Prioritising people

The 2019 CBI/Pertemps Employment Trends Survey results and what they mean for business

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People and Skills

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Contents

Forewords – CBI 4

– Pertemps 5

Survey results at a glance 6

Chapters

1. The Employment Outlook 10
2. Businesses remain confident about hiring 14
3. Firms facing tough decisions to afford the National Living Wage 18
4. Businesses are more concerned than ever about labour market competitiveness 26
5. Firms can get the best from their people through diverse workforces and inclusive practices 36
6. Prioritising employee engagement boosts performance and productivity 44

Overview 50

References 54

Foreword CBI

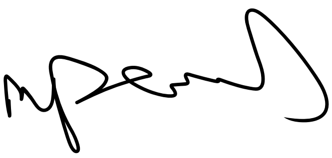
The UK must harness the power of people to capitalise on opportunities in the years ahead

The UK labour market has been remarkably resilient in the face of softening economic conditions and uncertainty. While Brexit discussions rumble on, businesses continue to create jobs, innovate, and generate prosperity. However, this must not be taken for granted.

Following a generation-defining General Election, the next government must combine the skills of enterprise and politics to find long term solutions to the biggest challenges of our day. Resolving Brexit and prioritising the domestic agenda will provide firms with much needed clarity about the UK's future. This could go some way to reversing the decline in the UK labour market's attractiveness and competitiveness that our survey again highlights this year.

The survey shows that businesses are focusing on their most valuable asset – their people. Whether it's by taking steps to improve levels of employee engagement, workforce diversity or the inclusivity of their workplaces, firms are striving to give their people opportunities to deliver at their best.

This is a savvy move given the that firms that act now will see real benefits for their bottom line and our research suggests that improving people practices could boost productivity by 19%, which could in turn add £110bn to the UK economy.[1] Given the size of the prize, business and government must work together to accelerate progress.



Matthew Percival
Director, People & Skills, CBI

Foreword Pertemps

Although the year began with political and economic uncertainty, businesses have seen some impressive results within the labour market. It remains strong and businesses are upping their endeavours to find the right staff for employers despite skills shortages.

There has been continuous change throughout 2019, but confidence remains high with 43 per cent of businesses expecting to grow their workforce over the next 12 months.

Businesses are remaining competitive through providing flexible working, progression opportunities and addressing pay gaps. It's encouraging to know that businesses are providing initiatives to attract, retain and develop employees to address the issues of a changing workforce, with greater investment in training for automation and artificial intelligence as we approach a fourth revolution.

For many years, we have worked with businesses across the UK to promote the benefits of diverse workforces and improved engagement. I am therefore delighted to see that organisations are placing employee engagement at the top of their agendas with 70 per cent of companies acting to improve gender diversity and reduce the gender pay gap. Embracing diverse workforces and inclusive workplace practices can help businesses get the best out of their people, where everyone feels encouraged and united to work together towards success.

The next year will involve change and uncertainty as we embrace the opportunities and challenges of a modern labour market, but, as usual, we will adapt, reshape and prosper in the face of new trials.

Tracy Evans

Group HR & Quality Director, Pertemps Ltd

Survey results at a glance

The employment trends survey 2019

- The survey was conducted between 27 August to 4 October 2019.
- 304 businesses, of all sizes and sectors across the UK, responded in total.

Businesses remain confident about hiring

- Over two in five respondents (43%) expect to grow their workforce in the next 12 months, a sustained proportion to 2018 (45%).
- Meanwhile, 14% of respondents anticipate that their workforce will be smaller next year – giving a balance of +29%.*
- This suggests that respondents' hiring expectations are weaker by comparison to 2017 (+42%) and 2018 (34%).
- The balance of SME respondents expecting to grow headcounts compared with those who expect them to shrink was +40% compared to +18% for larger firms.
- Permanent jobs growth is expected to increase in the next year with a balance of +27% anticipating more recruitment of these roles. Temporary roles growth could slow with a balance of -5% planning to add to these roles, down from 0% in 2018.

Businesses face tough decisions to afford the National Living Wage

- Just under seven in ten firms (68%) expect to raise pay for their employees in line with or above inflation at their next pay review.
- In response to the rising National Living Wage, affected firms are taking a range of actions including absorbing the whole cost through reduced profit (39%), increasing productivity through greater investment in training (34%), and increasing productivity through greater investment in automation (32%).
- Only three in five SME respondents affected by the NLW (60%) are able to absorb all or part of the cost of the rising National Living Wage, reduced from 75% in 2018.
- Looking ahead, fewer businesses than in 2018 expect to be able to absorb all (19%) or part (22%) of the cost of increases to the NLW in the next 3 years.
- Instead, firms expect to respond by investing in automation (43%), investing in training (36%), or by raising prices (32%).

**A 'balance' is the difference in percentage points between the percentage of firms answering "up" and the percentage answering "down" (for example, if 30% of firms say that employment is up, 60% that it is unchanged, and 10% that it is down, the balance statistic is +20%).*

Firms are more concerned than ever about the attractiveness and competitiveness of the UK labour market

- Two-thirds of respondent firms (65%) say that the UK labour market has become a less attractive place to invest and do business over the past 5 years, the highest proportion ever recorded in our survey's 22-year history.
- Over half of respondents (57%) believe that the UK labour market will become less attractive in the next 5 years, with around a quarter (26%) expecting it to become more attractive.
- The main current threats to the UK's labour market competitiveness are access to skills (72%), access to labour supply (55%), and the ability to move UK-based workers across the EU (48%).
- Businesses expect these challenges to grow in the years ahead with access to skills (74%), the ability to move workers across the EU (67%), and access to labour supply (61%) identified as the key threats to competitiveness over the next five years.
- Nearly all respondents (93%) continue to view the UK's flexible labour market as vital or important to competitiveness and the prospects for business investment and job creation.
- Firms report that pension contributions (73%), skills shortages (71%), and the apprenticeship levy (53%) are the key drivers behind the growing cost of employment over the past 5 years.
- Nearly two thirds of firms (64%) would be negatively impacted if the government was to end free movement before a new immigration system is simplified.*

**The fieldwork period for this survey came before the recently agreed Brexit extension and the announcement of the 2019 general election.*

Firms can get the best from their people through diverse workforces and inclusive practices

- In order to increase workforce diversity and create inclusive workplaces over two-thirds of respondent firms are introducing or extending flexible working opportunities for staff (68%), improving progression opportunities (67%), or investing in training for line managers (67%).
- Firms that see workplace improvements from inclusive workplace practices report a range of benefits, including increased ability to attract, retain and develop employees (70%), increased levels of staff engagement (55%) and increases in skills and capabilities (46%).
- 71% of respondent firms have taken steps to improve gender diversity and reduce gender pay gaps, whilst 65% have taken steps to improve ethnic diversity and reduce ethnicity pay gaps.
- Over two thirds of respondents (67%) have taken steps to attract, develop, or retain older workers.

Prioritising employee engagement can boost business performance and productivity

- Effective line management (49%) continues to be the key driver behind employee engagement. Shared companywide values (32%) and flexible working practices (28%) are also important.
- 98% of respondents have seen a workplace benefit from engaged employees, including increases in productivity and performance (74%), increased retention (60%), and improved workplace health and wellbeing (53%).
- Respondent firms will expect their top three priorities for the year ahead to be maintaining or achieving high levels of employee engagement (44%), improving leadership skills (44%) and retaining talent (41%).

The Employment Outlook

Employment continues to grow but signs of tightness appear in the UK labour market

Key findings

- Employment and unemployment remain at or around record rates, however falling vacancies throughout 2019 suggests that the UK labour market may be starting to lose steam.
- Pay growth improved noticeably in 2019 but remains below the average pre-crisis rate in real terms.
- Productivity remains well below pre-crisis rates.

UK labour market remains tight amid signs of a tailing off in growth

After a period of several years of strong growth, there have been recent signs of a softening in the labour market. The number of vacancies has been falling persistently over the past year **(Exhibit 1.1)**, often a lead indicator of employment growth. Indeed, employment itself fell in the three months to both August and September, driven by a decline in part-time employment.

But despite the recent softening in growth, it's clear that the labour market remains tight. The unemployment rate remains at a record low (at 3.8% in the three months to September), and businesses continue to report high levels of skills shortages. Other indicators also point to a very limited degree of labour market slack. For example, the proportion of part-time and temporary workers who are unable to find a permanent job has steadily fallen in recent years with just under a quarter of temporary workers (24%) and one in ten part-time workers (10%) reporting that they are unable to find a permanent position **(Exhibit 1.2)**.

Exhibit 1.1 Number of unemployed people per vacancy

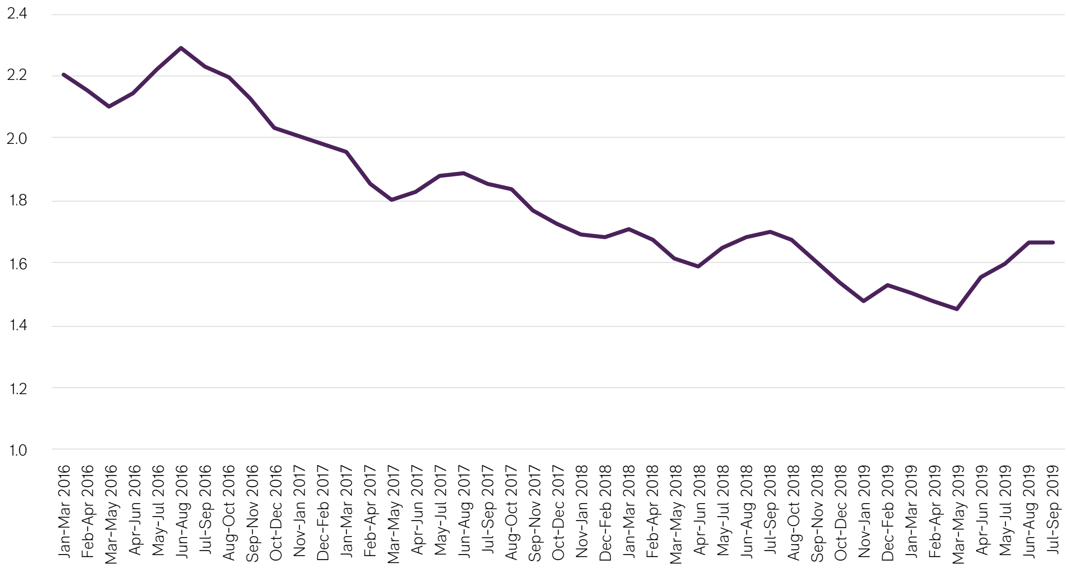
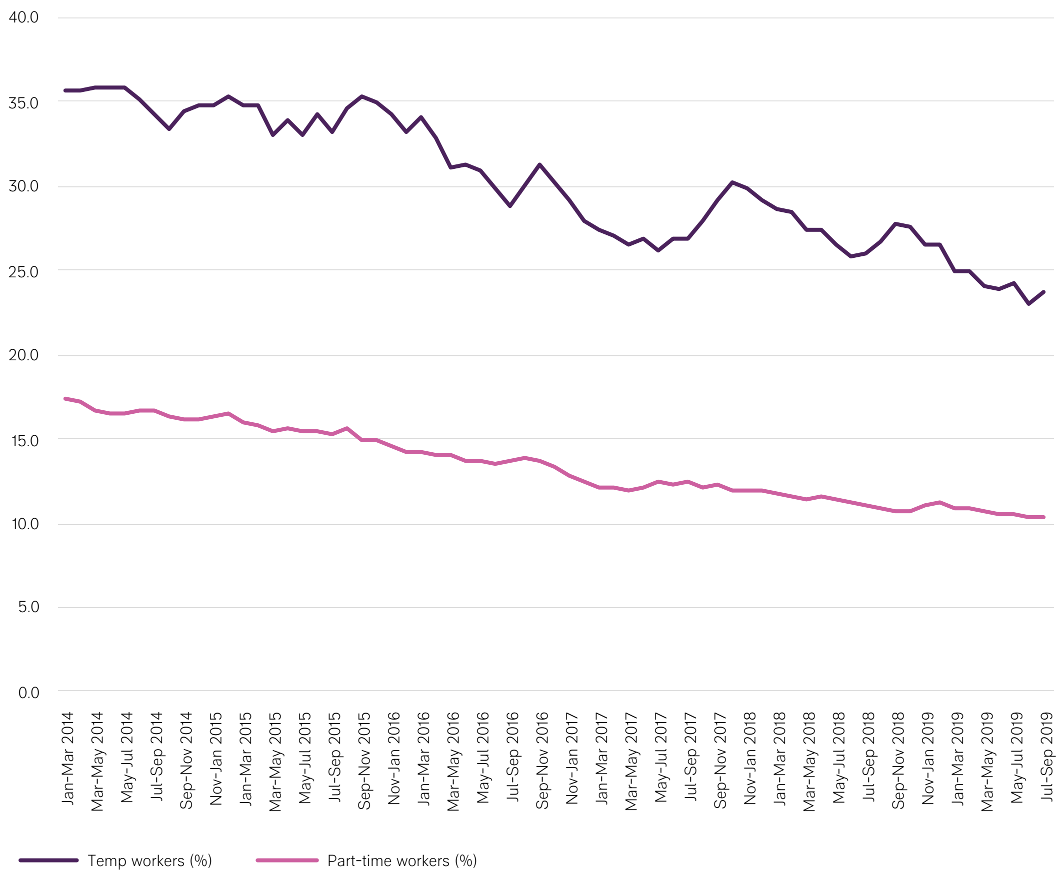


Exhibit 1.2 Percentage of temporary and part-time workers that are unable to find a permanent job

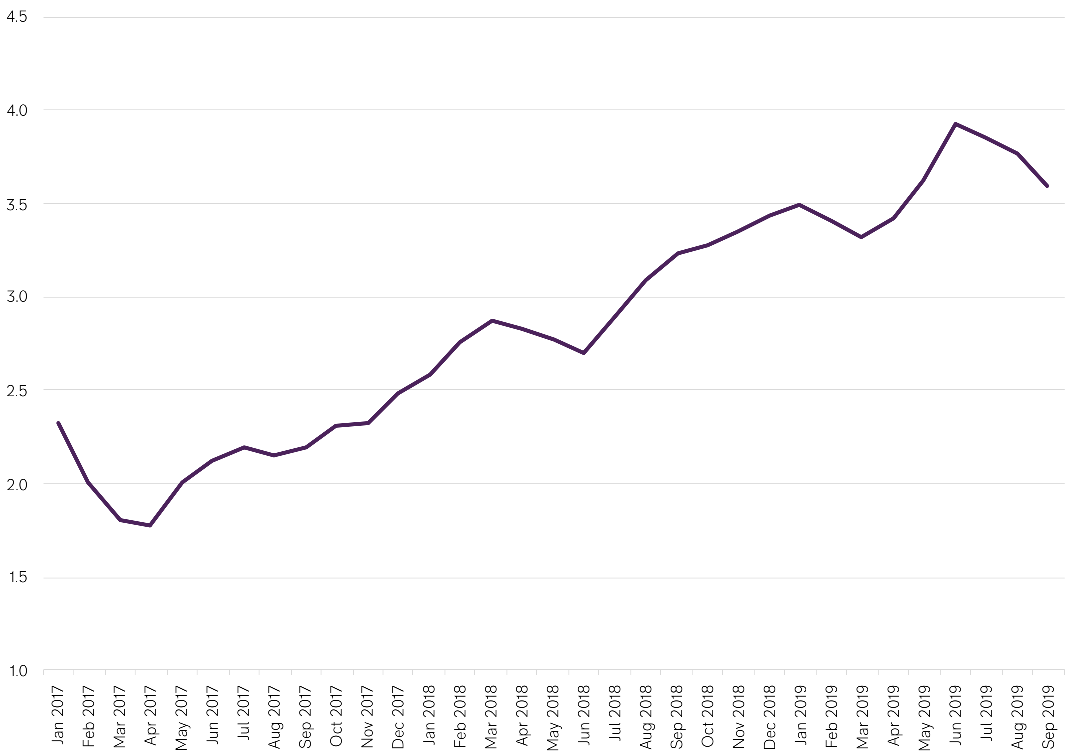


Pay growth has performed well during the year...

The tightness in the labour market appears to have fed through to earnings, with pay growth having steadily improved over the past year. Nominal regular pay growth (excluding bonuses and before adjusting for inflation) picked up to its quickest annual rate since 2008 in April to June 2019 (3.9%). Encouragingly for workers, real regular pay (excluding bonuses but adjusting for CPIH inflation) has also picked up in 2019, hitting its quickest annual growth rate since 2015 in April to June 2019 (2.0%) **(Exhibit 1.3)**. However, annual real pay growth remains below the average pre-crisis (2001-2007) rate of 2.1%.

Nominal pay growth is also showing signs of having peaked, with regular wage growth slowing to 3.6% in the three months to September. Signs of further pay pressure in business surveys also remain limited.

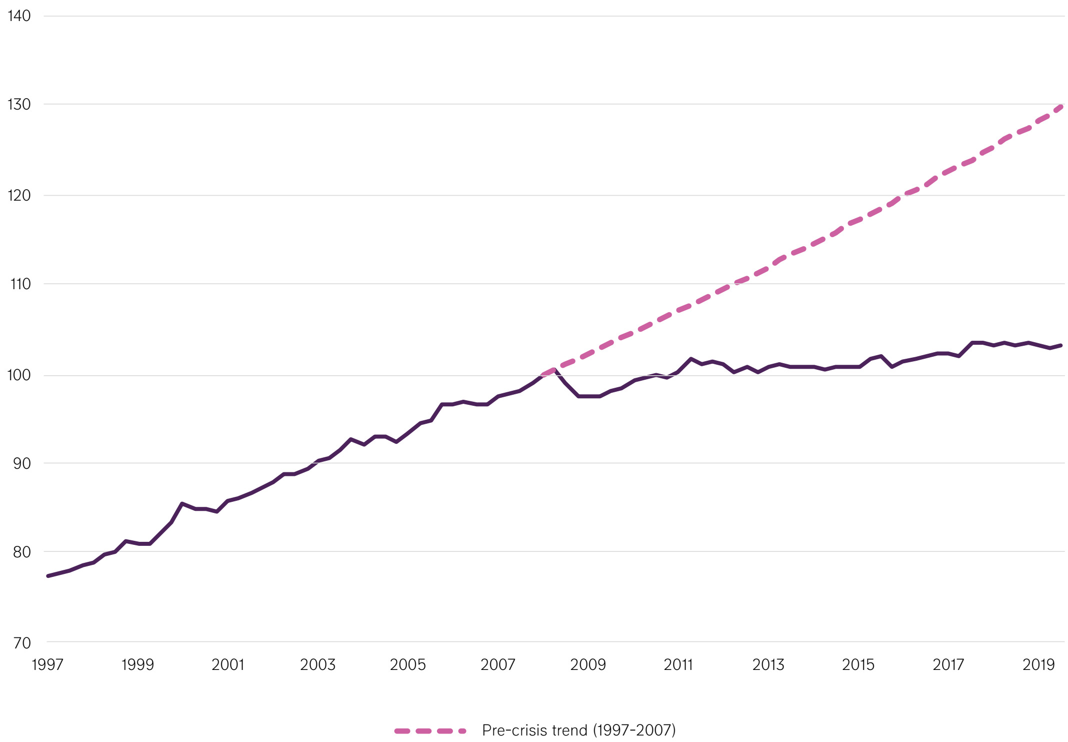
Exhibit 1.3 Nominal Pay Growth (y/y %, Jan 2017 – Sep 2019)



...however, sluggish productivity continues to be the UK economy's biggest challenge

The main constraint on securing more sustainable wage growth is the continual weakness in productivity. Since the 2008 financial crisis, UK productivity growth has been negligible compared with average annual growth pre-crisis of approximately 2% a year **(Exhibit 1.4)**. Had productivity continued to grow in line with this trend, output per hour in the UK would be around 26% higher than it is now. Low productivity stifles wage growth and constrains improvements in living standards while also making it harder for UK firms to compete in global markets.

Exhibit 1.4 Output per hour, pre-crisis trend vs actual (2008 Q1 = 100)



Businesses remain confident about hiring

The UK's labour market continues to perform strongly with near-record employment and unemployment rates. But businesses' expectations for generating more jobs have softened this year in line with economic conditions in the UK, although jobs growth is still expected. Small and medium-sized enterprises (SMEs) remain more confident about workforce growth than larger firms, which could be linked to the fact that they are more likely to trade domestically. In the longer term, reversing this trend of softening hiring expectations will be integral to sustaining the UK's labour market success.*

Key findings

- Over two in five respondents (43%) expect to grow their workforce in the next 12 months, a sustained proportion to 2018 (45%).
- Meanwhile, 14% of respondents anticipate that their workforce will be smaller next year – giving a balance of +29%.*
- This suggests that respondents' hiring expectations are weaker by comparison to 2017 (+42%) and 2018 (34%).
- The balance of SME respondents expecting to grow headcounts compared with those who expect them to shrink was +40% compared to +18% for larger firms.
- Permanent jobs growth is expected to increase in the next year with a balance of +27% anticipating more recruitment of these roles. Temporary roles growth could slow with a balance of -5% planning to add to these roles, down from 0% in 2018.

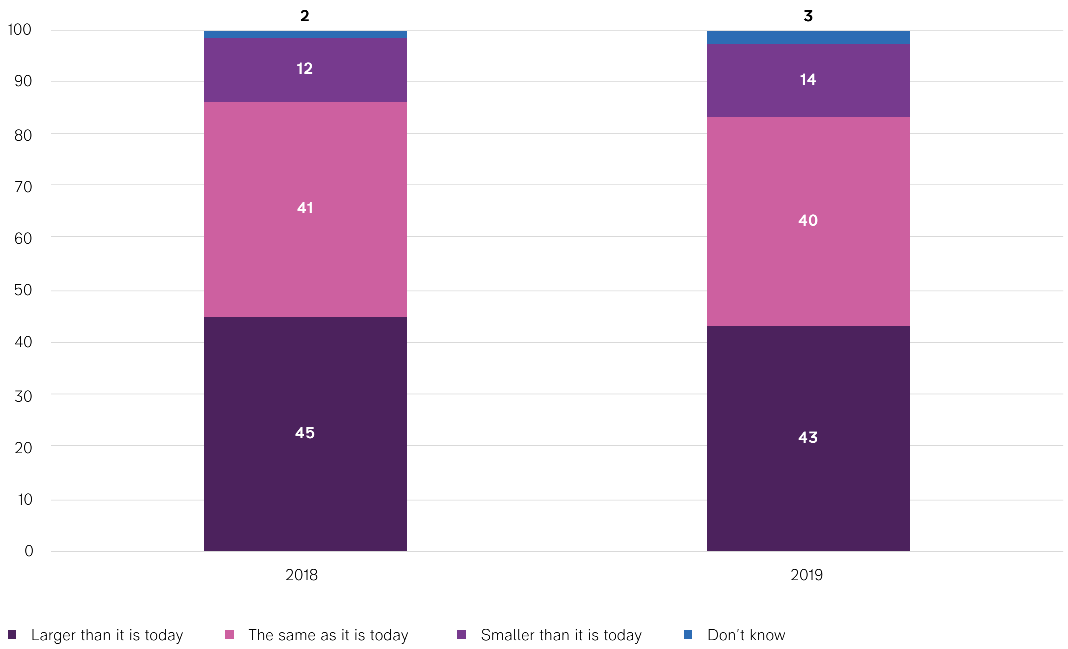
**For the purposes of this report, we define an SME as a firm with fewer than 250 employees.*

**A 'balance' is the difference in percentage points between the percentage of firms answering "up" and the percentage answering "down" (for example, if 30% of firms say that employment is up, 60% that it is unchanged, and 10% that it is down, the balance statistic is +20%).*

Most businesses expect to increase headcount over the next year...

Over two in five respondents (43%) expect to create additional jobs over the next 12 months **(Exhibit 2.1)**. In contrast, one in seven firms (14%) expects their workforce to be smaller while two in five businesses (40%) think that it will stay the same. Continued jobs growth is a sign of the resilience of the UK labour market with the proportion of firms expecting growth at a similar level to 2018 (45%).

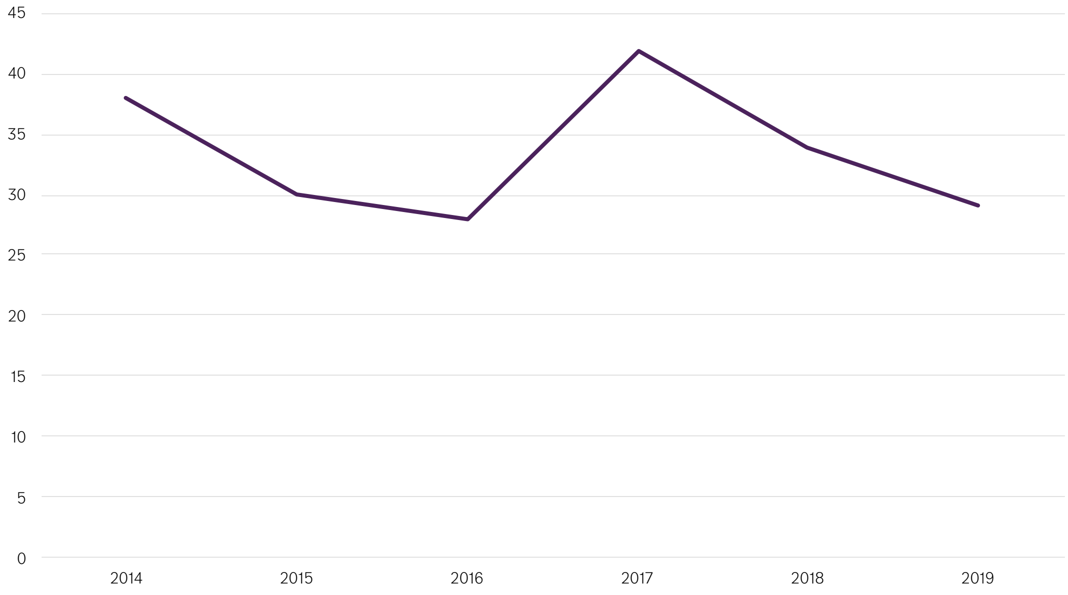
Exhibit 2.1 Expected size of workforce in 12 months' time (%)



...however, jobs growth could soften

The balance of firms expecting their workforce to grow compared with those that expect it to shrink was reported at +29% **(Exhibit 2.2)**. This balance was weaker than 2018 (+34%) and 2017 (+42%). We saw a similar trend in the three years leading up to 2016. This may reflect uncertainty from Brexit, the tightness of the UK labour market, or it could be linked to the rising cost of employment that businesses currently face – a topic which is explored later in this report.

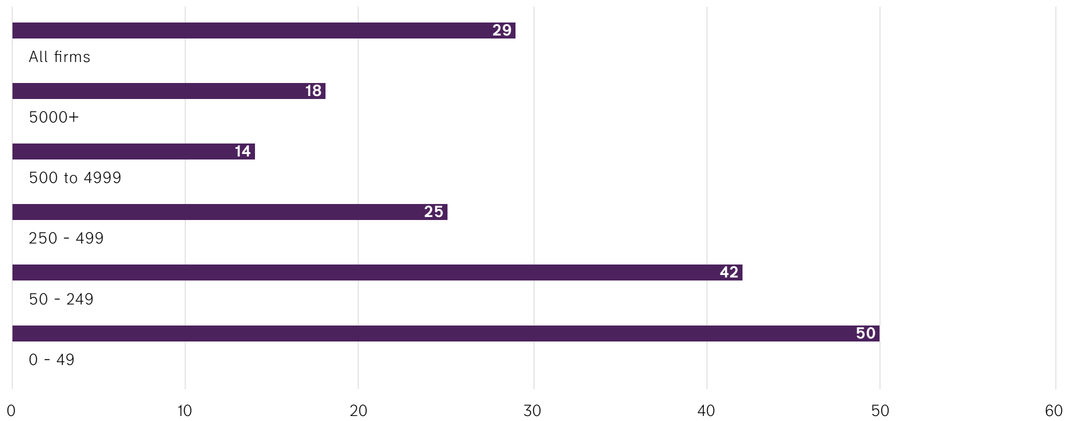
Exhibit 2.2 Positive balance of firms expecting workforce growth 2014 – 2019 (%)



SME jobs expectations are stronger than in large firms

Consistent with last year's report, smaller firms are more optimistic about jobs growth than their large counterparts. Among SMEs, a balance of +40% expect to take on more employees in the coming 12 months, compared to a +18% balance for large firms **(Exhibit 2.3)**. In general, confidence in adding roles correlates negatively with the size of respondents however the balance of confidence is lowest amongst businesses employing between 500 and 4,999 employees, standing at +14%.

Exhibit 2.3 Positive balance of firms expecting workforce growth 2014 – 2019 (%)



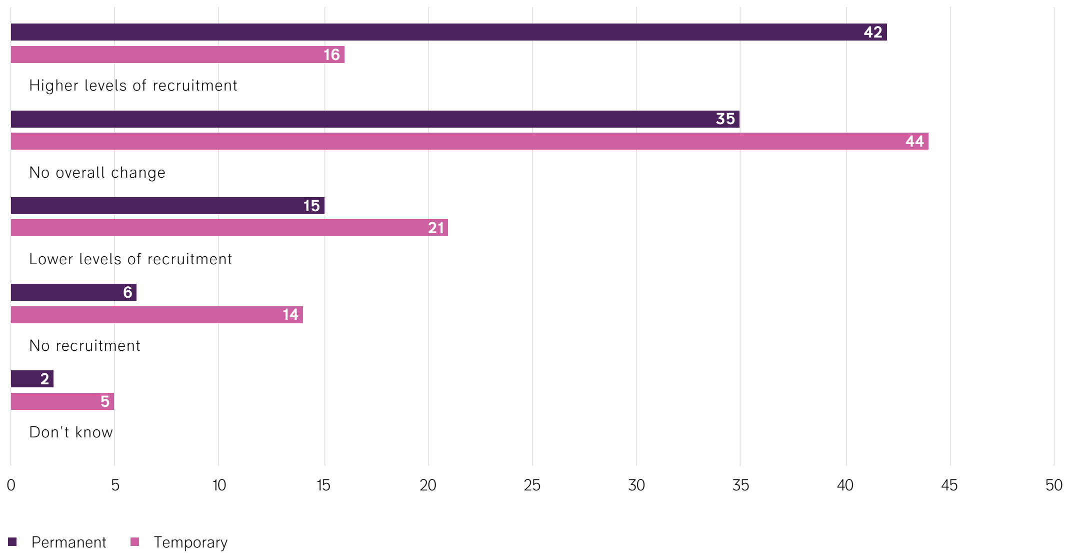
Permanent jobs expectations remain robust...

We asked firms to indicate their hiring expectations for both permanent and temporary positions for the year ahead. For the seventh year in a row our survey shows that the rate at which firms add to their permanent roles will increase in the year ahead. Over two in five respondents (42%) expect higher levels of recruitment in the next 12 months and over one in seven (15%) expect the rate of permanent recruitment to be lower **(Exhibit 2.4)**.

...but temporary positions growth could slow

Whilst expectations for permanent roles remains robust, the growth of temporary jobs could soften in the next 12 months. Around one in six firms (16%) expect higher levels of recruitment for temporary positions in the next 12 months, but more than one in five (21%) expect lower levels of recruitment for these roles.

Exhibit 2.4 Plans for recruitment over the next 12 months (% of respondents)



Firms face tough decisions to afford the National Living Wage

Pay growth has picked up throughout 2019 and it's now close to its strongest rate since the financial crisis. While many firms still believe that they will be able to improve wages in the year ahead, increases in the National Living Wage (NLW) continue to affect more and more firms. Economic uncertainty about the future business environment makes it more difficult for firms to adapt and make long term plans and investments. Combined with poor productivity performance, businesses are faced with difficult decisions about how to manage rising pay, with the options much more limited for smaller firms.

Key findings

- Just under seven in ten firms (68%) expect to raise pay for their employees in line with or above inflation at their next pay review.
- In response to the rising NLW, affected firms are taking a range of actions including absorbing the whole cost through reduced profit (39%), increasing productivity through greater investment in training (34%), and increasing productivity through greater investment in automation (32%).
- Only three in five SME respondents affected by the NLW (60%) are able to absorb all or part of the cost of the rising NLW, reduced from 75% in 2018.
- Looking ahead, fewer businesses than in 2018 expect to be able to absorb all (19%) or part (22%) of the cost of increases to the NLW in the next 3 years.
- Instead, firms expect to respond by investing in automation (43%), investing in training (36%), or by raising prices (32%).

Employers will continue to boost pay in the next 12 months...

This year's survey reveals that over half of respondents (54%) will match inflation* with a general pay increase when it comes to their next pay review, up from 51% in 2018, and less than one in ten firms (8%) will increase pay at below inflation levels.* Only one in twenty businesses (5%) are expecting a pay freeze **(Exhibit 3.1)**.

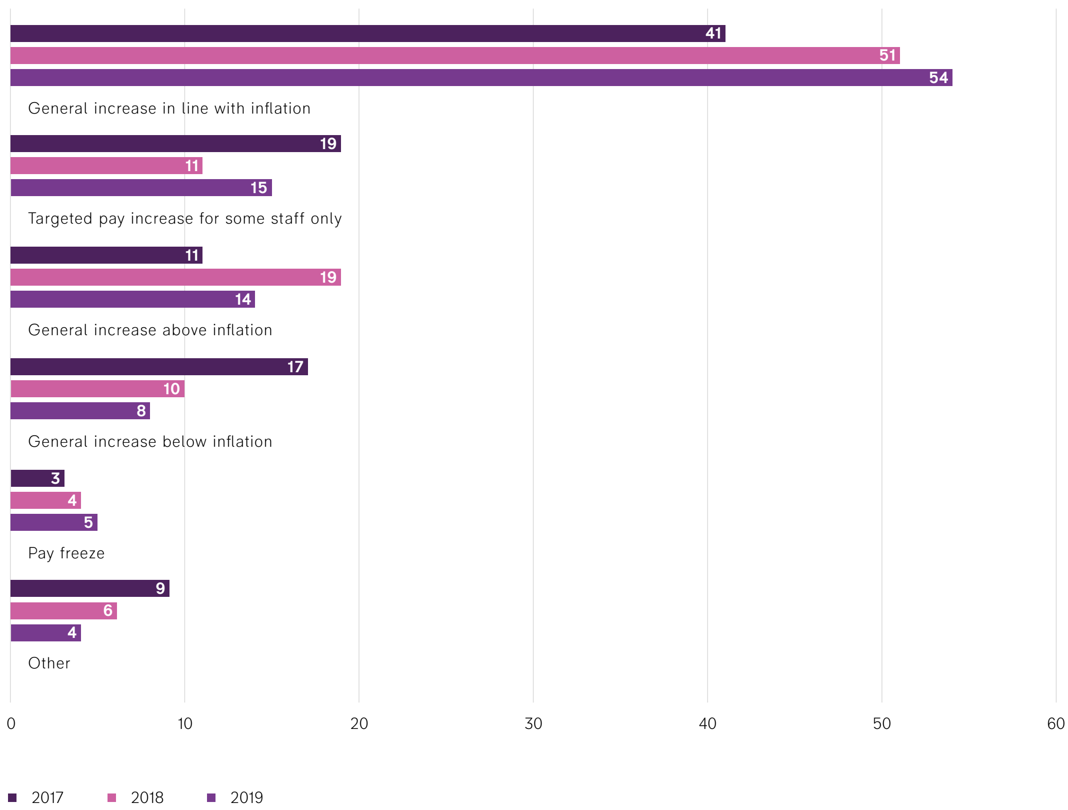
**Our survey asks about inflation in a general sense, rather than a specific measure such as CPI, RPI, or CPIH*

**Excluding 'Don't know' responses*

...but in a more targeted way to make increases affordable

Whilst these results are positive, only around one in seven firms (14%) will be increasing pay above the rate of inflation, down from 19% in 2018, and 15% will be adopting a targeted pay increase for some staff, up from 11% in 2018. This could suggest that a greater proportion of firms are having to be more strategic about where they can afford to award pay rises rather than being able to afford them across the board.

Exhibit 3.1 Firms' approach to their next pay review (% of respondents)



Coping with the rising National Living Wage is becoming more difficult for firms...

The National Living Wage is set to reach 60% of median earnings in April 2020. Since its introduction in April 2016, the minimum wage for those aged 25 or above has risen by 14% from £7.20 to £8.21,[2] far above the rate of median wage growth which was 8.5% over the same period.[3] Poor UK productivity performance since the financial crisis has limited the pace at which wages have grown which makes the trajectory of the NLW more stark.

To accommodate these increases, businesses that are affected by the NLW have responded in a range of different ways **(Exhibit 3.2)**. The most common business response, taken by nearly two in five respondent firms (39%), is to absorb the full cost of the rise through reduced profit, up from 34% in 2018. A further quarter of firms (27%) are absorbing part of the cost through reduced profits but this represents a fall from 35% in 2018. Taken together, we see a greater proportion of firms this year who are looking to pay for the entire increase in other ways.

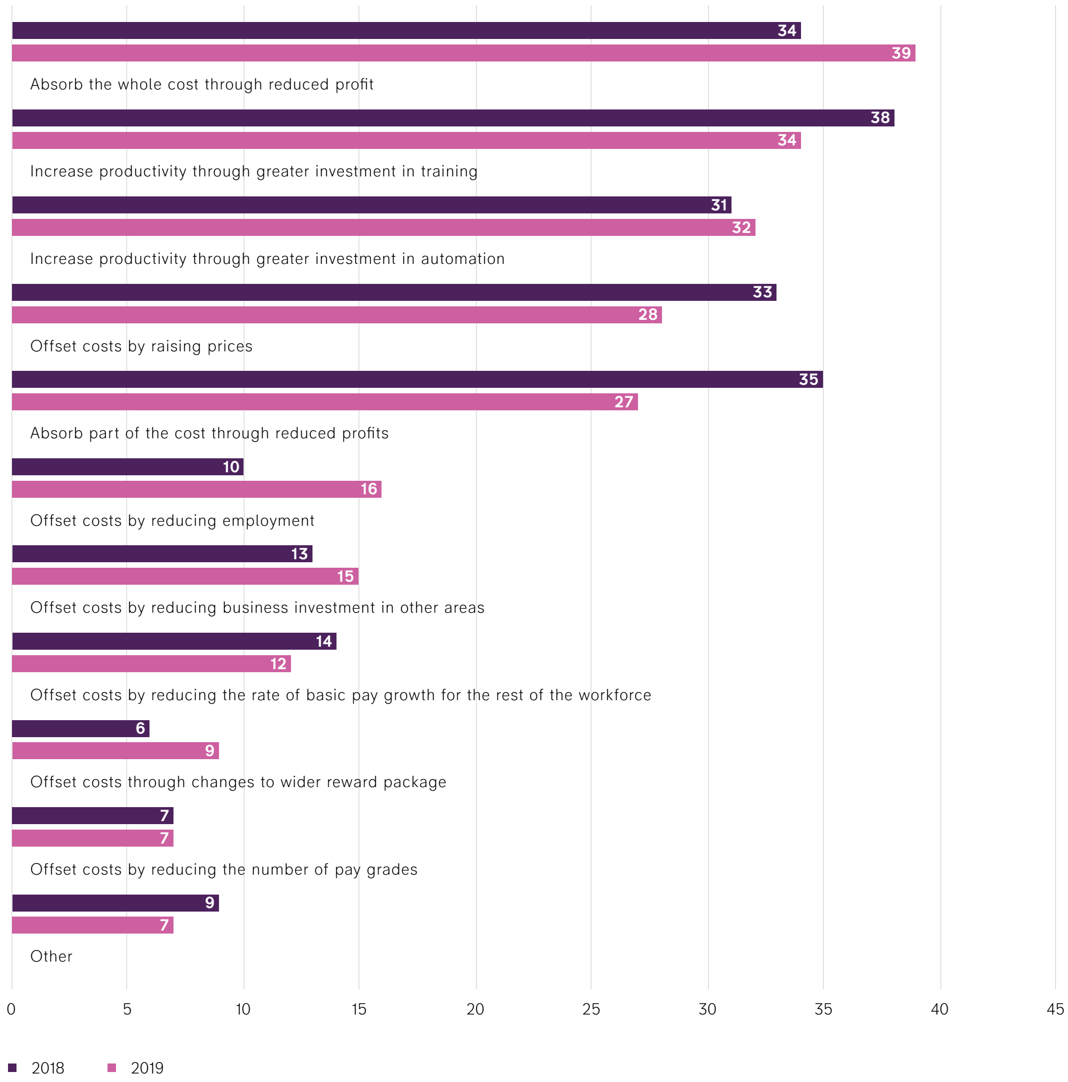
One method for affording the increased wages is for affected businesses to increase their productivity. This was the intention of government when introducing the NLW. Yet only around a third think this could still be possible through investment in training (34%) and automation (32%), with the former reduced from 38% in 2018 and the latter remaining at the same share as last year. These approaches need cash upfront which can be a significant barrier for firms who are already struggling to keep up with cost base pressures. They also tend to have a longer-term pay-off so will often need other mitigating actions to relieve cost pressure in the short term.

With firms unable to rely on increasing productivity to help afford NLW rises, it may be expected that costs would be passed on to consumers. However, internationally tradeable sectors and those where domestic competition is intense will struggle to do so while maintaining their competitiveness. The number of businesses seeking to pass the cost on has fallen this year with less than three in ten businesses (28%) offsetting costs by raising prices, down from 33% in 2018.

The final option available to affected firms is to cut headcount and this year we see the proportion of firms cutting jobs as a way of coping with the NLW increasing to one in six (16%), up from 10% in 2018.

The figures suggest that respondents are finding it hard to adjust to the rising minimum wage by boosting productivity and are instead having to shoulder the burden themselves through reduced profits or, increasingly, by reducing employment. Businesses support the government's objective of delivering a high-wage economy which boosts wages and raises living standards, but a revival in productivity is the only route for sustainable and affordable increases.

Exhibit 3.2 Response to the introduction of NLW (% of affected businesses)



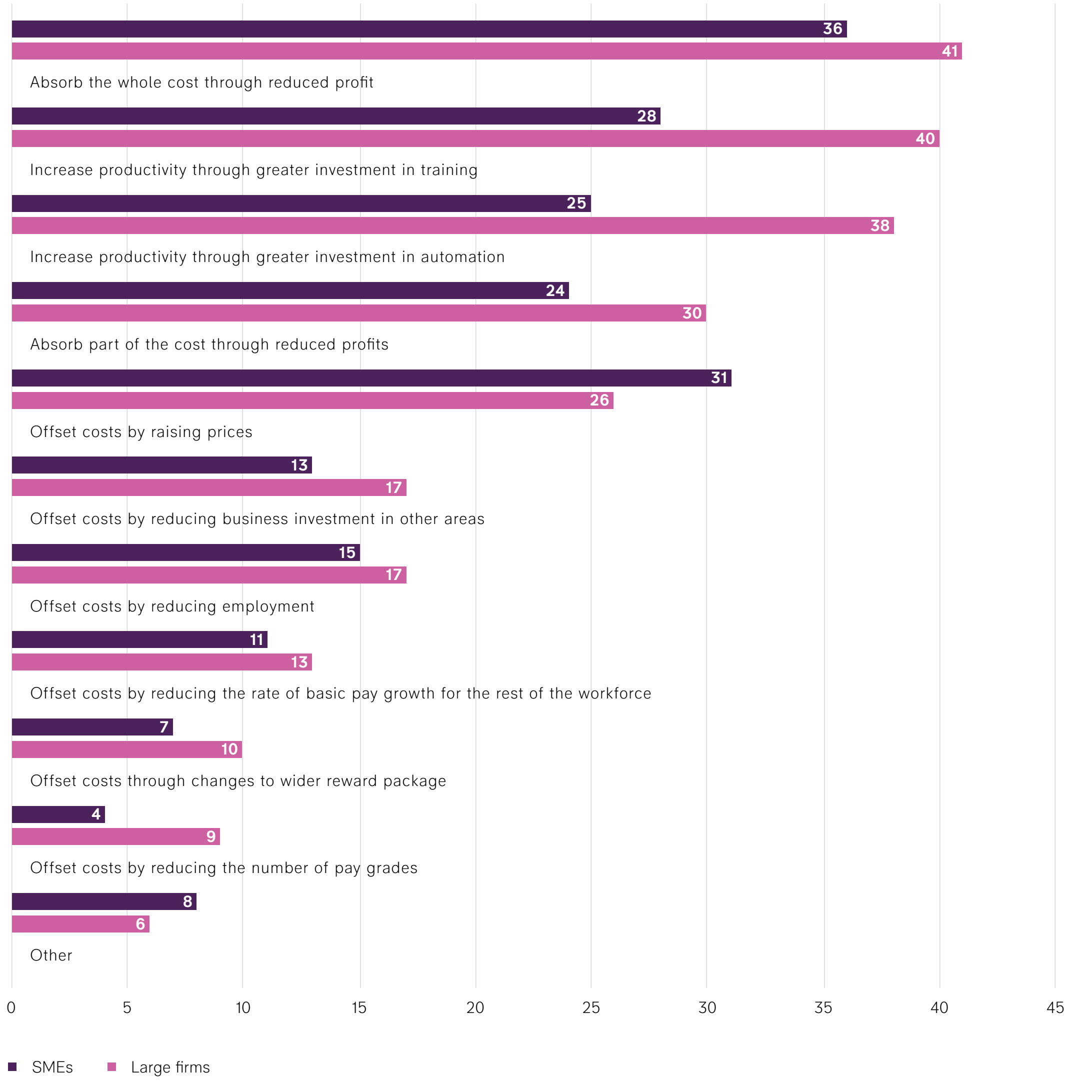
...and this is more pronounced for small and medium sized firms with a lower proportion responding to increases by trying to boost productivity than in larger firms

Year-on-year business' ability to afford increases in the NLW without taking further action diminishes. This is particularly concerning for smaller firms **(Exhibit 3.3)**.

In 2018, while three quarters of SME respondents affected by the NLW (75%) were able to absorb either the whole or a part of the cost, this decreases to three in five (60%) in 2019. We also see only a quarter of small and medium-sized firms (25%) investing in automation to boost productivity compared to nearly two in five larger ones (38%) doing so. A similar picture can be seen when asking whether companies are increasing training to boost productivity: 28% for small companies compared to 40% for bigger ones.

Therefore, SMEs seem to be both less likely to be able to absorb increases or invest in order to try to pay for increases through higher productivity, than larger firms. Whilst businesses across the board are feeling the pinch of the rising NLW, the pressure seems to be particularly heavy for smaller firms.

Exhibit 3.3 Response to the introduction of NLW (% of affected businesses, by size)



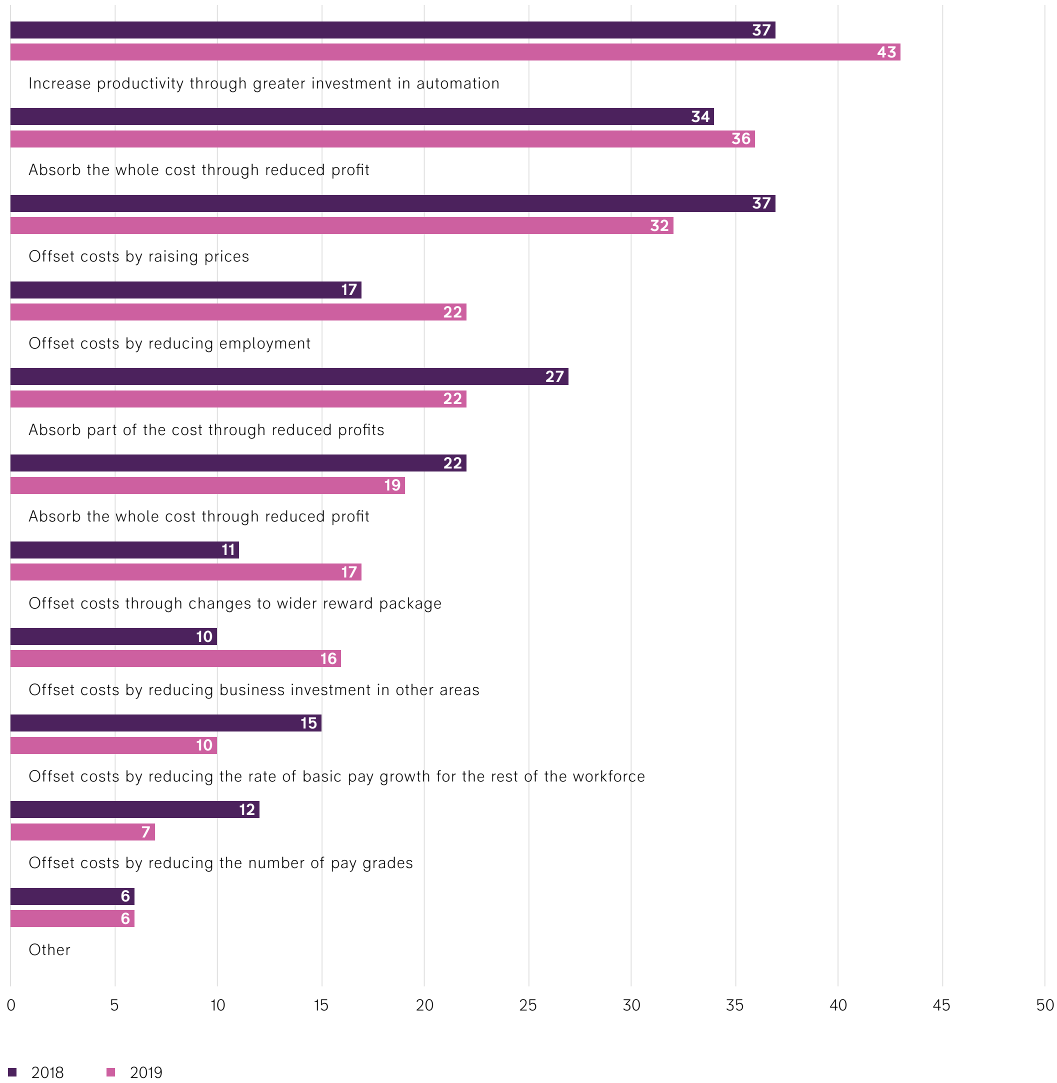
A new target for the NLW makes the path beyond 2020 more challenging for firms

When analysing the steps that affected businesses expect to be taking in three years' time, there is a concern about the impact that a new target of the NLW will have on their ability to absorb either the whole or a part of the cost of the increases **(Exhibit 3.4)**. Under one in five (19%) are planning to absorb the full cost of the NLW while just over one in five (22%) expect to absorb part of the cost. It is concerning that while four in five are needing to take action to afford the NLW, fewer than half (43%) expect to automate processes and tasks to boost productivity.

The recently announced new target for the NLW to reach £10.50 in the next five years represents a real challenge for businesses.[4] The fieldwork for this survey was completed before the new target was formally announced but after a target of two-thirds of median had been heavily trailed by former Chancellor Phillip Hammond.[5] Our survey finds that firms were already predicting that future NLW increases would have an increased impact on jobs with more than one in five business (22%) expecting to reduce employment in three years' time.

Business shares the ambition for a thriving UK economy that supports rising wages, particularly for the lowest paid. And the National Minimum Wage (NMW) has been hugely successful at increasing wages without damaging employment prospects. The National Living Wage, however, is a much more rigid policy that hasn't proven it can protect workers during a recession in the way that the NMW has. The future role of the Low Pay Commission (LPC) is essential. No country has yet increased its minimum wage to two-thirds of its median wage. The impact of doing so is unknown. This makes the LPC even more important in the future than the already important role that it has played in the past. To be an effective counterweight to politicised targets, the LPC must be given the flexibility to monitor the impact of the NLW on economy and its impact on workers. This should include pay differentials and their impact on progression opportunities, as well as the impacts on jobs and hours that this survey suggests will become more common, particularly among SMEs. Rather than responding only to a recession, the LPC's new mandate should give it the flexibility to respond to lacklustre growth and if pay is not supported by productivity.

Exhibit 3.4 Planned response to the National Living Wage in the next three years (% of affected businesses)



"To be an effective counterweight to politicised targets, the LPC must be given the flexibility to monitor the impact of the NLW on economy and its impact on workers."

Businesses are more concerned than ever about labour market competitiveness

The UK has long been an attractive place to create jobs, but firms believe this has declined over the past five years and expect it to continue deteriorating. Concerns about future access to skills, labour mobility, and the rising cost of employment are weighing on business confidence in the competitiveness of the UK labour market. Businesses need clarity if they are to be able to make longer term plans and investments. Much of this will rest on whether they are able to access the skills and people that they need. It is essential that the government safeguards flexibility by adopting evidence-based policies that are well-targeted to fix situations where flexibility is unbalanced, while protecting it for the millions of workers who value or depend on it.

Key findings

- Two-thirds of respondent firms (65%) say that the UK labour market has become a less attractive place to invest and do business over the past 5 years, the highest proportion ever recorded in our survey's 22-year history.
- Over half of respondents (57%) believe that the UK labour market will become less attractive in the next 5 years, with around a quarter (26%) expecting it to become more attractive.
- The main current threats to the UK's labour market competitiveness are access to skills (72%), access to labour supply (55%), and the ability to move UK-based workers across the EU (48%).
- Businesses expect these challenges to grow in the years ahead with access to skills (74%), the ability to move workers across the EU (67%), and access to labour supply (61%) identified as the key threats to competitiveness over the next five years.
- Nearly all respondents (93%) continue to view the UK's flexible labour market as vital or important to competitiveness and the prospects for business investment and job creation.

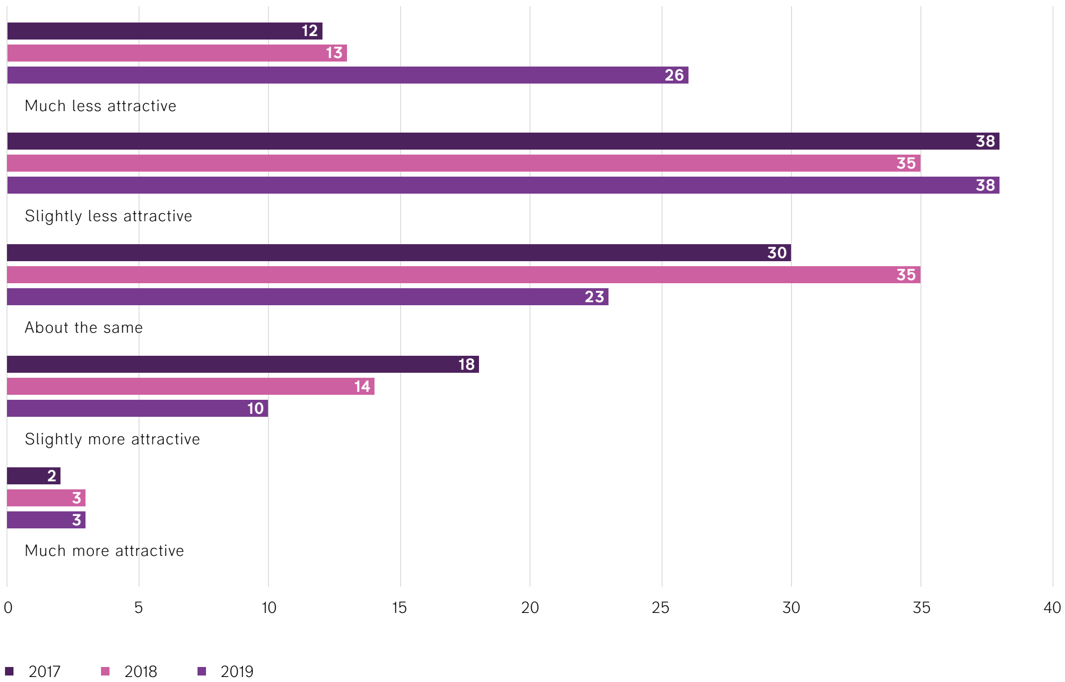
- Firms report that pension contributions (73%), skills shortages (71%), and the apprenticeship levy (53%) are the key drivers behind the growing cost of employment over the past 5 years.
- Nearly two thirds of firms (64%) would be negatively impacted if the government was to end free movement before a new immigration system is simplified.*

The attractiveness of the UK as a place to invest has continued to decline relative to 2018...

Consistent with a trend that began in 2016, this year's survey reveals a further fall in the balance of firms that think that UK labour market competitiveness has worsened over the last five years **(Exhibit 4.1)**. In 2016, the balance of firms saying that the UK had become a more attractive place to invest, do business, and employ people over the past five years was +3%, with that figure falling to -52% this year.

Nearly two thirds of respondents (65%) now believe that the UK has become less attractive in the past five years, with just under one in seven (13%) saying that it has become more attractive. This decline in attractiveness is causing businesses to delay or relocate investment and is hindering their ability to make long term plans.

Exhibit 4.1 The UK as a place to invest/ do business over the past five years (%)

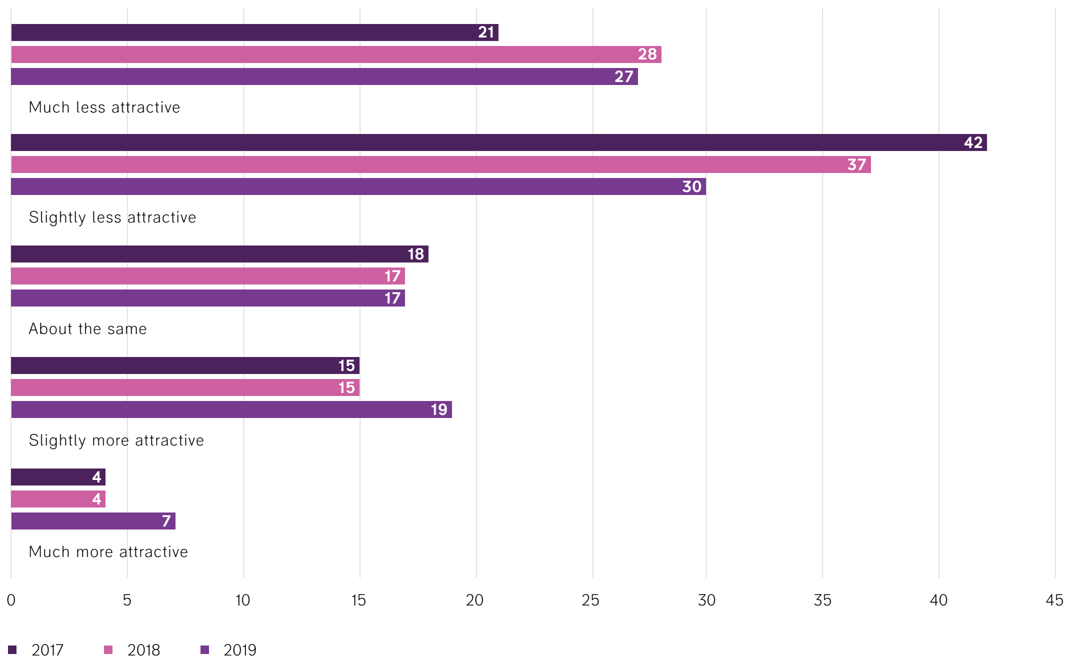


The fieldwork period for this survey came before the recently agreed Brexit extension and the announcement of the 2019 general election.

...and firms remain gloomy about the UK's labour market attractiveness in the future

When looking ahead at the next five-year period, businesses continue to be pessimistic about the attractiveness of the UK labour market **(Exhibit 4.2)**. Over a quarter of respondent firms (26%) think that the UK will become more attractive but nearly three in five (57%) still feel it will become less attractive over the next five years.

Exhibit 4.2 The UK as a place to invest/ do business in five years' time (%)

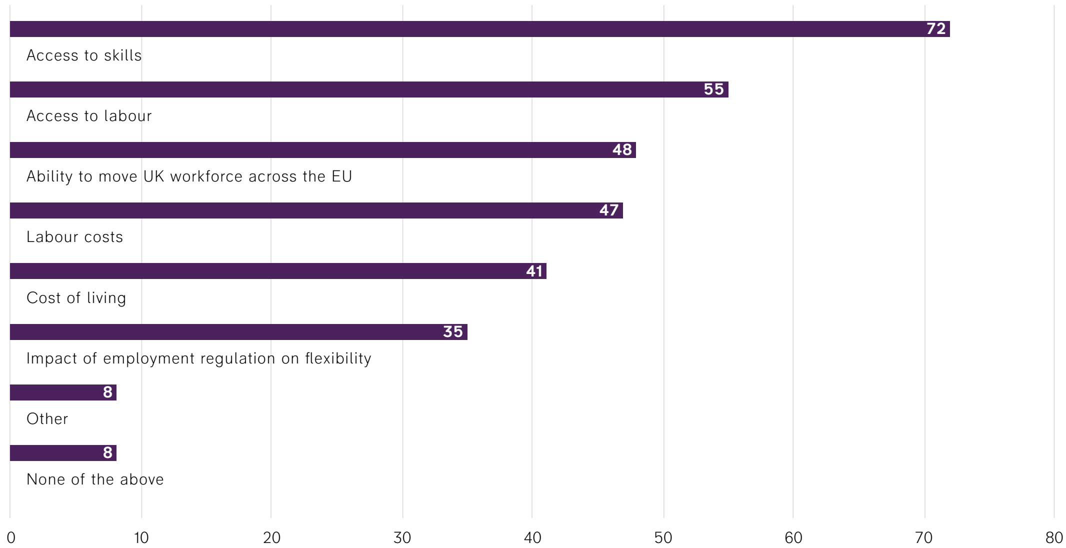


Access to skills and people continue to be the key threats to UK's labour market competitiveness...

For the sixth successive year access to skills is the key concern for UK firms with nearly three quarters (72%) telling us that it currently threatens the UK's competitiveness, although this is down from 2018 (83%) **(Exhibit 4.3)**. This matches some key findings from the 2019 CBI Education and Skills Survey which reveals that employer demand for people with skills at all levels is expected to increase in the years ahead, but also that many firms are concerned that they won't be able to access people with the rights skills to meet their business need.[6]

Access to labour (55%) and the ability to move UK workers across the EU (48%) are also key concerns for firms with the latter rising from 27% in 2018. Elevated concerns about moving the UK workforce across the EU possibly reflects ongoing uncertainty around how easy it will be to deploy workers overseas in the future and around the future relationship with the EU.

Exhibit 4.3 Current threats to UK labour market competitiveness (2019, %)



...and we must work now to protect our flexible labour market as these threats look set to become more pronounced in future

The same set of concerns are front of business minds when we asked them to consider threats to UK competitiveness in the next five years **(Exhibit 4.4)**. Access to skills (74%), the ability to move UK workforce across the EU (67%), and access to labour (61%) represent the three most frequently reported threats. Businesses are clear that the UK's flexible labour market is central to the competitiveness of the UK's labour market and the prospects for business investment and job creation with nearly nine in ten firms (88%) saying that it is either vital or important **(Exhibit 4.5)**.

The UK's flexible labour market provides businesses with access to labour that they need to manage demand and capitalise on new opportunities, whilst also allowing more people to participate in the labour market on terms that suit them. Failing to address the prominent concerns that firms have about the future could undermine the flexibility that is wanted by all.

Exhibit 4.4 Threats to UK labour market competitiveness in five years' time (2019, %)

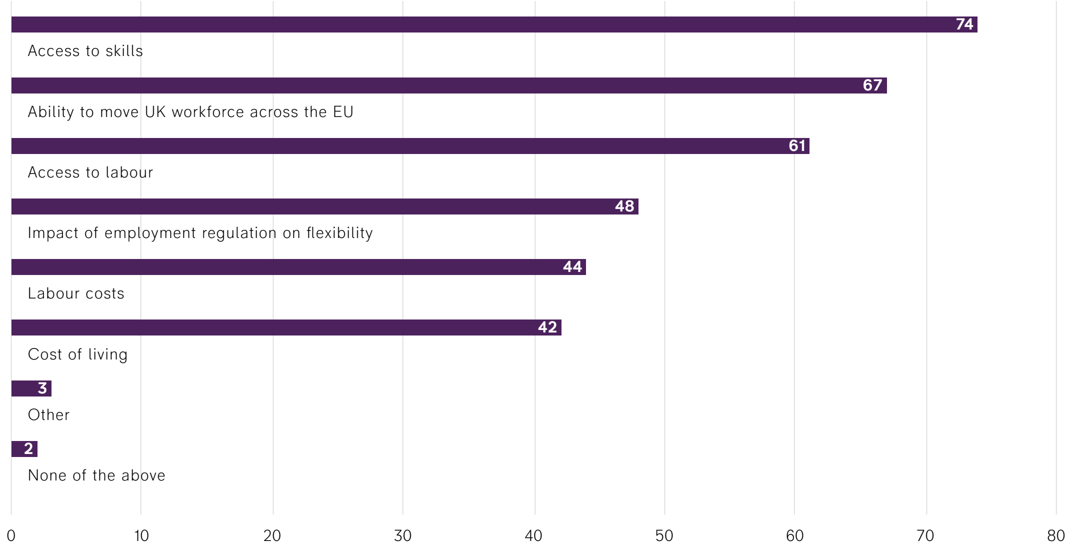
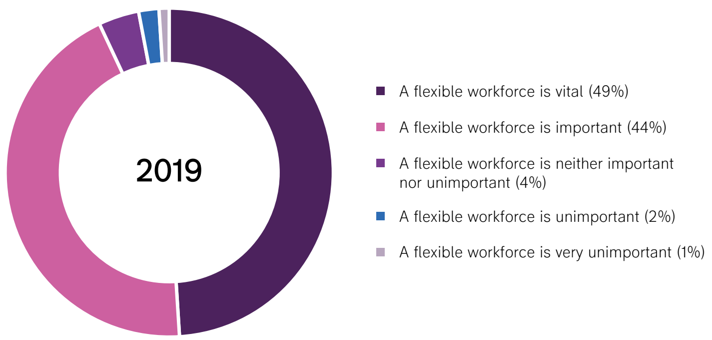


Exhibit 4.5 Importance of a flexible labour market (%)



A rising cost of employment also threatens the competitiveness of the UK labour market

Labour costs has been a consistent feature on firms' list of threats to the competitiveness of the UK labour market. The cost of employment has been rising for several years, driven by a range of policy decisions and structural factors. These factors can drive up employment costs and, as they have generally not been accompanied by rising productivity, the pressure on businesses to be able to afford these increases grows continually.

Structural factors, such as skills gaps and employment tribunal dysfunction, drain resources as a by-product because they make it harder for firms to operate. However, some factors are introduced with the aim of increasing labour costs, such as the National Living Wage. It is hoped that such policies will push firms to increase productivity, but there is no evidence that this is how firms are responding. In recent years, this survey's results have shown that only a minority of respondents feel that productivity can make the NLW affordable. Businesses are only able to deploy every pound generated once but are currently having to stretch this across many different areas which is unsustainable in the long term. As the pressure of firms is ratcheted up by new factors, it leaves them less able to grow, compete, and create employment opportunities.

We asked firms to tell us how a range of policies had impacted on the cost of employment for their business. Affected businesses reported that the key drivers behind an increased cost of employment for their business over the past five years have been pension contributions (73%), skills shortages (71%), the apprenticeship levy (53%), and employment tax changes, such as National Insurance Contributions or IR35 reforms (48%) **(Exhibit 4.6)**.

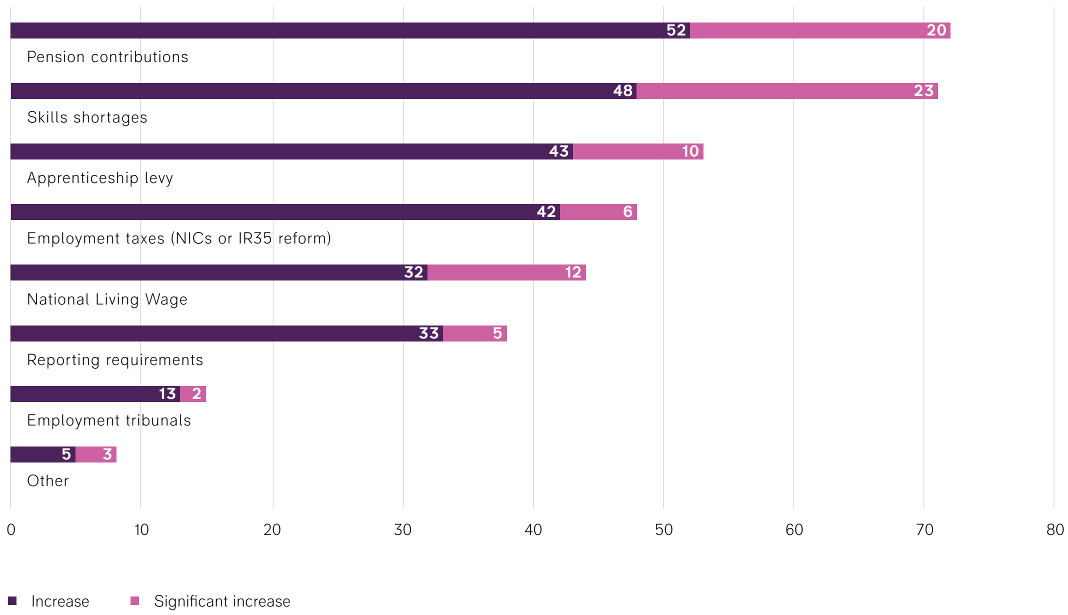
It is also important to note the scale of the impact on firms with around a quarter of affected firms (23%) reporting that their cost of employment has been significantly increased by skills shortages and one in five (20%) seeing significant increases from pension contributions.

Whilst pension contributions top the list, it is important to recognise that businesses are supportive of Automatic Enrolment which is a key driver of the rising cost of employers' pension contributions. This is also seen in the CBI's support for the recommendations of the Automatic Enrolment Review to also encourage saving among lower earners. That the policy was designed in collaboration with business and that it is delivering its objective are key reasons why it is supported. It is proof that businesses will pay for systems that work. Indeed, other CBI research indicates that more than seven in ten businesses (71%) believe that for their employees to have sufficient levels of retirement income, employers will need to make higher contributions to automatic enrolment schemes in the future and nearly three-quarters believe that government should seek to extend automatic enrolment to self-employed workers.[7] While these changes will be difficult in the context of poor productivity growth, business can support them if they continue to be developed in collaboration and because there is a clear, shared objective.

While businesses are committed to investing in UK skills – 84% intend to increase investment next year[8] – their experience of the Apprenticeship Levy is significantly less positive, and they want it to be significantly reformed. Many firms face problems using the Apprenticeship Levy, which is stopping them from being able to access and deliver the quality training they need. The Levy must evolve into a flexible skills levy. To take the first steps towards a flexible skills levy, the new government must focus on increasing transparency and commit to public consultation on long-term reform.[9]

These examples show that businesses can support measures that increase the cost of employment in support of clearly defined economic and social goals. Too often however, policies are not developed with business and the link between the goal and the policy are not clear. While it is not the competitive strength of the UK labour market, the cost of employment must not become a significant weakness. Government must carefully consider their approach and the existing pressure on businesses as they draw up future policy plans that may further add to the cost of employment.

Exhibit 4.6 Extent of increase on cost of employment (% of affected respondents)



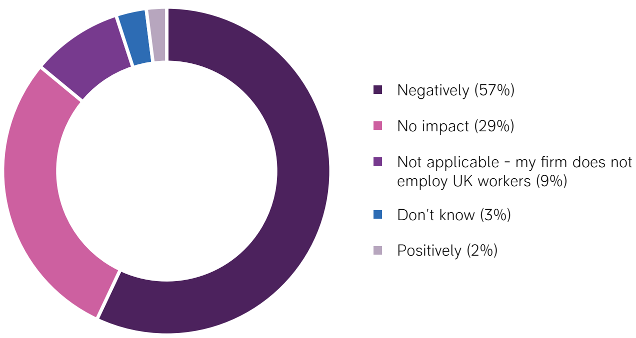
Government must radically simplify the UK's immigration system before free movement ends...

With access to skills and the ability to move workers around the EU featuring heavily in businesses' list of current and future concerns, getting the new immigration system right is vital. The December 2018 Immigration White Paper sets out welcome proposals to streamline and digitise the new immigration system, including radical reform of the existing sponsorship process. However, time is running out for government to implement these reforms before its self-imposed deadline of introducing the new system from January 2021.

The CBI believes that the system must be simplified before visas for EU workers are brought under a single system. In its current form, the system is prohibitively complex, time consuming, and expensive to navigate without the aid of professional advisers, all of which make it inaccessible for the majority of firms. Businesses are increasingly concerned that the Home Office will not have the time and capacity to deliver a system that works from day one. Moving to a system with similar sponsorship processes and IT system as the current non-EEA immigration system, with only the promise of reforms at some point in the future would be a real concern for business **(Exhibit 4.7)**.

Nearly three in five of respondent businesses (57%) told us that they would be negatively impacted if free movement ends before the immigration system is simplified. Only a small percentage of businesses (2%) told us that they would be positively impacted in this scenario. This highlights the importance of delivering the reforms outlined in the immigration White Paper in full, before switching to the new system.

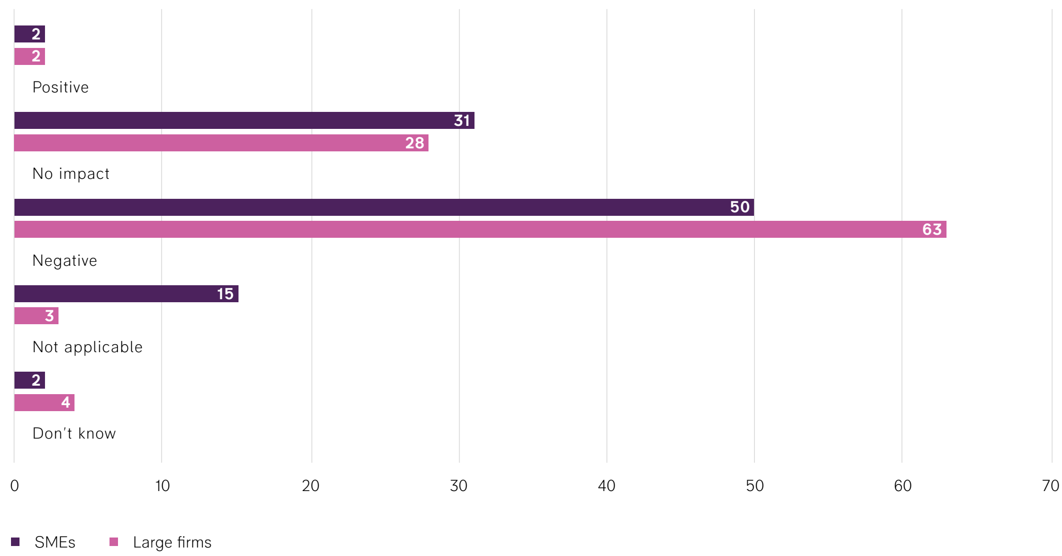
Exhibit 4.7 Impact if immigration system is not simplified before free movement ends (%)



...and not doing so would have negative implications for businesses of all sizes

Looking closely at the results reveals that not simplifying the immigration system before ending free movement would be detrimental for most businesses, irrespective of size **(Exhibit 4.8)**. The impacts would be most pronounced for large firms with over three in five respondents (63%) saying that they would be negatively impacted as well as half of SME firms (50%). Large firms are more likely to have experience of the current Tier 2 system and to understand the risks to their business if it becomes the norm. However, CBI research shows that SMEs are potentially more likely to find this system challenging because of how difficult it is to navigate.[10]

Exhibit 4.8 Impact if immigration system is not simplified before free movement ends (%)



"It is essential that the government safeguards flexibility by adopting evidence-based policies that are well-targeted to fix situations where flexibility is unbalanced, while protecting it for the millions of workers who value or depend on it."

Firms can get the best from their people through diverse workforces and inclusive practices

*The benefits of a diverse workforce and inclusive workplace practices cannot be understated, and many employers have made significant progress over the last few years as they increasingly view policies fostering diversity and inclusion as an important route to unlocking productivity and the potential of their employees. Firms continue to engage with gender pay gap requirements and are taking steps to close their pay gaps whilst readying their organisations for the introduction of ethnicity pay gap reporting. The CBI is working closely with members to help them choose how best to improve the diversity of their workforce and introduce inclusive workplace practices, including through our Great job and Mind the gap guides.**

Key findings

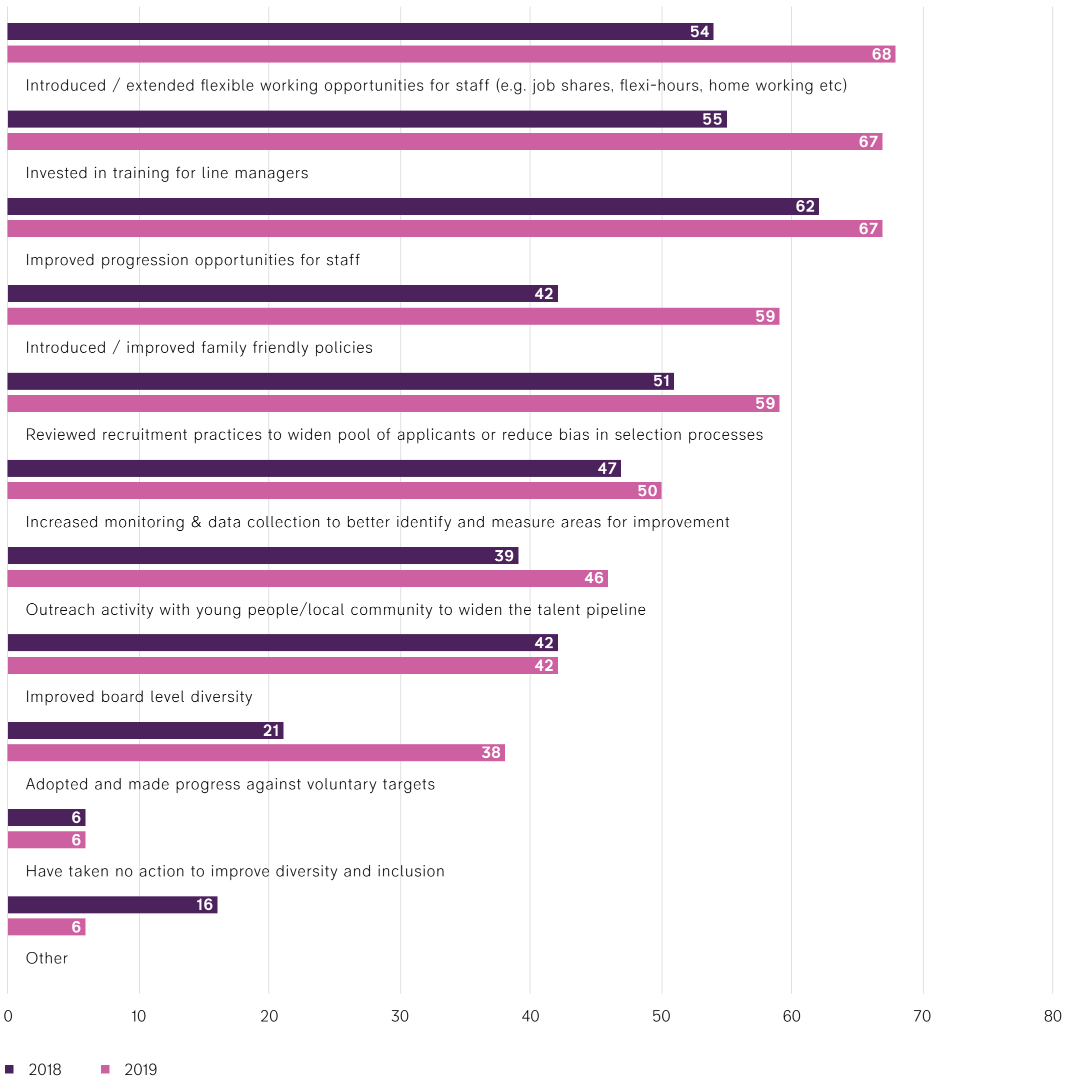
- In order to increase workforce diversity and create inclusive workplaces over two-thirds of respondent firms are introducing or extending flexible working opportunities for staff (68%), improving progression opportunities (67%), or investing in training for line managers (67%).
- Firms that see workplace improvements from inclusive workplace practices report a range of benefits, including increased ability to attract, retain and develop employees (70%), increased levels of staff engagement (55%) and increases in skills and capabilities (46%).
- 71% of respondent firms have taken steps to improve gender diversity and reduce gender pay gaps, whilst 65% have taken steps to improve ethnic diversity and reduce ethnicity pay gaps..
- Over two thirds of respondents (67%) have taken steps to attract, develop, or retain older workers.

**Both reports are available for members to download on My CBI (www.cbi.org.uk)*

The case for achieving a diverse workforce and adopting inclusive workplace practices has never been stronger...

Firms continue to pursue the value of a diverse workforce and inclusive workplace practices with more than nine in ten (94%) having taken a step towards this over the past five years **(Exhibit 5.1)**. The most frequently cited steps taken by respondents include introducing or extending flexible working opportunities for staff (68%), improving progression opportunities for staff (67%), and investing in training for line managers (67%). Strengthening flexible working opportunities and investment in training for lines managers come through particularly strongly in this year's survey with a 14% and 12% rise respectively from 2018. The latter result aligns well with the findings of our *Great Job* report which highlighted that managers have the single greatest impact on a person's experience of work.[11]

Exhibit 5.1 Steps taken to increase diversity in the past five years (%)



...but smaller firms still lag and may find it harder to invest time or resource

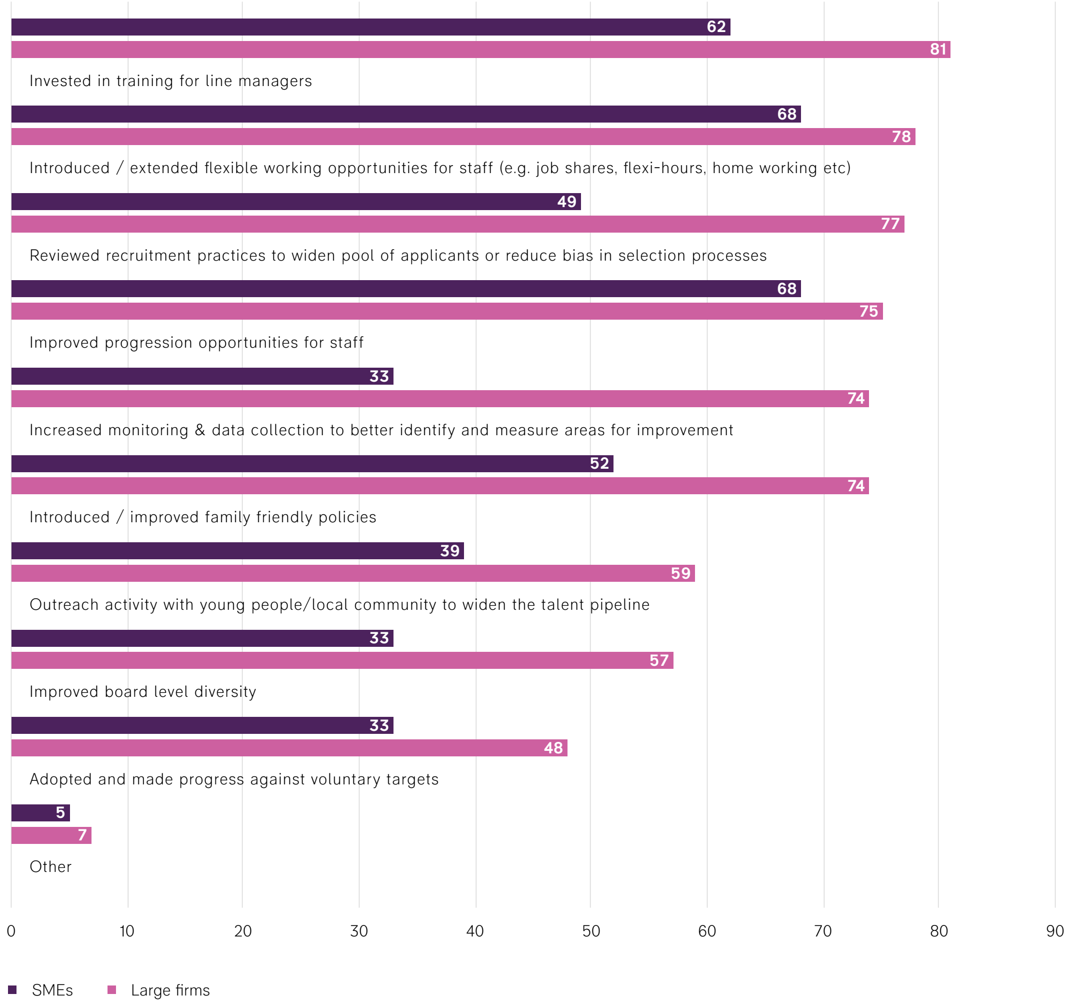
Despite diversity and inclusion being high on the agenda of most firms we still see one in ten SME respondents (10%) and more than one in five micro business respondents (21%) not having taken any action to improve it.

Smaller firms are less able to invest time or resources in building their diversity and inclusion agenda. While larger businesses have often hired somebody specifically to work on diversity and inclusion issues, the vast majority of small businesses don't have full-time Human Resources support. The CBI's *Great Job* report found that smaller firms face different barriers to acting than larger ones. Smaller businesses are generally held back by concerns over the expense and value of good practices, and a higher proportion invest after knowing the benefits of improving people practices and what good looks like.[12] Encouraging best practice sharing between firms and setting out a range of options for improving could help smaller firms to take that initial step.

Looking in more detail at the steps of firms that have taken action shows that the options taken by smaller firms looking to boost workforce diversity and introduce more inclusive workplace practices are different than those of larger firms **(Exhibit 5.2)**. Businesses of all sizes recognise the importance of improving progression opportunities for staff with over two thirds of SMEs (68%) and three quarters of larger companies (75%) having taken this step. Introducing or extending flexible working opportunities for staff is similarly popular with over two thirds of smaller firms (68%) and over three quarters of large ones (78%) doing so.

Beyond this however, a clear gap appears between SMEs and large firms. Whilst over four in five large firms (81%) report that they have invested in training for line managers in order to increase diversity, just over three in five SME respondents (62%) have done the same. Similarly, a third of SME respondents (33%) say that they have increased monitoring and data collection to better identify and measure areas for improvement compared to nearly three quarters (74%) of large respondents. The scale of this gap could be linked to the introduction of mandatory gender pay reporting for large firms and may also reflect that analysing data yields less insight when sample sizes are smaller. Meanwhile, nearly half of SME respondents (49%) have reviewed their recruitment practices to widen the pool of applicants or reduce bias compared to over three quarters of large firms that responded (77%). The results suggest that the time and resource available to small and medium-sized firms to take steps towards a more diverse workforce or introduce inclusive workplace practices could restrict the options available to them.

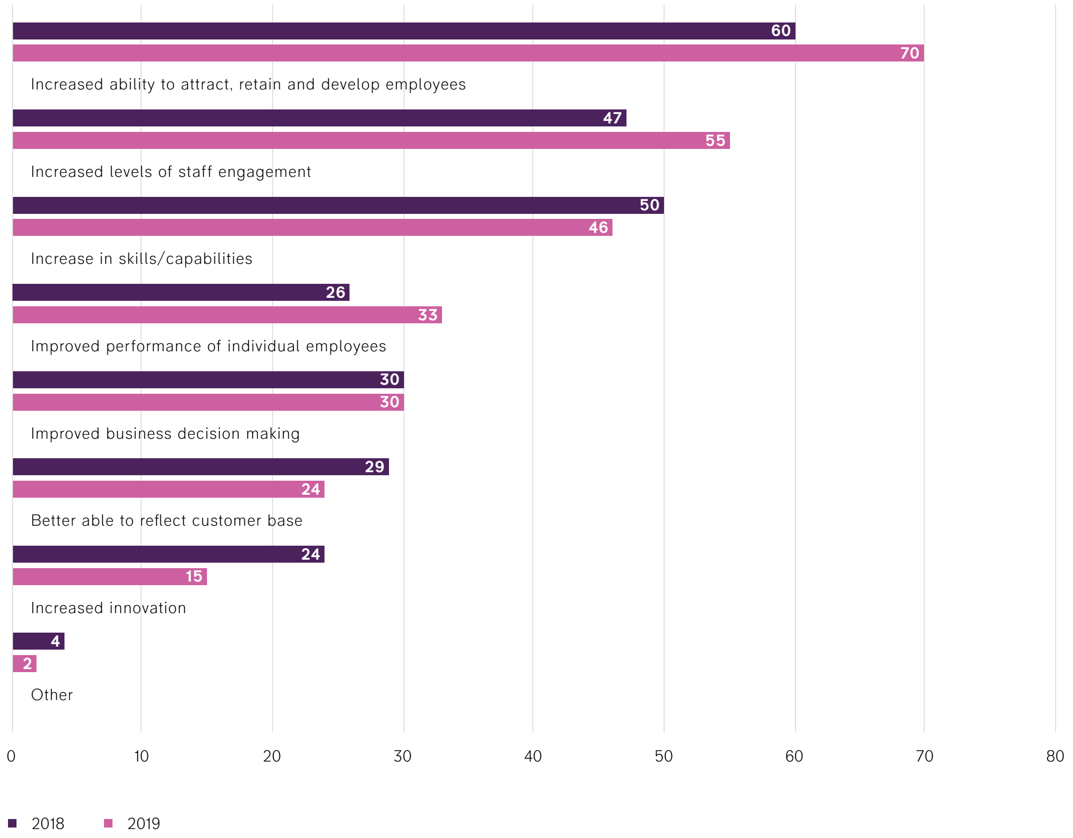
Exhibit 5.2 Steps taken to increase diversity in the past five years (% of firms that have taken steps, by size)



Businesses recognise a range of benefits from inclusive workplace practices

Nearly all businesses (96%) were able to identify benefits flowing from inclusive workplace practices. Of those that cited a benefit, the benefit most frequently reported continues to be an increased ability to attract, retain, and develop employees with seven in ten businesses (70%) experiencing this, up from 60% in 2018 **(Exhibit 5.3)**. Nearly three in five (55%) firms have seen increased levels of staff engagement whilst nearly half (46%) identify an increase in skills or capabilities within their workforce.

Exhibit 5.3 Main benefits of inclusive workplace practices (%)

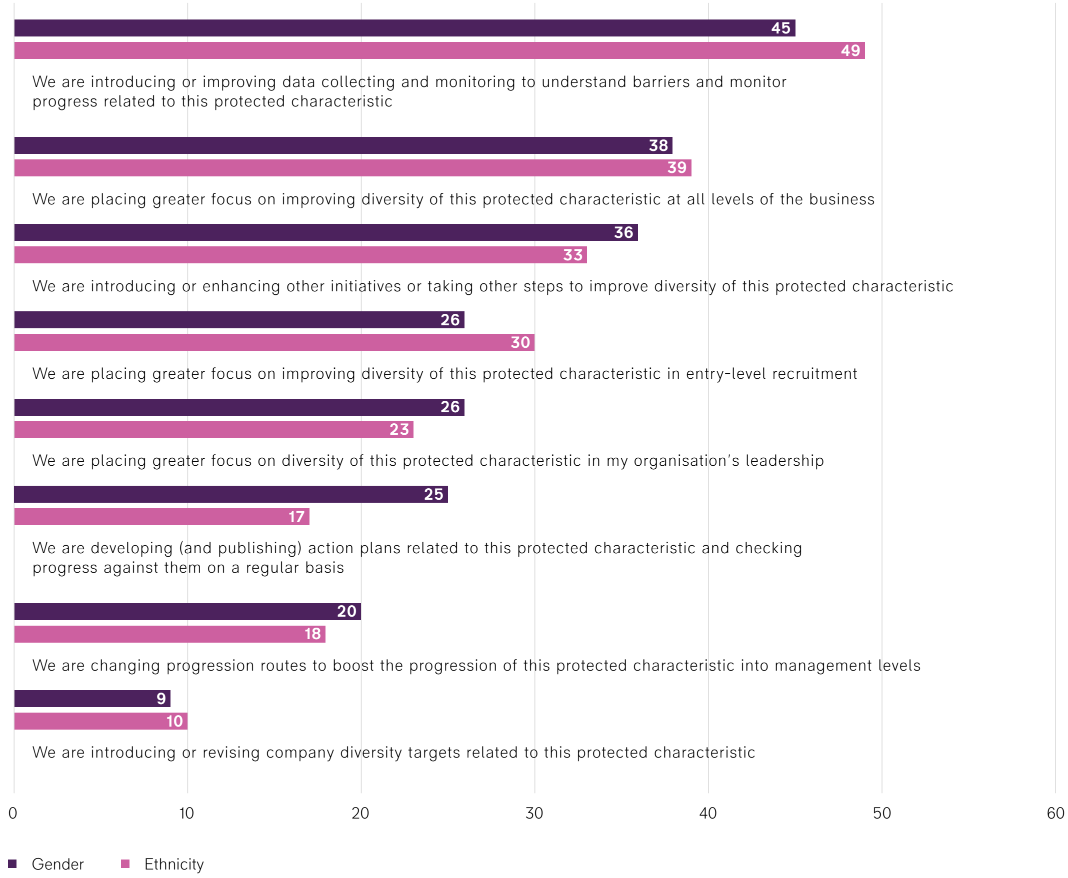


Firms are taking a variety of steps to improve gender and ethnic diversity although the strategies for each are distinct

Over seven in ten firms (71%) are taking steps to actively improve gender diversity and reduce gender pay gaps, whilst nearly two thirds (65%) are seeking to address ethnic diversity and ethnicity pay gaps within their organisations. Of those that have taken action, for both protected characteristics the step most frequently cited is to introduce or improve data collection and monitoring to understand barriers and monitor progress with nearly half of respondents doing this on gender (45%) and race (49%) **(Exhibit 5.4)**. Nearly two in five of respondent firms report that they are placing a greater focus on gender (38%) and ethnicity (39%) at all levels of the business.

A difference arises when looking at the specific parts of the business where companies are focussing their attention. For gender, of those firms that have taken action, the proportion focussing on diversity in their organisation's leadership and in entry-level recruitment is the same, at just over one-quarter (26%). However, for ethnicity, whereas just under a third of firms (30%) are focussing on diversity in entry-level recruitment, under a quarter (23%) are looking at ethnic diversity in their organisation's leadership. This reflects the different progress that has been against each of these protected characteristics and the impact that this progress has had on the makeup of workforces. 'Other' responses included introducing diversity steering groups and changing recruitment practices.

Exhibit 5.4 Actions companies are taking to close gender and ethnicity pay gaps (% of firms taking steps)



The CBI continues to work closely with members to help them meet their gender pay gap reporting obligations and has been active in influencing governments plans for ethnicity pay gap reporting. The CBI believes that ethnicity pay gap reporting can be a catalyst for actions to tackle existing barriers in the workplace for people from ethnic minority background. However, we are clear that on both protected characteristics there is no one-size-fits-all solution to closing pay gaps as every firm is different, and progress will not happen overnight. Businesses must be able to target their pay gaps with practices and policies that will work for their organisation as this is the best way to making sustainable improvements.

Businesses across the UK recognise the importance of unlocking the opportunities of longevity...

In 50 years' time, it is estimated that improving health in old age will lead to an additional 8.2 million people aged 65 years and over in the UK.[13] This demographic shift has contributed to an ongoing rise in the number of older workers.

Engaging older workers effectively will require firms to adjust their culture, processes, and workplaces to ensure that they are able to retain people in their organisations as they enter different stages of their lives, recruit and integrate older workers, and develop people as they progress through different parts of their careers. Over two thirds of all respondents (67%) are currently taking steps to attract, develop or retain older workers (50 years or above).

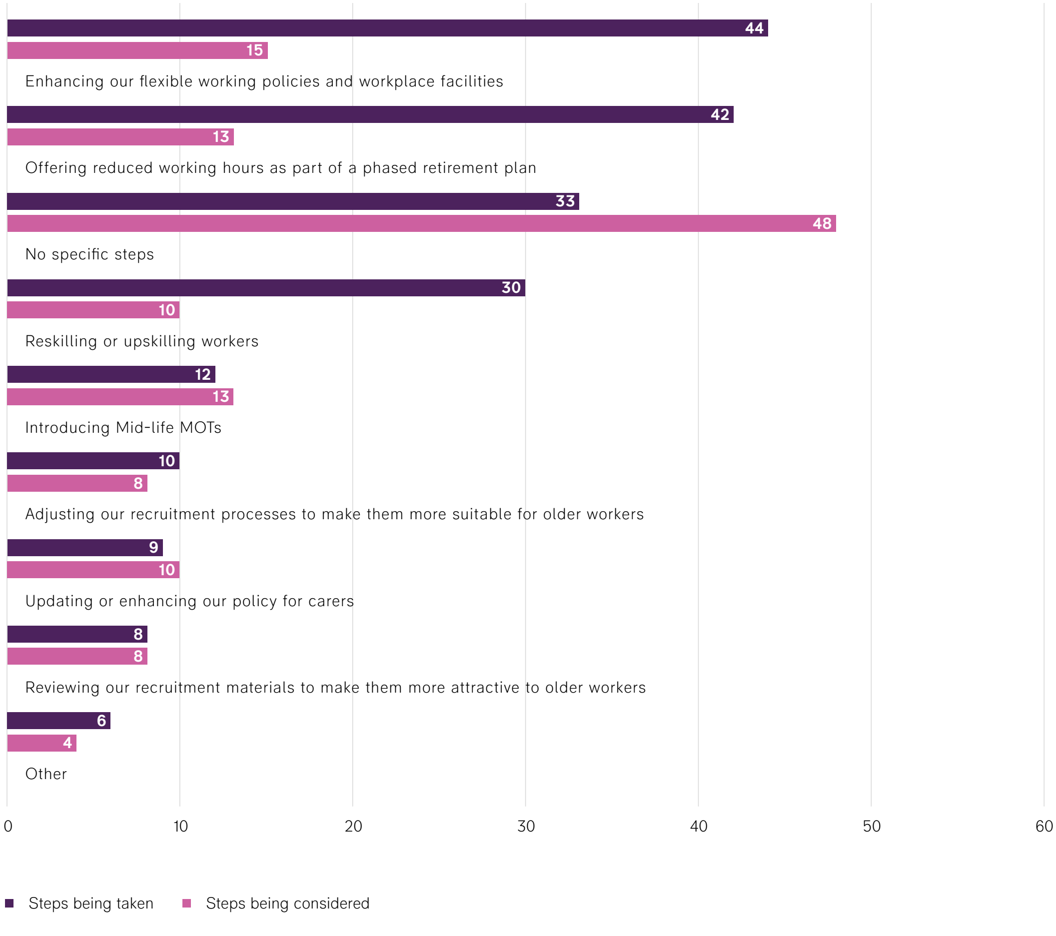
...and they are taking a variety of approaches, although many firms still need to prepare

We asked firms to indicate the steps they are currently taking and the approaches that they are considering to attract, develop or retain older workers **(Exhibit 5.5)**. Over two in five respondents (44%) are currently enhancing flexible working policies and workplace facilities, and a similar proportion (42%) are offering reduced working hours as part of a phased retirement plan. Three in ten respondents (30%) are approaching this issue through reskilling and upskilling existing workers.

But looking ahead, nearly half of businesses (48%) tell us that they are not considering specific steps in relation to older workers. There are huge benefits to be realised for those planning ahead now and preparing their organisations for the demographic changes which we know are coming. Fortunately, many of the steps that firms can take to make their workplace generally more inclusive will also help them to be a business that is more attractive to older workers and is set up to get the best from them. For example, flexible working policies and facilities that are helpful for parents can also be beneficial for older workers with caring responsibilities, or who are looking for a phased retirement.

Enhancing flexible working policies is the most frequently reported step that firms are considering with just under one in six respondents (15%) thinking about this approach, while offering reduced hours is similarly popular (13%). In addition, just under one in seven (13%) are thinking about introducing mid-life MOTs while one in nine respondents (11%) have already done so. This is a concept initially piloted by Aviva in 2018 for workers aged over-45. Workers are encouraged to review their wealth, work and wellbeing, which helps them to reposition towards a longer working life and supports Aviva with the retention of valuable skills and experience.[14]

Exhibit 5.5 Steps taken and steps being considered to attract, develop, or retain older workers (% of respondents taking steps)



Prioritising employee engagement boosts performance and productivity

It is people and their skills that make UK businesses great. Engagement is a core driver of business success given the clear link to higher profits and lower absenteeism. UK firms recognise the importance of engagement but there are still many benefits to be realised. This is why the CBI published its Great Job report which focuses on the importance of good people practices and the direct link to business performance.[15]

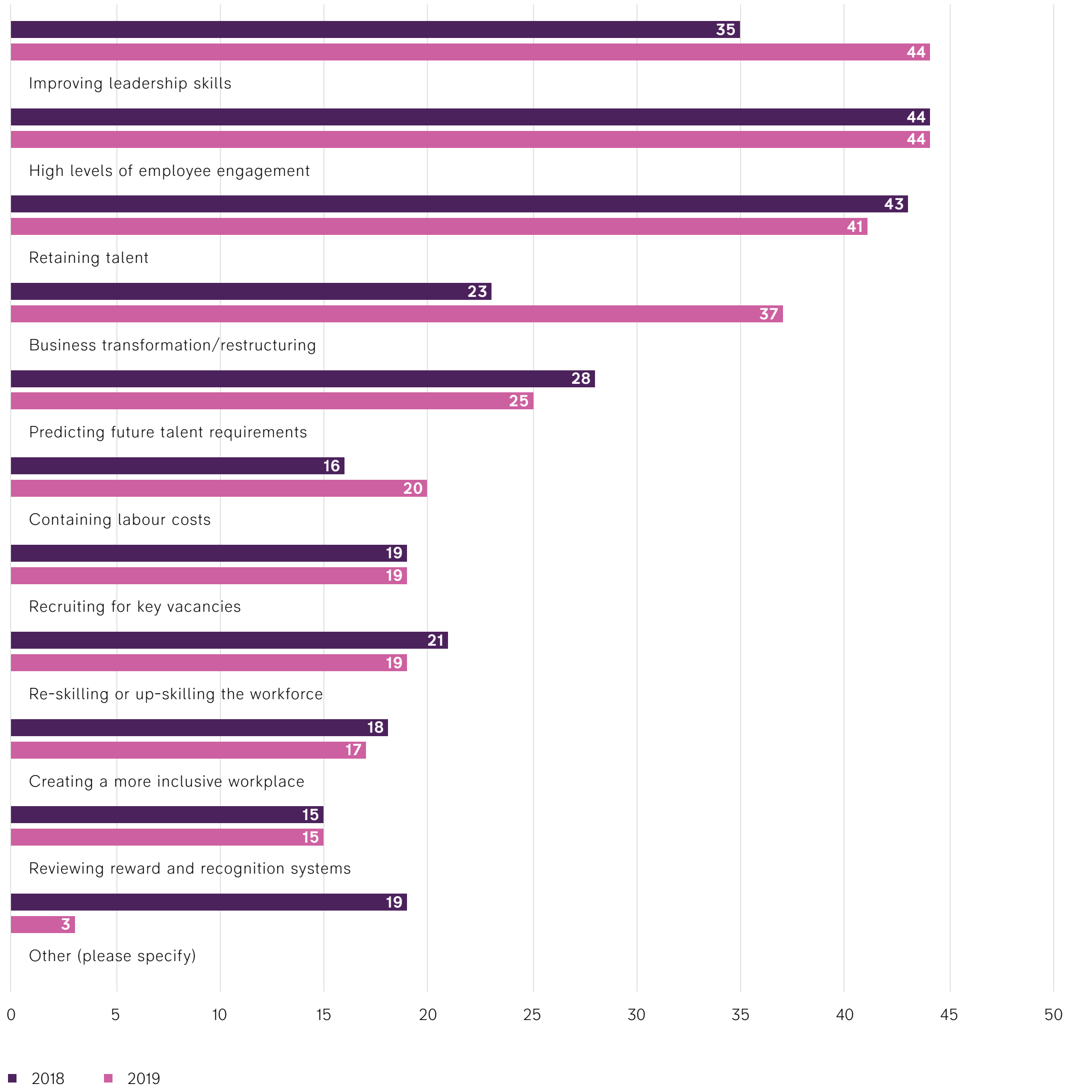
Key findings

- Effective line management (49%) continues to be the key driver behind employee engagement. Shared companywide values (32%) and flexible working practices (28%) are also important.
- 98% of respondents have seen a workplace benefit from engaged employees, including increases in productivity and performance (74%), increased retention (60%), and improved workplace health and wellbeing (53%).
- Respondent firms will expect their top three priorities for the year ahead to be maintaining or achieving high levels of employee engagement (44%), improving leadership skills (44%) and retaining talent (41%).

Engaging employees, improving leadership skills and retaining talent will be the workforce priorities for firms in the next 12 months

We asked businesses to indicate their top three workforce priorities for the year ahead **(Exhibit 6.1)**. Achieving or maintaining high levels of employee engagement continues to be the top-cited priority with over two in five firms (44%) saying that it will be a key focus for the year ahead. The same proportion (44%) will be looking to improve their leadership skills which is an increase from 35% in 2018. A similar proportion of respondents indicate that retaining talent will be a focus (41% compared with 43% in 2018), remaining high on the list of priorities for firms.

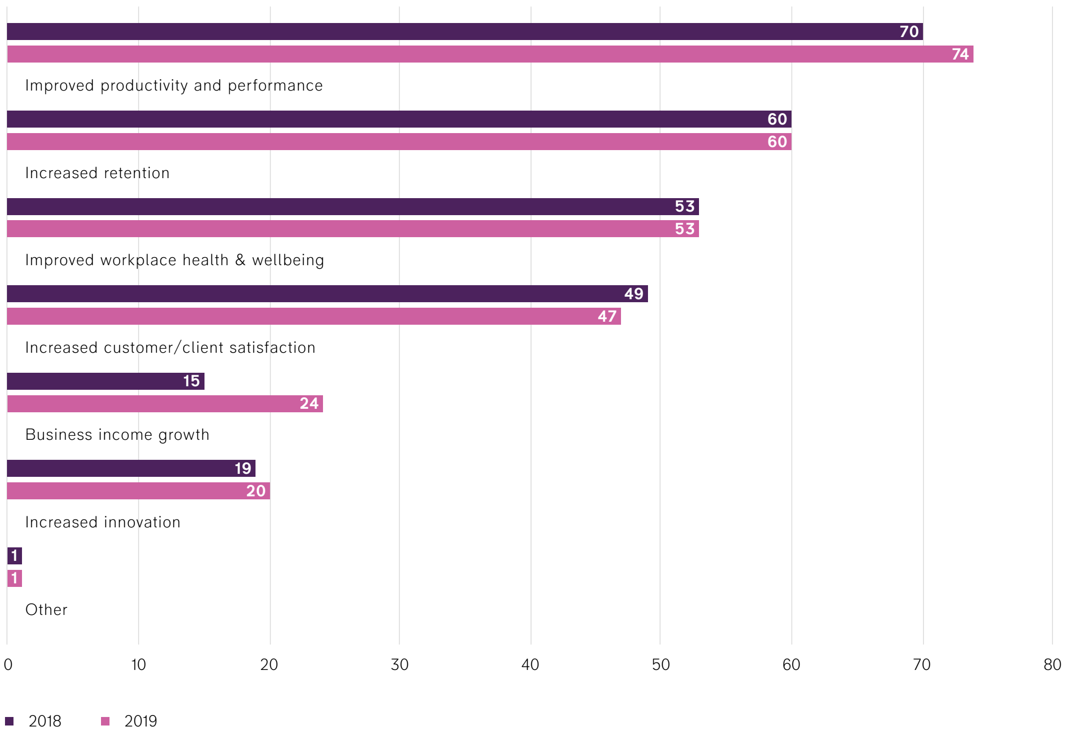
Exhibit 6.1 Workforce priorities in the coming year (%)



Focusing on boosting employee engagement can have tangible benefits for businesses...

There are a range of benefits that flow from engaged employees **(Exhibit 6.2)** and nearly all firms (98%) identify tangible benefits that they see in their organisation. Of those that cited a benefit, just under three quarters (74%) cited that achieving good employee engagement has led to improvements in productivity and performance. Three in five (60%) report improved retention and over half of respondents (53%) have experienced improved workplace health and wellbeing as a result of engaging their employees. The case for engagement strengthening commercial aspects of a business is further strengthened by nearly half of firms (47%) indicating that they have seen increased customer or client satisfaction.

Exhibit 6.2 Main benefits of engaged employees (%)



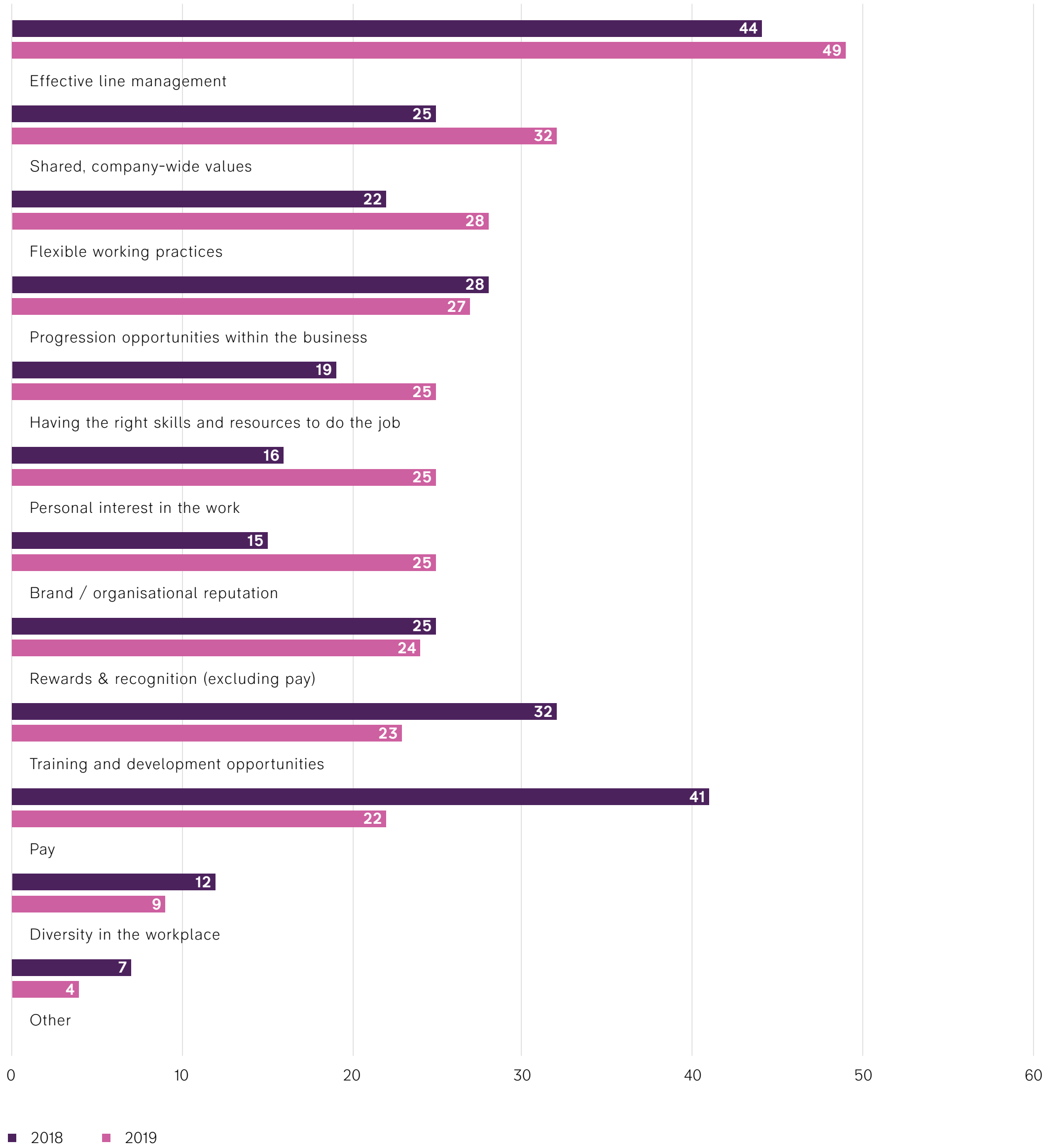
...and effective line management continues to be the best driver of engagement

In the CBI's *Great Job* report we showed how improving people practices can benefit individual company performance as well as boost UK productivity. Employee engagement is at the heart of this. That is reinforced by the findings of this survey with respondents asked to identify the three key drivers of employee engagement in their organisation **(Exhibit 6.3)**.

Of those respondents that cited at least one driver, effective line management stands out as the top driver of employee engagement (49%) for the third year in a row. Shared company-wide values (32%) and flexible working practices (28%) represent the next most popular drivers, up from our 2018 report by 7pp% and 6pp% respectively. Having the right skills to do the job, a personal interest in the work, and brand/ organisational reputation (all 25%) have also seen increases relative to last year's results.

Increases in such a range of drivers comes at the expense of a significant fall in the proportion of respondent businesses identifying pay as a key driver of engagement (22%, down from 41% in 2018). While this represents a notable decrease relative to last year, it returns to the 20% share seen in 2016. It is important to remember that businesses are only able to choose three drivers and so these results suggest that fair pay may be necessary but not sufficient to engage employees. Whilst unfair pay is deeply disengaging, it is not the case that the more an individual is paid the better they are engaged. We also see under a quarter of respondents (23%) highlighting training and development opportunities as a key driver of engagement this year, reduced from 32% in 2018.

Exhibit 6.3 Drivers of engaged employees (%)



Overview

This year's survey was carried out in the period 27 August to 4 October 2019. There were 304 respondent businesses in total.

Sectoral analysis

Respondents were drawn from all parts of the private sector **(Exhibit 7.1)**. Manufacturing companies made up the largest single grouping (29%), followed by professional, scientific, and technical activities (13%), and other service activities (11%).

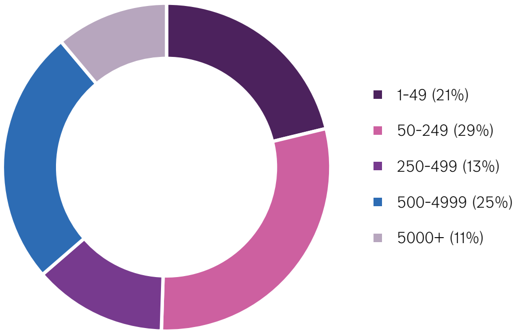
Exhibit 7.1 Respondents by economic sector (%)

Sector	%
Accommodation and food service activity	1
Administrative and support service activities	1
Agriculture, forestry and fishing	2
Arts, entertainment and recreation	1
Construction	7
Education	4
Electricity, gas, steam and air conditioning supply	2
Financial and insurance activities	6
Human health and social work activities	1
Information and communication	5
Manufacturing	29
Mining and quarrying	1
Professional, scientific and technical activities	13
Public administration and defence, compulsory social security	1
Real estate activities	4
Transportation and storage	4
Water supply; sewage, waste management and remediation activities	1
Wholesale and retail trade, repair of motor vehicles and motorcycles	6
Other service activities	11

Respondents by company size

This year's survey had a 50/50 response rate split between SMEs (less than 250 employees) and large firms (250 or more employees) **(Exhibit 7.2)**. Looking at the different ends of the spectrum, small businesses made up just over one in five responses (21%) while one in nine firms (11%) were a very large company with over 5,000 employees.

Exhibit 7.2 Respondents by number of employees (%)



Respondents by region

Most respondents had employees based in several regions of the UK **(Exhibit 7.3)**. Just under four in ten (39%) of respondent companies had employees based in London whilst around a third had employees in the South West (35%), South East (34%), West Midlands (33%), North West (33%), and North East (32%).

Nearly half of all companies (46%) had employees based in the devolved nations.

Exhibit 7.3 Respondents with employees in a given UK region (%)

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12 Ibid.

13 Overview of the UK population: August 2019, ONS, 23rd August 2019

14 Aviva launches 'Mid-Life MOT' for it's over 45s, Aviva, October 2018

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December 2019

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