Pay-Setting among Employers in the Agriculture, Cleaning, Hospitality and Retail Sectors

National Institute of Economic and Social Research (NIESR)
Report to the Low Pay Commission

October 2023

Ekaterina Aleynikova, Sophie Kitson, Jasmin Rostron (National Institute for Economic and Social Research) and Johnny Runge (King's College London).

About the National Institute of Economic and Social Research

The National Institute of Economic and Social Research is Britain's longest established independent research institute, founded in 1938. The vision of our founders was to carry out research to improve understanding of the economic and social forces that affect people's lives, and the ways in which policy can bring about change. Over eighty years later, this remains central to NIESR's ethos. We continue to apply our expertise in both quantitative and qualitative methods and our understanding of economic and social issues to current debates and to influence policy. The Institute is independent of all party-political interests.

National Institute of Economic and Social Research
2 Dean Trench St
London SW1P 3HE
T: +44 (0)20 7222 7665
E: enquiries@niesr.ac.uk
niesr.ac.uk
Registered charity no. 306083

Contents

Executive Summary

In recent years, the UK economy has been undergoing significant changes, shaped by major events and global trends. The measures adopted in response to the global pandemic have influenced, and continue to influence, consumer behaviours and demand. The UK's changing trading relationship with the EU has influenced the supply of workers and contributed to labour shortages in many sectors of the economy. Russia's invasion of Ukraine has led to rising prices and subsequent cost-of-living shocks.

The consequences of these events are far-reaching but include impacts for employers in the low paid and labour-intensive sectors, particularly for smaller businesses. These developments have the potential to impact employers' pay setting decisions, including decisions regarding pay levels, pay differentials, progression and pay reviews. A better understanding of the ways in which these factors affect employer pay setting is crucial for an understanding of how these employers responded to recent changes in the National Minimum Wage and the National Living Wage, and for discussions about how they will manage future increases to the National Minimum Wage and the National Living Wage (NMW/NLW).

In this context, building on previous qualitative projects commissioned by the Low Pay Commission (LPC), this research aims to broaden the evidence base on employer pay setting decisions and how those are influenced by the changing economy, and could be influenced by future NMW and NLW rises.

This qualitative research project is based on semi-structured interviews with employers in four low-paying sectors: hospitality, retail, agriculture and cleaning. These sectors are all in the 'top 5' low paying sectors in the UK, with between 20-45% of jobs in each sector being paid at or below two thirds of median pay (ONS, 2022). Senior managers in 41 businesses across the UK were interviewed to explore how they set pay and why, how their pay setting has been influenced by the changes in the NMW and the NLW rates, as well as the contextual factors over the recent years, and what strategies they have for managing future rises in the NMW and NLW.

The key findings of this research are:

- Employer pay-setting behaviours varied by employer size and sectors, with smaller employers in particular having more informal and relatively unstructured pay-setting processes. Some employers interviewed reported paying employees above the NLW rates, with key reasons for that being staff recruitment and retention, and a desire to make employees feel valued.
- Some employers reported not using the NMW youth rates, due to concerns around fairness. Others chose not to use the NMW youth rates or specifically target younger workers in their recruitment as they felt that younger workers were not as productive as more senior workers and required more training. Those employers specified that they would not employ apprentices due to the extra responsibilities this would put on the staff in charge of training them.
- The strategies that employers mentioned they use to absorb the NLW/NMW increases included increasing prices, reducing their workforce size, reducing pay rises or staff hours, finding efficiencies to reduce overheads, and using their own time or money to cover the gaps. Small and medium-sized employers reported finding it harder to absorb the annual increases in the NMW/NLW rates. Smaller employers were more likely to use short-term strategies or invest their own time and money, while some larger

businesses spoke about more long-term solutions such as investing to improve productivity.

- Employers described increasing challenges they experienced in the contexts of rising prices, the effects of the COVID-19 pandemic and Brexit. Some of those challenges included staff shortages, complications of supply chains, increasing costs and bureaucracy of exporting goods to Europe, operational difficulties, increasing costs of operating and changes to customer spending habits.
- Employers found contextual challenges hard to disentangle. They instead reported it was the high rates of increase to the NMW/NLW, alongside compounding contextual impacts, that had made pay setting and employment more challenging of late.
- Some employers reported having already recovered or found strategies to offset contextual challenges, while others, particularly small employers, raised concerns about their ability to absorb NMW/NLW increases in this context, and subsequently concerns for the future of their businesses.

Overall, the findings of this research highlight some challenges that employers, particularly small businesses, face in relation to NMW/NLW increases, with some reporting facing potential business closures or employment cuts. As this study is qualitative and based on a small sample, the findings are not quantifiable or generalisable. However, as the findings suggest that it is small employers who report potential business closures, it could be argued that this is unlikely to have an impact on employment on the aggregate level. This would be the case if workers were then moving to larger companies, as was observed by Dustmann and colleagues (2021). This research highlights some areas where further attention may be needed to support small businesses in managing the NMW/NLW increases, particularly in relation to impact on small business owners and safety of operations for workers.

Background and introduction

The National Minimum Wage (NMW) is the legal minimum that employers must pay workers per hour in the UK and is dependent on the workers' age. The National Living Wage (NLW) is the legal minimum that employers must pay workers per hour in the UK if they are aged above 23. This is a change from April 2021, when the NLW only applied to workers aged over 25 (National Minimum Wage and National Living Wage rates - GOV.UK (www.gov.uk)).

The NMW and NLW have been steadily increasing year on year, based on the Low Pay Commission's (LPC) evidence and the government's aim for the NLW to be the equivalent of two-thirds of median earnings by (October) 2024. The LPC has also advised that workers aged 21-22 should be brought into the NLW by 2024 (LPC, March 2023).

Figure 1: National Living Wage and National Minimum Wage increases, 2021-22 and 2022-23

NMW/NLW Rises between April 2021-2023	Workers aged 23 and over (NLW)	Workers aged 21 to 22 Years Old	Workers aged 18 to 20 Years Old	Workers aged 16 to 17 Years Old	Apprentice Rate
April 2021-22 Rates rose from/to	£8.91 to **£9.50**	£8.36 to **£9.18**	£6.56 to **£6.83**	£4.62 to **£4.81**	£4.30 to **£4.81**
April 2022-23 Rates rose to	**£10.42**	**£10.18** (+10.9%)*	**£7.49**	**£5.28**	**£5.28**

*NB: Workers aged 21-22 had the highest percentage increase to their wages in April 2023. This was to create a more gradual transition from NMW to NLW rates for this age group, by 2024.

As shown in Figure 1, the increase made to the NLW in April 2023 was the largest ever cash value increase made. This was not directly influenced by the level of inflation, but instead aiming to meet the two-thirds of median earnings goal without being detrimental to employment. The LPC is currently consulting on the potential effects the 2024 rise in NMW and NLW rates may have on employment. This report forms part of the evidence to inform this consultation.

This research explores pay setting in four low-paying sectors – agriculture, cleaning, hospitality and retail – and aims to answer the following questions:

1. What factors do employers in the four low-paying sectors consider when they set pay?
    a. How is employer pay setting influenced by the changes in the NMW/NLW rates?
2. What strategies have employers used for managing previous increases in the NMW/NLW (in 2022 and 2023), and what strategies do employers have for managing future rises to the NMW/NLW?
3. How, if at all, have employer pay setting behaviours been affected by:
    a. Rises in prices and the cost of living;
    b. Any impacts of the COVID-19 pandemic;
    c. The UK's new trading relationship with the EU?

Methods

To gather evidence on the research questions outlined above, **41 in-depth semi-structured interviews** were conducted with employers across 4 low paying sectors: **agriculture, cleaning, hospitality and retail**. The fieldwork was conducted between April and July 2023. Of those 41 interviews, the breakdown by sector was as follows:

- 9 agriculture,
- 11 cleaning,
- 12 hospitality,
- 9 retail.

Within each employer organisation, a senior manager was interviewed. Interviewee job titles include Managing Director, General Manager, Proprietor, Landlord/Landlady, Partner, and Company Secretary. Interviews were conducted with employers based across the UK, including in Wales, Scotland and Northern Ireland.

Prior to interviews, employers were provided with a research brief, outlining the nature of the project and their involvement. This brief emphasised the confidentiality of their responses, and that no individual or organisation would be named or identified in any publications resulting from the research. These principles were also outlined verbally prior to each interview.

The interviews lasted around 30-45 minutes and were conducted online or over the phone. Participants were not offered any reward for their participation. A topic guide was used to ensure that the same set of key issues were covered in each interview, while allowing some flexibility to ask probing questions on company-specific issues. Consent to record the interview was acquired prior to the start of the interview, and all participants consented. The interview questions covered the following themes:

- **The business**: key information about the business, its characteristics and workforce.
- **Pay setting**: pay levels, pay determinants, pay setting, pay reviews, the use of the NLW and NMW, including use of youth rates.
- **Changes in practise:** how employers pay setting practises have changed in response to the different rise in NMW/NLW in April 2022 and April 2023.
- **Context**: the impacts of Brexit, COVID-19, rises in prices, and the NLW, on the business and pay setting.
- **Future**: impacts of potential future increases in the NLW and NMW, including changes to youth rates, on the business and pay setting.

Recruitment

Employers were recruited to take part in the interviews using an employer database supplied by Market Location. Using this database, invitations to take part in the research were sent to employers within the four target sectors, based on specific subsectors within the relevant Standard Industrial Classification (SIC) codes (see Appendix 1 for list of SIC codes used for the four target sectors). Market Location updates the database on an ongoing basis, which means employers are 'warm' and have agreed to be contacted. The database provides information on the following variables: employer size, turnover, years established, geography (postcode, county, region), and premises type (home office, office).

The employers who responded to the invitation to interview were asked to complete a brief online survey with initial screening questions to identify the employers that fit our sampling criteria. This survey collected data on employer size, location, organisational structure, pay systems and rates, and the use of the NLW and NMW. Based on this, we sampled employers for interviews, according to a sampling framework outlined below. While this approach ensured that a range of employer characteristics were covered in the sample, the research inevitably involves a degree of self-selection bias, since only those employers who responded to our invitations took part in the interviews.

Sampling

This research used a purposive sampling approach to select employers for interview: this aims not to achieve a representative sample but to include a variety of employers as participants, to capture the depth and breadth of experience across employers in the specified low-paying sectors. The sampling criteria involved flexible quotas which aimed to recruit an even spread of sectors, a variety of employer sizes, a variety of businesses and different locations in the UK. The following tables show an overview of the achieved sample in terms of different characteristics.

Table 1. Interview sample by sector and region

Sector	Region	Proportion (BEIS business population estimates)	No. Employers
Agriculture	East Midlands	8%	1
Agriculture	East of England	9%	3
Agriculture	London	1%	0
Agriculture	North East	3%	0
Agriculture	North West	7%	0
Agriculture	Northern Ireland	6%	0
Agriculture	Scotland	11%	2
Agriculture	South East	9%	0
Agriculture	South West	15%	1
Agriculture	Wales	5%	1
Agriculture	West Midlands	8%	1
Agriculture	Yorkshire Humber	19%	0
Cleaning	East Midlands	6%	0
Cleaning	East of England	9%	3
Cleaning	London	18%	1
Cleaning	North East	2%	0
Cleaning	North West	9%	1
Cleaning	Northern Ireland	1%	0
Cleaning	Scotland	5%	2
Cleaning	South East	13%	1
Cleaning	South West	8%	2

Cleaning	Wales	3%	1
Cleaning	West Midlands	7%	0
Cleaning	Yorkshire Humber	19%	0
Hospitality	East Midlands	6%	2
Hospitality	East of England	8%	0
Hospitality	London	15%	0
Hospitality	North East	4%	1
Hospitality	North West	11%	1
Hospitality	Northern Ireland	2%	1
Hospitality	Scotland	9%	2
Hospitality	South East	12%	1
Hospitality	South West	9%	1
Hospitality	Wales	5%	1
Hospitality	West Midlands	8%	0
Hospitality	Yorkshire and The Humber	11%	2
Retail	East Midlands	8%	0
Retail	East of England	9%	2
Retail	London	14%	0
Retail	North East	3%	0
Retail	North West	11%	3
Retail	Northern Ireland	3%	0
Retail	Scotland	6%	0
Retail	South East	12%	0
Retail	South West	8%	1
Retail	Wales	4%	2
Retail	West Midlands	9%	1
Retail	Yorkshire Humber	14%	0

Table 2. Interview sample by sector and employer size

Sector	Employer Size*	Proportion (BEIS business population estimates)	No of Employers
Agriculture	1 to 9 employees	92%	5
Agriculture	10 to 49 employees	7%	1
Agriculture	50 to 249 employees	1%	2
Agriculture	250+ employees	0%	2
Cleaning	1 to 9 employees	77%	3

Cleaning	10 to 49 employees	18%	8
Cleaning	50 to 249 employees	4%	0
Cleaning	250+ employees	1%	0
Hospitality	1 to 9 employees	75%	3
Hospitality	10 to 49 employees	23%	7
Hospitality	50 to 249 employees	2%	1
Hospitality	250+ employees	0%	1
Retail	1 to 9 employees	86%	7
Retail	10 to 49 employees	13%	2
Retail	50 to 249 employees	1%	0
Retail	250+ employees	0%	0

*In our reporting, an employer is considered small if they have 1-9 employees, medium-sized if they have 10-49 employees and large if they have 50 or more employees.

Table 3. Interview sample by sector and sub-sector

Sector	Sub Sector	No of Employers
Agriculture	Fish Farms/Processing	2
Agriculture	Farming (Mixed)	2
Agriculture	Bulb Growers and Suppliers	2
Agriculture	Nurserymen	2
Agriculture	Potato Merchants	1
Cleaning	Commercial Premises Cleaning	3
Cleaning	Cleaning Contracting Domestic	5
Cleaning	Cleaning Contracting Commercial	2
Cleaning	Hygiene and Cleaning Services	1
Hospitality	Public House	3
Hospitality	Take Away Meal Outlets	2
Hospitality	Restaurants	2
Hospitality	Holidays (Self Catering)	1
Hospitality	Hotels	1
Hospitality	Nightclub	1
Hospitality	Cafes and Snack Bars	1
Hospitality	Clubs Social and Associations	1
Retail	Games and Toys Shop	1
Retail	Music Shop	2
Retail	Baby and Nursery Equipment	1
Retail	Cycle Shop	1
Retail	Jewellery Retailers	1

Retail	Bakery	1
Retail	Discount Store	1
Retail	Gift Shop	1

Table 4. Profile of organisations interviewed, and their use of the NLW and NMW age-related youth rates.

Employer	Sector	Business Headcount Range	Employ anyone under 23?*	Use Youth Rates?	Lowest adult (23+) rate*	Proportion of staff on lowest rate (incl. youth rates) *
1	Agriculture	1 to 4 employees	Yes	Yes	NLW	-
2	Agriculture	1 to 4 employees	Yes	No	NLW	50%**
3	Agriculture	1 to 4 employees	No	N/A	£14.30	100%
4	Agriculture	5 to 9 employees	No	N/A	NLW	100%
5	Agriculture	5 to 9 employees	Yes	Yes	£14.00	11%
6	Agriculture	20 to 49 employees	Yes	Yes	NLW	40%
7	Agriculture	100 to 199 employees	-	No	Real Living Wage***	-
8	Agriculture	200 to 499 employees	Yes	No	NLW	6%
9	Agriculture	999 + employees	Yes	No	NLW	-
10	Cleaning	1 to 4 employees	Yes	Yes	£10.50	67%
11	Cleaning	1 to 4 employees	No	N/A	NLW	*"Majority"*****
12	Cleaning	1 to 4 employees	No	N/A	NLW	100%
13	Cleaning	10 to 19 employees	Yes	No	NLW	75%
14	Cleaning	10 to 19 employees	Yes	No	£10.45	55%
15	Cleaning	10 to 19 employees	No	N/A	£11.20	67%
16	Cleaning	10 to 19 employees	No	N/A	NLW	-

17	Cleaning	20 to 49 employees	No	N/A	£12.99	40%
18	Cleaning	20 to 49 employees	No	N/A	£11.00	*"Most"***
19	Cleaning	20 to 49 employees	Yes	Yes	NLW	70%
20	Cleaning	20 to 49 employees	Yes	No	NLW	79%
21	Hospitality	1 to 4 employees	No	N/A	-	-
22	Hospitality	5 to 9 employees	No	N/A	£10.50	100%
23	Hospitality	10 to 19 employees	Yes	Yes	£11.00 (+tips)	15%
24	Hospitality	10 to 19 employees	Yes	No	NLW	42%
25	Hospitality	500 to 999 employees	No	N/A	NLW	3%
26	Hospitality	5 to 9 employees	Yes	Yes	NLW	43%
27	Hospitality	10 to 19 employees	No	N/A	£11.00	100%
28	Hospitality	10 to 19 employees	Yes	Yes	NLW	43%
29	Hospitality	10 to 19 employees	Yes	Yes	NLW	10%
30	Hospitality	10 to 19 employees	Yes	No	£10.50	100%
31	Hospitality	10 to 19 employees	Yes	Yes	NLW	24%
32	Hospitality	50 to 99 employees	Yes	No	£11.00	-
33	Retail	1 to 4 employees	Yes	Yes	N/A*****	-

34	Retail	1 to 4 employees	No	N/A	NLW	33%
35	Retail	5 to 9 employees	No	N/A	£12.47	-
36	Retail	5 to 9 employees	No	N/A	NLW	75%
37	Retail	5 to 9 employees	Yes	Yes	£11.23	20%
38	Retail	5 to 9 employees	Yes	No	£15.00	-
39	Retail	5 to 9 employees	Yes	Yes	£10.75	38%
40	Retail	10 to 19 employees	Yes	Yes	NLW	75%
41	Retail	20 to 49 employees	Yes	Yes	NLW	*"Most"*****

*Where provided.

** This employer paid themself below NLW.

*** 2022-23 Real Living Wage value is £10.90 across UK, £11.95 in London.

**** Some employers would not quantify an exact proportion and are instead quoted.

***** The owner does not employ anyone over the age of 23 and has not included themself in payroll.

Stakeholder workshop

An employer stakeholder workshop was held to invite comments on the initial themes emerging from the analysis. This was conducted after the completion of interviews, and half-way through the analysis. Eight employers, who had previously been interviewed as part of this research, as well as LPC officials, attended a 1.5-hour online workshop. Initial themes, for example, in relation to employer pay setting behaviours and strategies and challenges for absorbing NMW increases, were presented and followed by an open discussion on their relevance. This provided us the opportunity to 'sense-check' the initial themes against stakeholders' perspectives. Contributions from the workshop were then integrated into this report.

Data analysis

All interviews were audio recorded and transcribed, with consent from the interviewees. Interview transcripts were analysed thematically using qualitative data analysis software NVivo. Codes were used to identify cross-cutting themes across the interviews. Analysis was done iteratively, to allow for any emerging unanticipated themes to be reflected. Emerging findings were presented in workshops to the LPC officials and to employers, to gather feedback and further develop the findings.

Strengths and limitations of the data

The evidence in this report is based on qualitative research that is not – and does not set out to be – representative of the wider population. Instead, the research has focused on generating in-depth insights on the experiences of 41 employers across four low paid sectors in 2023. This research used purposive sampling, with the selected employers covering a range of different businesses, across various locations in the UK, different subsectors within the different industries, and with different numbers of employees. This sampling strategy allowed us to explore a breadth of experiences within these sectors. This research contributes to the previous studies in this area by particularly highlighting the views and experiences of smaller employers, which is a relatively under researched area. By conducting semi-structured qualitative interviews, we were able to generate detailed data on the experiences and perspectives of our interviewees. Semi-structured interviews also ensure that data collection is led in part by the participants' priorities and views, rather than by any prior assumptions of the interviewer.

In addition to the views of the employers being illustrative rather than representative, it is important to note that by asking employers to opt in to interviews, this research involved a degree of self-selection bias. As these employers were self-selected and not offered incentives for participating, it is possible that employers with particularly strong views about the NMW/NLW were more likely to participate. This may include some employers with particularly favourable views of the NMW/NLW and strong commitments to paying their staff competitive wages, as well as some employers who may have been more sharply affected by some of the challenges we discuss in this research, and therefore more likely to express negative views of the NMW/NLW. We aim to present and contextualise this range of views.

Findings

Employer practices

This section outlines employer practices in pay setting described by the employers interviewed for this research. It starts with describing employer reported views on the NMW/NLW, including some of the challenges they experienced. Then, employer practices in pay setting, use of pay differentials and pay reviews are outlined.

A large share of the interviewee sample for this research are small or very small firms, which impacts the types of pay setting behaviours and practices described in this section. Consistent with existing evidence on behaviours of small and medium firms, our findings show that these employers generally set pay informally, often determined by owners' discretion, personal views and preferences. Hence, the pay setting behaviours and mechanisms described here are often relatively unstructured.

Employer perspectives on the National Minimum Wage/National Living Wage

Employers described the NMW as a good mechanism to ensure all employers face the same requirements in having to pay their workers fairly, but some expressed concerns over employers in their sectors not following the law.

It is a legal requirement for all workers to be paid at least the National Minimum Wage, or the National Living Wage if they are aged 23 and over. These rates differ depending on an employee's age and if they are an apprentice aged 16-18 or in the first year of their apprenticeship course.

Employers interviewed for this research all operate within low paying sectors, often with low margins and pressures on labour costs. Despite those factors, many employers expressed favourable views of the NLW/NMW, viewing it as a mechanism to ensure workers are paid fairly.

> *"Fair pay within businesses can only be a good thing." – Large Employer, Agriculture*

Employers also noted it is helpful that the NLW/NMW rates and increases are set by the Government, meaning the same rules apply to all employers within and across low paid sectors, reducing competitive pressures. This was mentioned by employers in relation to both the level of the NLW/NMW and increases in the NLW/NMW.

At the same time, some employers expressed concerns over being undercut by employers in their sectors who were not paying the NLW/NMW. For example, an employer in the cleaning sector described losing customers to other cleaning businesses or individuals who charge customers rates below the NLW/NMW:

> *"I know of things that happen where people have not even been paid the minimum wage. But there doesn't seem to be any structure anywhere to make sure that does happen. I have never been checked up on, on what wages I am paying, in 35 years I haven't. So, nobody has ever come along and said to me, 'Look, prove that you are paying these wages that the government set'. And that allows cowboys out there to be ripping people off. And you know it's detrimental to my business in the long term because I know we are a quality operation, but cleaning is still cleaning. And if you are exploiting people on a much lower wage*

than you should be … a lot of people that I want as customers are paying cash in hand everywhere. They pay cash in hand, they don't worry about the wage, they just do a deal with a person, and it's like … it's like the Wild West. That's my biggest bug bear there is nobody out there checking on that, on their safety or anything at all. So, but there's nothing I can do about that. But that's the area that I think is very neglected." – Medium-sized Employer, Cleaning

Small businesses also reported facing pressures in the affordability of paying the NLW/NMW and absorbing NLW/NMW increases. Small employers described being outcompeted by larger businesses in terms of prices and ability to recruit employees. This challenge was particularly highlighted by small and medium-sized employers in retail, who described being outcompeted by online retailers, while they maintained high labour costs to keep their stores open.

Pay setting

Employers who pay above the NLW/NMW described doing so to ensure they recruit and retain quality staff, as well as out of their desire to reward or value their employees.

Many employers interviewed for this research reported that they pay above the NLW/NMW. Those who reported this often explained that they do so to recruit and retain quality staff.

"We pay the same for all our sound engineers, as I say, over the market rate, as it were, which guarantees we have decent engineers, really." – Medium-sized Employer, Hospitality

Competitiveness in recruitment, and benchmarking against competitor businesses, were also mentioned as reasons for paying above the NLW/NMW. During the employer workshop, some employers described benchmarking pay against their competitors through information sharing amongst employers in their local area, monitoring local vacancies, as well as benchmarking against employers in other low-paid sectors, not only their own sector. Importance of salary competitiveness was particularly highlighted by employers located in areas with a high concentration of employers.

"We grow probably about a third of the country's vegetables in this area. So, there's an awful lot of demand for skilled or unskilled workers. So, unemployment is very low in this area, so people can pick and choose where they work." – Large Employer, Agriculture

In this way, setting pay above the NLW/NMW is seen to impact both recruitment and retention, with salary competitiveness being seen as a key reason why workers leave their jobs. Some smaller employers reported struggling to benchmark pay against their competitors, particularly if those competitors are larger businesses.

"[Paying above the NLW/NMW] is for recruitment, yeah. It's to encourage people to take the job on. And, even then you can't retain them because there are so many opportunities. As soon as somebody offers them fifty pence an hour more they're off." – Small Employer, Agriculture

Some employers also mentioned paying above the NLW/NMW as a reward to their employees. For example, some employers in the hospitality sector mentioned paying at higher hourly rates for busy shifts.

> *"If we have a really busy shift, I'll give her ten pounds for an hour, she's normally seven fifty, something like that usually, because she's eighteen." – Medium-sized Employer, Hospitality*

Employers in hospitality also mentioned that their employees often get paid above the NMW/NLW when tips are taken into account. One employer mentioned using this information during recruitment, to incentivise applicants to apply to them instead of competitor jobs in other low-paid sectors, by telling applicants that their average tips per hour per head are £3.

Many employers who reported paying above the NLW/NMW explained that they do so to signal to their employees that they are valued. Employers linked this to staff retention as well as "looking after" their employees and fostering a good working environment.

> *"My criteria is that [our salaries are] always well above minimum wage and living wage, to make [the employees] feel valued. I don't want them thinking that I am just paying them the bare minimum that I am required to pay them. So, it's always more than the living wage." – Small Employer, Retail*

> *"I don't want to ever feel like I've undervalued someone in any way, in my attitude towards them or, and how they're paid and how I do the finances, because I think it's really important." – Medium-sized Employer, Hospitality*

Some employers also described paying above the NLW/NMW out of a sense of moral obligation. For example, one employer explained that in their view, better pay contributes to employees' health and wellbeing, in turn contributing positively to the local community.

> *"You can think in terms of like, you know, what's best for, in a civic way or what's best for your area, your community or what's best long term?" – Medium-sized Employer, Hospitality*

Some employers however noted that even those staff who are paid above the NLW still struggle with their costs of living. This is particularly the case due to the recent cost-of-living increases.

Other approaches to pay setting described by the interviewed employers included using pay differentials and discretionary bonuses, but rarely negotiations or bargaining with staff.

Employers who use differentials in pay reported increasing pay by managerial responsibility, with managers earning more.

> *"Once I have got the baseline, then we end up paying supervisors more to do the supervisory roles. And it ends up being a bit of a pyramid from there." – Large Employer, Hospitality*

Roles that require specific qualifications also were reported to be paid more. For example, in the hospitality sector, employers often offered higher rates of pay for roles such as chefs.

Employers also described bonuses and benefits that they provide as part of their pay setting strategies. Some employers, particularly smaller employers, described linking bonuses or pay rises with employees' birthdays. This is an example of discretionary pay practices being relatively informal and linked to employer preferences. Other benefits described by employers included flexible working hours, for example, flexibility to select own shifts in the hospitality sector, social events or reimbursement for travel costs. Some employers in the hospitality sector reported offering meals during shifts as a benefit.

The employers interviewed reported very low rates of staff bargaining or unionisation in relation to pay setting. In the cases where staff bargaining was mentioned, this was done on an individual basis and related to personal circumstances rather than collective bargaining.

Age-related NMW rates are seen by some employers as unfair, while those who use them justify them by offering young people work experience and flexible working arrangements.

Our sample included a mixture of employers who use and do not use age-related NMW rates. Some employers also reported having used age-related pay in the past, but many had since moved away from this practice.

Employers who did not use age-related pay reported concerns over age-related pay being seen as unfair, particularly when younger employees have similar responsibilities to older employees. Some of those employers further explained that they prioritise recruiting and retaining qualified employees over making savings on salaries.

> *"We don't use the discrimination on age, we believe it is not right. If they are doing a job role, they are doing a job role and no matter what age you are." – Large Employer, Hospitality*

Those employers who did use age-related NMW rates tended to describe the roles they recruited younger workers for as the kind of work that young people can do temporarily, to gain first work experience or to fit it around studies. Employers describing these roles as particularly beneficial or suitable for young people suggests that such flexible arrangements may be seen by employers as a trade-off for the lower salary that these young people receive. For example, a quote below from an employer who uses age-related pay describes the benefits they see of the flexibility they offer in their roles to young workers.

> *"If there's a party, at the last minute, they're teenagers, they'll say, "Oh, there's a party," and, I said, "You go," and I think that first job experience, is a really important thing for kids." – Medium Employer, Hospitality*

Employers reported using pay reviews to ensure their pay levels are in line with the NMW rates, as well as to account for inflation and reward staff for good performance. For small employers, these are often done in a relatively informal and unstructured way.

For most employers interviewed, pay reviews are carried out on an annual basis ahead of the planned increases of the NMW/NLW in April. Employers reported using those pay reviews to ensure their pay levels adhered to the NLW and NMW requirements.

Those employers who pay above the NMW or NLW rates reported that they consult the rates of increases in the NLW and NMW prior to increasing their own wages, to remain competitive compared to these rates.

Pay reviews were also described by employers as a way to reward staff for good performance and/or longevity of service. For example, one employer described their pay levels being above the NMW youth rates and increasing after a year of service.

"When I'm bringing in new [employees], provided they're 18, they start on a flat rate of £9.00 an hour and go up then after a year of service to £10.00 or £11.00, if they're good." – Small Employer, Agriculture

The small employers interviewed for this research generally described the pay review processes as being informal and unstructured. This is common for small businesses, who often are family owned, and have pay-setting behaviours shaped by owner's personal views or priorities.

"Because it's a family business, we don't have a lot of corporate structure in the way that you would normally find in any of the other firms that I've worked in. [Pay review] is a bit informal. If we have a good year, we slip them a cheque. We want them to feel valued, because we want them to do their best work. So, we give them birthday presents, have team dinners. We're a family business. [...] Their partners and dogs and children, we invite them round to our house for our annual party. We're like a group of friends. It is very unusual, but it's how Grandma ran the business." – Small Employer, Retail

Managing Wage Increases

This section looks at the methods businesses have employed to offset or absorb labour costs from rising wages, particularly in response to increased NLW/NMW rates over recent years. It explores how current methods may differ from past strategies due to factors such as the rise in the cost of living and post-pandemic spending patterns. This chapter also looks at strategies that employers have in place for managing projected future labour cost rises. We examine how ability to, and methods for, managing rising labour costs varies by sector and employer size.

Current Methods for Managing the Rise in Labour Costs

As discussed earlier in this report, employers across the four sectors tended to set their staff wages at or just above the NMW and NLW, with small to medium-sized employers who remained slightly above these rates mostly doing so for recruitment or retention purposes. Therefore, when the NMW and NLW rates increased in April 2022 and again in April 2023, employers used a variety of methods to cover the cost of increasing their staff's wages. The following part of this section describes the methods employers have used to manage rising labour costs in recent years, including whether this differs from their past approaches, and describes potential drawbacks to these methods.

Absorb wage costs financially, through profits or loans

Only a few employers, who were mostly large businesses, described offsetting the recent rise in wage by absorbing these within their profit. However, as many of the employers we spoke to in this research were from small or medium-sized businesses, most did not feel they could absorb the costs as part of their profits, often due to experiencing decreased profits and higher overheads in recent years.

One employer from a small business did say they managed to cover the cost of increasing wages by taking a profit loss, and they chose to do this as they felt they couldn't pass the cost to customers whilst remaining competitive:

"We have to absorb them [labour costs], we can't constantly put our prices up in store. It's such a cutthroat market ... we just take that cost on... [Interviewer: So,

you take a loss in profit overall?] Yes, yeah. Yeah, that's it it's just a loss to us." - Small Employer, Retail

Another retail employer from a mid-sized company said that they had also been able to absorb the increases to NMW and NLW rates as part of their profits as they had set their prices high enough in previous years.

When discussing specific NMW increases, some employers noted that the 2023 increase was larger than the increases in any previous years, making it harder for employers to absorb. That, in combination with other cost pressures, was reported as a challenge for some businesses. One employer stated that whilst they were able to absorb the increase in past years, they were concerned about their ability to continue to do so if the NMW continued to rise at the same rate:

> *"We're at the level where we try and put [salaries] above [NMW] to keep staff retention, so if there's any more ... when there are big jumps and rises, it will be a challenge, but as long as they're small I do believe that we'll aim that we are always increasing wages slightly every year... It's good to have a jump but not by as much next time I don't think. That big jump was hard for a lot of agriculture employers." – Small Employer, Agriculture*

Some employers said that they instead relied on government support schemes, such as the Recovery Loan Scheme, to cover the increase in labour costs and to avoid passing costs to the customer. One employer in the hospitality sector said that:

> *"The government handout of the employment allowance effectively goes to the staff. We get a rebate for the first I think £5,000 of National Insurance and effectively that counts [as] part of our bottom line in our payroll calculations.... And also, at the moment the council still give us a business rate rebate, so that's another £5,000 that effectively goes into the pot as opposed to out of it. So all of that supports [labour costs] rather than asks the customer to support the pay rise." – Medium-sized Employer, Hospitality*

Another employer from the agriculture sector said that they used to rely on the farming subsidies to help cover costs, which have since been discontinued.

Pass wage costs to customers

It was common for employers that we interviewed across sectors and business sizes to cover the recent increased wages in part, or in full, by passing the cost to customers. Employers often did this by increasing costs of all products and services by a set percentage or cash value.

One employer described that the amount they would have to charge to customers would also be higher than the increase to the NMW rates as they would need to cover insurance and employer benefits too:

> *"We have to charge out £2 extra per hour to the client, so for every 50p that the Living Wage goes up we have to charge out £1 extra because it's not just 50p, it's 50p plus the holiday pay, plus sick pay that we all have to sustain these days, plus insurance because insurance is calculated based on the size of your wage roll, so each 50p is actually a £1 hike" – Small Employer, Cleaning*

Whilst some employers said this would be the first time they could not absorb wage increases and had to pass these costs onto their customers, others said it is their usual strategy to pass any increases to wages onto customers. One employer explained that they would rather do that than take on any debt:

> *"We make 85p on a cup of coffee, that has to pay for all this increase in wages and all the rest of it and energy... It's unavoidable, it's irresponsible to go into debt so you have to make a profit...We have to put our prices [up] every time the minimum wage goes up to cover our costs." - Medium-sized employer, Hospitality*

Employers who said this would be the first time they would pass rising wage costs to their customers often explained this was due to pressures from other recent increased costs that had reduced their margins, such as the cost-of-living crisis and energy price spikes. Another employer said that it was the high percentage that the NMW and NLW rates had risen by in the past year that was the reason they could not just absorb labour costs as they had done previously, and instead had to pass some of the costs to their customers:

> *"When I calculated the original contract price I felt it was fair. It enabled me to pay a fair wage... And I wasn't greedy about my profit... I was able to absorb these price increments initially for the first few years because I'd set a nice level at the time, which was fair for all concerned. But obviously that's when wages were quite low. The National Living Wage was quite low at that point in time... It made me make that decision where I could keep my prices reasonably low because my overheads weren't high." – Small Employer, Cleaning*

Instead of adding a blanket sum to all client contracts or products, some employers instead charged a premium to only some of their customers, and others kept their prices the same, but for less product.

One employer from a small retail business, instead of increasing their product costs, described a method of 'shrinkflation' to pass the cost to their customers. They charged their customers the same retail price but reduced the size and weight of their goods:

> *"So, how we look at generating more revenue is maybe changing the size of the cakes or changing the cost of the products we sell. So, it's, yeah, cost-cutting where we can.... So, for example, a tray of Bakewell would have historically made twelve slices, we now cut it into sixteen slices" – Small Employer, Hospitality*

Another employer, from the cleaning sector, described how they kept prices the same for most of their clients, but would then charge a higher premium to those who employed them more irregularly or for shorter durations.

Concerns around customer loss and competition

Many employers who passed wage costs to customers expressed concerns that this would result in them losing customers to their competitors. This was particularly the case for small and mid-sized employers across the cleaning, hospitality and retail sectors.

Small retailers were particularly concerned about competition from larger supermarket chains or online stores. Those in more rural areas were also concerned about competition from smaller shops in the same area, as they knew they sold similar products from similar suppliers, and therefore any increase they made to their own product prices would be clear to customers.

Small and medium-sized employers from the cleaning sector were often also concerned about price competition from other small businesses, especially self-employed cleaners, who could offer lower prices by not having to award pay rises to staff:

> *"The best increase on contracts we've had is seven and a half percent, and that's … that's just lately, last year we got four, occasionally we got five... what we recover from our work relates to what we can give the staff... It's competitive really.... At the moment, we're still sort of scrapping it a little bit with guys out there that can offer a one-man band, he doesn't need to worry about pay rises for his staff, he can just go well, I'll work that little bit harder … It's that competitive edge really, like we're competing against people who probably got a lower cost base than us and that can absorb the work when times are tough" – Medium-sized Employer, Cleaning*

One hospitality employer from a rural area described how, despite having lower prices than competitors in the town, they still had to be wary of raising their own prices as they were in a less desirable location. They felt that businesses closer to the town centre could keep their prices higher to manage wages as they had more footfall to weather customer loss from price increases.

Staff loss due to customer loss. Some employers also discussed concerns that losing customers by raising their prices would then result in them no longer being able to afford their current staff, and therefore having to let people go:

> *"So, if we are in a position where we lose clients through increasing rates then that does put people's jobs at risk because then we are forced to look at you know reducing our workforce if they don't have the same amount of work to be able to provide the staff with the required hours. So that is the downside if we do lose work through increasing rates then obviously that would directly impact the staff." – Small Employer, Cleaning*

And for some businesses, this had already happened:

> *"... It's all interrelated. Because if you lose that relationship with your client, all of a sudden we start losing lots of sites and we're going to have to lay off a guy at the moment, our specialist caretaker, because there's not enough work [to pay] for him, we've lost the odd site, so … we've just got to tighten things up really." – Medium-sized Employer, Cleaning*

Mitigating client loss. One employer described how they tried to mitigate losing customers by meeting with their clients to placate them about the increase to their prices and to prove that they are a high-quality service that is worth the higher prices:

> *"I've gone to the clients to see if they want to reduce costs and where to reduce costs... to keep them. I've made adjustments; I've had to prove my value... For example, I'll throw in a carpet clean for them... Or I'd show them the health and safety registered, the staff get training, if there's any maintenance issues they are reported... All that stuff that they like to see that I spend time and effort putting those systems in place... So if a member of staff goes off sick that normally cleans that place, I've got a member of staff ready because I make sure all my staff are trained on other sites.... I have to make sure operationally that I am tip-top and*

that I am worth the money because I’ve increased the prices and they don’t like it" – Medium-sized Employer, Cleaning

The effects of COVID-19 and cost-of-living increases. Many employers felt less confident to put their prices up since COVID-19 and the cost-of-living crisis, stating that customers were more hesitant to spend on non-essential items and were therefore more likely to shop around for bargains and the cheapest options for the items that they did need.

One large employer who sold potted plants described how they had made a loss this year due to customers not spending as much on their products as they are not essential items. This made it harder for them to absorb labour costs, however they also felt they couldn't put their prices up as a solution because they were already losing clients:

> *“I guess the challenge this year is because volumes have been down, all of these costs make a bigger difference. So, we're in a non-discretionary patch, nobody needs to buy a plant. We're not an essential item, so our volumes have definitely been about 30 percent less than they have been in previous years, which is why all of these decisions have been incredibly hard, because you don't get the overhead dilution when you've got less volume going through the business ... [I need to make sure that] we don't lose business because we're too expensive... The sector and the factor of the economy has been problematic... It's very difficult to pass a lot of cost on [to the customer] when you're not selling the volume, and your customer is not selling the volume of your product.” – Large Employer, Agriculture*

On the other hand, another employer from a large business described how they would usually have absorbed some of the cost, but with extra cost pressures such as increased energy, they were forced to pass the cost to customers:

> *“...If you take the living wage increase this year was about, I think it’s about 9.7%, we have then had to pass that [to the consumer], so we have put all our prices up 10%… All our products are in the premium end of the market so most of it will be absorbed. But our view was, if you take last year our food costs went up 31% and we only [passed] 10% onto the customer. Where energy and interest rates have gone [up], we really took the decision this year that we can’t absorb another something else, so we’ve passed the full impact of the wage increases onto the customer... And [with] interest rates, we really had just nowhere else to go, it was just a pure [cost] it has to be passed onto the customer.” – Large Employer, Hospitality*

In comparison, some employers from smaller businesses, who worked closely within the community such as pub owners and domestic cleaners, were mostly concerned about the impacts passing labour costs onto prices would have on their customers’ livelihoods in the context of the cost-of-living crisis. They acknowledged that many people in their community had been struggling with rising costs, and one employer said they would only be raising their client prices as a last resort:

> *"We will hold off as long as we possibly can because we understand everybody is in the same financial position and we want to obviously see how things go through the summer... If it doesn’t go to plan and the company isn’t performing*

or growing the way we were hoping then we probably would need to look to increasing our rates" – Small Employer, Cleaning

Despite concerns about the impacts passing costs to consumers would have on the number of clients and ability to remain competitive, some employers reported that they did not receive the negative pushback they had been expecting.

One employer thought this could be due to their competitors also having to raise their prices, so they were not losing customers to lower prices. Others felt it was because customers were aware of the rise in NMW and NLW rates so they would have been expecting the employers to increase their prices accordingly. In this way, annual NMW increases were helpful because they are transparent and anticipated by all stakeholders and apply equally to all employers.

One employer praised the NMW in allowing them to increase customer prices to cover wage rises and not receive pushback because of it:

> *"Over the last year or so, I have increased the prices slowly and I've had very little push back, and I have to say, the National Minimum Wage is a really positive thing from my perspective, because when you write out and say that their fees are going to increase by x number of percent, they all know that the National Minimum Wage is going up... It's not about me absorbing them, it's a very simple business model, the National Minimum Wage goes up and I put up prices accordingly... It's a really easy issue." – Medium-sized Employer, Cleaning*

Another employer suggested that they had received little pushback from customers on price increasing because of the 'current climate', and that customers would be expecting everything to go up in price due to inflation. Another employer from the cleaning sector felt that they did not receive pushback from their clients because of the quality of service they demonstrated having justified the increase in their prices.

Pre-determined prices preventing employers from passing costs to customers

In contrast to employers in other sectors, one agriculture employer described that employers in their part of the sector were unable to pass costs to customers, despite this being a potential method of managing wage rises, because they have no market power. Therefore, they stated they would have to let staff go if NMW and NLW rates continued to rise:

> *"...In terms of the way farming works is we're a bit of a unique business because we aren't able to set prices at all. So, we are told what we can sell things at and we are told what we can buy things at, we have no ability of setting prices. The only things that we can do is decide whether we want to sell at that price or whether we want to gamble and hope that the prices will go up or find that the prices go down. So, when it comes to having price rises pushed onto us by suppliers, national minimum wage going up or anything like that, we don't have the ability to pass that onto our customers... It comes to the stage of do we continue employing somebody or not and as fast as the rates keep going up the answer to that has to be no, and so rather than that person getting some wage they'll get no wage and they'll have to go and find it from somewhere else." – Small Employer, Agriculture*

Reducing labour costs

In addition to, or instead of, passing costs to customers, employers also described ways of affording higher NMW and NLW rates by reducing their workforce size, changing existing

approaches to pay setting and reducing billable hours. This included reducing their workforce by either letting people go or not replacing people who left, reducing employee hours, changing employee contracts and changing their typical pay rise structure. Employers were concerned that these strategies would result in them struggling to recruit and retain their staff, and to ultimately keep their business open.

Reducing employee wages, pay rises and pay setting to lower labour costs

For some employers, this meant changing the way they had previously set pay to account for the increase in NMW and NLW rates and cut total labour costs. This included reducing the youngest staff to the NMW instead of the NLW, awarding a lower pay rise to all staff and reducing differentials by; only awarding a pay rise to the lowest paid staff or awarding a smaller pay rise to higher paid staff.

> *"So, up until recently, like historically I would have tried to keep people about a pound above [NMW], but in more recent years they've probably been 50p above, and now everyone's on the same wage because it's just gone up to £10.50 and we're trying to balance the books." – Small Employer, Hospitality*

However, some employers raised concerns that they felt forced into awarding pay rises to lower paid staff to the detriment of higher paid staff, as they could not afford to give pay rises to both. Some employers said this felt unfair to their staff, as this meant they were often rewarding their more junior workers instead of senior workers who were more experienced, more highly trained and had worked for the business for longer. Other employers went on to suggest that if they continued to reduce their differentials, or if they did not pay above the NMW, that they would struggle to both recruit and retain their staff in the future.

Another hospitality employer, who used youth rates, added that the rising of NMW took away their ability to use pay rises as a reward for commitment shown to the company or experience gained, as entry-level staff would know they would be receiving an increase in pay regardless of their work performance. They felt it took away the incentive for newer staff to demonstrate their value and suggested there should be a lower probationary rate so employers didn't have to 'overpay' new staff who they felt were not showing a commitment to their role or to the business:

> *"...It takes away from the pay rise as a reward because it's compulsory, it makes any pay rise that I do kind of irrelevant... It's perceived as an entitlement rather than something earned... When somebody is learning there should be a probationary rate... so that it can be acknowledged that while somebody is training they are not the fully capable staff… [otherwise] there is just no room for improvement." - Medium-sized Employer, Hospitality*

The use of accommodation offset rates. We asked employers if they had used, or considered using, accommodation rates to reduce labour costs. Only one of the employers we spoke to currently provided accommodation for their workers, but they said they did not use this to offset any salary costs:

> *"Lowest annual salary, they also have houses included, the full-time lot... It would be £22,500 plus a house... we don't ... to be honest it's not offset against anything particularly, it's just that that's included in their contracts... They're on separate ASTs, agricultural short hold tenancies, on their properties to cover that." - Small Employer, Agriculture.*

The majority of employers across sectors had never considered providing accommodation and using accommodation offset rates, and when accommodation offset rates were explained, employers said they would not use this as a mechanism for managing wage increases. One employer of a medium-sized business in the agriculture sector had heard of the accommodation offset rates and had considered using these, however they felt it would not justify the price of having to rent and manage the accommodation.

The use of youth rates. We additionally asked employers if they had used, or would consider using, youth rates, including apprenticeships, to reduce their labour costs. As previously described in the chapter on employer approaches to setting pay, many employers were against the use of age-related pay, feeling it was unfair.

Employers also said that they were reluctant to hire through the apprenticeship scheme as they felt it was unsafe in their sector, or that they would require too much additional responsibility for their current team, who would have to train them:

> *"I have never considered the apprentice scheme to be honest.... We're too small a team. For me that would put too much extra stress and responsibility on the team to manage looking after younger, untrained employees. And... I resent the fact that they get paid so little... I mean I'm aware of the apprenticeship scheme, it's not something I've been willing to wrap my head around managing. I believe they're also usually sixteen to eighteen age group, is that right? Which comes with extra health and safety and management responsibilities for employing under eighteens." – Small Employer, Hospitality*

Other employers had considered using apprenticeships to help reduce wage costs, but also felt that their business was not properly equipped to support an apprentice. Another employer said that they had employed apprentices, but that their local college had not managed the process well, which had put them off doing it again.

Reducing workforce and employee hours

Another method for reducing overall labour costs was by employers reducing their workforce size or reducing the amount of work for their current staff. These methods were mostly described by small and medium-sized employers interviewed.

Letting staff go and not replacing staff. Many small-to-medium sized employers that had staff on permanent contracts lowered labour costs by either letting staff go or by not replacing staff who had recently left.

One agriculture employer explained that he chose not to replace staff who left to avoid having to either reduce staff hours, or to let staff go in the future, due to his unpredictable sales and uncertainty around being able to afford their future labour costs:

> *"I'm conscious that we will need to save as much money as we can to give to existing members of staff, to ensure that they've got continuity of employment moving forward... So, I'm consciously not going to recruit anybody [to replace staff who recently left] until I can be sure that our sales exceed the amount set which means you actually can employ people... So, what I don't want to do like a few years ago, is take people on and then over Christmas everybody goes down to a three-day week or three fifths of their working week for a month." – Medium-sized Employer, Agriculture*

Another employer, from the hospitality sector, explained that they had chosen to let some of their current staff go to cut labour costs as they felt that their staff's quality of work fell short of their wage cost. Whilst they previously could afford to keep staff who they deemed as 'low quality', they now felt they were not worth their cost of employment:

> *"I had to [recently] let two people go...[I used to say] 'oh it's alright it's a pair of hands it helps'. But now that they are on the same or very close to the same money that key members of staff are, you just can't carry people." – Medium-sized Employer, Hospitality*

They went on to describe how they felt younger employees, despite being able to pay them less, were not worth their cost due to not applying themselves well to the job. The employer explained that whilst they used to look to employ the cheapest person, using age-related youth rates, they now would hire someone who was 'good value for money':

> *"...You are not looking just to get a 16 year old just as a pair of hands... [Now] you might be just looking to pay the extra money and get somebody who is competent... more looking towards getting value for money, rather than paying less."* – Medium-sized Employer, Hospitality

Reducing staff hours by cutting or shortening shifts

In addition, some of these employers reduced labour costs by reducing staff on shift or by changing shift lengths; opening late, closing early and reducing breaks. There were mixed opinions on whether these were preferable solutions, with some employers feeling that these decisions would lead to further problems for their businesses and would be unfair to staff. Other employers said they felt their employees would receive these changes well, as they felt their staff were young and not reliant on their salaries to live.

One retail employer who cut his employee's shifts in preparation for the rise in NLW rates explained that he shared his reasoning to his staff when making this decision, and made sure to cut an hour from everyone's shifts evenly so that it felt fairer to the team:

> *"I've made a tweak this year to save one hour a day, which has been good. I looked at the team in the kitchen and thought I think we can save an hour here. We don't need all these people in at nine o'clock in the morning. We will have one less in at nine. I said to the team, 'Look, I believe we can save an hour of wages here... With what's coming down the track with the Living Wage rise in April, nearly ten per cent… I've just got to be as efficient as we can.... I do believe this is something that would work for the kitchen, and it would be shared out, that reduction'... I shared it out fairly so everyone had the same sort of hit, if you know what I mean, as fairly as I could" – Medium-sized Employer, Retail*

In comparison, another retail employer said that they easily reduced the shift hours for their staff and did not feel the need to justify this decision to their staff, as they believe that since most of their staff were young, they would not mind shorter shifts as they were not reliant on their salaries to live.

However, other employers raised concerns about how fair reducing staff hours is, and its potential to lower staff recruitment and retention. Many employers were also concerned that, by reducing the number of staff on shift, they would be risking staff safety.

Agriculture employers gave the example of machinery that cannot be operated alone, whilst retail, hospitality and cleaning employers were concerned about the risk to the individual's safety if they were on their own:

> *"Well, there's a balance between how much you can reduce isn't there? So, if it takes ten hours to do a job and you need two people doing it there becomes a balance between [service] reduction... And there's also a balance between health and safety on site... I don't personally agree with lone working. I know some retail businesses do, but if you're in a city centre, I mean it's not particularly safe to have one person on site on their own." – Small Employer, Hospitality*

Furthermore, one retail employer noted that by reducing the number of staff in their store they were reducing the quality of service they could provide, which could lead to customer loss, profit loss and ultimately create further financial pressures, as opposed to reducing costs:

> *"… It's a difficult combination. So, if you reduce the number of staff in store then customers complain they had to wait and so you have to keep the staff numbers up but it's difficult to keep them up if you can't generate profit." - Small Employer, Retail*

An employer in the hospitality sector also stated that reducing their opening hours could lead to further financial pressures instead of reduced costs, as this would decrease opportunities for customer spending, and therefore the money saved from reducing shifts would not warrant the profit loss.

Investments and Cost-cutting

As an alternative, or in addition to, trying to reduce labour costs with contract and shift changes, some employers looked at investments to replace or supplement the workforce, as well as efficiencies that could help to cut their costs.

Automation to replace or supplement workforce

Some employers, mainly from larger agriculture and hospitality businesses, described how investing in the automation of processes helped them to reduce labour costs.

One employer described how automation had allowed them to reduce the amount of agency staff they relied on, and to move employees in other areas of the business on to full-time contracts:

> *"[The business is] highly automated. We've invested quite a lot in robotics, and automated handling. So, over the last five years, particularly, we've had a decline in the amount of operational colleagues that we employ...We used to employ about sort of 15 percent of our overall workforce, but use a lot of agency labour. Over the last three/four years, we've particularly refocused on de-seasonalising the business, trying to do automation, and therefore employ more colleagues directly, working to give them regular 40 hour a week contracts." – Large Employer, Agriculture*

Another employer described the investments they had made into sustainability and upgrading their machinery in areas of their business to cover the increase in labour costs they had predicted. They felt that even with these investments they were less profitable this year due to increased costs, but that they had minimised the impact of current and future labour costs by investing:

"Well, our view is we'd seen some of this [rise in NMW] coming so we would invest heavily. One thing to remember about the hospitality business is not every pound of revenue is equal. So, a pound in the restaurant doesn't have the same profit as a pound in the bar, doesn't have the same profit as a pound in a bedroom so on and so forth... There are parts of the business, we run our own laundry for the three hotels. So, it is purely more automation so investment [in machinery] ... We are working through each part of the business looking at where savings are from a sustainability piece ... It [the business] is significantly more profitable, but that profit then has been eaten up by the increased costs... If anything, we will be slightly less profitable than we were last year, but by doing all of the things we are doing it's going to minimise the impact of it. If we hadn't have done it, it'd have probably been a significant enough drop [in profit]." – Large Employer, Hospitality

Employers across the agriculture and hospitality sectors did however raise concerns about replacing people. They also felt that the quality of human workers could not be matched in all areas by automation.

One employer from a small hospitality business reflected that, despite their automation of some processes, they could not fully replace people in the workforce as it would not make sense for a business in their sector to not have people in their workforce. They therefore focused on automating processes that they considered to be more onerous tasks. Employers from smaller businesses and sectors such as cleaning and retail, did not consider automation as a way of reducing labour costs. One cleaning employer discussed how they felt there was no scope for automation in their industry, saying:

"It's a job that requires time. There's no machine that we can use that makes it faster. So, our scope for productivity improvements, which I think is what the Government's trying to generate from this extent, isn't really very high." – Medium-sized Employer, Cleaning

Productivity investments

An additional way some employers said they covered labour costs was through productivity investments. This included expectations that employees would take on more responsibilities for the same wage, complete the same amount of work within shorter shifts and/or by employers changing production systems or improving employee skills so they could be more efficient.

One employer, who had not replaced employees who had left in order to cut labour costs, explained that they would now expect employees who remained to pick up this additional work. They went on to describe that they would be looking at ways to help employees achieve this, including investing in machinery, and changing their production process to be more efficient:

"The ones [employees] that are left behind, sorry, but you're going to have to do a little bit more work, I haven't said that to them but that's the reality of it.... You're not behind them with a stick beating them, you have to think right how can this task be done quicker... So, the management look at the tasks that need to be done and then tried to implement some rudimentary sort of time saving, practical solutions to tasks to make it easier to make the worker more productive. So, that might be a roller conveyor belt in the top packing shed, it might be

different ways of working so making the boxes up first before you pack them to save you making them during the packing process. Move the potting benches to where the plants have been lined out on the outside beds as opposed to potting them in one area and then moving. So, you're always trying to look at Kaizen[1] *methods of working to improve the productivity of the individual that is there, instead of saying to them go faster." – Medium-sized Employer, Agriculture*

However, some employers raised concerns about the fairness of this approach, especially asking staff to complete more work in the same or less time, or asking them to take on further responsibilities without a salary increase:

> *"One of the things that has to go through your mind is can you get from the staff the same amount of work for less hours and I think that's where eventually the minimum wage will fizzle out... That's when it'll start to hurt, that's when individuals will say 'hang on a minute, there's no point in doing this anymore'. I think we are close to approaching that point, and that would be cruel to say to staff 'all you'll do is earn exactly the same as you were earning before but on less hours'." – Medium-sized Employer, Hospitality*

Another cleaning employer from a mid-sized company added that they could lose clients by asking their cleaners to complete the same quality of work in less time, as clients would see they had spent less time at the property and wouldn't be satisfied with the service:

> *"No, I don't do that [productivity investments] at all, I wouldn't do that.... Because the service wouldn't be there, you know. That is a really slippery slope to go down. So, if the client is paying for three hours of cleaning, the staff have to do three hours of cleaning." – Medium-sized Employer, Cleaning*

Upskilling staff. Two large agriculture employers stated that one of their methods for reducing labour costs was instead to focus on investing in and upskilling their staff, therefore increasing their employee's productivity, efficiency and quality of work:

> *"So, we try and keep people developing so that they then qualify for the next pay band, and therefore we can pay them more. So, it's really about investing in people, encouraging them to do some more skilled jobs, and therefore moving their pay rate. Which we get the benefit of because one thing that we can see is a difference between the output of people that are skilled and motivated, and invested in, versus people that come in via an agency, for example, and are just doing a job. They're less efficient and therefore it pays us to invest in people, because we get that sort of operation efficiency benefit. And, also people care more about the work they're doing as well." – Large Employer, Agriculture*

Reducing overheads costs

Another way employers tried to cover labour costs was by identifying opportunities to cut overhead costs, particularly around fuel and energy use. For larger employers this included investments to save energy costs in the future, such as investing in solar panels to cover energy costs. Smaller employers tended to focus on more immediate money-saving strategies.

---

[1] The Kaizen method is a business philosophy that seeks to involve all employees in the gradual and continuous improvement of various areas of a company. It is based on the idea that small improvements made consistently over time can lead to significant gains in productivity and quality.

One cleaning employer looked at how they could reduce petrol costs by altering employee rotas, as well as ensuring they were not overpaying for their cleaning products:

> *"[I] Monitor the petrol that we are using, and make sure that the rotas that I produce ... We are not driving everywhere … I am just on it all the time in terms of where the best place is to buy the products that I need... I am using stuff that the average housewife would buy. And there are bargains around, so I just hunt them down." – Medium-sized Employer, Cleaning*

However, one small agriculture employer said that, despite investing in new machinery to try and cut fuel costs, they felt this did not resolve the challenge of affording to pay a full-time worker at current NMW/NLW rates.

Employers using their own time or money to cover labour costs

Some employers in small to medium sized businesses, especially in the hospitality and cleaning industries, described how they would use their own time or money to cover labour. Some would take on work that they could no longer afford to employ staff to do and/or reduce or remove any salary paid to themselves or family members. Others said that they would put any profits made straight back into the business to cover staff wages.

These actions were typically taken by employers who saw no other way to cut costs, such as passing costs to consumers, and therefore couldn't afford their current staff on sales alone. They therefore covered labour costs by using their own money to pay staff, and by doing work themselves so they could pay lower wages, or no wages at all:

> *"This year I've taken a twenty percent wage reduction. My wife works with me, so between us we've taken twenty percent salary reduction to fund this [years pay rise]." – Medium-sized Employer, Retail*

> *"When the shop is dead...I can't even pay myself.., I mean my staff is always [my] priority, although I don't pay myself, they always get paid." – Small Employer, Retail*

Strategies to Manage Projected Labour Costs

The following part of this section describes how employers responded when asked about their planned strategies for managing further increases to the NMW and NLW rates. Many employers across sectors and sizes said they would continue to use the same strategies as they had in recent years to manage future increases to the NMW and NLW rates. However, whilst some had plans that looked to the future and the growth of their businesses, many other employers, particularly smaller businesses, were more despondent and said they could not plan for an uncertain future.

'Firefighting' strategies

Employers who reported that they planned to use the same strategies as they had in recent years often appeared to be 'firefighting', with employers describing these methods as 'trying to keep afloat' rather than looking to the long-term.

These plans including passing costs to customers, taking on work themselves as the business owner, and trying to reduce labour costs through other means, such as by letting staff go, stopping recruitment and reducing staff hours.

Some employers who had previously only passed some of the wage increase cost onto customers said that they planned on increasing the amount they passed to customers each year as wages rose:

> *"I think that we will need to increase our prices. So, we had already increased some of our prices to customers to try and cover some of the losses we were making on our overheads and our outgoings. But we just need to continue to monitor that closely but there's no two ways about it that obviously if we are then paying staff more and our outgoings are more that the only way to ensure survival of the business is to increase what we charge to our clients... It is just a bit of a vicious cycle at the moment... So, if we didn't increase our prices we wouldn't be able to absorb those costs at all." – Small Employer, Cleaning*

The employer in the agriculture sector who explained they were unable to pass labour costs to their clients due to fixed product prices said that they would instead no longer pay themselves to afford their worker's salary. They went on to predict that when they could no longer afford that one member of staff, they would eventually take on all the farm work themselves.

Small business employers from the other three sectors, who said they could not pass costs to customers for fear of losing them, also predicted a situation where they could no longer recruit any staff and would have to take on all the work themselves to keep their business afloat.

One employer added that they expected they would only be able to afford to recruit staff who were lower skilled, and would therefore accept a lower starting salary. They said they would begin to recruit at a lower skill level so that they could continue to afford the rising wages of their current staff:

> *"It's [wages] a much larger chunk of our business now... that [increased wages] puts a lot more pressure on the business, having to give that pay step up... And when we're recruiting and looking going forward, the salaries I can offer people, new people coming in are having to be lower, and maybe less skilled because of it, because the overall budget doesn't stretch to recruiting... Or offering the pay that we'd like to offer. Because we always pay those who are with us already." – Small Employer, Agriculture*

Investing for the long term

In contrast, there were some employers who did feel able to plan for the long term.

Some medium and large employers in the agriculture and hospitality sectors described plans for automation investments as part of their long-term strategy for managing future wage increases. This included applying for an Innovate UK grant and other technology grants, purchasing robotics equipment, solar panels for heating and machinery for packing.

One large agricultural employer described plans for a sizeable automation investment that would allow them to improve their efficiency and capacity for production, as well as allow their employees, who they refer to as their 'partners', to do less manual roles:

> *"We will improve our efficiency and capacity through automation and investment in equipment. We are making 4 million pounds in investment this year in that very way to take the latest equipment. And there are two reasons for that is, it gives us that improvement in capacity and efficiency and the productivity and performance, but it also means that our partners are having to work less hard in*

> *doing it. It's work smart and not harder in a sense of manual handling" – Large Employer, Agriculture*

However, some employers, from both the agricultural and other sectors, felt they had already automated as much of their processes as possible, particularly during the pandemic. Therefore, they described that there were no more opportunities in their business model to use automation as a method for replacing or reducing labour costs.

Many of the employers who planned to use investments as a solution were large companies with more money to invest.

Some smaller businesses, particularly in the retail sector, described how the money needed to meet NMW/NLW increases meant they had lost confidence in their ability to invest for efficiency or growth, as they were not confident their business would survive long enough to reap the rewards.

One employer at a medium-sized retail company said that they felt they would be acting immorally by taking a loan for an investment in sustainable energy, such as solar panels, when they could not guarantee their business would survive long enough to repay it:

> *"The mentality of having to find this amount of money for the Living Wage it changes your whole mindset about the confidence you've got to go and open new stores or get solar panels installed or embark on projects that could end up either not seeing the benefit or not having the value that you might have hoped when you embarked on them... I'd love to put solar panels on the building, but of course it would mean me going out and borrowing £140,000. And, yes, we'd have a four-and-a-half-year payback, but I've got to take on that risk … How can I in good conscience sign up for a four-year payback on something that will save me money in the long term, but there might not be a long term?" – Medium-sized Employer, Retail*

Two smaller agricultural employers had vaguer responses about their strategies for managing future costs but stated that they would be focusing on growing the business and investing, describing a flexible approach to managing future wage costs, by trying to project and plan for future gains and losses, whilst avoiding taking loans that meant they would be 'living beyond their means'.

Changing the business focus

In addition to employers investing to improve efficiencies of their current operations, employers also described plans and investments that centred on a change to their customer base or business focus.

Of the employers we spoke to, there were employers from across all four sectors and business sizes that reported a long-term strategy for managing future wage rises that required a change or adaptation to their business focus.

One employer from the retail sector who owns a small music shop gave the example of focusing more on selling online by investing in a website audit and hiring staff to manage this. They described that this would expand their customer base and move them away from reliance on footfall, which they noted had dropped since the pandemic. They were also looking at potential music contracts with schools, to further expand their customer base. They asserted that this expanded customer base would lead to increased profits to cover future wage increases.

An employer from the cleaning sector described their plans to change their business focus and establish themselves as an eco-brand, to justify charging higher premiums on their services to create 'more of a cushion' for wage increases. An employer from the hospitality sector described a similar plan for justifying higher costs to cover wage increases, explaining that they were investing in a brewery that would charge at higher prices to create an alternative profit centre so they could keep their general pub prices *"more accessible for people who are still struggling a bit, ordinary working people"*.

One large hospitality employer explained that they would manage increasing labour costs by focusing on markets outside of the UK that have more disposable income, and predicted that others in their industry who could not similarly pivot their business focus would not be able to manage the wage rises:

> *"A quarter of our business comes up from Ireland and a quarter comes in from North America … Only half of it is impacted locally ... We will probably be one of the least impacted hospitality businesses, but your local pub, your local restaurant they are going to be the ones that have not got enough head room to manoeuvre what they need to do.... It may just be a lot less bars and restaurants on the high street … That may just be the journey of our industry I don't know, but for us our pivot is massively towards our new businesses, we are focusing on mainly not UK business." – Large Employer, Hospitality*

Uncertainty about managing future wage increases, and the survival of the business

Small employers across the agriculture, hospitality and retail sectors often said that they could not plan for the future and had no strategy in mind to manage future wage rises.

Some employers said this was because they felt the increases made to NMW and NLW rates were often hard to predict, and that there wasn't enough time after they were announced to make a strategy to manage them. Employers noted that the wage rises in the past year had been larger than they had anticipated, which made it difficult to manage, even for large business employers. Employers from the stakeholder workshop also raised this point, and representatives from the LPC asked if employers were aware of the forecasts they published. Employers reported that they were previously unaware of these.

Employers from the workshop added that more long-term forecasting would be helpful for managing future rises, and one employer highlighted that "the low pay escalator from around 3 years ago" had been very helpful for planning for NMW and NLW increases.

Employers we interviewed also felt that they had already done all they could to manage the recent increases to wages, and that they would be unable to raise customer prices further as a solution. This led some employers to conclude that the continued rise in NMW and NLW rates, compounded with the broader cost base in recent years, would result in their only option being to close their businesses:

> *"I'm now at the point of saying 'what's it all about?'. I think I'll go and work for someone else and I'll close down my business... I guess the Living Wage is one brick of the house... When it was going up as it did, one percent, two percent, okay, fine, no problem, but... Pushing up the Living Wage exponentially... Well, there will be eighty people having to find jobs next year as it stands" – Medium-sized Employer, Retail*

“I’m open to suggestions... To be frank we’re at tipping point as a business. The increase in wages is an extra factor towards that tipping point. So, I’m not sure it [future increases to the NMW] will be something that I have to manage within this business.” – Small Employer, Hospitality

"We’ve put our business on the market because we can't sustain this, we’re just getting out of the business and it's heart-breaking.” – Small Employer, Retail

Impacts of contextual factors on pay setting

This section looks at how the wider social and economic context has shaped employers’ approaches to pay setting. Notably, Brexit, the COVID-19 pandemic and the cost of living, have compounded challenges for employers operating in low paid sectors. Distinguishing the impact of these contextual factors is challenging, and employers reflected that it is sometimes difficult to point to a singular factor to explain changes in their sector, for example shortages of quality staff. Some employers are also still recovering from costs incurred during the COVID-19 pandemic, increasing costs of operation due to Brexit and cost of living crisis which have all affected business productivity and their ability to keep up with increases in the NMW and the NLW.

Untangling impact is particularly challenging as the interviews took place in 2023, and asked employers to reflect on past events. The next section will explore the perceived consequences of these events on employers approaches to pay settings.

The UK’s trading relationship with the EU

Employers in low paid sectors described pressures resulting from Brexit as mostly a shortage of workers, complications in supply chains and increasing costs and bureaucracy incurred in exporting goods to Europe. Employers across the participating sectors linked Brexit with a shortage of workers, due to the new limitations on European migrants into the UK. Employers across sectors also told us that they had noticed a reduction in job applications from European candidates, in particular from Eastern European countries for employers in the cleaning and agriculture sectors. Some employers also reported having to downsize due to their inability to recruit staff. Roles highlighted as difficult to recruit include lorry drivers, farm hands, cleaners and hospitality workers.

“The issue for us is a total lack of supply and that happened with the Brexit bill; European cleaners stopped coming.” – Medium-sized employer, Cleaning

Employers reflected that it was the combination of Brexit-induced uncertainty, subsequent pandemic-related closures of sectors and the current cost of living crisis that may have discouraged some workers from returning to these jobs.

Secondly, the effects of Brexit on various sectors have also led to changes in sourcing and supply chains. Employers told us that the reliability and cost of importing European goods into the UK had been affected by Brexit.

Additionally, employers who used to outsource parts of their supply chain to European businesses, found it increasingly complicated to justify the cost, and had to shut down part of their operation.

“Brexit has absolutely ended certain lines of business that we do. We used to send watches to be repaired to Denmark or Germany – you’d just pop it in the post. Now, we have to pay VAT on the value of the thing being repaired. You’ve got to

fill in an enormous amount of paperwork, which you can't automate. And if there's even one slightly wrong thing with the paperwork, it'll get returned. So, postage costs have gone up from a fiver to nearly £100 per parcel." – Small employer, Retail

Thirdly, employers who exported goods into Europe were affected by the changes in export legislation post-Brexit. This affected employers in the agriculture and retail sector much more than employers in cleaning and hospitality due to the international sales of their products. Employers noted that increases in the price of shipping, additional taxes and new bureaucracy had created new barriers to exporting into Europe.

Some employers attempted to adapt to the changes and spent time training their staff on new regulations and business practices and hiring European "middlemen" to support their sales. This is seen mostly in the agricultural sector, where exporting hurdles due to regulatory changes and increased costs have compelled businesses to adapt, often at the expense of profit margins.

"There's quite a bit of hostility to UK export presenting in the European market. So, what we did was find ourselves an agent in France so, we had to give up some of our profit via an agency to gain access to the market. The paperwork, the bureaucracy was a bloody nightmare having to relabel, on and on and on and on, lots of training for staff." – Small employer, Agriculture

On the other hand, some employers within the retail sector have suspended their European sales and shifted to UK sales only due to the unaffordable cost of continuing to export their goods to Europe.

It is important to note that the impact of Brexit is not uniform across the low-paid sectors included in this research. Some businesses reported minimal effects, particularly those that employed individuals from the local area, relied on local supply chains and did not export goods to Europe. Indeed, even within sectors, our interviews highlight differences in both the extent and nature of impacts from Brexit. For example, an employer in the agricultural sector reflected that those working in horticulture were more affected by Brexit due to staff shortages as their produce needs to be collected manually. As this employer grew cereals, they were less affected by Brexit-related staff shortages as they already automate their collection. Instead, for this employer, the consequences of Brexit arose as they relied on cereal sales to Europe and were struggling to export their product due to increased exportation costs and bureaucracy.

Therefore, Brexit impacted pay setting more for some employers than others. Some who had been impacted by staff shortages reported increasing their wages more than in previous years, to remain competitive and to recruit and retain staff. Other employers who experienced increased costs of operations, had to adapt to new legislation or stop operating within the EU, struggled to manage the NMW/NLW rises as they previously had, due to decreasing productivity and profits cause by reduced customer markets and higher import and export costs. On the other hand, employers who hadn't been affected by these did not report a link between their pay settings and Brexit.

The COVID-19 pandemic

The COVID-19 pandemic has placed additional pressures on some employers in low paid sectors through operational difficulties, financial burdens, staff shortages and changes to customer spending. However, some employers, notably in cleaning and agricultural sectors, found the pandemic period to be profitable.

COVID-19 lockdowns impacted businesses' ability to generate profit and retain staff. For many employers, this period was marked with uncertainty and constantly changing guidance which impacted their ability to operate and generate profit. For those forced to shut, the furlough scheme had often enabled employers to retain staff during the lockdown period and was widely received as positive.

One hospitality employer linked their ability to start operating again promptly post-lockdowns to the furlough scheme. As they were able to retain their staff, they did not have to spend time recruiting, unlike some of their competitors:

> *"The consequence of [furlough] was, that actually when we came back to work, we were able to really gear back up quickly because we had people who were being paid throughout. Who would come straight back into work. A lot of other employers, the commercial employers in Edinburgh had let go of their staff before furlough came into play." – Large employer, Hospitality*

For some hospitality employers, the 'real pay' of employees, which they counted as including tips, was not factored into furlough calculations, which left employees with less than 80% of their pre-COVID-19 pay. Some businesses who were able to open during lockdown still made use of the furlough scheme for their vulnerable workers (such as in agriculture), or those without driver's licenses (such as in cleaning). However, other employers found that the furlough scheme did not ensure that staff returned to their roles when their business re-opened. Employers complained that these employees had taken advantage of the furlough scheme and had simultaneously taken a job elsewhere. From our sample, it appeared that employees working in less favourable roles, such as agricultural workers and chefs sought out better paying work with less unsociable hours.

> *"I went into the pandemic with three or four employees receiving furlough, I came out with basically nobody because they had chosen to continue working. So, between the hospitals and the schools and the services that were still employing more people because of the pandemic, I ended up coming out of the lockdown having to start completely afresh with staff." – Large employer, Agriculture*

Similarly to the impacts of Brexit, some employers also linked worker shortages to COVID-19, as prolonged periods of unemployment and unstable work were cited as reasons for moving away from low paid sectors.

Other employers complained at the quality of staff post-COVID-19. With a reduction in the number of applicants per role they were less able to find suitable employees. Employers also noted that COVID-19 had affected younger employees, who they felt were less socially prepared, due to prolonged periods of social distancing, to work in hospitality. However, due to the need for labour, they continued to employ workers, even if those individuals had fewer skills and motivation to work compared to pre-COVID-19. Employers reported that reduced workforce and low-quality workforce impacted business productivity and profits, and thus their ability to absorb increases to the minimum wage.

Due to the wider staff shortages, employers also said they looked to provide better benefits to staff such as private healthcare, provision to support mental health and wellbeing, and flexible working arrangements, to remain competitive without a large wage rise.

Government loans were appreciated by some of the employers we spoke with, however employers also emphasised that they had been closed for prolonged periods of time, without being able to make profits, and hence were anxious about repaying these loans. For those able to work during COVID-19, the cost of operating was frustrating, as employers were asked to pay for the cost of gloves, masks and sanitation gels.

> *"It cost me £4,500 just to buy Perspex so I could actually open." – Medium-sized employer, Hospitality*

Some employers we spoke with, particularly within the agricultural and cleaning sectors, saw an increase in profits during the COVID-19 pandemic, due to the demand for gardening plants and for sanitation services. Others found creative ways to stay afloat such as a music venue who crowdfunded online to cover staff costs and sold tickets for future gigs in advance. Another agricultural business reduced costs by replacing their previous spending on travel for business meetings by video-conferencing.

Employers also found that client habits had changed post-COVID-19, which had impacted profits and, in some cases, meant downsizing to accommodate the fall in demand. Employers reported that post-COVID-19 there were less customers, and less client spending in hospitality and retail sectors. Some hospitality employers reflected that customers were more anxious to enter crowded places such as bars or cafés, leading to a post-COVID reduction in footfall and drop in profits.

> *"We did, because obviously, we had to close and we stayed closed for eighteen months and we found that people are coming out less, the older generation, aren't coming out as much. They're possibly the ones with more disposable income" – Small employer, Retail*

A fall in demand was also seen in areas which previously were heavy foot traffic areas, such as bus stations and central business districts, which was linked to increases in hybrid and remote working. Reductions in client spending was also linked to the cost-of-living crisis and to increases in prices of goods due to Brexit.

To adapt to changes in client spending, some employers found themselves downsizing (for example, employers in cleaning) and reducing staff hours (for example, employers in hospitality). Other employers found it difficult to justify increasing prices to customers and were concerned about losing more customers due to price hikes. However, employers also felt they were unable to absorb increasing wage costs onto profits due to already feeling the impacts of reduction in footfall.

Similarly to Brexit impacts, the effects of COVID-19 were diverse amongst employers. Their ability to generate profit in the last three years and maintain productivity impacted their views on the NMW and NLW increases. Some felt they were able to increase staff wages without increasing costs to clients, due to low impact from COVID-19. Others struggled to see how they would afford staff in the future and how they would maintain their business whilst still repaying government loans and experiencing reduced footfall.

Rising costs of living

In the context of rises in the cost of living, employers spoke about the difficulties in adapting to increasing operating costs and changes to customer spending. With the costs of goods increasing, compounded by the impacts of Brexit and COVID-19, employers ability to respond to increases to the minimum wage depended on their ability to remain profitable despite these challenges.

With electricity and gas prices steadily increasing, employers struggled to maintain profits and often offset their rising costs by increasing the prices of their goods and services. This was particularly an issue for employers in the hospitality and retail sectors, who have to factor in the additional cost of heating their premises.

One employer described how they had to increase prices more than once this year already, because of the rise in cost of living:

> *"I've had to put my prices up, I normally put my prices up once a year. In a couple of weeks, I'm putting my prices up for the second time within eight months." – Small employer, Retail*

Many employers were concerned about future trends, but there was a sense from others that prices would decrease in the coming years, and it was a case of 'riding it out'.

The other main area where employers faced increasing costs was the cost of labour. As highlighted in the previous two sections, Brexit and COVID-19 have both been linked by some employers to staff shortages. Employers also noted that increases in the cost of living led some employees to seek better paying work outside the sector or 'shopping around' for the best wages. Additionally, employers found staff more prone to bargaining for pay rises.

As a result of increased costs, some employers said they awarded a higher pay rise than normal, or awarded an additional, early pay rise, to support their workers during this time of increased costs:

> *"We gave a 10% pay increase [in 2022] because of the pressure on pay for our workers. And inflation disproportionately affects those at the lower end, because those are the ones with the least disposable income, they spend the majority of their pay on rent and food, you know living costs." – Large employer, Hospitality*

Employers also linked changes in client spending to increases in the costs of living. Mainly, employers felt that clients had less disposable income and hence were now more careful with their spending. Overall, this meant a reduction in sales and profits for employers.

To counteract increases in operating costs and reduced client spending, some employers stated they had to cut their labour costs by reducing hours, moving younger employees to the NMW youth pay rates, or starting to offer zero hours contracts and offsetting costs to clients more frequently. Many employers from smaller businesses expressed concerns as to future increases, and their ability to absorb costs despite falling profits. Some employers also stated that this would be the first year they could not pay their employees above the NLW rates, due to increased costs.

The complex impacts of these contextual factors meant employers found these difficult to untangle.

This section has discussed the impacts of three overlapping and majorly disruptive factors on employers in low paid sectors. As already explained, employers found it difficult to untangle the effects of these different factors, but overall, many reported significant negative impacts as a result.

Overall, staff shortages have contributed to a reduction in businesses' productivity where they felt they had no choice but to employ less suitable candidates. Increases in operating costs have also reduced profits, and in some cases meant employers are forced to increase their process at faster rates than they previously had to.

> *"As everything has gone on then we have had to put prices up more in the last 2 years, than I probably had collectively in 20 years. It was like … it's like every two minutes you are changing your prices." – Medium-sized employer, Hospitality*

In this climate, some employers expressed concerns about their ability to afford further increases to the NMW and NLW rates. Without viable routes to increase their profits and/or reduce operating costs, for some the additional need to increase labour costs was viewed unfavourably.

> *"To be honest, no I don't know what it's due to but it's things like Brexit, the war in Ukraine, things like that and energy's gone through the roof, it's almost unsustainable and again you have to put peoples' wages up." – Small employer, Retail*

Discussion and conclusions

The findings of this research highlight the numerous and complex pressures facing businesses in the unprecedented contexts of major changes to the UK economy. The ways in which businesses respond to those challenges vary by sectors, business sizes and specific local contexts. Unlike previous qualitative research for the LPC (Heffernan et al. 2021; Dickinson et al. 2020; IDR 2020; Adascalitei et al. 2019, Hudson-Sharp et al. 2019), this research has greater emphasis on the experiences of employers from smaller businesses. Our findings reflect how these businesses have been largely impacted by recent contextual factors, compounded with the higher NMW and NLW rises. The key findings of this research are summarised below.

Key findings

Some employers interviewed reported paying employees above the NMW/NLW rates, with key reasons for that being staff recruitment and retention, and a desire to make employees feel valued.

This reflects previous research within the hospitality and retail sectors (Heffernan et al. 2021) that found the most pressing employment issues for many relate to recruitment and retention.

Employers interviewed who reported paying their (adult, 23+) staff above the NLW cited recruitment and retention as the main reason for doing so. Recruitment and retention issues were emphasised by employers in competitive regions and sectors. In particular, employers in agriculture reported facing labour shortages. Some employers linked those labour shortages to the impacts of the UK leaving the European Union.

Some employers who pay above the NLW/NMW also described feeling a sense of moral obligation to pay their staff above the required minimum. Similarly, those employers who pay their younger workers above the NMW youth rates mentioned a sense of fairness as a reason, as they and/or their employees may feel it is unfair to pay a different rate for the same role based on just employee's age.

This echoes what has been frequently reported in previous research on employers' use of youth rates (IDR 2020). We found that the continual reduction in age qualifying for the NLW would not affect many of the employers we spoke to. This contrasts with 2021 research by Heffernan and colleagues, who found that employers they spoke to had been affected by the changes to the age threshold for the NLW.

Small and medium-sized employers reported finding it harder to absorb the annual increases in the NMW/NLW rates.

Only a few employers in our sample, who were mostly large businesses, reported that they could absorb these increases within their profits. Others had to use different strategies. Contrastingly to findings from 2021 research by Heffernan and colleagues, the latest increase in the level of the National Living Wage (NLW), was higher than many organisations had anticipated.

The strategies that employers mentioned they use to absorb the NLW/NMW increases included increasing prices, reducing their workforce size by either pausing recruitment or letting staff go, reducing pay rises or billable hours, reducing overheads, and using their own time or money.

These strategies reflect previous findings from Adascalitei's et al (2019) research on the impact of NLW on businesses within the retail and hospitality sectors. They found 50% of employers reported that the increases in NLW led them to increase prices. Our findings similarly showed that employers most often passed costs to customers to manage wage increases. Adascalitei similarly found, like our research, that a number of employers could not pass on increased costs to customers as they were constrained by market pressures. They also reported that 46% of survey respondents opted to not replace leavers in response to the NLW and its uprating. The next most common responses were increased use of variable hours contracts (38.6 percent), reducing the number of full-time workers (25.6 percent) and increasing the number of part-time workers employed (23.8 percent).

Employers interviewed in this research also reported changing contracts of employees, as well as only awarding pay rises to their lowest paid staff. As previously found (IDR 2020; Adascalitei et al. 2019), this resulted in reduced differentials. Employers also found that employees who had been at the company longer or who had more responsibilities, were unhappy with this reduction, and it could lead to them seeking employment elsewhere. Heffernan et al. 2021 reported that this could make it harder for organisations to encourage staff to take on greater responsibility for rewards that are perceived as insufficient. Whilst we found no evidence to support this, one employer described how instead they felt the NLW made it harder to encourage younger staff to be productive, because they would be receiving an increase in wages yearly regardless of performance.

Very similar to findings from the 2019 research by Adascalitei and colleagues, interviewees in this research said they would consider employing younger workers and paying them at the NMW rate to manage future wage costs. However, others said they would instead reduce the amount of younger workers they were employing as they felt they were less productive and with increasing wage pressures, they wanted to ensure their staff were experienced and felt younger workers were less productive.

The prevalence of strategies to manage increasing NMW and NLW varied across sectors and business size of interviewees. Most employers described passing on some or all of the cost increases to their customers through price increases, however some smaller businesses expressed concerns over losing customers due to these price increases. Employers were particularly concerned about losing customers within the context of recent years, having already noticed a change in customer spending habits due to post-COVID anxieties and rise in cost of living saving measures. More long-term strategies that employers described when asked about their future plans for offsetting increasing labour costs included investing to increase productivity and changing the business focus. Larger businesses seemed more able to plan such investments, whilst small business employers expressed concerns for the future of their businesses.

Our findings also supported work from previous years (Heffernan et al. 2021) that found some employers are doubtful that the future NLW increases are sustainable. We also interviewed employers who cautioned against further large increases to the NLW, but this was more due to the ongoing challenges facing them in weathering the rising cost of living rather than in previous years the concerns around COVID recovery.

Employers in the low paid sectors examined in this research faced significant challenges in the contexts of the rising prices, the effects of the COVID-19 pandemic and Brexit.

The impacts of these contextual factors are complex and were difficult to untangle. These factors are placing additional pressures on employers and impacting the extents to which employers feel able to use their usual strategies for absorbing labour cost increases. For some, this has meant adapting to changes by decreasing production or reducing operating hours. This is also seen in the wider literature, where post-COVID, small businesses have been forced to re-think their business models (Heffernan et al. 2021).

Brexit has placed additional pressures on low paid sectors, in particular employers link Brexit to a shortage of workers, complications of supply chains and increased import and export costs.

Particularly in the cleaning and agriculture sectors, employers expressed concerns about the reduction of high-quality European applicants for their jobs, some reporting having to downsize due to their inability to recruit staff.

The COVID-19 pandemic has placed additional pressures on some low paid sectors through operational difficulties, staff shortages and changes to customer spending.

Employers described facing challenges with staff shortages due to employees re-assessing their work priorities. Research from 2021 found that employers in the hospitality sector hoped that labour shortages would ease when the CJRS came to an end, and that furloughed employees would return to their sector. However, our research found that labour shortages continued to be a challenge within the hospitality sector as employees had not returned post-pandemic. This research by Heffernan and colleagues (2021) particularly highlighted that the pandemic exacerbated acute role shortages such as chefs.

One hospitality employer interviewed in this sample again highlighted chefs as particularly difficult to recruit and suggested they had moved to roles with less unsociable hours and better pay, as a result of re-assessing their ideal work-life balance during the pandemic. Employers interviewed also reported an increasing lack of trained, high-quality staff post-COVID.

At the same time, some employers, notably in the cleaning and agricultural sectors, found the pandemic period to be profitable. This was reported to be related to increased demand for specific services such as cleaning.

In the context of increasing costs of living, employers spoke about the difficulties of adapting to increasing costs of operating and changes to customer spending.

Increasing costs, particularly the costs of heating, increase costs of operation for employers. At the same time, the rising costs of living are reported to impact customer ability and confidence to spend. As a result, some employers felt less able to pass on their labour cost increases to customers.

Implications

The aims of the annual NMW and NLW increases and targets for those increases are to ensure workers are paid a living wage and are able to sustain themselves on their wages, without a cost to employment. In pursuing these aims, it is important to understand the impacts that the

NMW and NLW increases have for different businesses. This research aimed to provide more evidence in this area. Future research should integrate these perspectives with employee perspectives, for a holistic picture.

The findings of this research suggest several implications for future NLW and NMW increases.

Lowering the age at which workers are entitled to be paid the NLW to 21 would not affect many of the employers interviewed for this research. As some employers interviewed reported not using age related NMW rates due to unfairness or safety concerns with young workers, and already paying all aged workers the NLW, this change would not affect them.

Some smaller employers interviewed reported reducing employment, downsizing or potentially closing their businesses as a result of struggling to absorb increases to the NLW. While the findings of this research are not generalisable or quantifiable, it highlights the views of some small employers, suggesting that a rise in the NLW rate at 7-8% may result in some business closures and reduction in staff employment in small businesses. As the findings suggest, it is mostly small employers who report potential business closures, so it could be argued that this is unlikely to have an impact on employment on the aggregate level. This would be the case if workers were then moving to larger companies, as was observed by Dustmann and colleagues (2021). Moreover, other employers reported that they have already recovered from certain contextual pressures. There were employers across sectors and sizes that set out strategies to mitigate future increases.

Some employers cautioned that the rising NMW and NLW rates would lead to others in their industries exploiting workers by paying below the legal requirements and using cash-in-hand. These findings echo previous research that showed 27% of employers surveyed in the hospitality and retail sectors believed that their direct competitors paid workers less than the statutory minima. In addition, a few interviewees believed that non-compliance was a problem in their sector, and a number of examples were given in interviews (Adascalitei et al. 2019). Employers interviewed in this research also highlighted these concerns, and an argument was made for more investigation of employers' compliance with statutory pay, as well as worker conditions.

This research hence highlights some areas where attention and further support may be needed, to address those challenges. The findings suggest that small employers can face particular challenges in the context of the NLW/NMW increases. Some small business owners reported paying themselves below the NLW, diverting to using own savings, working longer hours or getting support from family members to sustain business operations with increasing labour costs. Some reported concerns over the safety of operations, due to fewer people working on cites, even for tasks that require a certain number of workers to be done safely. This suggests that the NLW/NMW increases should be accompanied by support, advice and guidance to employers, particularly small business owners, on how to avoid such scenarios.

Research by IDR in 2020 concluded that there was a widespread call for the Government to announce NLW increases (and forecasts) earlier, to enable better planning. Findings from our stakeholder workshop again highlighted that long term forecasts for projected NMW and NLW changes would help businesses to better plan to manage these increases. Whilst these forecasts may already exist, we suggest better promotion is needed for employers to be aware of this support. More advice and guidance specific to small businesses could also support them to use more long-term strategies, such as improving productivity by investing in skills or technology, rather than 'firefighting' to address future wage increases.

Appendix 1: List of SIC codes in four sectors

Agriculture

01110 Growing of cereals (except rice), leguminous crops and oil seeds

01120 Growing of rice

01130 Growing of vegetables and melons, roots and tubers

01140 Growing of sugar cane

01150 Growing of tobacco

01160 Growing of fibre crops

01190 Growing of other non-perennial crops

01210 Growing of grapes

01220 Growing of tropical and subtropical fruits

01230 Growing of citrus fruits

01240 Growing of pome fruits and stone fruits

01250 Growing of other tree and bush fruits and nuts

01260 Growing of oleaginous fruits

01270 Growing of beverage crops

01280 Growing of spices, aromatic, drug and pharmaceutical crops

01290 Growing of other perennial crops

01300 Plant propagation

01410 Raising of dairy cattle

01420 Raising of other cattle and buffaloes

01430 Raising of horses and other equines

01440 Raising of camels and camelids

01450 Raising of sheep and goats

01460 Raising of swine/pigs

01470 Raising of poultry

01490 Raising of other animals

01500 Mixed farming

01610 Support activities for crop production

01621 Farm animal boarding and care

01629 Support activities for animal production (other than farm animal boarding and care) n.e.c.

01630 Post-harvest crop activities

01640 Seed processing for propagation

01700 Hunting, trapping and related service activities

03110 Marine fishing

03120 Freshwater fishing

03210 Marine aquaculture

03220 Freshwater aquaculture

Hospitality

55100 Hotels and similar accommodation

55201 Holiday centres and villages

55202 Youth hostels

55209 Other holiday and other collective accommodation

55300 Recreational vehicle parks, trailer parks and camping grounds

55900 Other accommodation

56101 Licensed restaurants

56102 Unlicensed restaurants and cafes

56103 Take-away food shops and mobile food stands

56210 Event catering activities

56290 Other food services

56301 Licensed clubs

56302 Public houses and bars

Cleaning and maintenance

81100 Combined facilities support activities

81210 General cleaning of buildings

81221 Window cleaning services

81222 Specialised cleaning services

81223 Furnace and chimney cleaning services

81229 Other building and industrial cleaning activities

81291 Disinfecting and exterminating services

81299 Other cleaning services

96010 Washing and (dry-)cleaning of textile and fur products

Retail

45111 Sale of new cars and light motor vehicles

45112 Sale of used cars and light motor vehicles

45190 Sale of other motor vehicles

45200 Maintenance and repair of motor vehicles

45310 Wholesale trade of motor vehicle parts and accessories

45320 Retail trade of motor vehicle parts and accessories

45400 Sale, maintenance and repair of motorcycles and related parts and accessories

47110 Retail sale in non-specialised stores with food, beverages or tobacco predominating

47190 Other retail sale in non-specialised stores

47210 Retail sale of fruit and vegetables in specialised stores

47220 Retail sale of meat and meat products in specialised stores

47230 Retail sale of fish, crustaceans and molluscs in specialised stores

47240 Retail sale of bread, cakes, flour confectionery and sugar confectionery in specialised stores

47250 Retail sale of beverages in specialised stores

47260 Retail sale of tobacco products in specialised stores

47290 Other retail sale of food in specialised stores

47300 Retail sale of automotive fuel in specialised stores

47410 Retail sale of computers, peripheral units and software in specialised stores

47421 Retail sale of mobile telephones

47429 Retail sale of telecommunications equipment other than mobile telephones

47430 Retail sale of audio and video equipment in specialised stores

47510 Retail sale of textiles in specialised stores

47520 Retail sale of hardware, paints and glass in specialised stores

47530 Retail sale of carpets, rugs, wall and floor coverings in specialised stores

47540 Retail sale of electrical household appliances in specialised stores

47591 Retail sale of musical instruments and scores

47599 Retail of furniture, lighting, and similar (not musical instruments or scores) in specialised store

47610 Retail sale of books in specialised stores

47620 Retail sale of newspapers and stationery in specialised stores

47630 Retail sale of music and video recordings in specialised stores

47640 Retail sale of sports goods, fishing gear, camping goods, boats and bicycles

47650 Retail sale of games and toys in specialised stores

47710 Retail sale of clothing in specialised stores

47721 Retail sale of footwear in specialised stores

47722 Retail sale of leather goods in specialised stores

47730 Dispensing chemist in specialised stores

47741 Retail sale of hearing aids

47749 Retail sale of medical and orthopaedic goods in specialised stores (not incl. hearing aids)

47750 Retail sale of cosmetic and toilet articles in specialised stores

47760 Retail sale of flowers, plants, seeds, fertilizers, pet animals and pet food in specialised stores

47770 Retail sale of watches and jewellery in specialised stores

47781 Retail sale in commercial art galleries

47782 Retail sale by opticians

47789 Other retail sale of new goods in specialised stores (not commercial art galleries & opticians)

47791 Retail sale of antiques including antique books in stores

47799 Retail sale of other second-hand goods in stores (not incl. antiques)

47810 Retail sale via stalls and markets of food, beverages and tobacco products

47820 Retail sale via stalls and markets of textiles, clothing and footwear

47890 Retail sale via stalls and markets of other goods

47910 Retail sale via mail order houses or via Internet

47990 Other retail sale not in stores, stalls or markets

77220 Renting of video tapes and disks

95210 Repair of consumer electronics

95220 Repair of household appliances and home and garden equipment

95230 Repair of footwear and leather goods

95240 Repair of furniture and home furnishings

95250 Repair of watches, clocks and jewellery

95290 Repair of personal and household goods n.e.c.