Resolution Foundation

REPORT

Industrial strategies?

Exploring responses to the National Living Wage in low-paying sectors

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Executive Summary

From its announcement at the Summer Budget in July 2015, it was clear that the National Living Wage (NLW) would be a transformative policy, significantly raising the legal wage floor for those aged 25 and over. Less clear however was how employers would react. Although the evidence base built up since the introduction of the National Minimum Wage (NMW) in 1999 provided a helpful guide, the initial rate of £7.20 and the planned trajectory to 60 per cent of median earnings of those aged 25 and over represented a step into the unknown for the UK's wage floor and cautioned against overly simplistic assumptions about past responses being repeated.

Analyses of labour market data and surveys of employers across the economy have given some sense of the immediate post-implementation response. However, these overviews are likely to mask specific reactions in those industries most affected by the NLW. To better understand the responses of employers operating in some of the key low-paying sectors where the NLW is likely to have the biggest impact, this report combines a survey of 800 organisations with detailed semi-structured interviews with 15 employers. The combined analysis supports previous findings that the majority of employers affected by the NLW have not significantly altered their business models to date, with efforts to raise productivity, price rises and changes to employment all being used, though to different extents in different sectors.

Half of firms surveyed faced wage bill increases

A representative telephone survey was carried out between September and October 2016, six months after the policy came into force, asking 800 employers split across *wholesale and retail* (referred to here as 'retail'), *accommodation and food service* ('hospitality'), *cleaning and landscaping* ('cleaning') and *food manufacture/processing* ('food processing') how the NLW has affected them.

Just under half (47 per cent) of the employers surveyed answered that the NLW had increased their overall wage bill, with 19 per cent saying their wage bill had increased "a lot" and 28 per cent saying "a little". Unsurprisingly, these figures are higher than those reported in previous surveys that have covered all parts of the UK economy. It is notable though that even in these traditionally low-paying sectors the wage bills of half the organisations contacted (52 per cent) were unaffected.

That overall picture did vary. Medium-sized (50-249 employees) and large (250+ employees) employers were more likely to have faced a wage bill increase as a result of the NLW (59 per cent and 61 per cent respectively) than small employers (41 per cent), in contrast to previous analysis on the NLW's impact. Sectoral differences also emerged. The NLW had increased the wage bill of nearly six in ten (59 per cent) hospitality employers surveyed compared to four in ten (39 per cent) in retail.

The employers interviewed in detail were more likely to have been affected by the NLW than those surveyed, with 10 of the 15 facing wage bill increases so far. Within those 10, the extent to which their wage bills were affected varied greatly: in one organisation an estimated three-quarters of staff members were given some uplift to either remain at or above the legal minimum or to maintain differentials, while only a small minority of employees were affected in other instances. Despite this variety however, there was little difference in the scale of post-implementation response reported by the 15 employers. However large the effects, employers reported few significant shifts in organisations' business models to date or overall approaches to staff, prices or other elements of the day-to-day running of the firm.

With nearly six in ten of those affected saying they'd raised prices to some extent

Employers who reported their wage bill had increased in the survey were then asked about the responses they had made. Nearly six in ten (58 per cent) employers said they had raised the price of the goods and/or services they sell, although only 6 per cent raised prices "a great deal", with 25 percent doing so "a fair amount" and 28 per cent "not very much" – to help manage the wage bill increase. Large organisations were least likely to raise prices, with just 34 per cent passing the cost of the NLW onto customers in any way.

Cleaning organisations were much more likely to have opted for this response, with 78 per cent raising prices (21 per cent by "a great deal") in contrast to retail and food processing (48 per cent and 47 per cent raising prices to any degree). These sectoral trends were apparent too in the detailed interviews, with differing environments and pressures playing on the minds of employers, for instance how big a share of total outgoings labour costs represented. For example, the retailers interviewed were firmly of the view that price rises were not yet an option given the "price wars" that many supermarkets were engaged in. Price rises were also deemed more of a risk than an opportunity in food processing, because of the relative market power of the largest buyers (again, often supermarkets).

Those in hospitality and hairdressing who had chosen to raise prices explained that they felt their previous prices provided customers with "a good deal" for the product or service they offered and as such felt comfortable increasing the amount they charge. Among social care employers, views varied. Some felt that the rates charged to "self-funding" patients could be raised to some extent, but their expectation was that this would not significantly offset the NLW. Instead, more emphasis was placed on negotiations with local authorities, with providers making clear that these additional labour costs would have to be reflected in the price that local authorities pay for care.

One in four affected firms had altered their employment structures

Given long-standing concerns about potential trade-offs between jobs and minimum wages, the extent to which employers affected by the NLW alter their employment structures is an important metric. Among those employers reporting being affected by the NLW in the survey, around one in four (27 per cent) said they had taken some action on employment, with 18 per cent using fewer staff and 9 per cent using different kinds of staff. The majority (58 per cent) had chosen *not* to make such changes. Cleaning organisations were the least likely to have used fewer (4 per cent) or different kinds (4 per cent) of staff for whom, as discussed above, price rises have been more relied upon.

Within the 27 per cent of employers who had made some staffing changes, the most common response was to hire fewer new staff than would otherwise have been the case (62 per cent). Just over half (52 per cent) said they had offered fewer hours to staff, while 43 per cent reported using more casual or zero-hours contract workers. Only 12 per cent of these firms had used more self-employed workers and just 2 per cent reported making any redundancies as a response to the NLW.

Three in ten (30 per cent) of those making any of these employment changes said they had done so "a little", 43 per cent "a moderate amount" and 27 per cent "a lot". The upshot is that just 3 per cent of the overall sample of 800 firms in low-paying sectors said that they had made "a lot" of employment changes in response to the NLW.

None of the 15 employers interviewed had made redundancies, offered reduced hours or slowed recruitment in direct response to the NLW with one describing such changes as "a last resort". One hairdressing salon owner reported becoming more likely to hire workers under 25 as a result of the NLW, while a hospitality employer had begun to reduce the use of casual staff used by the organisation, viewing them as less productive than permanent staff.

A number of employers also reported reducing their use of agency staff. Although the flexibility of such staff was valued when demand was unpredictable or to ensure that enough staff were always available (particularly for care providers for whom legal staffing requirements were a consideration), the hourly rate that firms paid for agency workers was in some cases 30-40 per cent higher than their permanent staff. One employer said they had offset the majority of the NLW increase to their wage bill by hiring a greater number of permanent staff and reducing their agency workforce.

Changes to other pay or benefits was a less common response in the survey

Changes to non-pay elements of employees' reward packages by some large employers have been discussed in the media following the implementation of the NLW. However, this was a less common response among the employers surveyed in this research. Of those whose wage bill had increased, 17 per cent reported making changes to pay or benefits as a result of the NLW. The proportion of affected firms saying they had made "a lot" of such changes was just 2 per cent, with a further 6 per cent using "a moderate amount" and 8 per cent "a little".

Of the 17 per cent of NLW-affected firms making changes to pay or benefits, reducing pay rises for staff earning more than the NLW was the most common response (18 per cent). Other responses included removing or reducing Bank Holiday pay (9 per cent), overtime pay (7 per cent), Sunday pay (6 per cent), paid breaks (5 per cent) or pension contributions (3 per cent).

Although relatively uncommon among survey respondents, such changes had been used more widely among the 15 employers involved in the more detailed interviews. For example, a food processing employer reported cutting both the amount of overtime that had been available to staff – an estimated 25 per cent of the hours worked in the site had been as overtime – and the rates that had been paid. A hospitality employer had taken a similar approach, as well as reassessing the employee benefits scheme offered, reducing it from a broader, more expensive but relatively little-used programme to a cheaper, more popular package. They had also stopped providing subsidised accommodation for staff.

While many employers offered few such perks in the first place, viewing the hourly rate as the primary factor weighed by potential employees and therefore key to attracting the best staff, some discussed the NLW's raising of the floor as making such "add-ons" more important. In order to differentiate themselves in a jobs market in which a growing number of roles are paid at the NLW, providing attractive benefits and the potential of training and career progression – a common refrain across many employers and sectors – was viewed as an increasingly vital part of a firm's recruitment strategy.

Though some employers had explicitly decided to raise the wages of better-paid employees by less because of the NLW, most offered annual pay increases in line with previous years which is reflected in recent pay growth figures. In many cases, the squeezing of pay differentials that followed had caused difficulties. Again, the increased emphasis on progression was suggested by a number of employers as a way to manage such difficulties. But in some, this was viewed as an unpleasant but unavoidable consequence of a rising wage floor.

Boosting productivity remains a key response to higher wage costs

Previous surveys on the NLW have highlighted a desire among significant numbers of firms to boost productivity, though further probing raised question marks over just how any gains might be secured. Our latest survey finds that among those affected two-thirds (67 per cent) said they had already put processes in place to raise productivity in response to the NLW.

The most commonly cited approach was to invest in training to improve staff skills, with 44 per cent of employers affected doing so. Also popular were making greater use of more-highly skilled staff (29 per cent), asking staff to work harder or more quickly (28 per cent), investing in technology to help staff be more productive (25 per cent), and changing staff roles to include more complex or varied tasks (24 per cent). Eight per cent of firms said they had invested in technology with the aim of replacing staff.

These numbers varied by sector, with two in three (45 per cent) cleaning organisations whose wage bill has increased saying they hadn't sought to introduce productivity-raising actions. Given the types of tasks involved, raising productivity for cleaning firms may prove more difficult and again explains why price rises have been relied upon.

Approaches differed too. For example, food manufacturing firms were more likely than others to invest in labour-enhancing technology (42 per cent) while hospitality and food processing employers were more likely to ask staff to work harder or more quickly (35 and 37 per cent respectively). Food processing organisations were also the most likely to invest in technology, whether it be labour-enhancing (42 per cent) or labour-replacing (22 per cent).

There were also clear dividing lines by company size. Small employers were less likely to seek productivity gains (62 per cent) than medium or large employers (77 and 71 per cent respectively). This may be because there are fewer parts of the organisation and its processes that can be made productive, or could reflect a lack of knowledge on how to achieve such gains. The interviews with employers suggested both factors played a role. While larger employers in social care, retail and food processing were aware of potential avenues to improve productivity – even if they were pessimistic about the scale of offsetting this could provide – smaller employers in hairdressing and hospitality were less able to identify any potential gains.

Looking ahead, a rising wage floor is expected to result in further price increases, profit reductions and searches for productivity

The 800 survey respondents were asked to look further ahead and consider which approaches they feel they are likely to use as the NLW rises towards its target of 60 per cent of median earnings. Of course, the views of employers today are not always a reliable guide to what they eventually do, especially in an uncertain economic environment. But their responses give an indication of which options are on the table.

The first thing to note is that an increasing number of respondents declared that they would take some form of action – highlighting the extent to which the NLW is expected to affect more firms as its value rises. Whereas 47 per cent of respondents said they'd already faced an increase in their wage bill, the proportion setting out future NLW responses rose significantly to 78 per cent, indicating the wider reach of the policy as the rate rises higher. A further 20 per cent plan to take no response.

As in our economy-wide survey carried out earlier in 2016, price rises remain the most popular response: of all employers, 54 per cent included this as part of their NLW strategy up to 2020. Absorbing increased costs (45 per cent), asking staff to do more (41 per cent) and investing more in training of staff (38 per cent) were among the most common alternative responses. One in three (32 per cent) planned to reduce their use of labour in one way or another, be it through using fewer workers, offering fewer hours to staff or slowing recruitment.

Among the employers interviewed, there was generally much uncertainty about how their response to the NLW would develop. In many cases, the interviewees were unable to isolate a part of their strategy that was specifically formulated in response to the NLW from that which was part of a shift in response to broader factors such as the company's performance or industry trends.

Some intended to continue their approach to date of taking "a little spoonful from each bowl" – making small changes to various aspects of the organisation rather than any sweeping changes. Others felt that more serious responses would eventually be required however. This was particularly prevalent in the social care sector, in which some interviewees were already aware of care contracts being handed back to local authorities and were concerned that increasing the number of self-funders at the expense of local authority-funded customers would lead to care shortfalls. The NLW was painted as an additional pressure in what was already a straitened financial environment.

Views of how the NLW would increase also varied. In the vast majority of cases, the employers interviewed assumed that the NLW would reach £9 by 2020 and did not mention the link to typical wages. Others expected it to be higher still. The kinds of responses employers were considering and the intensity of those responses were in many cases guided by these projections and what it would mean to their wage bill. This suggests that clearer communication of the likely route of the NLW based on revised forecasts would be helpful to organisations that are setting responses in train today in order to prepare for tomorrow.

Section 1

Introduction

Since 1999, the UK has developed a strong evidence base on just how employers and the labour market have adjusted to the introduction and development of a legal wage floor. It is clear that firms have adapted well, with little if any negative employment effect. Instead, employers have displayed a range of coping mechanisms. For example, some firms have reduced profits while others have compressed wage distributions, giving smaller pay rises to those just above the National Minimum Wage (NMW). There is also some evidence that larger firms have increased productivity. And in some of the sectors most exposed to a minimum wage, there is some indication that the NMW led to higher prices.[1]

With the arrival of the National Living Wage (NLW) – the new legal minimum wage for those aged 25 and over – from April 2016, we might have expected firms to follow a similar pattern of adaptation. Yet the NLW marked something of a step change in government policy, meaning that history may not be a perfect guide. There were with three key differences from the NMW.

- First, the age at which the 'main' rate applied shifted upwards from 21 to 25. This distinction raised the prospect of employers making increased use of age-based substitution as a means of controlling wage costs.
- Second, the rise from the prevailing NMW level of £6.70 to an NLW of £7.20 in April 2016 was among the largest single year increases in the wage floor since 1999. The scale of this increase had the potential to pose challenges for those firms with sizeable numbers paid at or near the wage floor – particularly when considering how out of line this increase was with the consistently disappointing performance of wage growth across the economy post-financial crisis.
- Third, the aim of the policy centred on establishing the NLW as equivalent to 60 per cent of the median hourly wage of employees aged 25 and over by 2020. While meeting this target is subject to "sustained economic growth", it includes some tolerance for lower employment growth than under the NMW's remit. There is therefore an expectation baked into the policy that firms might choose to make more use of employment adjustments as a response to the NLW than has been the case in relation to the NMW.

A sense of the early impacts of the NLW can be gauged from data published since April 2016. The LPC's Autumn 2016 report summarised what can be judged of the effect so far:

> *Our analysis of the introductory rate broadly supports the view that the NLW is a substantial change for the labour market, business and workers, with large effects on pay and differentials, possible effects on prices, but (perhaps inevitably at this early stage) limited evidence so far of consequences for employment and hours in the available data.*[2]

This report seeks to add to the early evidence base, building on previous investigations of employers' responses to the NLW. Chief among these are a joint CIPD-Resolution Foundation analysis prior to

[1] For further discussion of the research on these responses see for instance J Plunkett and A Hurrell, *Fifteen Years Later: A discussion paper on the future of the UK National Minimum Wage and Low Pay Commission*, Resolution Foundation, July 2013

[2] For further analysis of the impact of the NLW see Low Pay Commission, *National Minimum Wage Low Pay Commission Report Autumn 2016*, November 2016

the introduction of the NLW in late 2015 and a Resolution Foundation survey in June 2016.[3] While complementing these studies, this report also aims to fill in some important gaps.

- We focus solely on low-paying sectors, as opposed to the economy-wide approach taken in the two highlighted pieces of research. By doing so, we home in on the kinds of employers most likely to have staff earning at or close to the wage floor, and therefore facing the biggest adjustment.
- We ask not just what kinds of responses employers have made alongside implementing the NLW, but also the intensity of those responses. As such we can capture whether – for example – a reported increase in prices was a significant or just a minor undertaking.
- We deliberately repeat some of the questions asked in earlier studies in order to gauge whether changes following the EU referendum result are having any additional effect.

The report is divided into three further sections. The first of these (Section 2) presents the findings from a representative survey of 800 employers in key low paying sectors, carried out in September and October 2016. We highlight the extent to which firms in each of the different sectors say they have been affected by the NLW to date (along with their expectations for the future) and what adaptations they have made in terms of people, prices, profits, productivity and pay. Section 3 then reports on semi-structured interviews with 15 firms spread across these lower-paying sectors of the economy. This detailed deep-dive gives us the opportunity to better understand the decision-making processes undertaken in these firms.

We offer some conclusions in Section 4 and provide more details of the methodology in the Annex.

[3] C D'Arcy & G Davies, *Weighing up the wage floor: Employer responses to the National Living Wage*, CIPD & Resolution Foundation, February 2016; C D'Arcy & M Whittaker, *The first 100 days: Early evidence on the impact of the National Living Wage*, July 2016

Section 2

Survey of low-paying sectors

Our survey of 800 employers in four low-paying sectors finds that just under half have faced wage bill increases as a result of the National Living Wage, with six in ten hospitality employers affected. The main responses among those dealing with a rising wage bill has been raising prices and seeking productivity gains. The sorts of responses preferred varied by sector: cleaning organisations were more likely to raise prices and food processing companies were most likely to seek productivity gains. One in four employers reported either using fewer or different kinds of staff in response to the NLW while one in six had made changes to pay and benefits. Overall, the survey paints a picture of low-paying sectors adapting to the NLW with a combination of responses, for the most part without making significant adjustments to the way they operate their business but with a small minority opting for larger changes to prices, productivity, employment or pay and benefits policy.

Methodology

Between 20 September and 17 October 2016, 800 employers were surveyed by Ipsos MORI. To add value to previous economy-wide surveys on responses to the NLW, the intention was to concentrate on employers in what are considered by the LPC to be low-paying sectors.[4] Rather than focus on a single low-paying sector in great detail or attempt to cover every sector deemed to be low-paying, four sector groupings were chosen. These are set out in full detail in Table X in the Annex but, for the sake of simplicity, will be referred to in the rest of this report as 'retail', 'hospitality', 'cleaning' and 'food processing'.

In order to gain an insight into the changes that each organisation had made in direct response to the change in the wage floor, interviews were conducted with the person declared responsible for the implementation of the NLW. This included chief executives, managing directors, finance directors, business owners/partners, human resources or payroll managers, office managers and others.[5] The margin of error for the overall sample is 2.4 percentage points to 4.1 percentage points.

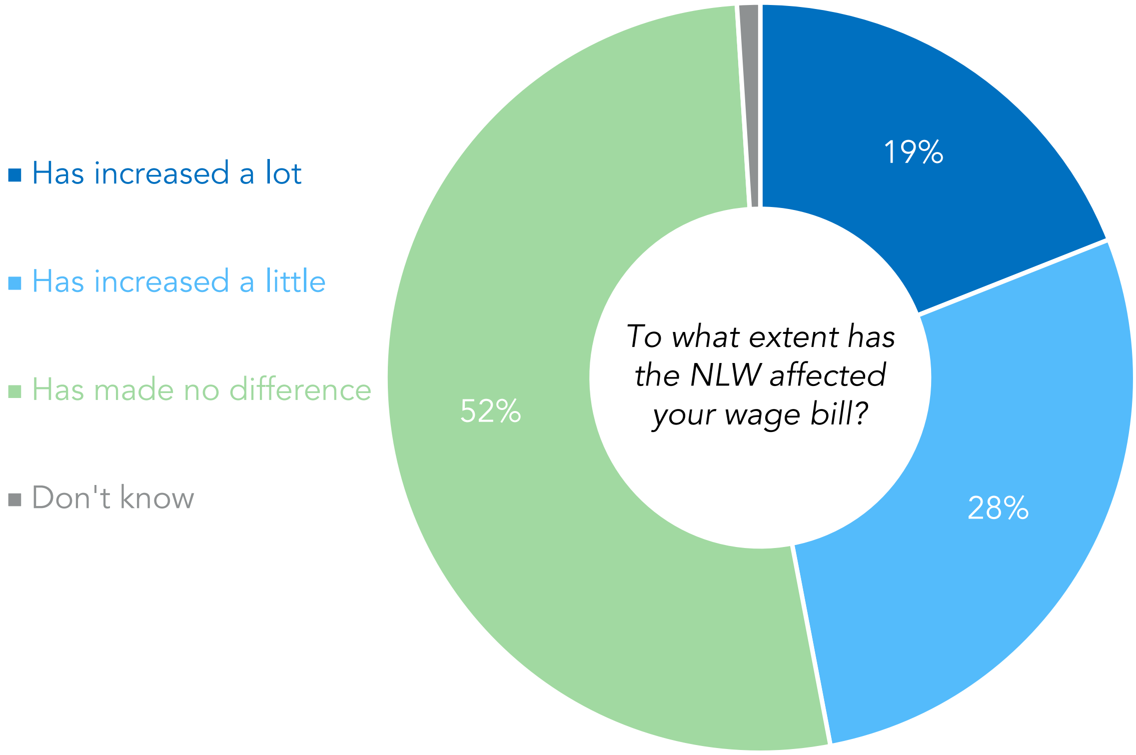
To date, the NLW has increased the wage bill of half of the employers surveyed

The key question used in this survey to determine whether or not organisations have been impacted by the NLW was "To what extent, if at all, would you say that the introduction of the NLW has increased, decreased or made no difference to the overall wage bill of your organisation?" As Figure 1 illustrates, the organisations surveyed were split roughly in half. Just over half (52 per cent) reported that the NLW had made no difference to their overall wage bill. Just under half (47 per cent) answered that the NLW had increased their wage bill with those saying it had increased "a little" (28 per cent) outnumbering those for whom it had increased "a lot" (19 per cent).

[4] For full details of the sectors classed as low-paying by the Low Pay Commission see Appendix 3, pp222-223, Table A6.1 of Low Pay Commission, National Minimum Wage: Low Pay Commission Report Autumn 2016, November 2016

[5] For the breakdown of these roles across the survey, see Annex.

Figure 1: Half of employers surveyed affected, half unaffected by the NLW



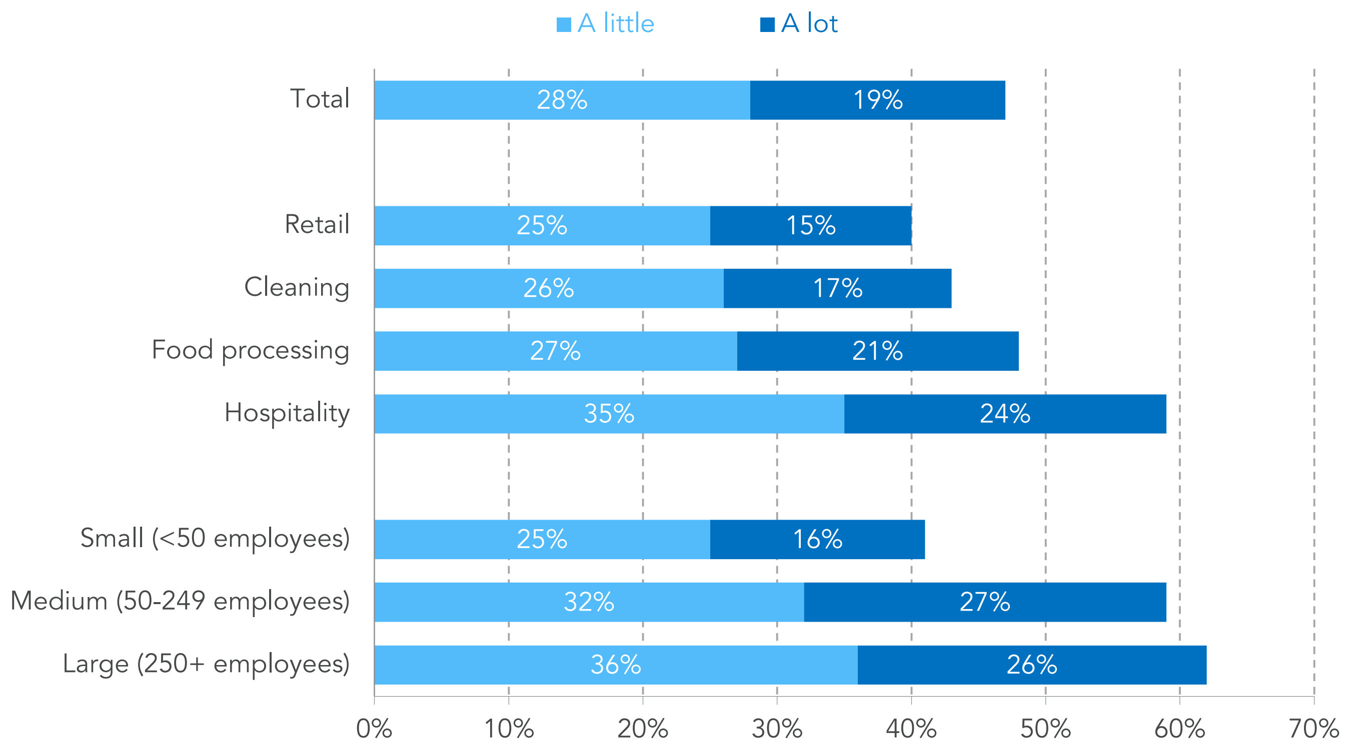
Base: All employers (n=800)

This picture varied by the characteristics of the organisation, with Figure 2 exploring differences across both sectors and numbers of employees.[6] In relation to sectors, it shows that hospitality had the highest share of respondents indicating that the NLW had increased their wage bill (59 per cent). Given the generally lower levels of pay across hospitality relative to the other sectors considered (and the greater role played by tips in boosting the gross pay of workers), this is unsurprising.

[6] Although information on the demographics of the organisations contacted was collected, sample size restrictions mean that some breakdowns, including regional dispersion, are not available.

Figure 2: NLW's effect particularly felt by large employers and hospitality

Proportion responding that the NLW has increased their wage bill "a little" or "a lot" (%)



Base: Employers that said the NLW has increased their wage bill (n=376)

It is worth noting that, despite smaller overall differences between the other three sectors, the proportion of firms in the food processing sector who said that the NLW had raised their wage bill "a lot" was some way higher than in either cleaning or retail and was not far short of the level in hospitality. The implication is that, while the NLW impact might be less generalised in food processing than in hospitality, it is an acute issue for a similar size minority.

Overall, the chart confirms the perception of these sectors as being low-paying industries in which many employees will have required pay increases in order to at least meet the new wage floor. At the same time, the fact that approximately half of employers in these sectors have not faced a wage bill increase as a result of the NLW is a useful reminder that many employers, even in low-paying industries, pay above the minimum level.

Turning to organisation size, Figure 2 shows that small employers (fewer than 50 employees) are the least likely to have faced a wage bill increase as a result of the NLW. Two in five (41 per cent) small employers said their wage bill had risen, compared with closer to three in five medium and large employers (59 per cent and 62 per cent respectively). This finding contrasts with other research conducted on the NLW to date.[7]

Having established the scale of the NLW impact on the organisations surveyed, the rest of this section discusses their responses to those wage bill increases. Unless otherwise specified, only those who responded that their wage bill had increased – the 47 per cent displayed in Figure 1 – are used as the baseline group.

[7] See for instance C D'Arcy, A Corlett and L Gardiner, *Higher ground: Who gains from the National Living Wage?*, Resolution Foundation, September 2015; C D'Arcy and G Davies, Weighing up the wage floor: Employer responses to the National Living Wage, CIPD/Resolution Foundation, February 2016; Incomes Data Research, *Impact of the National Living Wage. Research Report for the Low Pay Commission*. October 2016

Price rises continue to be one of the most popular NLW responses

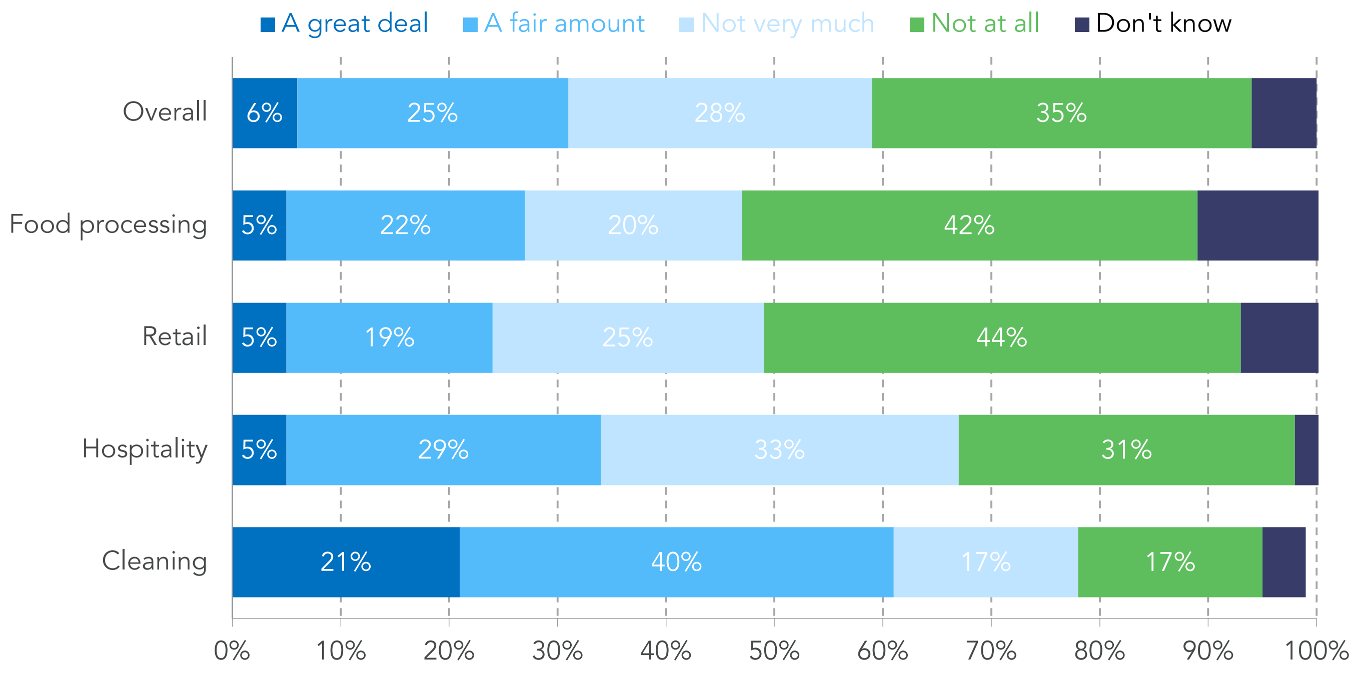
As discussed in the Introduction, price rises emerged as the most popular response in our previous economy-wide survey on the NLW. It was again among the most frequently cited mitigation tools in our new survey. Close to six in ten (58 per cent) organisations whose wage bill had risen as a result of the NLW said they had increased their prices at least to some degree. This total comprised 28 per cent who had raised prices "not very much", 25 per cent who had lifted them "a fair amount" and 6 per cent increasing them "a great deal". Just 36 per cent said they hadn't increased prices "at all".

As is the case in any question which puts the intensity of response into words rather than percentages or cash figures, the interpretation of descriptors like "a great deal" and "not very much" will likely vary from organisation to organisation and from sector to sector, with price elasticity perhaps being higher in some parts of the economy than others. Despite this, clear variations are visible across the sectors surveyed.

As shown in Figure 3, price increases were much more likely to have occurred in cleaning than in any other sector. A combined three in four (79 per cent) cleaning employers who had faced an increase in their wage bill said they had raised prices. This included more than one in five (21 per cent) who had increased them "a great deal". In contrast, the overall figure fell to 47 per cent in food processing and 48 per cent in retail. In these sectors, just 5 per cent of firms said they had raised their prices "a great deal". As is discussed in Section 3, the relationship between customers and sellers, relative market power and the intensity of competition may well explain some of this disparity between the sectors.

Figure 3: Cleaning up? Price rises most common in cleaning companies

To what extent, if at all, has your organisation had to raise prices of goods/services you sell to help manage the wage bill increase since the introduction of the NLW?



Base: Employers that said the NLW has increased their wage bill (n=376)

While large ("a great deal") price rises were also limited in the hospitality sector (5 per cent), the overall proportion of employers saying they'd used some increase in prices as a means of coping with higher wage costs stood at two in three (66 per cent) significantly higher than in either food processing or retail. This aligns with what we can see in inflation indices. In the CPI basket for instance, restaurant and hotel prices have risen by 2.6 per cent in the year to November 2016.

Some firms have altered employment approaches, but very few have made redundancies

Opposition to minimum wages has often centred on the potential employment risk they can pose to the intended beneficiaries: those in low-paid roles. While most research into the NMW has found overall employment has not been significantly affected by its introduction, the scale of the increase associated with the NLW is such that concerns about employment consequences have returned to public debate. Indeed, reporting alongside the announcement of the NLW in July 2015, the OBR estimated that overall employment would fall by between 20,000 and 120,000 by 2020 as a result of the policy.[8]

The OBR acknowledged significant uncertainty around these estimates and the actual employment response unfolding among employers is set to be very carefully monitored over the coming years. In particular, it is important to consider precisely *how* any changes in employment approaches manifest themselves. For example, responses that involve employing the same number of people while reducing average hours will have different implications from those that involve lowering overall numbers in work. Likewise, reducing employment by scaling back recruitment is likely to look quite different to a programme of redundancies.

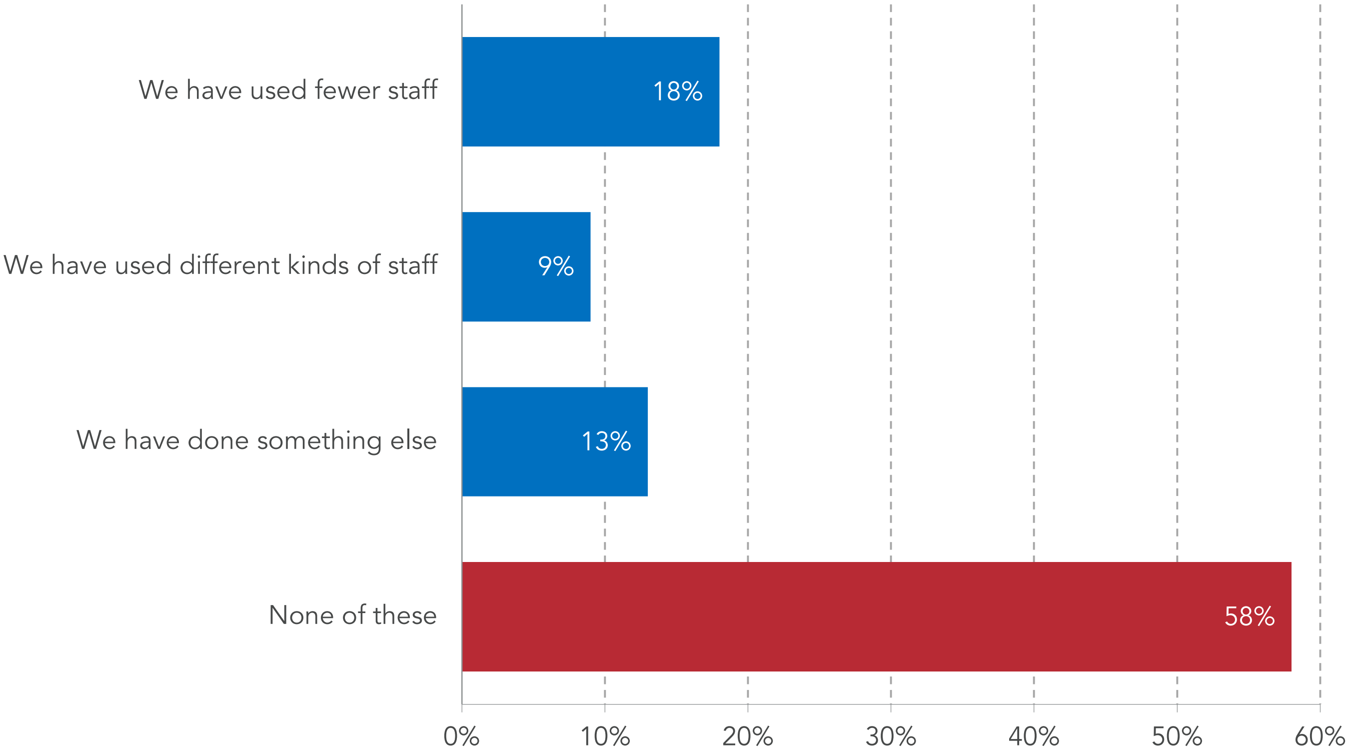
There are also important questions over the *kind* of employment offered. For example, in order to have tighter control over the number of hours worked and best respond to varying demand, employers might choose to make more use of zero-hour or casual contracts. They might even choose to recruit more people on a self-employed basis, thereby sidestepping minimum wage legislation.

To get at some of these questions, our survey asked employers whose wage bills had increased whether they had used "fewer staff" or "different kinds of staff" before subsequently identifying the specific response taken. As Figure 4 illustrates, four in ten (40 per cent) said they had made some form of employment response. This total comprised 18 per cent "using fewer staff", 9 per cent using "different kinds of staff" and 13 per cent doing "something else".

[8] OBR, Economic and fiscal outlook July 2015

Figure 4: Most affected respondents have not changed employment but one in five have used fewer staff

Proportion of affected respondents making specified change

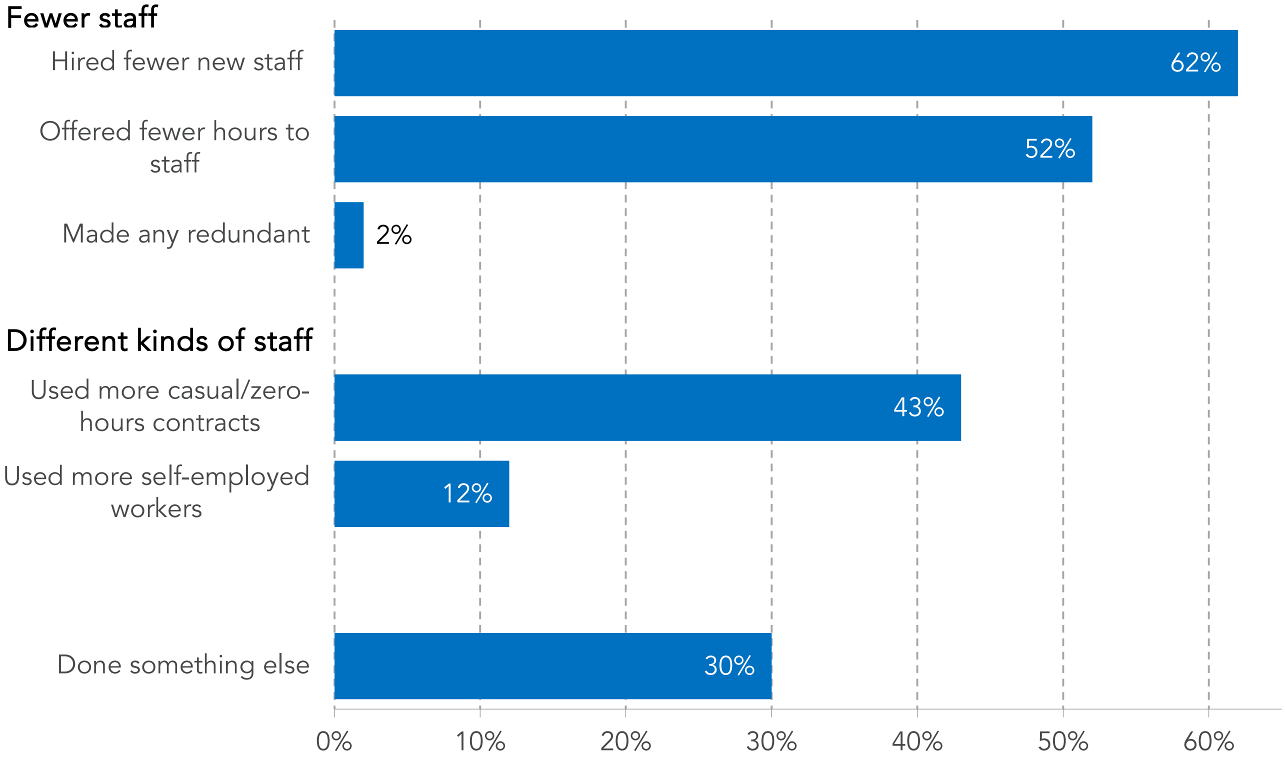


Base: Employers that said the NLW has increased their wage bill (n=376)

Figure 5 digs further into the 27 per cent of respondents saying they had used fewer or different kinds of staff to shine a light on the specific alterations employers are making. Multiple responses were permitted.

Figure 5: Among those changing employment, slower hiring and reduced hours for staff were most common

Which of these statments comes closest to describing your organisation's response to managing the wage bill increase since the NLW was introduced?



Base: Employers that said they had used fewer or different kinds of staff (n=93)

Looking first at changes that directly affect employment levels or the number of hours worked, we see that 62 per cent of employers affected by the NLW who made employment changes had hired fewer new staff than would otherwise have been the case. Just over half (52 per cent) reported offering fewer hours to their workforce. Only 2 per cent of affected employers making employment changes had made any redundancies.

Turning next to the use of different kinds of workers, 43 per cent said they had used more zero-hour or casual workers in response to the NLW. Increasing the use of self-employed labour was less common, but non-trivial, with 12 per cent of firms making employment changes doing so. Interestingly, three in ten (30 per cent) made unspecified "other changes".

In considering the impact on employment, a second key question is the *intensity* of reported changes. The survey shows that, among those employers using fewer or different kinds of staff in response to the NLW, 30 per cent described the changes as "a little", 43 per cent as "a moderate amount" and 27 per cent as "a lot".

It is worth noting just how few firms this final group covers. Under half of the firms in the sample said they had faced a rise in their wage bill, and just over one in four of these said they had used fewer or different kinds of staff. With just over one in four of this group saying their employment changes amounted to "a lot", we are picking up just 3 per cent of the entire sample of 800 employers. Nevertheless, it is clear that some organisations have made considerable changes to their employment approaches. And, while it is reassuring that less than 1 per cent of all firms in these low-paying sectors had made redundancies, trends in the number of hours worked and hiring rates should be monitored as the NLW rises higher.

Just one in six of those affected by the NLW have changed other parts of their pay and benefits packages

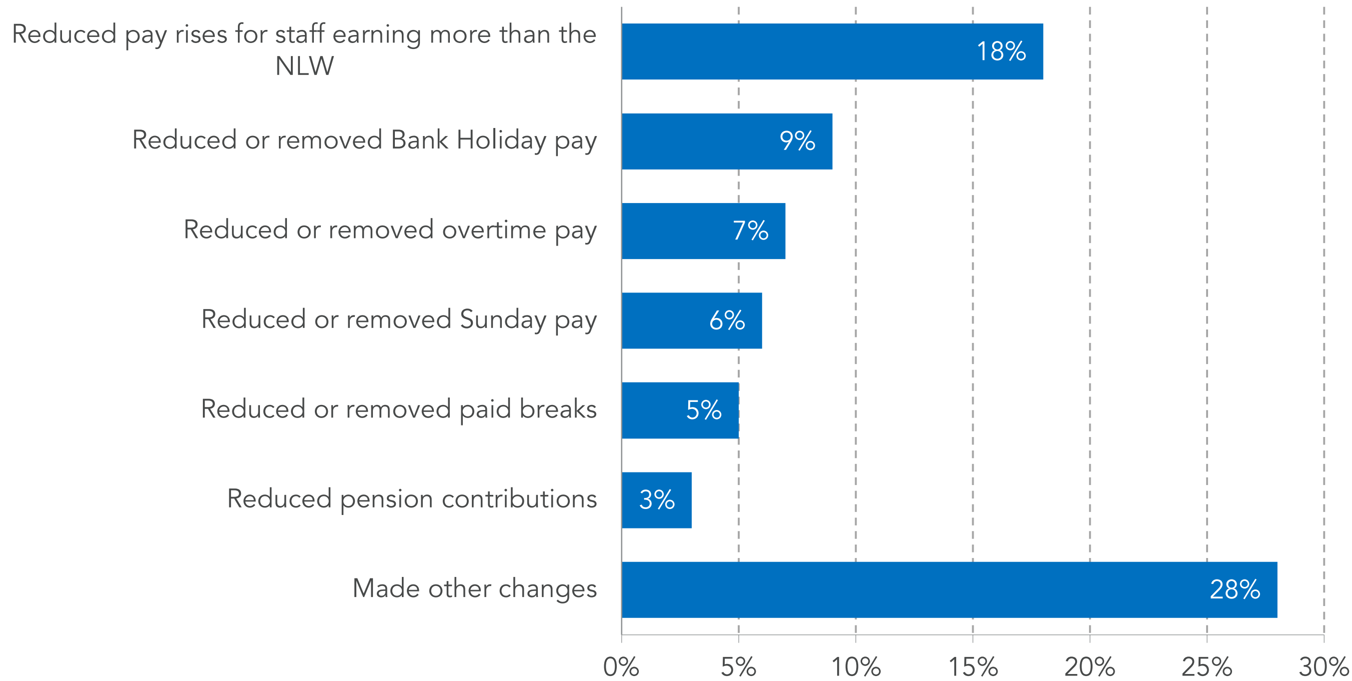
Another potential offsetting response from employers is to leave employment and prices alone but make alterations to other parts of their pay and benefits structure. Such responses have been much-discussed in the media since the NLW's introduction with a number of high-profile employers taking such a tack and the Chancellor at the time arguing that doing so was against the "spirit of the law".[9]

Despite this coverage, our previous survey suggested that such changes were less common than making adjustments to prices or simply absorbing the additional cost of the NLW. This finding is replicated in this survey, with only 17 per cent of those affected by the NLW making changes to pay or benefits. Half of those (49 per cent) said they had changed pay and benefits "a little", 38 per cent had made "a moderate amount" of changes with 13 per cent making "a lot" of changes. In general then, cutting other pay and benefits has been a limited strategy and those that have done so have tended to make small or moderate changes.

Figure 6 drills down into the specific changes that those 17 per cent of affected employers have made. The most common (18 per cent) was to reduce pay rises for staff earning more than the NLW. While this appears to be a response used by very few employers (representing just x per cent of the overall sample of 800), the cost pressures associated with maintaining pay differentials were raised by a number of the employers interviewed and is discussed further in Section 3.

Figure 6: NLW has slowed pay rises for higher paid staff in some organisations

Proportion of those who have changed pay and benefits that have used specific responses (%)



Notes: Of the 133 respondents who said they had made changes, 68 (51%) responded 'yes' to at least one of these responses while 65 (49%) responded either 'no' or 'don't know' to all of these responses. The response of these 65 is therefore unclear.

Base: Employers that said the NLW has increased their wage bill (n=376)

[9] See for instance http://www.bbc.co.uk/news/business-36082247

Other elements of the pay package were reduced or removed by some employers – including Bank Holiday pay, overtime pay, Sunday premiums, paid breaks and pension contributions – but fewer than one in ten of employers making changes to pay and benefits opted for any one of these.

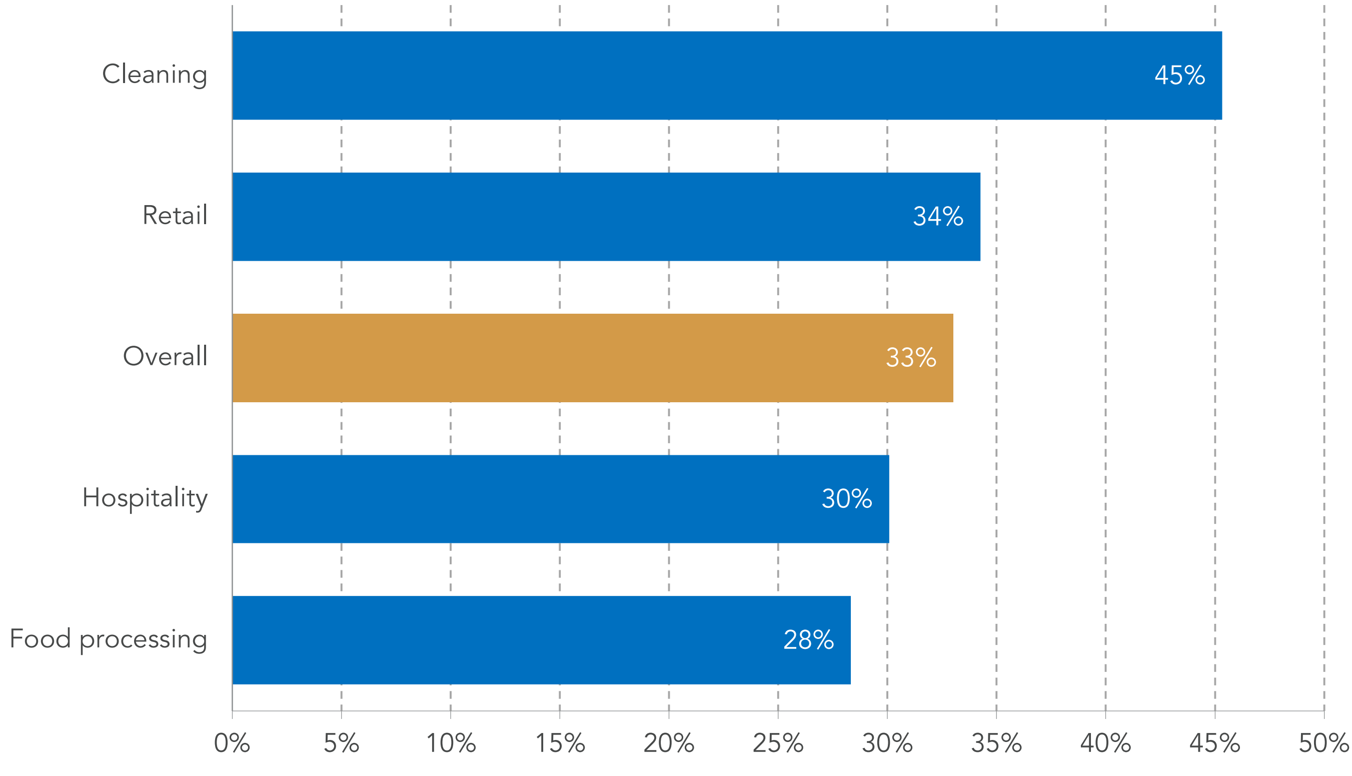
Investing in staff skills the most common productivity-booster

Another route through which higher wage costs can be offset is to make the organisation more productive, producing more for every hour worked than in the past. In previous surveys, in particular the joint CIPD-Resolution Foundation analysis carried out prior to the introduction of the NLW, boosting productivity emerged as one of the most popular planned responses among employers. But less detail was available from that research on the kinds of productivity-boosting strategies employers had in mind.

Figure 7 shows that two in three (67 per cent) of firms affected by the NLW say they have attempted to raise productivity in response. The figure again differs by sector, with food processing firms (72 per cent) being much more likely to cite this strategy than employers in cleaning (55 per cent) for instance. Average firm size, the differing nature of the work done in these sectors and the extent to which productivity gains are viewed as achievable are likely to play an important role in this pattern. These issues are discussed further below and in Section 3.

Figure 7: Most of those affected have tried to raise productivity but less so in cleaning

Proportion affected by the NLW that have not sought to raise productivity by sector (%)

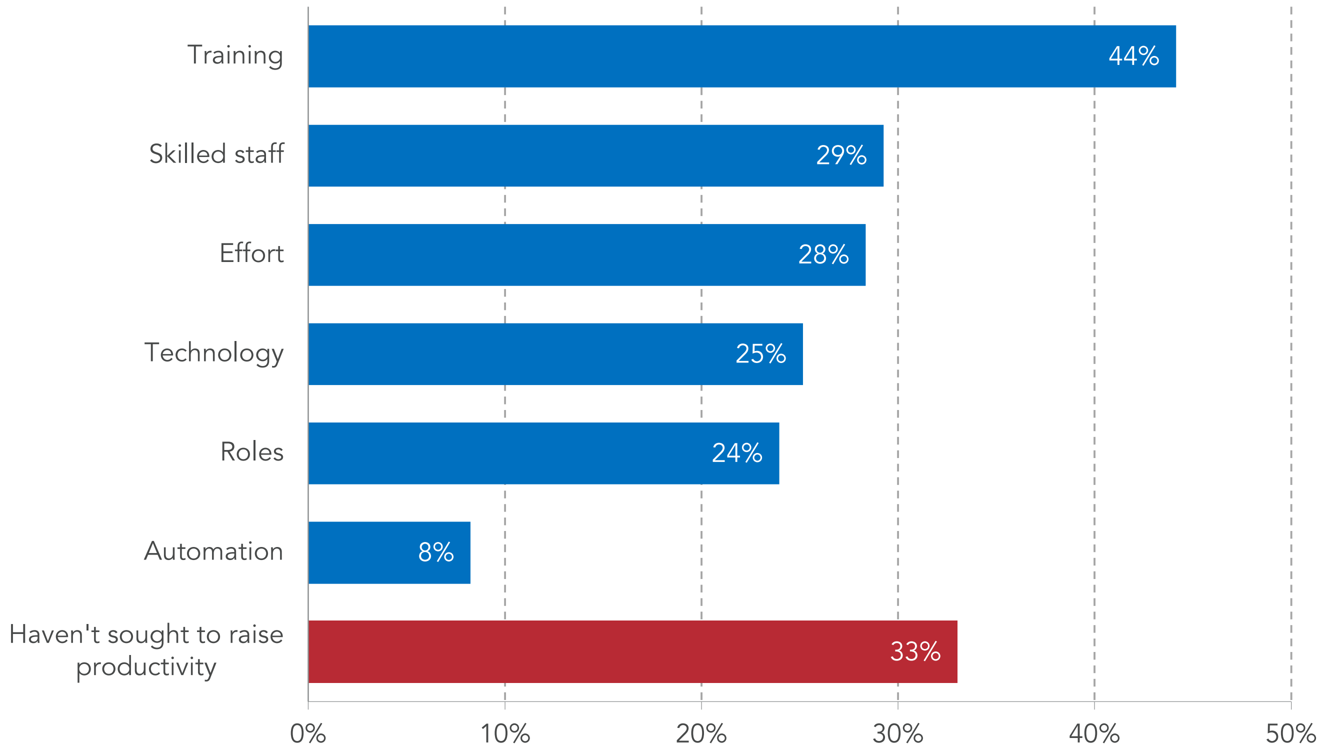


Base: Employers that said the NLW has increased their wage bill (n=376)

Among those seeking productivity gains, a range of responses have been utilised – as set out in Figure 8. Most focused on raising the output potential of existing staff, with just 8 per cent of employers affected by the NLW reporting investing in technology specifically to replace staff members. Instead, 44 per cent of employers said they had invested in training to improve the skills of their workforce, 28 per cent asked staff to work harder or more quickly and 25 per cent had invested in technology designed to complement staff. Changes in working practices were also evident, with 29 per cent making greater use of more highly skilled staff and 24 per cent of employers saying they had altered staff roles to include more complex or a wider range of tasks.

Figure 8: Investing in training has been the most common productivity-boosting response

In which, if any, of the following ways has your organisation sought to raise productivity in response to the NLW?

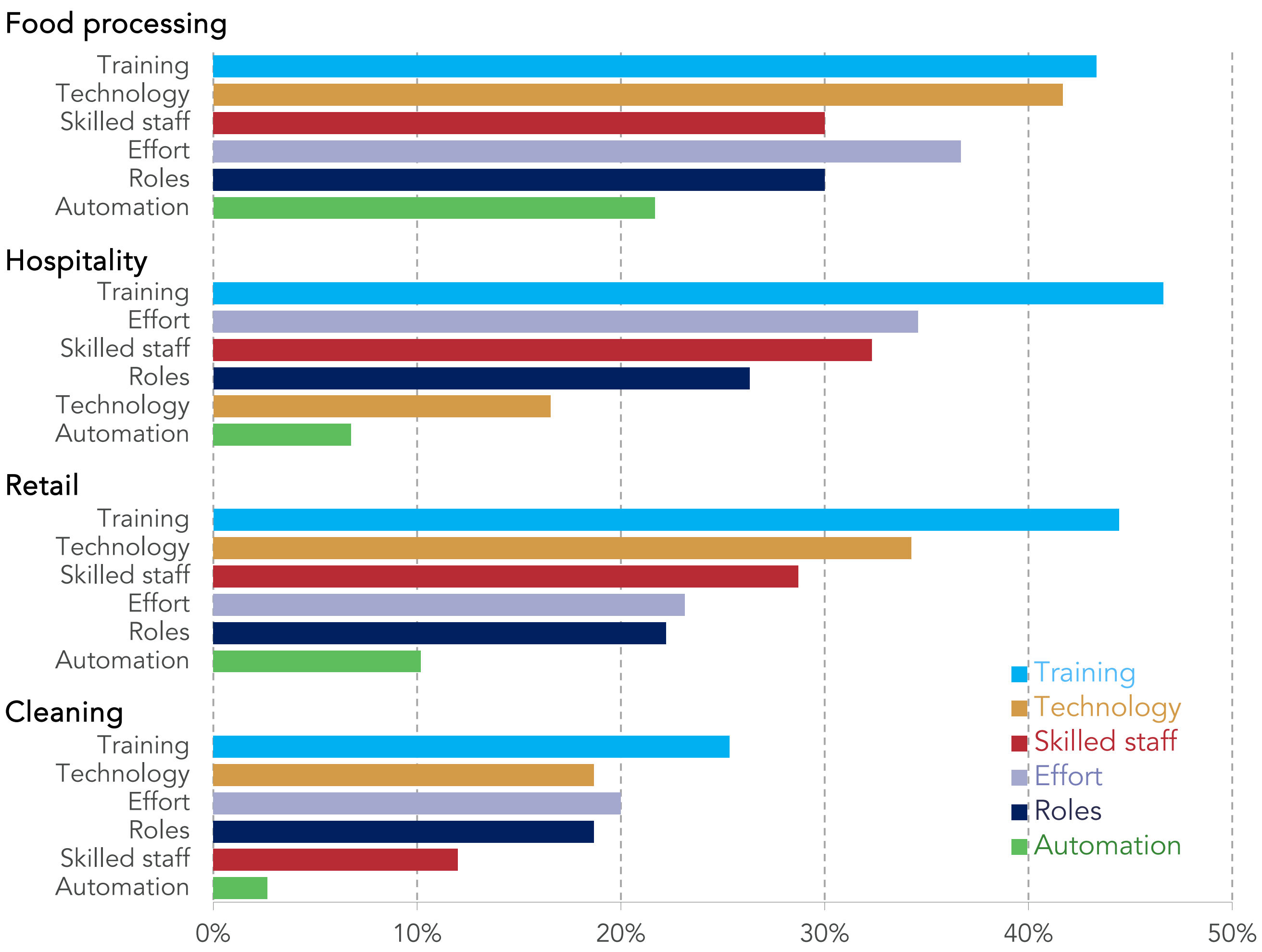


Base: Employers that said the NLW has increased their wage bill (n=376)

As noted above, the extent to which these differing approaches appeal to employers will depend on the types of roles their low-paid employees are performing and the business environment in which they are operating. Figure 9 illustrates how those approaches have varied by sector. In each sector surveyed, investing in training was the most popular productivity-enhancing response.

Figure 9: Productivity-boosting responses vary by sector but training is most popular in each

Responses among those who have attempted to boost productivity by sector (%)



Notes: Employers were allowed multiple responses to this question. For full detail of question responses see questionnaire in Annex

Base: Employers that said the NLW has increased their wage bill (n=376)

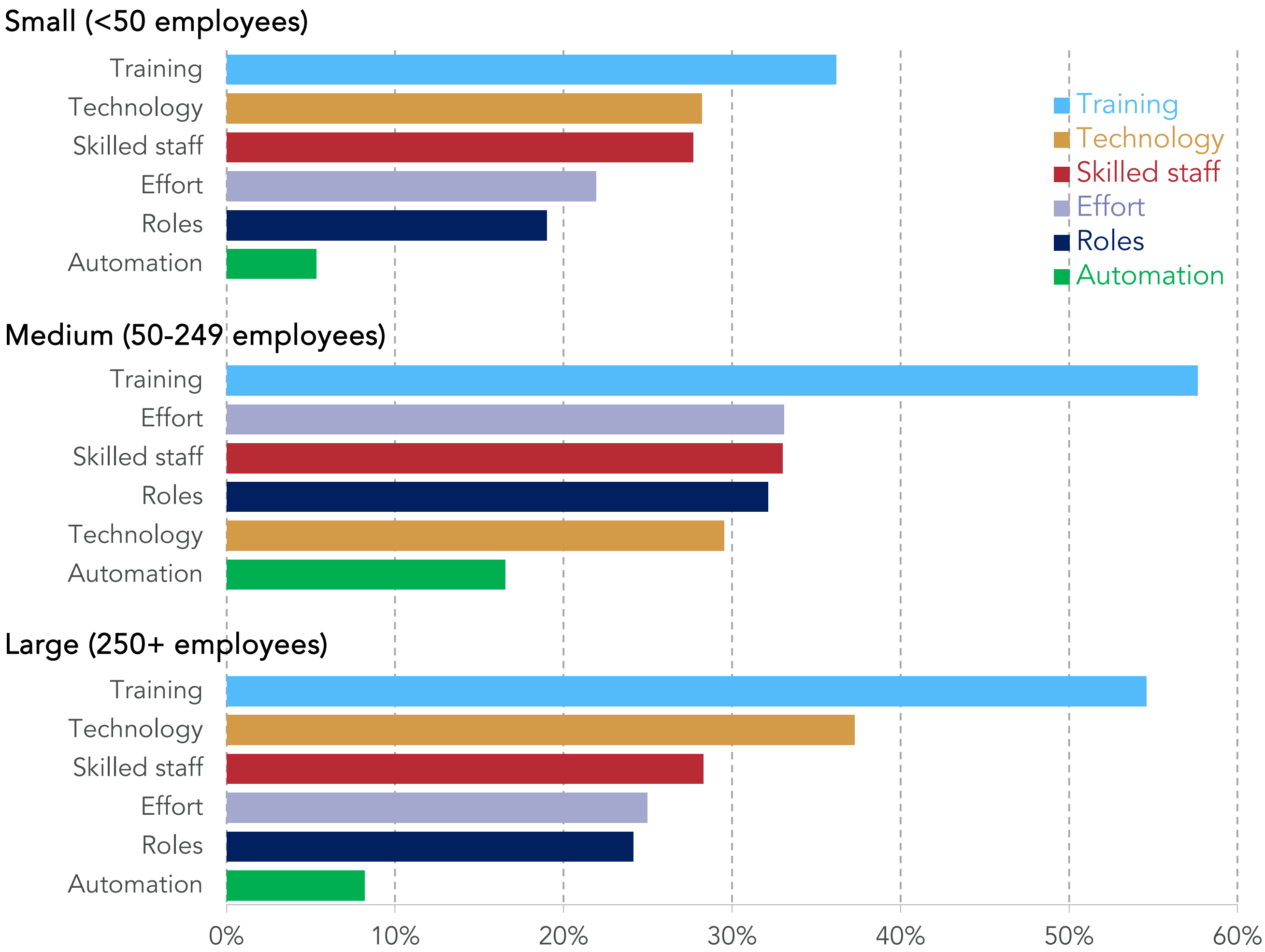
Some sector-specific trends do emerge however. In part these reflect the overall propensity for productivity already covered in Figure 7, but differences in the mix of approaches adopted is also worthy of note.

For example, while firms in both the food processing and hospitality sectors were broadly equally likely to say they had sought to boost productivity in response to the NLW, those in food processing showed a higher use of technology while those in hospitality were a bit more likely to focus on staff roles and effort. These differences reflect the nature of the two industries, with food processing already making significant use of machinery and hospitality being more labour intensive.

A strong finding of previous qualitative research into the NLW's impact is the relative difficulty smaller employers have in generating ideas for raising productivity. This again comes to the fore in our new survey, as highlighted by Figure 10. It shows that smaller employers reporting being affected by the NLW have taken fewer actions to try and raise productivity than their larger counterparts. Medium-sized firms have been most likely to try to raise productivity, with asking employees to work harder ("effort", 33 per cent) and investing in technology to replace employees ("automation", 17 per cent) more popular than in large employers.

Figure 10: Smaller firms have been least likely to try to raise productivity

Responses among those who have attempted to boost productivity by size of organisation (%)



Notes: See notes to Figure 9

Base: Employers that said the NLW has increased their wage bill (n=376)

As will be discussed later in this section, when asked what help government could offer to make the implementation of the NLW smoother, incentives to invest in training and technology ranked well below tax cuts. While there are of course limits to the gains that can be made, the higher productivity achieved by firms in similar low-paying sectors elsewhere in the OECD suggests more serious consideration of how to achieve such improvements could be fruitful.[10]

Looking forward, employers continue to point to a range of approaches for dealing with the NLW

Having discussed their responses to date, employers were then asked about their plans for future NLW increases. Before considering what this part of the survey showed, it is necessary to remind ourselves of the caution that should be applied in interpreting such forward-looking answers. As highlighted by the disparity in responses between the CIPD-Resolution Foundation survey prior

[10] See for instance S Thompson et al, *Boosting Britain's low-wage sectors: A strategy for productivity, innovation and growth*, IPPR, May 2016

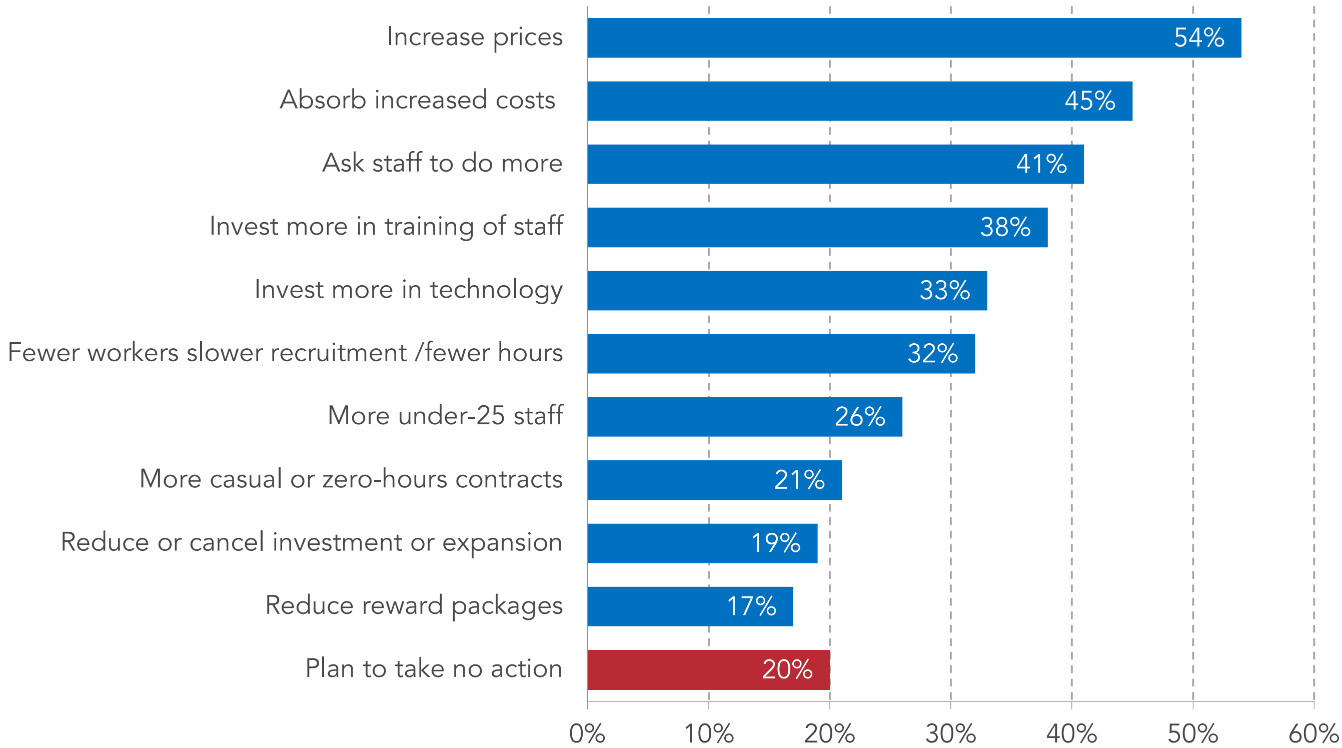
to the introduction of the NLW and the subsequent economy-wide survey in June 2016, employer views on future strategies do not always correspond perfectly with their eventual responses. And, as is discussed in Section 3, employers have tended to overestimate the pace at which the NLW is set to rise relative to the latest projections of the NLW's trajectory.[11]

Nevertheless, given that many firms will be taking action today in order to prepare for what they expect to happen in the coming years, these speculations on the future are worthy of consideration. Of the total 800 employers, 78 per cent said they planned to take some form of action as the NLW rose towards its target for 2020. The implication is that significantly more (but not all) firms in these lower paying sectors expect to be affected by the NLW as its value increases.

Figure 11 details the range of responses and shows that, as in previous research, raising prices (54 per cent) was the most popular response. This was followed by lowering profits (45 per cent), asking staff to do more – for example by taking greater responsibility or more varied roles (41 per cent) – and investing more in training (38 per cent). Investing more in technology (33 per cent; not specified whether labour-enhancing or –replacing) and using less labour (32 per cent) were the next most common.

Figure 11: Four in five employers surveyed expect to respond in some way to NLW increases in coming years

Thinking about the next four years, do you expect your organisation to take any of the following actions in response to this proposed increase of the NLW towards £9



Base: All employers (n=800)

[11] Low Pay Commission, National Minimum Wage: Low Pay Commission Report Autumn 2016, November 2016; OBR, Economic and fiscal outlook November 2016

Looking across the sectors, employers in hospitality were the most likely to say they would take action (86 per cent). They were also more likely than average to say they would raise prices (67 per cent). Cleaning firms were also a little more likely to raise prices (61 per cent) and were less likely to use fewer workers (21 per cent). Food processing employers were a little more likely to take lower profits (54 per cent) or invest more in technology (41 per cent). Retail employers were a little less likely to raise prices (45 per cent).

By size, a divide again emerges between small employers and their medium and large counterparts. Large and medium organisations were more likely to be planning to invest in staff (48 per cent and 51 per cent respectively, compared to 38 per cent overall) or to invest in technology (42 per cent and 45 per cent versus 33 per cent overall). Small employers were slightly more likely to plan to use fewer workers or offer fewer hours (35 per cent, compared to 32 per cent overall) and to hire workers aged under 25 (30 per cent versus 26 per cent overall).

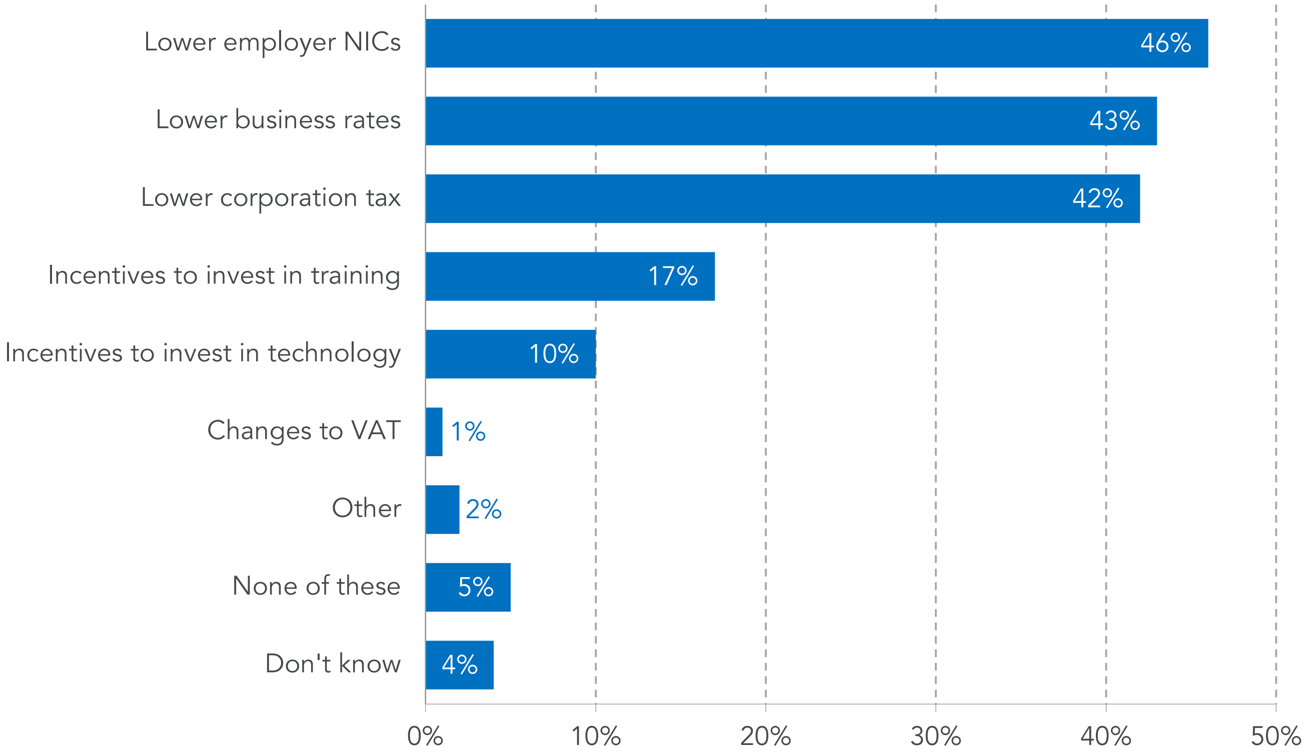
Focusing just on those who have already seen their wage bill increase, just 6 per cent plan to take no action in future. The ranking of the responses is similar to that above: raise prices (73 per cent); ask staff to do more (58 per cent); lower profits (51 per cent); invest more in training (49 per cent).

In terms of government action designed to help with NLW costs, employers displayed a clear preference for lower taxes rather than investment incentives

The final question asked of employers related to their preference of responses from government to help them manage the higher staff costs they faced as a result of the NLW (now and going forward). As Figure 12 shows, the three most direct tax change options presented were the most popular. A reduction in employer National Insurance contributions (46 per cent), lower business rates (43 per cent) and lower corporation tax (42 per cent) were all viewed by employers as being helpful. Incentives for employers to invest in training (17 per cent) or technology (10 per cent) also featured, but potential changes to the VAT threshold or rate were less supported (1 per cent).

Figure 12: Direct tax cuts more popular than incentives to invest in offsetting NLW

Which government actions would be most helpful to your organisation in managing higher staff costs



Base: All employers (n=800)

Organisations in the cleaning sector were more likely than other sectors to prefer lower corporation tax (50 per cent, compared to 42 per cent overall) and incentives to invest in training (25 per cent versus 17 per cent overall). In line with the discussion of technology usage above, food processing organisations were more likely to favour incentives to invest in technology than other sectors (22 per cent, compared to 10 per cent overall).

Small organisations had a stronger preference for lower business rates (50 per cent, compared to 43 per cent overall), medium-sized organisations were more likely to favour technology incentives than other employers (18 per cent, compared to 10 per cent) and large organisations were significantly more likely to find incentives to invest in training to be helpful (32 per cent, compared to 17 per cent).

Overall then, the survey reinforced a number of the findings of previous research in relation to preferences for raising prices and boosting productivity in response to the NLW, rather than primarily adjusting approaches to employment. Unsurprisingly, the proportion saying they have been affected by the NLW – or expect to be in the coming years – was higher in this sub-sample of low-paying sectors than it was in previous economy-wide surveys. The proportions pointing to different coping mechanisms were correspondingly higher. What's new is the deeper understand of how adaptations have and will differ across different sectors and by organisation size.

Digging further still, in order to understand the thought processes underpinning different responses, means moving beyond quantitative research to speak directly with those responsible for staffing decisions in those organisations most likely to be affected by the NLW. That's what we turn to in the next section.

Section 3

Interviews with employers

Alongside the survey, 15 in-depth interviews with employers in low-paying sectors were conducted. The interviews shone a light on the factors influencing the decisions made by firms as outlined in Section 2. While most employers had coped relatively comfortably with the increase to the £7.20, there were more concerns about managing future increases, with a widespread understanding that the NLW would be £9 (or higher) come what may.

The retailers interviewed highlighted the limited scope they have to raise prices in response to higher wage costs given the competitive nature of the industry. Relative market power was also discussed in food processing, with large players in the market – mainly supermarkets – able to dictate a large extent the price charged. Increased use of technology, both labour-enhancing and labour-replacing, was most discussed by food processing companies. For employers in social care, the NLW was an additional pressure on already squeezed budgets, with virtually no ability to change staffing levels due to legal requirements. For hairdressers, the NLW was located by many as being within a broader concern about skills within the industry, the increasing prevalence of self-employment and, as with retail, the difficulty of passing costs onto customers.

Methodology

The survey results discussed in Section 2 paint a representative picture of how firms in four low-paying sectors have responded to the NLW to date and how they may adjust in future. But what we can infer from these findings about *why* firms opted for particular measures is limited. To gain an insight into the decision-making processes of affected firms, interviews were conducted with 15 senior staff members in organisations operating in retail, hospitality, food processing, hairdressing and social care.

Semi-structured telephone interviews were carried out between August and October 2016. Unlike the representative survey, the impact of selection bias should be borne in mind when evaluating the findings presented here. Employers were contacted by trade bodies or similar groups representing industries. Because of self-selection – only employers who agreed to participate were interviewed – it may be that firms that participated were particularly affected. This is supported by the fact that 10 of the 15 employers reported facing wage bill increases this year as a result of the NLW – higher than the share in the survey – with an additional three expecting it to affect them next year. Nonetheless, the insights provided offer a valuable insight into the options being weighed and how these vary across sector, firm size and region.

This section first provides an overview of the interviews and some recurring themes before focusing on sector-specific findings.

The overall impression: limited impact this year but challenges ahead

Overall, the experiences of the 15 employers aligned well with the findings of the survey. In the main, responses to the introduction to the NLW had so far been minimal. In some cases this was because all staff were already paid above the NMW and so the increase had not been as large as it would have otherwise been and the additional labour costs were simply absorbed.

Prices

Views on the ability of firms to raise prices varied within and across sectors. Some organisations said it was inevitable that when costs increase so too must prices, and had therefore chosen to raise their customer charges faster than in previous years. Others viewed any price increase as counterproductive, arguing that the risk of driving away customers was a bigger concern than squeezed profits.

Many felt constrained in the extent to which they could raise prices. For some, particularly in the retail and food processing sectors, these constraints were framed in terms of what competitors were doing. For others, this challenge was portrayed as an unfortunate reluctance or lack of knowledge on the part of customers to pay more despite labour costs having risen:

> *The more that you charge, the less customers are going to want to come in. Or they'll spread their costs. So if they can make a haircut last eight weeks and not six weeks because it [now costs] £20 more, they're going to do that. So our revenue stays virtually the same but our costs increase... The NLW, I do agree with it but I do think that the general public don't have a perception of spending money. We had 10 years of austerity drummed into everybody, and having to cut their cloth accordingly, and now people don't want to [spend money]. [Small hairdressing salon, South East].*

Quality

Rather than raise prices directly, another approach taken by some was to offer less for the same price, reducing the size or quality of the product or service. For some, a downward shift was appealing, cutting back on the "frills" and "nice-to-haves rather than need-to-haves" offered to customers without the risk of visible price rises. Among those employers planning to cut corners in one way or another the idea that this shouldn't be noticed by customers was a common one.

> *Anything our guest touches and feels shouldn't be impacted by any cost-saving measures. But we should be looking to our suppliers to make sure we're getting the very best from them. I know our operations director has done a couple of reviews with the big companies like laundry, beer suppliers and that kind of thing... We're looking at things and saying actually, in terms of value for money 'are we getting it?'*
>
> *But also we're looking at the service that we're providing, looking and making sure that it's not impacting it because I think if you go too far, that impacts the guest. And that's what we can't have... the guest then saying 'actually, you've scrimped and saved on this bit and you've got tracing paper for toilet paper'... You need to make sure it's still good quality because that's what they're paying for. [mid-sized hotel group, West Midlands and South East]*

It should be noted that this approach to quality wasn't true of all of the employers interviewed. Some said that the NLW represented an impetus to move to a *higher* quality service, investing more in the physical infrastructure, skills of staff or the product itself in order to justify higher staff costs and potentially higher prices.

Perks

Some firms told us they'd put moves in place to reduce costs even before the announcement of the NLW. These efficiency measures included taking out layers of middle management and consolidating "perks" into the single hourly rate.

Yet we also heard that the introduction of the NLW had caused some employers to look at *improving* non-wage perks. With the NLW representing something of a 'going rate' in some firms and sectors, some employers believed that offering an attractive package of employment benefits was crucial to differentiating themselves and attracting (and retaining) the best staff. For similar reasons a handful of organisations had chosen to go beyond the NLW, raising their wage floor to £7.50 or above.

Differentials

Most employers had not protected the entirety of pre-existing pay differentials between staff. Although the size of the gaps between the lowest-paid staff and those on the next rung up varied, in the majority of employers this gap had narrowed as a result of the NLW rising faster than the pay increase given to the rest of the workforce.

The extent to which this caused difficulty within the organisation varied, with this seemingly depending on a number of factors including the culture within the organisation, the extent to which other (negative) changes had been made to employees' pay and conditions, the level of employee turnover and the perceived possibility of progression for staff.

Strategies to combat dissatisfaction with narrowed differentials varied. One approach was to put more emphasis on the training, qualifications and promotions available within the organisation. Indeed, progression was a hugely important concept in relation to recruitment and retention for almost all the employers. Many discussed examples of employees who had started on the minimum wage before rising into management positions over time. Other firms emphasised the importance of non-wage benefits, with staff discount cards valued highly by some employees for instance.

Recruitment strategies were changing, with firms making more of the wider pay package on offer. This was particularly true among those employers who paid a significant proportion of their workers at or very close to £7.20. Despite this, there was a feeling in many sectors and parts of the country that the hourly rate remained the ultimate factor in most people's employment decisions, with those people paid close to the NLW would change jobs for pay increases of as little as 20p, with the hourly rate being the ultimate factor in most people's decisions on where to work.

Different kinds of staff

Another survey finding confirmed in the interviews was the greater use of highly skilled staff and a cutting back on the use of zero-hours contract, casual and agency workers. These workers were often viewed as less reliable, less productive or – in the case of agency workers – more expensive.

The reasons agency workers were utilised varied. In social care, the most important reason was legal requirements stipulating the minimum number of staff per patient. In food processing, variability of demand was a greater concern. Notwithstanding these issues, most employers were keen to reduce their use of agency staff to some extent.

There were no examples of permanent staff having their contracted hours reduced in response to the NLW, but the cutting back on the use of these 'auxiliary' staff did in some organisations reduce the total number of hours worked.

Regional variation

Among those firms that had operations in different locations across the country, the interviews uncovered some evidence of diverging approaches within the same organisation. For example, we heard that social care recruitment in the South East and London was set to become more challenging with growing competition from other industries. Yet in areas with lower employment rates, the NLW's impact was expected to be negligible on recruitment.

There was also concern that social care packages were at risk of being "handed back" in some local authorities, reflecting a lack of profitability. Similarly, within the retail sector we were told that branches in less profitable parts of the country were at risk of closure.

Terminology

A concern that was not sector-specific was confusion arising from the name 'National Living Wage'. For one social care employer, their "first reaction was 'what the hell does this mean?'" This puzzlement was perhaps most acute among those who used the voluntary Living Wage as a rate for at least some of their employees:

> *[If you're an employee] all of a sudden, you're scratching your head going 'Well my employer's got me on £9.40, government's now saying the Living Wage is £7.20 – are you saying you're going to reduce my pay?' And that's been part and parcel of the confusion attached to this whole exercise. [large social care employer, England]*

> *I was quite disappointed when the Chancellor stole our clothes. I felt it personally. Because really the last thing the real Living Wage wants to be is a political football. [small hospitality employer, South West]*

The vast majority of employers interviewed supported the policy and understood the argument for a higher wage floor. Repeatedly, it was framed as "it's a fair approach but…" with the "buts" varying from the lack of government funding for social care, to customers not understanding the extent to which labour costs have risen, to other less scrupulous businesses undercutting them through avoiding tax or providing a poor quality service.

Uncertainty about £9

Thinking ahead to further increases in the rate, participants were more concerned about the dwindling of options to offset their growing wage bill and the consequences of a rising wage floor. In some cases, this was informed by their sense of the trajectory of the NLW. In the vast majority of cases, employers assumed that the NLW would reach £9 by 2020. Others expected it to be higher still, having heard or read news sources that indicated it would be £9.20. This is at odds with the latest expectations of the OBR, LPC and others, with central estimates of the NLW in 2020 varying from £8.61 to £8.80.

Some interviewees were aware of the potential for the NLW to come in below £9 in 2020, particularly following a change in government and the EU referendum result. As one employer described, "we're also wary of trying to model this… all the way through to 2020".

The kinds of responses employers were making and the intensity of those responses were in many cases guided by their projections for the rate and what it would mean to their wage bill. Clearer communication of the likely route of the NLW based on revised forecasts is likely to be helpful to organisations as they put plans into action.

Ideas for responses to the rising NLW in future diverged by industry with particular issues or approaches discussed in more detail below by sector. For most employers, redundancies remained a last resort. In some cases, there was a sense that underperforming aspects of the business would be reduced or closed in order to better focus on the successful elements. Again, for most employers these were shifts that were already in motion, but the NLW acted as an accelerant to this process.

Brexit

In looking ahead, the impact of the EU referendum was raised in a number of interviews. The degree of concern was directly linked to the number of EU nationals the organisation employed.

Some employers, particularly those in the North and East of England, employed few non-British workers. As such, any worries they had about the repercussions of leaving the EU were tied to how the economy as a whole was performing rather than their recruitment prospects. But in those organisations in which EU nationals comprised a large proportion of their workforce, concerns were more clearly expressed about what it might mean for their workforce and pay rates.

Responses varied by sector

While there were clear common themes running through the interviews, we also identified distinct sector-specific concerns The following sub-sections provide a of responses, highlighting some of the unique or key trends across five specific industries.

Hairdressing

Five interviews were conducted with employers in the hairdressing industry. The salons were based in London, coastal towns in the South and East of England and towns and villages in the South East and Yorkshire. The majority of hairdressing staff employed were paid at a base wage that was at or very close to the NLW, with commissions linked to performance. Each of the interviewees was the owner or director of the salon.

As in a number of the other sectors, the employers interviewed highlighted that the NLW interacted with and exacerbated pre-existing trends or concerns. That said, the primary actions taken by the employers in response to the NLW interviewed varied somewhat.

For some, only a handful of staff were affected by the NLW with senior stylists already paid well above £7.20. As they faced only a small impact on their wage bill, these employers generally opted to simply absorb the additional costs from the NLW. One employer had sought to reduce other costs facing the business. Some salons raised their prices slightly more this year than in past years, but excessively large increases were seen as unsustainable. Options considered but rejected included using cheaper products. This was seen as a false economy, ultimately damaging customer relationships.

Alongside these common trends were issues that emerged particularly strongly in hairdressing compared to employers in other sectors.

For example, unlike the majority of employers interviewed, most salons used the full range of age-related minimum wages and the apprentice minimum wage. These were everywhere topped up by commissions, the level of which varied but were often in the region of 20-30 per cent of what a customer paid once that customer had become a repeat client of a particular hairdresser.

One hairdressing employer saw the gap between the NLW and the youth rates as a disincentive to hire older workers or retain them as they age:

> *It makes the selection process of who you're going to employ from the juniors more complicated. Fiscally, it hasn't had an impact on our business yet. But it raises the barrier to say 'well actually, if you wanted to take somebody on to pay them £6 an hour as a student, or £7 an hour, a job you could give them two days a week, now you can't give them that job. [small salon, London]*

Qualifications were also discussed as a distinct issue among hairdressers, with the poor quality of hairdressing NVQs repeatedly raised:

> *The NVQ system isn't working at all. When I did my training, we did three years of apprenticeship, two years of improvership, so really we did five years of training. They've condensed that down now into one year of training. The*

> *only way they can do that is by removing parts of the syllabus... When you take that to an employer and say "I've got an NVQ2", you're unemployable. That's why the system isn't working. It needs to be recognised that to do any job, you need to be trained properly and thoroughly. And so to do that it's going to be a minimum of two years. [small salon, London]*

For some, this was closely connected to the culture of low pay within the industry, with the prospect of licensing raised as one means of raising quality and pay:

> *If you're paying the minimum wage then this cycle of low pay, low standards, perception of the industry being for 16 year olds who haven't succeeded at school and are too dim to do anything else perpetuates itself. [Licensing] means you would have to raise standards. [small salon, South East]*

Employers who aimed to offer an above-average quality service felt limited in the amount they could charge. This was seen as a first mover problem. For employers who were keen to raise their charges and who had highly qualified staff, the concern was that they were being undercut by other salons.

The frequency with which price rises could be passed through to customers was also viewed as limited, with the minimum wage rates increasing in October followed by the NLW in April posing a difficulty:

> *I only put my prices up for customers once a year. And there's only so much you can push your prices. So I just have to make cutback where I can. The girls have to have their pay. I don't begrudge them any of it but I can't by the same token keep increasing my prices twice a year to keep up with the minimum wage and living wage. It's blooming confusing! [small salon, Yorkshire & Humber]*

The use of self-employed stylists within salons was another issue specific to hairdressing, and one that was considered controversial among many of the employers interviewed. For some, it was first and foremost a way of minimising the tax liability of the salon:

> *The microscope has been on this practice for a number of years from HMRC because unfortunately some people do use it as a tax fiddle... A certain number of hairdressing salons are trying to have it both ways. They think they're chair-renting. That frees them up from what they see as onerous red tape. [small salon, South East]*

Rather than being particularly focused on the lowest earning members of staff as a way of avoiding the NLW, the employers interviewed suggested that it was their higher-paid stylists who were more likely to be self-employed. Nonetheless, this was viewed as a way of keeping down total staff costs including employer NICs and holiday pay, partially in response to the NLW. It was viewed as a longer-term trend within the industry, which many of those interviewed saw as a negative:

> *The whole industry is being driven to be self-employed, the whole service is just going down the toilet. [small salon, South East]*

Unlike larger organisations, another option that these smaller businesses reserved was to reduce their own salary. As one salon owner in Yorkshire and Humber described it "when things get tough, I just have to go without my wages." In that case, it was related to refurbishment but this was another coping mechanism available.

Social care

Four social care employers based around England were interviewed. Each of the employers stated that the NLW had had a significant impact on their workforce. The share of employees affected varied however, from an estimated one-quarter in one organisation to three-quarters in another once wage spillover effects were factored in.

Social care employers regarded their task in responding to the NLW as being more challenging than employers in other sectors, with the range of options available to them perceived as more limited. For example, reducing staffing levels was not an option due to Care Quality Commission legal minimums. This aligns with other recent research into the impact of the NLW on social care.[12]

Additionally, respondents pointed to complications associated with the sector's business model. That is, because fees for local authority funded patients are negotiated en masse, care providers lack the same straightforward business/customer relationship enjoyed by other sectors. One approach for dealing with this situation that employers raised centred on negotiating harder with local authorities over care fees. For example, one organisation had made a concerted move to improve their negotiation capacity by hiring new senior staff with greater expertise in this area. Nevertheless, there was broad agreement that this option would prove difficult:

> *65 per cent of [our] business is a negotiation with the local authorities to say 'how much are you going to pay us for that bed?' So if our costs increase, therefore where do you put that cost? Somehow you have to pass that cost onto your customers...*
>
> *However, pushing through an increase to local authorities is like hitting your head against a brick wall. Because they turn around and go, 'well, we haven't got the funding either'. So in many ways it's that circular argument of the government saying 'we need the NLW', which you kind of understand, but they're not funding that for organisations like ours that actually get their contracts from local authorities.*
>
> *So if the government isn't funding it that means that we've got to find the money from somewhere. Or we have to close homes or make other cutbacks from somewhere else. So that calls into question our longer-term sustainability. [large care provider, England]*

With funding available from local authorities viewed as ultimately being limited and the social care precept making little or no difference, providers said they were considering the balance between local authority funded patients and self-funders (those who entirely pay their own fees). Self-funder fees are typically higher and potentially easier to vary, presenting two potential avenues.

First, some employers pointed to the possibility of increased "cross-subsidisation" – whereby higher fees for self-funders offset in part the increased wage bill costs associated with the NLW – though the extent to which this was thought to be a viable strategy varied. None presented it as a solution that would *entirely* offset the NLW-related wage bill increase, but one employer argued that "we might be able to squeeze a little bit of an increase through for self-funders" [large care provider]. For another organisation however, there was "no scope" to raise charges for self-funders.

[12] L. Gardiner, *Rising to the challenge: Early evidence on the introduction of the National Living Wage in the social care sector*, Resolution Foundation, August 2016 ; G Giupponi, A Lindner, S Machin and A Manning, The Impact of the National Living Wage on English Care Homes. Research Report for the Low Pay Commission. Centre for Economic Performance, London School of Economics; and University College London, October 2016

A second approach related to changing the mix of self-funders and local authority funded patients, effectively raising the former and lowering the latter. A number of the interviewees presented this as regrettable but inevitable on current trends, potentially leaving vulnerable people without a bed. This however was seen as unsustainable and ultimately the responsibility of government to ensure that the sector was properly funded.

The challenge of managing pay differentials was also commonly cited as a particular issue among social care employers. We heard that some staff earning slightly above the NLW had already started to query the narrowing of the gap between themselves and the wage floor:

> *In some homes, we've had some grievances from employees, head housekeeper roles which we've looked at and addressed on an ad hoc basis, so they've tended to come in piecemeal rather than everyone up in arms. [large social care provider, England]*

In some organisations maintaining differentials came alongside an increase in the responsibilities of existing, higher paid staff, resulting in them overseeing more staff than they previously had. Other employers reported that there had not been difficulties to date, but acknowledge that there were long-term concerns over the incentives available to qualified care staff. One employer who paid the voluntary Living Wage to qualified care assistants had projected that by 2020 much of the gap between the two rates would disappear:

> *An unqualified care assistant who hasn't gone through an NVQ will find in 2020 that their pay is £9 per hour. Whereas a qualified care assistant, who has done the NVQ and is linked to the true Living Wage rate, will be on something like 10 or 12p per hour more. You start to get to the point where people are questioning 'should I bother with a qualification?' [large social care employer, England]*

On recruitment, the competition posed by other employers was described generally as increasing. Supermarkets in particular were thought to be paying higher wages than social care providers, in a less emotionally demanding job:

> *That challenge has probably been exacerbated by the NLW but it always existed. It's just not funded effectively. I'm looking to recruit somebody and they could go work for Tesco and stack shelves and it's dead easy. Or they could come work for one of my services and I have to trade on the fact that it's a vocation and it's fulfilling. [large social care employer, England]*

> *We're competing with Tesco's and Sainsbury's and the big warehouses...We have lost staff to the warehouses, they go and pick and pack for a pound an hour more. When someone's earning £7 an hour, £7.50 an hour, they will move for an additional 20p an hour. [large social care employer, England]*

The extent to which this was an issue varied across the country however:

> *No one in this sector would have any problems recruiting somebody on the NLW in Darlington or Rochdale. And it's impossible to do it in Surrey... The big thing is what's the employment like in the area. [large care employer, England]*

Recruitment difficulties led to a number of care providers operating in the South East relying heavily on agency staff. This was viewed as unfortunate by many, believing a more changeable workforce ultimately offered a poorer standard of care. But while some saw the continued use of agency workers as inevitable, one employer had offset much of the NLW increase to their wage bill from reducing their use of agency staff:

> *We were spending an awful lot of money on agency staff because we had to fill the gaps. It's not like a factory where if you haven't got enough staff you just produce less. If we haven't got enough staff we get closed down. We were bringing agency staff in who were costing £13, £14 an hour, instead of paying somebody £7.50 plus on costs which is about £9 an hour. So [using agency staff] becomes more expensive and the quality of care you provide [suffers]. [large social care provider, England]*

In response to this they raised their wage significantly above £7.20.

> *All of a sudden, our vacancy numbers just dropped. And the difference in response. A year ago, we'd struggle to find 10 people to interview and we might offer to one out of those ten... [Nine out of ten,] we couldn't offer them a job because they'd just be dangerous, the kind of work we do. Now, we're offering to nine out of ten, and the one we're not offering to is probably the one we would have offered to a year ago. It's a massive change in our recruitment, retention has improved... We are probably spending less on salaries and staff costs than a year ago, even though we're paying our staff more. Our agency costs dropped from £140,000 a month to £40,000. Which is a hell of a difference. [large social care provider, England]*

Retail

Some of the retailers interviewed for this report had significantly restructured their reward package *prior* to the announcement of the NLW. In the main, this diverted some of the value of 'perks' such as pension contributions and overtime pay into the hourly rate. So while the introduction of the NLW had not affected their wage bill, the view taken by those interviewed was that if this restructuring had not taken place, the NLW would have required a similar deal to be arranged.

A further reaction related to the overtime, with respondents saying they had both reduced the *rate* of overtime pay and the *use* of it, instead choosing to improve timetabling processes. The combination of lifting the wage floor, reducing 'perks' and lowering overtime use had resulted in squeezed differentials between those on the NLW and those on the next rung up, generally supervisors within stores.

A common theme across the retailers interviewed was the difficulty of raising prices in such a competitive market. The retailers interviewed considered themselves to be mid-market. As a result, they had found the recent years difficult and felt under pressure not only from the discounters but also from 'premium' brands:

> *What we'd like to see really is... it will be the market that changes with the constantly squeezing through of price challenges through the supply chain will have to give. And I think it will be a sectoral thing. In the same way that price-cutting, it's not just been one supermarket and nobody follows. The whole market follows really. It's a good question, when will we reach that point when those costs will be passed onto the public. [large retailer, North West]*

One retailer had recently closed some stores. These were shops that had failed to make a profit over a number of years, but the NLW was cited as a factor in making the decision. Some of the shops had been sold on to another company, while others were closed outright. Another retailer argued that closures are a normal part of the competitive process, with the NLW playing little role:

> *It could be that certain businesses really struggle and individually go out of business but that's really what you get anyway with competition. [large retailer, East of England]*

The approaches of the retail firms to employment structures varied. In general, they had sought to remove roles and functions from the shops that were seen as less crucial – such as fishmongers, butchers and deli counters.

'Delayering' was put forward as another likely option. One retailer said they expected to keep the same number of stores going forward but that they were considering reducing staffing levels, primarily by cutting the levels of staff within their stores from four to three within 18 months. They expected this to reduce the number of staff working in stores by approximately 5 per cent to 6 per cent over the coming years, with much of this coming from not replacing staff as they leave and redeploying staff into other stores, though redundancies were described as a possibility.

Proposed reductions in staffing numbers were based in part on the anticipated rise in the NLW. One interviewee expected it to rise to £9.20 by 2020. Another, who was anticipating £9, explained that their chosen approach would be likely to vary if the cash target was lower:

> *If the economy does slow down then the £9 by 2020 might become £8.50 and that would be great from a funding point of view. [large retailer, North West]*

Hospitality

The two hospitality employers interviewed differed significantly in their size and exposure to the NLW.

A small employer in the South West has for the past two years paid all its staff significantly above the NLW. While the NLW has therefore not impacted the firm, its decision to move to the voluntary Living Wage and how it made it affordable is instructive as to the kinds of approaches available. A seasonal business, its primary adjustment mechanism was to reduce the bonus given to staff who complete the full summer season with the organisation. By staying well above the statutory wage floor, the organisation felt it attracted a higher calibre of employee. It also reduced employees' likelihood of leaving the organisation and thereby reduced recruitment and training costs. The business was viewed as offering a "premium product", charging more than similar businesses in the area.

A mid-sized hotel group operating primarily in the South East faced a larger impact from increases in the wage floor, with half the staff on the NLW or the NMW. Despite this large impact, we heard that the business has performed well in the past six months, hiring more staff in order to keep pace with demand. Rather than opt for any large, single approach, they had chosen a more piecemeal approach to the changes:

> *It's almost like there's a little spoonful taken from each bowl. Because what you don't want to do is do too much from one space and then do damage. [mid-sized hotel groups, West Midlands and South East]*

The "bowls" taken from included the removal of previous perks like subsidised accommodation and transport. Initially this was a "big deal" within the organisation, with a number of employees unhappy. These benefits had only been used by a small part of the staff though. And, in recognition of the value of non-wage benefits, the hotel offered a new staff benefits card including discounts on insurance and restaurants.

Prices provided another adjustment mechanism, with the NLW acting as a "slight pressure" on the rates charged for rooms. An additional change made by the hotel was tightening up on the charges racked up by customers during their stay: "if they've ordered a coffee to their room, they should pay for it."

Food processing

Our interviews covered just one food processing company – a large one based in Yorkshire and the Humber. It said that many of its employees had been affected by the introduction of the NLW and that, due to other changes in the business environment, it was also going through a period of restructuring which overlapped with the NLW period. The primary way in which the company had reduced costs in this period was to cut back on the amount of overtime worked:

> *At [one] site, they traditionally have had a slight premium on the minimum wage and so we tried to maintain that and moved to £7.35 there. But to fund it, we reduced the overtime pay from time-and-a-half and double-time to time and a quarter and time-and-a-half.*
>
> *Overall, for someone working 40 hours they would be better off. However, there are a proportion of that workforce that work significantly longer hours and so they've been hit on two counts: their overtime premium has been reduced and they're working less hours because we are trying, as much as we can, to reduce overtime working because it's such an expensive way of running the factory. [large food processing company, Yorkshire and Humber]*

Prior to this change, eight to ten hours a week would have been overtime (25 per cent), though that figure includes a "huge uplift" at Christmas. The shift caused a lot of "negative feeling", but no one left the company. More generally, we were told that the adaptability of workers remained a valued attribute.

The firm remarked that some other employers chose not to not pay breaks and advertised their hourly "working time" rate, a practice it described as misleading:

> *At the moment we pay breaks and I think we'll continue to pay breaks because it's really important that people do have the right breaks in the time. But what seems unfair is that it's an uneven playing field. So someone like [a supermarket] declares a base rate of £8 whatever, but they're not paying for breaks. Now, if we took the breaks out of our calculation and calculated what we're paying for working time, our rates would be above £8 an hour. [large food processing company, Yorkshire and Humber]*

Asked whether the big supermarket chains are becoming more likely to accept higher prices, the food processing employer said they "haven't seen any signs of that":

> *I think the issue is that we still have a retail market where the big five retailers are still competing on price all the time. Still price matching. And so unless they collectively agree that they will take on board a 3.5 per cent increase in product costs due to the 3.5 per cent increase in the Living Wage, I don't think that's going to happen. They will find other ways of doing it. And I know manufacturers are changing pack sizes, 'respec-ing' products, just to meet the price points that the consumer is prepared to pay. [large food processing company, Yorkshire and Humber]*

As was discussed in Section 2, the use of machinery is already more widespread in food processing than in many other sectors. While the employer interviewed had lots of technology in its factory and is "constantly looking at new kit" unrelated to specific changes in the minimum wage, it acknowledged that there are limits and trade-offs:

> *One of the difficulties is that it's hard to automate some of the [food processing] because the [products] are different sizes... it's not always straightforward to automate. The other thing about food processing is that there is an element*

> *of fashion to it and the life cycle is relatively short so specs can change quite dramatically. So you have to moderate your investment to the life of the product. [large food processing firm, Yorkshire and Humber]*

As noted at the start of this section, the interviews we conducted cannot be considered to provide a representative take on the challenges and responses undertaken by firms across the different sectors we have researched. Nevertheless, the insights they provide offer a valuable glimpse of just how firms go about making decisions relating to the NLW and of the extent to which these decisions are affected by sector-specific – and sometimes firm-specific – circumstances.

Section 4

Conclusion

This report provides another contribution to evidence on the impact of the NLW to date. But as both the survey and interviews revealed, the policy is still in its infancy, just six months since it came into force. As such, employers' responses so far and their stated intentions may not perfectly reflect how firms adapt in coming years.

So far however, no dramatic changes are visible at an aggregate level. With half of employers even in low-paying sectors unaffected by the NLW's initial rate of £7.20, and many others experiencing only a small increase in their wage bill, this is perhaps unsurprising. Clearly however, a small minority of firms have struggled with the NLW's introduction and some employers interviewed expressed concerns about their ability to keep pace with the rising wage floor over the next few years.

But in both the interpretation of the survey results and in the views of employers expressed in the interviews, isolating the NLW's impact from other pressures and changes is difficult. This research was carried out three months after the EU referendum. Economic indicators show some signs of a knock-on effect from the decision to leave the EU but on the whole, the labour market response in the latter half of 2016 has been minimal.

For low-paid employees, the findings here generally represents good news, with some surprising upsides in relation to increased perks, greater focus on progression and more productivity. Of course on many of these, the gap between what is promised and what is delivered is likely to be wide and as the NLW rises higher, the inability to raise productivity may mean employers face more difficult decisions. But the NLW's link to median pay rather than an arbitrary cash target perceived should mean that the wage floor's progression to 2020 is broadly in line with wage growth and the performance of the economy overall. But the need is clear for continued monitoring of the policy's impact to ensure it can deliver what is was intended to for the UK's lowest earners.

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Annex

Table A.1: Overview of the sectors surveyed

Low-paid sector	SIC Code	Number of businesses	Proportion of businesses	Number of interviews
Retail	46 (Wholesale) 47 (Retail)	194,755	55%	275
Hospitality	55 (Accommodation) 56 (Food & beverage) 82 (Organisation of conventions)	130,465	36%	225
Cleaning	81 (Services to building and landscape activities)	26,120	7%	175
Food processing	10 (Manufacture of food products)	5,715	1%	125

Figure A.1 Job titles held by survey respondents

Which position do you hold in the organisation?

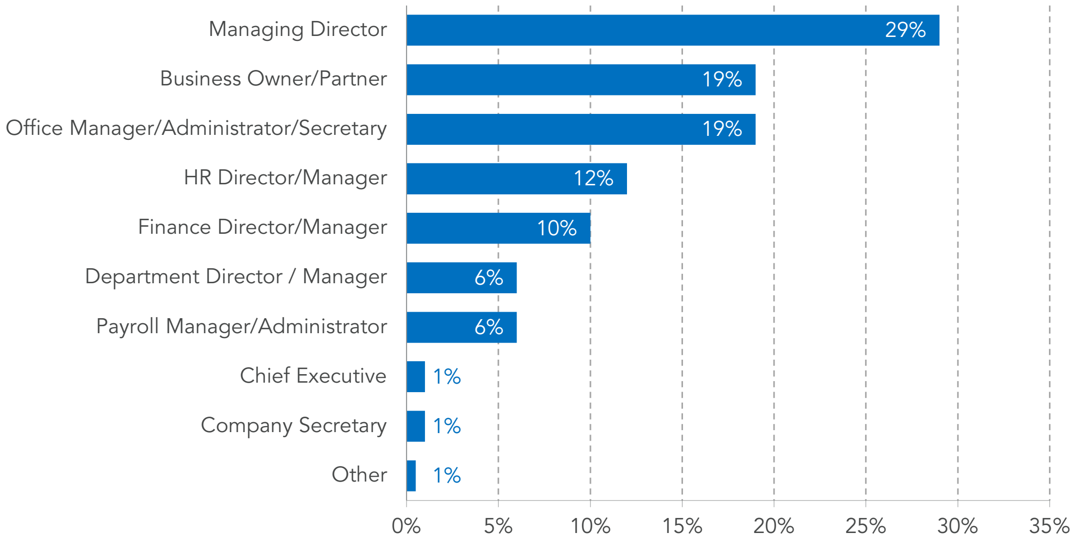

Figure A.2 Size of respondents by sector

Low-paid sector	Micro (1-9)	Small (10-49)	Medium (50-249)	Large (250+)
Retail	53%	18%	16%	13%
Hospitality	36%	32%	16%	17%
Cleaning	37%	25%	28%	10%
Food processing	20%	31%	32%	17%

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