the number of guests per employee) and better workforce planning. As part of this better planning, the group will seek to minimise the number of hours worked by casual staff, a decision explained by their HR director:

'We will more strictly enforce the casual contracts. A casual should be there to be called up to say, "Look, we've got a big function on the Saturday night, could you do a couple of hours?" And that's what a casual should be there for. We should be able to manage our business with our part-time and full-time employees. ... If someone's a casual or people are in and out of the business, they tend to be less skilled, so if we can focus more on the skilled people, that won't impact our service levels at all.'

They feel they cannot raise prices as doing so *'might price us out of the market, and then everyone will be out of a job'.* A similar perspective has driven their decision to leave staff numbers unchanged, with the view that the guest experience – and ultimately bookings – will suffer as a result. Despite the differences in price across hotels within the group, the same response is planned across all their different establishments, as they are all under the same brand. They do not specifically intend to hire younger workers as they place more emphasis on hiring the best person for the role. Given the size of the increase to their wage bill, they did not expect the Employment Allowance and corporation tax cuts to do much to offset the costs.

The group already spends a lot of time and money on training, both external and internal. That ranges from basic health and safety to cake decorating and wine tasting. This was seen to add value in terms of staff knowledge but also makes the staff happier. Progression is a priority in order to grow and develop. This year, 22 staff members were promoted, with 16 the previous year. Staff turnover remains high, however, and they fear the NLW will make it more difficult to recruit the best people as many more firms will be competing for the same staff at very similar pay levels.

Looking ahead, they intend to revise their strategy each year but feel that more information and guidance is needed from the Government on the likely path of the NLW in order to help them implement it.

The accommodation offset

A couple of years ago, they had considered becoming a Living Wage employer, again in order to differentiate themselves from a recruitment and retention perspective. The primary obstacle from their perspective is that the single rate of both the Living Wage and the legal wage floor do not take adequate account of the accommodation and food they provide to their employees. With the accommodation offset for 2015 set at a maximum of £37.45 per week, staff in effect pay approximately £150 a month for the accommodation and meals offered. This is the group's primary complaint about the NLW. They support the case for a higher wage floor, but feel the current offset does not sufficiently take into account how the hotel industry operates.

Support services

Background
This Scottish-based company employs approximately 425 people in the facilities management and construction sectors. The workforce comprises around 260 field engineers, with the remainder employed in various office-based roles across their locations. The company has recently reported a loss and made 12 people redundant because of challenging business conditions. As a result, the company will be looking to reduce costs in the future, mainly through a reorganisation of their business operations.

Rationale for introducing the National Living Wage
'The Living Wage Foundation rate might cost more in the short term, but in the longer term it should generate more benefit in terms of lower staff turnover and help us win more contracts.'

The company is working towards becoming a Living Wage employer, having already carried out an exercise recently to assess the impact of introducing the Living Wage Foundation hourly wage rate.

The drive to increase the hourly wage rate to a minimum of £8.25 per hour, for weekly paid staff, was mainly driven by the requirement to pay the Living Wage for a current tendering exercise. However, the company is also keen to be accredited as a Living Wage employer as part of the company's medium- to long-term strategy to increase productivity through *'being an employer of choice'.* The introduction of childcare vouchers, an employee well-being strategy and a more attractive benefits package are key components of the strategy. Looking ahead, the firm is looking to provide more training, introduce healthcare cash plans and even introduce cycle or computer schemes.

The HR director of the business adds, *'If you look after your staff, you will have happier, more productive employees. Customer service improves, people come back, and you put money on the bottom line.'* The return of ten employees who had left the organisation reflects the success of the strategy to be known as a 'good employer'. However, this long-term strategy can sometimes be challenged by the senior management, who can be 'sceptical' and 'short term' in their thinking because of the competing strategy to make 'cost efficiencies'. However, senior managers are generally supportive of the long-term strategy.

Response to the wage bill increase
The new National Living Wage will have little impact on the organisation because they already pay 97% of the organisation's employees above the recommended rate. However, the voluntary Living Wage hourly rate of £8.25, set by the Living Wage Foundation, will add £30,000 to the overall wage bill of £2.7 million.

The organisation's primary response to this modest increase is simply to absorb the cost and work to win more business because of the 'fine margins' that exist in the sector. In addition, the firm says the uplift for the lowest-paid employees at the organisation will reduce the differentials between them and the rest of the workforce. However, the firm does not rule out reducing overtime in the longer term.

Looking ahead
The company says that the Living Wage is 'a good thing' because it will promote more fairness and transparency with their internal pay structures and simplify job roles. In addition, the firm will be looking to introduce more controlled and regular salary and role reviews as an indirect result of the introduction of the Living Wage. The company hopes to be back in profit by 2018 to ensure that the future Living Wage rate increases do not lead to any consequences elsewhere in the organisation.

Local government

While many private sector employers feel they have a limited number of options available to them in responding to the NLW, for employers in the public sector, this is an even more pressing concern. The local authorities interviewed are contending with a unique range of pressures and limitations. With local government budgets having seen substantial cuts since 2010, many changes have already been implemented in order to make the workforce more efficient. Non-essential services have been cut, with employee numbers falling steadily in recent years.

A large local authority in the south of England

'It's very difficult to forward-plan when the end goal is moving. We don't have a definitive "it's going to move from X to Y over this point in time in these incremental stages." It's not as clear cut as that. So I think in terms of future-proofing, it's incredibly difficult to forward-plan for that. Where are we going to be in 2020? Are we going to be at £9? Are we going to be at £9.35? Or are we going to be somewhere different? … So that is difficult to try and predict and try and come up with a plan that takes all of that into consideration.'

Background

This local authority employs 15,000 employees who work across a variety of sites and services, ranging from staff employed in parks to those with back-office administrative duties. As would be expected, the pay of those employees varies greatly, with a system of 13 pay grades with 36 column points in place.

In common with councils across the country, recent years have seen its budget cut significantly, forcing difficult decisions to be made. This has led to a drive to raise efficiency across the council, seeking ways of 'streamlining' the services it provides. Looking ahead, it is bound by the 1% cap on total wage bill increases announced at the Summer Budget over the next four years.

The council is well informed about the NLW and supportive of the move. The NLW, though, will have a considerable effect on the council's wage bill. While the specific percentage of employees likely to be affected by the NLW is not available, a 'significant' proportion of council staff are set to see their wages increase in April 2016. These staff work in roles ranging from technicians to cleaners. By 2020, the impact of the NLW is expected to be much broader, however, affecting a more diverse group of workers. Of the 36 column points in its pay structure, the NLW is likely to cover the bottom ten of those by 2020, affecting a much wider range of employees.

Response to the National Living Wage

The HR director of the council reports that productivity improvements, cuts to the training budget and redundancies are the most likely responses to the NLW, although there is some uncertainty about this.

Ongoing discussion about pay differentials provides the backdrop to the uncertainty about employment levels at the council. The council reports that pay grades have been agreed independently, though they closely match the national pay agreements. A national pay offer has been made by unions to councils and so much of the decision-making needs to be made on that basis, once it has been agreed. Because of that, the effect on differentials has not yet been decided, but it is unlikely that differentials can be maintained. As part of the wider reduction in public sector staffing levels, job cuts may be necessary as the NLW moves towards £9 in 2020.

When a plan for a response is finalised, it will be done at a senior political level. However, it is expected that there will be some flexibility within departments to choose how they respond. This means that individual managers with different parts of the council may have discretion over how productivity gains could be achieved. This will form part of the ongoing efficiency drive sparked by cuts to local government budgets. But while the potential of 'getting more' out of council staff was discussed, training that was deemed as 'nice to have' is already being cut back on and is likely to be decreased further.

When the pay deal is finalised, it is expected that an initial two-year deal will be agreed. Following that, the council and unions will re-examine how the costs are being borne and what opportunities there are. It will discuss how best to adapt with neighbouring councils.

Difficulty of planning ahead

Even putting aside the ongoing negotiations as to how much of the increase should be passed on to other staff, the council admitted that putting any effective long-term plan together is made challenging by the lack of certainty surrounding the future path of the NLW.

A medium-large local authority in the north-east of England

Background

A council in the north-east of England has contracted a large multinational firm to operate schools within the area. The contract covers 4,200 employees, many of whom will be affected by the NLW, including staff working in catering, caretaking and teaching assistants. The contract that the firm has includes a 'pass-through' arrangement, with the council having to fund additional costs above those specified in the contract. The NLW falls into this category. A number of contracts are operated on this basis, most running for three to five years.

The council receives lower funding than many of the other councils in the area. It has worked closely with these neighbouring councils, many of whom are already paying the voluntary Living Wage. The council, however, had investigated the affordability of being a Living Wage employer, but ultimately decided it would not be affordable to do so. As well as the pressure on wages from local government cuts and the 1% pay cap, the council's outgoings continue to be elevated by the legacy of equal pay judgements.

The council considers itself very well informed on the NLW. The NLW has been discussed at the highest level with the council because, whatever response is chosen, it is likely to have political consequences. Focusing solely on the 4,200 employees across its schools, 610 are set to be affected by the NLW. Wages are estimated to be 85% of costs within the council's schools, so this represents a significant increase in costs.

A rigid pay grade system is in place. Their proposal is to pay a rate slightly above the NLW – which is aligned with one of the pay grades that is slightly above the NLW – but still lags the Living Wage paid by other local councils by roughly 45p. In order to balance this with the 1% pay cap placed on local government, higher-paid staff will receive a smaller pay increase.

Response to the National Living Wage

The council is limited in terms of what they can do with staff pay and benefits because of pay-bargained agreements with unions. The agreement reached with the unions is that they will pay above the NLW. Other responses will be to raise productivity with more outcome-based evaluations and try to reduce the number of days lost to illness. They don't intend to differentiate by age but had already planned to hire more apprentices and pay them at a lower rate.

In terms of concerns, recruitment and retention of staff is a concern. There are specific fears of the effect on social care, but this is part of a broader concern around funding and an ageing population rather than the NLW in isolation.

Reducing service provision

In the context of previous and future reductions in local government budgets, it is likely that some council-provided services will be reduced. While the NLW is not the sole driver of this process, it is seen as another pressure. As the HR director of the local authority puts it:

'A local authority might have 27 libraries. Politically, the organisation is going to have a decision to make about whether or not those things are maintained. Because you have a statutory requirement and then there's your optional. So your statutory requirement might be you have to have 20 libraries and they'll have to make a decision about the ones that are over and above. I think that's something that most businesses, not just the public sector, will be looking at. We'll say, "Right, what do we absolutely have to deliver, what do we need to deliver, and what's nice to deliver?" and then you have to work back from that.'

Other

A school academy in the public sector

Background

This academy in the south-west of England employees 180 members of staff and has historically paid slightly above the NMW. About a year before the announcement of the NLW, the academy discussed the merits of moving to the voluntary Living Wage but ultimately decided it would have proved 'unaffordable'. The academy was in a relatively strong position in terms of its overall funding because its pupil numbers were growing well, a major part of the funding calculation for schools. They expressed a concern for other schools with falling pupil populations which would see budgets reduced.

The academy feel they are not particularly well informed about the NLW, especially on the path it will take post-2016. Although the majority of their staff are teachers and so are well above the wage floor, the NLW will nonetheless have a large impact on the academy's wage bill. Other roles at the school, including teaching assistants, cleaners, caretakers and administrative staff, are likely to be affected by the NLW.

The academy has modelled that the NLW will grow by 45p each year to 2020. Under this arrangement, this would represent a 1% rise above what they had budgeted for in 2016–17, taking into account pay rises linked to the cost of living and the NMW. Looking ahead, these wage increases would increase during the current parliament, finally reaching 4.4% in 2020. In practice, about 75% of the academy's support staff will benefit from the NLW, which is equivalent to 50 people.

Response to the National Living Wage

The academy is therefore uncertain about how to respond exactly to the NLW increases over this current parliament. However, it is looking at ways of improving productivity levels and reducing the wage differentials to respond to the higher cost of the NLW.

Against the backdrop of the various pay grades at the organisation, which sees some earning 30p or 40p more than their lowest-paid colleagues, the school is currently developing two options to present to these staff. As the business director of the academy puts it: *'The first option is we don't worry about the compression and let it happen. As long as you're being paid fairly for the job that you do, why would you care what someone else is paid?'* The other option is to maintain some level of differentiation, whether passing on a particular percentage wage increase or a cash figure.

The academy is less concerned about recruitment and retention than some employers. They acknowledge that *'people have sat on virtually no pay rise for quite a lot of years now. And there's this so-called feel-good factor in the private sector.'* The commitment of low-paid staff to the social value of the school means they are in competition with other schools rather than broader private sector employers.

Changing pay policy

The academy sees the NLW as an opportunity to move towards more of a performance-related pay structure, which it hopes could boost staff performance:

'We are slowly moving towards a much more output-oriented organisation. And I think this first tranche, this first new pay policy will not look particularly at driving anything. It will be about embedding the culture of performance-related reward. I think the next round will be much more about driving productivity. Rather than not reward somebody for underperformance, we will reward people for exceptional performance. … Once you get to that point, you can make the reward bigger and more attractive but fewer people get it. So the budget may not be overly affected by it but what it does do is it drives performance amongst the workforce to really perform.'

A small childcare provider

Background

This childcare business has been in existence for almost five years. There are two parts to the business. The first provides payroll and employment contracts for around 800 clients that employ domestic workers across the country. The majority of the domestic workers are nannies. Other workers include gardeners and cleaners. The other strand of the business helps organisations as well as individuals find nannies, nurseries and childminders, either for themselves as individual families or for their employees.

The workforce comprises 11 members of staff. This includes eight people that are employed on a permanent contract on a part-time basis. In addition, three people are engaged as workers on zero-hours contracts. The majority of the workforce is employed in payroll administration and business development. Business performance is measured by the number of new clients the company generates and the number it retains. In addition, the firm looks at market share, which is reported to be increasing.

Rationale for paying the National Living Wage

The firm already pays at least £9 gross an hour to all workers, which lies well above the National Living Wage rate. The elevated wage rates and the flexible working options are part of the firm's broader strategy to recruit and retain the right people. In addition, the firm identifies fairness, keeping staff happy and consistency with market rates, which are relatively high because of the location and professional nature of the roles, as key drivers. Looking ahead, the company does not feel that the new National Living Wage will put upward pressure on wages at the organisation. The strategy will remain to follow 'what is standard in the market'.

Enforcement

However, the firm warns that many individuals and firms may flout the National Living Wage, which may have a disproportionately large impact on foreign nationals. It alleges that there are already a vast number of workers in the sector, mostly foreign nationals, who are already being paid below the current National Minimum Wage. Examples include client requests for nannies that do 65 hours per week for 'as little money as possible'. Meanwhile, some workers are 'willingly' signing employment contracts that state a gross hourly rate of around £6 per hour. The firm alleges that many people use a loophole by reclassifying nannies as au pairs to avoid paying the National Minimum Wage – despite the fact they are often not allowed time to study and are working in excess of the recommended 30 hours per week.

The firm recommends better enforcement and communication, especially to raise the low levels of awareness of the new laws among foreign nationals that employ domestic workers. It also warns that nursery costs will rise sharply following the introduction of the National Living Wage and outstrip the cost of employing a nanny or au pair, which may not increase at all. The company argues that this will be unfair because people who employ nannies or au pairs are often more able to afford the price increase than working parents who send their children to nurseries.

Higher-paying sectors

A large commodities company

Limited impact
A large commodities company describes itself as a market leader offering a high-quality service. It employs 500 employees in the UK, the vast majority of whom are paid well above the wage floor.

The company considers itself very well informed about the NLW. Only three of its 500 employees in the UK will be affected by the wage rise, so the impact on the business will be negligible. The business hasn't costed the impact of the introduction of the NLW because of how insignificant its introduction will be to their pay bill, even in 2020. They will not be taking any steps to increase productivity this year or over the next five years in direct response to the NLW, again because its impact on the company's costs will be small.

The board has taken an executive decision to adopt the NLW ahead of the Government's compulsory introduction date. It has made this decision because it is the 'morally right thing to do', viewing a higher wage floor as 'fair and equitable'.

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