

David Massey  
Low Pay Commission  
8th Floor, Fleetbank House  
2-6 Salisbury Square  
London  
EC4Y 8JX

June 2019

Dear Mr Massey,

**Re: FSB response to the Low Pay Commission's Consultation on the National Minimum Wage Rates (including the National Living Wage) to apply from April 2020 and the path for the minimum wage beyond 2020.**

The Federation of Small Businesses (FSB) is pleased to respond to the above named consultation. FSB is the United Kingdom's (UK) leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that's led by our members, for our members. Our mission is to help smaller businesses achieve their ambitions. As experts in business, we offer our members a wide range of vital business services, including advice, financial expertise, support and a powerful voice in government.

FSB is also the UK's leading business campaigner, focused on delivering change which supports smaller businesses to grow and succeed. Our lobbying arm starts with the work of our team in Westminster which focuses on UK and English policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

FSB has always supported the National Minimum Wage (NMW) and continues to do so provided the level set does not harm employment or business conditions. We believe that the Low Pay Commission plays a critical role in setting the wage floor by taking an independent view that reflects wider economic and labour market changes. The majority of small employers recognise the wage floor ought to reflect improvements in the growth of the UK economy and real term increases in average wages, we therefore support gradual increases in the NMW.

To inform their deliberations, Commissioners will be interested in the impact of the National Living Wage (NLW) on businesses to date. Our submission presents new evidence from a recent FSB survey of 1,162 respondents held in May 2019.

- 9 per cent of small businesses were paying all staff under £8.21 prior to the increase in the NLW in April 2019.
- 51 per cent report that all of their staff were being paid over £8.21 per hour at that time.
- 18 per cent report that the increase in the NLW in April 2019 has increased their wage bill "by a large extent".
- 40 per cent report that the increase in the NLW in April 2019 has increased their wage bill "to some extent".
- Of those whose wage bills have been affected, 71 per cent reduced profitability or absorbed the costs – an increase of 7 percentage points from last year.
- 45 per cent of respondents raised their prices in response to the 2019 increase.

- 15 per cent of respondents have cut back on training expenditure in response to the latest NLW increase.
- 29 per cent of respondents have cancelled/scaled down plans for investing in/expanding their businesses. Additionally – and potentially linked to this reduction in investment - only 12 per cent looked to improve efficiency or raise productivity in response to wage increases.

Yours sincerely,



**Michael Mealing**  
Chairman, Employment and Pensions Policy Unit  
Federation of Small Businesses

# **FSB submission to the Low Pay Commission's consultation on the National Minimum Wage Rates**

**June 2019**

## Small business, Government policy and economic outlook

This year's increase in the NLW coincided with other significant policy changes: two million small businesses above the VAT threshold fell within the scope of new reporting requirements due to the implementation of Making Tax Digital (MTD), up to 500,000 small firms experienced business rates hikes and more than a million small employers saw an increase in their minimum employer pension auto enrolment contributions.

This has all occurred in the midst of political and economic uncertainty. Small businesses have been a consistent powerhouse of job creation. However, our data from the first quarter of 2019 Small Business Index (SBI) found that small businesses reduced staff numbers for the first time since 2016.<sup>1</sup> This continued into the second quarter of 2019, with our latest SBI showing the net balance of small businesses that are increasing headcounts – the proportion of those hiring new staff less the proportion reducing their team size – stands at a three-year low (-2%).

The impact of Brexit uncertainty on small business appetite to hire and invest has been laid bare. The share of small business owners expecting to grow their firms over the coming 12 months (45%) is at a record-low, with a record-high one in three (33%) citing labour costs as a major barrier to growth. The domestic economy remains the most frequently cited expansion constraint, flagged by more than six in ten (63%) firms.

Although the labour market has remained resilient through the recent slowdown, the outlook for consumer-facing industries is still poor, with a considerable majority (68%) of small firms not expecting their performance to improve in the next quarter. Four in ten (41%) expect it to worsen.<sup>2</sup>

## Impact of the National Living Wage and National Minimum Wage

In May 2019, FSB surveyed our members regarding the impact of the NLW. A total of 1,162 small business owners responded to the survey. Respondent businesses represented a broad range of sectors, and came from all regions and nations of the UK. The survey was sent to FSB employer members only (i.e. excluding non-employing, one person businesses).

**Question One:** Prior to the recent increase in the National Living Wage to £8.21 an hour in April 2019, what were the pay levels in your business?

All interviews (1162 responses)	Total
All of my employees were paid £8.21 or more per hour	51%
Some of my employees were paid £8.21 or more per hour	37%
All of my employees were paid less than £8.21 per hour	9%

Our evidence suggests that there were few businesses which were paying all employees below £8.21 prior to the increase in April 2019, with only 9 per cent of businesses saying this was the case. 51 per cent of businesses were already paying all employees at or above £8.21, this is down from 60 per cent in 2018. This may indicate the impact of increased wages alongside the increase of auto-enrolment contributions. Interestingly, microbusiness (those

<sup>1</sup> FSB, Q1 2019, Small Business Index. Available at <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q1-2019-final.pdf?sfvrsn=0>.

<sup>2</sup> FSB, Q2 2019 Small Business Index, survey undertaken between 13 May and 27 May 2019.

employing up to ten staff) were more likely (56%) to pay all of their employees at or more than £8.21 than businesses employing more than 20 people (39%).

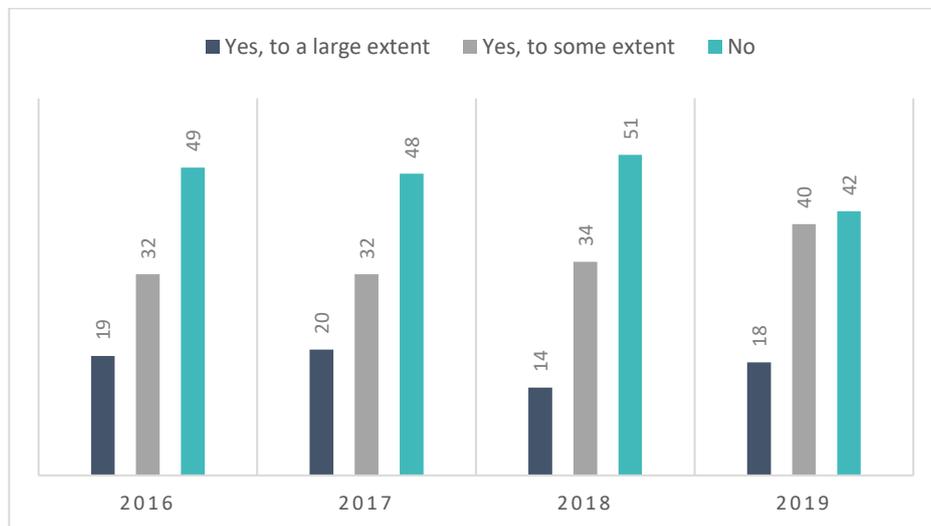
**Question Two:** Has the increase in the National Living Wage to £8.21 this April increased your organisation’s wage bill?

All interviews (1162 responses)	Total
Yes, to a large extent	18%
Yes, to some extent	40%
No	42%

As 51 per cent of small businesses were already paying all staff at or above £8.21 per hour before the NLW increase in April 2019, 42 per cent of all small businesses say that they had not needed to increase their overall wage bill. However, a significant proportion of businesses reported an increase in their wage bill, with 40 per cent of businesses reporting that the increase of the NLW has had some impact on their wage bill. Crucially this is the highest figure small businesses have reported having an impact of their wage bill since the introduction of the NLW in 2016.

**Figure 1:** Impact of the NLW on FSB small businesses wage bills

Source: FSB NLW survey, 2019



82 per cent of small employers in the Accommodation and Food Services sector reported an increase in their wage bill, 67 per cent of those in Wholesale and Retail and 64 per cent of those in Manufacturing reported an increase in their wage bill, as a result of this year’s NLW increase.

FSB's latest SBI data highlighted poor levels of business confidence in small Manufacturing (+2), Retail & Wholesale (-29) and Construction (-33) firms have suffered 25, 27 and 56 point drops in their SBI readings respectively compared to this time last year.<sup>3</sup>

Small businesses in London, the South East and in the Eastern region were more likely to pay their staff at or above the NLW prior to the increase in April 2019 (66%, 58% and 57% respectively). Research from the Ulster University Economic Policy Centre found that 'the bite of the NLW in both Wales and Northern Ireland (67% and 68% respectively) is higher than in England and Scotland ((59% and 60% respectively),<sup>4</sup> this corresponds with our data, in which Yorkshire and the Humber (73%) and Wales (72%) both saw a net increase in their wage bill. Highlighting the regional variation of the NLW impact. It is important that the LPC consider the varied regional and sectoral impact of the NLW, where there appears to be targeted areas of significant impact.

**Question Three:** You've said that the National Living Wage has increased your organisation's wage bill. How is your organisation managing these additional wage costs? (Select up to three)

<b>All with increased wage bill after NLW (675 responses)</b>	<b>Total</b>
Improved efficiency/raised productivity	<b>12%</b>
Taken lower profits/absorbed costs	<b>71%</b>
Reduced the amount of overtime/bonuses	<b>19%</b>
Reduced other aspects of the reward package (such as paid breaks or premium pay rates)	<b>8%</b>
Raised prices	<b>45%</b>
Reduced number of employees through redundancies	<b>6%</b>
Recruited fewer workers	<b>21%</b>
Reduced hours worked by staff	<b>23%</b>
Reduced the rate of basic pay growth for the rest of the workforce	<b>18%</b>
Hired more workers aged 24 and under (excluding apprentices)	<b>4%</b>
Recruited more apprentices	<b>1%</b>
Cancelled/scaled down plans for investing in/expanding the business	<b>29%</b>
Cut back on training expenditure	<b>15%</b>
Increased share of workforce on non-guaranteed hours contracts, e.g. zero hour contracts	<b>4%</b>
Reduced pension contributions to a minimum two per cent for employers (April 2018)	<b>4%</b>
Invested in machinery / automated certain processes	<b>5%</b>
Other	<b>4%</b>

The number of small businesses reporting which say they are taking lower profits/absorbing costs, as a consequence of the increase in their wage bills since April stands at 71 per cent. Since the introduction of the NLW small businesses have continued to make changes to their labour force as result of wage increases, either recruiting

<sup>3</sup> FSB, Q2 2019 Small Business Index, survey undertaken between 13 May and 27 May 2019.

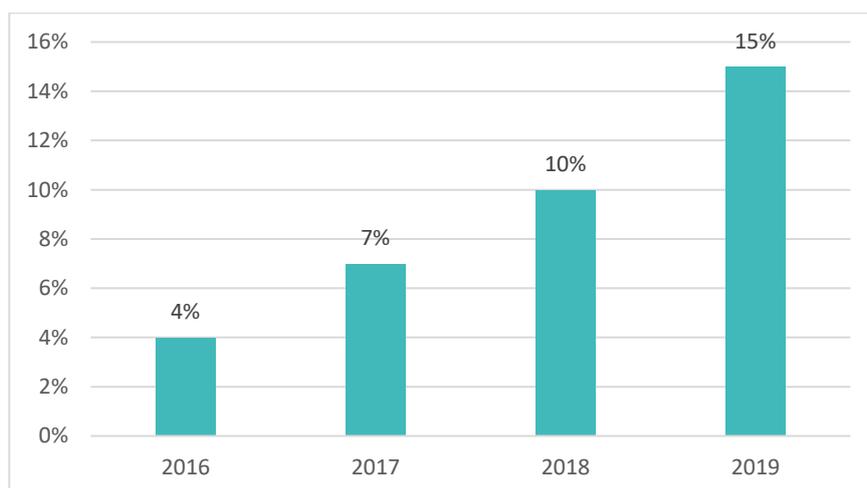
<sup>4</sup> Ulster University, Economic Policy Centre, Economic Implications of the National Living Wage in Northern Ireland in 2020m, March 2019. Available at <https://www.economy-ni.gov.uk/sites/default/files/publications/economy/Economic-Implications-of-NLW-in-Northern-Ireland-2020-Final-Report.pdf>.

fewer workers (21%) or reducing hours (23%). These figures have remained fairly consistent over the last three years. The most common reaction from small businesses following an increase to their wage bill is to raise prices (45%).

Boosting UK productivity is complex and calls for a range of policy responses, but it is largely agreed amongst policymakers that investing in training is one such required response. Therefore it is concerning that 15 per cent of small businesses say they have cut back on training expenditure in response to this year's NLW increase. This is an increase of 5 per cent from last year (10% in 2018) and 11 per cent since the introduction of the NLW in 2016 (4% in 2016). This also coincides with the number of small businesses scaling down plans for future investment (29%).

**Figure 2** - FSB Small business cutting back on training expenditure as a response to managing additional wage costs, 2016-2019

Source: FSB NLW survey, 2019



FSB research has consistently shown that small businesses are facing real skills shortages. Record high employment rates, exacerbated by the impact of Brexit uncertainty on the supply of EU labour, means that skills shortages are now the second biggest barrier to the future growth aspirations of smaller businesses (with a rise in the share of firms stating this between Q3 and Q4 2018).<sup>5</sup>

FSB research shows that 78 per cent of small firms employ at least one worker over the age of 50. In addition, 34 per cent of small businesses employ at least one person with low levels of educational attainment<sup>6</sup>. Therefore, training in small businesses is not only vital to improve career progression, but also to enable individuals to move out of low paid jobs.

The National Retraining Scheme (NRS), which is to be rolled out from 2020 has the opportunity to play a key role in assisting workers to retrain. The NRS is to focus on jobs that are at risk of automation, for adults over 24 with no

<sup>5</sup> FSB, Q4 2019 Small Business Index. Available here <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q4-2018-final.pdf?sfvrsn=0>.

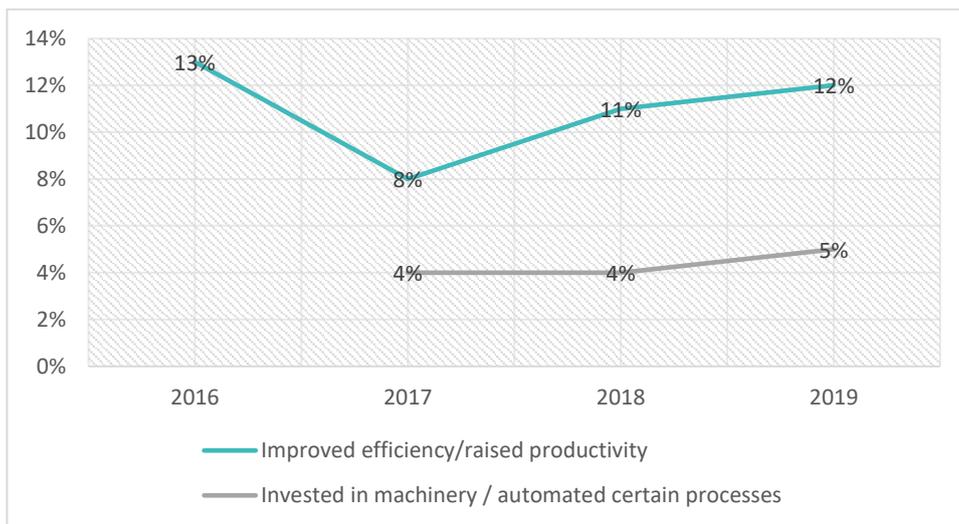
<sup>6</sup> FSB, Small Business, Big Heart, February 2019. Available here <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-small-business-big-heart.pdf?sfvrsn=0>.

degree qualification. It is, therefore, vital that the NRS focuses on smaller businesses and takes into consideration the training issues and needs of smaller businesses throughout its piloting phase.

There is a large and growing body of evidence which suggests that better management practices are associated with higher productivity. Previous FSB research found that only 18 per cent of staff and 17 per cent of business owners have undertaken training in leadership and management.<sup>7</sup>

Our evidence would suggest that despite small businesses support for the NLW, the NLW isn't leading small firms to invest in productivity enhancing technologies, training or improve efficiency of processes in the current economic climate - rather it may be deterring them from doing so. As shown below, there has been little growth in the number of small firms investing in machinery or automation since the introduction of the NLW in 2016.

**Figure 3** - Impact of the NLW on productivity and investment in machinery amongst FSB small businesses  
Source: FSB NLW survey, 2019



**Question Four:** How is your organisation improving efficiency/productivity?

All who have increased productivity / efficiency (83 responses)	Total
Job / work redesign. e.g. flexible working	37%
Additional investment in technology	28%
Additional investment in training	23%
Changes to the reward strategy/employee benefits package	22%
We expect morale to be lifted and productivity to improve as a result of the NLW increase	25%

<sup>7</sup> FSB, Spotlight on Innovation, July 2018. Available here <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/innovation-report-final.pdf?sfvrsn=0>.

Greater emphasis on in-work progression and career ladders	<b>16%</b>
Changes to employee engagement	<b>16%</b>
External business support	<b>4%</b>
Other	<b>16%</b>
Don't know/Not sure	<b>2%</b>

12 per cent of small business owners report that they have taken steps to increase productivity because the NLW has increased their wage bills. Job/work redesign, e.g. flexible working continues to be the preferred option for improving productivity. Research by FSB into flexible working found in general, small businesses by their nature are agile<sup>8</sup>. Many smaller firms tend to prefer informal flexible working arrangements based on trust. Smaller businesses need to be empowered to innovate and adapt their job design and wider business practices. This may require the adoption of new technologies that make remote working and other types of flexible arrangements easier.

<b>Some or all staff already earning above NLW (1162 responses)</b>	<b>Total</b>
The difference in pay between those earning the NLW and their managers/supervisors/other staff on higher wages has <b><i>stayed the same</i></b>	<b>38%</b>
The difference in pay between those earning the NLW and their managers/supervisors/other staff on higher wages has <b><i>decreased</i></b>	<b>15%</b>
The difference in pay between those earning the NLW and their managers/supervisors/other staff on higher wages has <b><i>increased</i></b>	<b>16%</b>
Not decided yet – pay review yet to be held	<b>8%</b>
Don't know	<b>2%</b>
Not applicable	<b>21%</b>

**Question Five:** What effect has the increase in the National Living Wage (NLW) had on the salary levels of staff who were already earning above the NLW (e.g. managers/supervisors/other staff on higher wages)?

There has been a slight increase in pay differentials following this year's NLW increase rising to 16 per cent from 13 per cent in 2018. Fifteen per cent of businesses say differentials had decreased, with 8 per cent stating that they had not yet decided. At the same time, 38 per cent of employers say that there had been no closing of the gap between those on the NLW and those on higher wage brackets.

<sup>8</sup> FSB, Small Business, Big Heart, February 2019. Available here <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-small-business-big-heart.pdf?sfvrsn=0>.

**Question Six:** How would your business respond if the National Living Wage were to increase to £8.67 in April 2020?

All with increased wage bill after NLW (1162 responses)	Total
Improve efficiency/raised productivity	8%
Take lower profits/absorbed costs	36%
Reduce the amount of overtime/bonuses	15%
Reduce other aspects of the reward package (such as paid breaks or premium pay rates)	12%
Raise prices	39%
Reduce number of employees through redundancies	10%
Recruit fewer workers	24%
Reduce hours worked by staff	22%
Reduce the rate of basic pay growth for the rest of the workforce	15%
Hire more workers aged 24 and under (excluding apprentices)	6%
Recruit more apprentices	3%
Cancel/scaled down plans for investing in/expanding the business	22%
Cut back on training expenditure	12%
Increase share of workforce on non-guaranteed hours contracts, e.g. zero hour contracts	6%
Reduced pension contributions to a minimum three per cent for employers (April 2019)	5%
Invest in machinery / automated certain processes	5%
Other	5%
None of the above	30%

FSB members were asked how they would respond if the NLW were to increase to £8.67 in April 2020, as per the LPC 2019 consultation published in March 2019. As in previous years, FSB small business owners say they will respond to this potential increase in 2020 by raising prices (39%), taking lower profits/absorbing costs (36%) and recruiting fewer workers (24%).

### Minimum wage beyond 2020

#### The role of small businesses in the Civil Society

Small businesses are very often more than just employers. They are often intrinsically connected to the communities in which they live. Our report, *Small Business, Big Heart* report found that small business community engagement is extensive across the country, with 80 per cent of FSB members stating that they have volunteered and/or contributed to a local community organisation or charitable cause in the last three years.

In addition, 95 per cent of small business employers have employed at least one worker from a labour market disadvantaged group in the last three years, such as individuals with a known disability or mental health condition (30%) and ex-offenders (3%). FSB recommends the Government introduces a one-year Employer National Insurance Contributions holiday for smaller businesses employing those from labour market disadvantaged groups. It is our view that small businesses seek to provide their staff with good quality jobs. This means not only often paying them

above the NLW, but providing them with the flexibility to manage other commitments, such as caring for children or ill relatives.

Understanding the importance of place is vitally important in understanding the role of small firms play in our economy and society. Many of our communities are in 'Less Favoured Areas' (LFAs) and, in these areas, small businesses utilise their position to tackle a variety of social challenges. We call on the LPC and Government to take account of how small businesses are not only a source of employment, but are also agents of social change.

If minimum wage policies are implemented at the wrong level and pace, they may not only lead to higher rates of unemployment, but also halt the ability of small firms to support social mobility, wellbeing and fuller working lives within their communities.

#### Rising cost of doing business

A significant number of constraints on smaller enterprises stem from Government policy, such interventions can hinder the enterprising spirit of smaller businesses, with sub-optimal consequences for both business and economic growth. FSB research shows the average VAT-registered UK small business is collectively spending over £480,000 each year on these interventions, up from £420,000 six years ago.

The costs that smaller firms bear as a result of a host of major Government policies are substantial. This means the benefits to the small business community of improvements to the business environment e.g. reducing corporation tax (heralded as making the UK the best place in the world to set-up, run and grow a business) are offset and exceeded by increased costs generated through a range of other taxes, regulations and policy decisions. There are growing constraints on smaller firms due to public policy decisions made by Ministers, many of which may seem justified on their own but cumulatively bear down on the small business community's capacity to innovate, raise productivity and grow.

FSB has estimated that the regulatory environment (excluding obligations such as the NLW) has been costing smaller enterprises in the UK around £183 billion a year in direct costs. Smaller firms face considerable burdens as a result of Government policy. Yet, if Government wants smaller businesses to further increase their already considerable contribution to employment growth and the lowering of unemployment, intensification of competition in industries, and consequent generation of greater levels of productivity and innovation, there must be careful consideration of the additional costs being placed on them. Specifically, policy needs to be aimed at significantly lessening the constraints and obligations on enterprise. Smaller firms can boost the economy, but they need the freedom to do it.<sup>9</sup>

#### Brexit

Small businesses have been a consistent powerhouse of job creation. However, our SBI data shows that small businesses have reduced staff numbers for the first time since 2016. The impact of Brexit uncertainty on small business appetite to hire and invest has been laid bare. Therefore, it is not a surprise that small business revenue growth has stagnated during the first quarter of 2019.<sup>10</sup>

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<sup>9</sup> FSB and CEBR, Impact of Government Policy Index, January 2019. Available at <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/igpi-2019-final.pdf?sfvrsn=0>.

<sup>10</sup> FSB, Q1 2019, Small Business Index. Available at <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q1-2019-final.pdf?sfvrsn=0>.

Looking further ahead all sectors are experiencing a period of sustained uncertainty due to Brexit's unpredictable timetable. Our recent evidence has found that businesses have also been suffering from weaker confidence and are shying away from committing to larger spending plans.<sup>11</sup>

Across the UK, businesses of all sizes are indicating that uncertainty has been clouding their outlook, and this is feeding through into investment, stockpiling and hiring decisions. Others, like the decision by a business to close a UK plant or an EU national to emigrate will have longer-term implications for the strength of supply chains the UK economy.<sup>12</sup>

The most disruptive scenario for business continuity in the short term would be that of a cliff edge 'no-deal' with no transition period. In this scenario the UK leaves the EU without a Withdrawal Agreement (WA), on 31 October 2019. A 'no-deal' scenario would mean there is no agreement on the framework for the future partnership between the UK and the EU 27 at the point at which we leave the EU. It is this framework (set out in a non-binding political declaration) which would shape any future trade deal / trading arrangements between the UK and the EU 27. A no-deal Brexit would place the UK outside of the EU Customs Union and the Single Market, leaving small businesses to trade with the EU under World Trade Organisation Rules (which don't cover all sectors of the economy).

### FSB recommendations for the National Living Wage and National Minimum Wage

Based on HM Treasury and the Bank of England forecasts, it is estimated that the NLW will reach its target of 60 per cent of median hourly earnings within £8.62-£8.67 in 2020. 30 per cent of FSB small business members report that such an increase will not have any effect on their wage bills, with the Information and communication and Professional, scientific and technical activities sectors the least likely not to be affected by an increase to £8.67. As in previous years, FSB small business owners say they will respond to next year's increase by raising prices (39%), taking lower profits/absorbing costs (36%) and recruiting fewer workers (24%).

In the October 2018 Budget, the Chancellor stated:

*"Next year we will need to give the LPC a new remit beyond 2020. We will want to be ambitious with the ultimate objective of ending low pay in the UK but we will also want to be careful – protecting employment for lower paid workers. So we will engage responsibly with employers, the TUC, and the LPC itself over the coming months gathering evidence and views to ensure we get this right – and I will confirm the final remit at the Budget next year."*  
HM Treasury noted that the OECD define relative low pay as two-thirds of median earnings.

Businesses impacted by the rises in the NLW have been absorbing costs, reducing investment and, to some extent, reducing hours worked. Retail, social care and hospitality sectors are particularly impacted by rising wage costs. It is our view that there is not sufficient evidence to understand the impact of the introduction of the NLW and its subsequent increases. This is why it is crucial for the LPC to maintain a firm level of independence - the NLW shouldn't be dictated by arbitrary political targets. The role of the LPC should be maintained and protected, with the LPC taking evidence from the widest range of groups including employers, trade unions, academics and

<sup>11</sup> FSB, Q1 2019, Small Business Index. Available at <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q1-2019-final.pdf?sfvrsn=0>.

<sup>12</sup> FSB, Q1 2019, Small Business Index. Available at <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q1-2019-final.pdf?sfvrsn=0>.

workers. The LPC has played an invaluable role over the last twenty years, proving an excellent steward of the NMW. Furthermore, small businesses value the role the LPC has to play and it is our view the LPC is the right body to monitor the impact of the NLW and make recommendations on the evolution of the NLW.

Smaller businesses have close relationships with their employees and seek to support them across a number of areas, thus many welcome aspirational policies which seek to benefit their workers and their communities. However, Government must recognise that the minimum wage has its limitations as an intervention in addressing income inequality. Significant changes to minimum wage levels alone will not achieve the goal of reducing poverty in the UK. Government should also review other major policy areas, such as Universal Credit, affordable housing, education, childcare and accessible transport - all have a vital role to play.

Our evidence shows that small businesses are cutting back on investment both for staff in terms of training and in machinery, undoubtedly impacting on their ability to increase productivity. As discussed above, the cost of doing business is continually rising, and may rise further, if future proposed policy changes are introduced, such as making employer pension contributions on the whole of income up to the upper earnings limit. Retail, hospitality and social care continue to operate under tight profit margins, these sectors are currently struggling with an increase in cost in wages. Setting a political target of two-thirds of median earnings may lead to a reduction in hours, but also jeopardise the sustainability of jobs in these sectors.

FSB recommends the LPC takes a cautious approach in working towards an aspirational goal. It is our view that Government should seek to implement any future ambitious pay goal over a ten year period. This will provide business with long-term predictability, giving employers sufficient time to respond to significant changes in the economy, adapt to any changes in the labour market and deal with the impact of other major policy changes. It is vital that the LPC continues to play an independent role in setting the wage floor and should be free to deviate from a political trajectory, if economic and labour market conditions warrant it to do so. If minimum wage policies are implemented at the wrong level and pace, it will not only damage the growth of small businesses, but lead to higher rates of unemployment which will only exacerbate poverty in the UK.

Government should also seek to support small businesses by committing to maintaining and uprating the Employment Allowance. The Employment Allowance, provides small businesses with a £3,000 discount on employer National Insurance Contributions bills, acting as an incentive for small firms to create jobs, increase pay and encourage business investment. It is our view that the Employment Allowance will continue to remain a vital source of support for small businesses, especially for those in sectors with tight profit margins.

### Young people and apprentices

The ability of employers to train young people provides young people with the opportunity to improve their employability and transferable skills. FSB's latest research shows that 58 per cent of small business owners employ at least one person aged 16-24.<sup>13</sup>

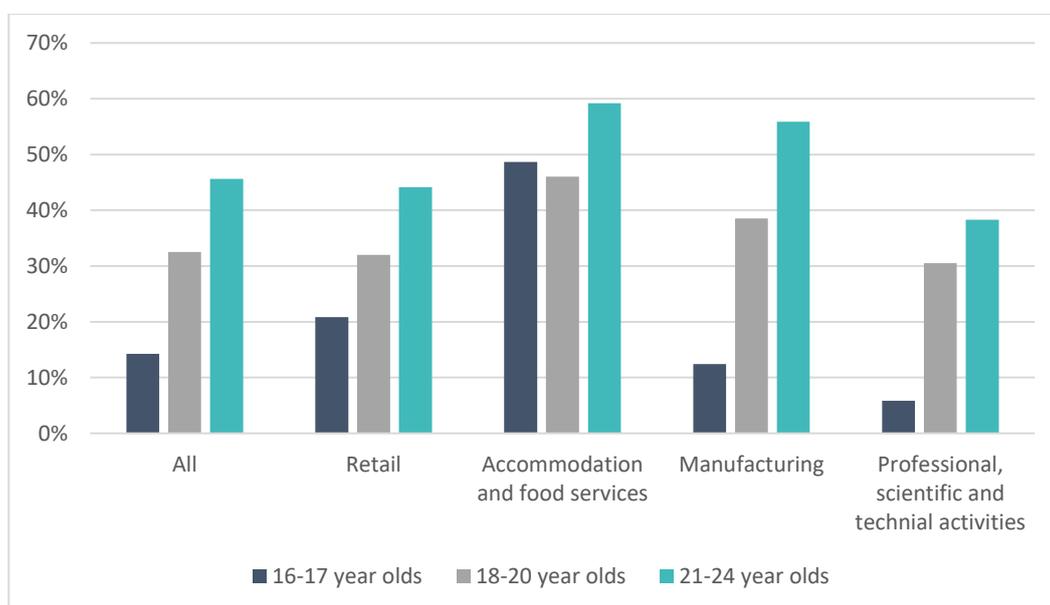
Young person age breakdown	At least one young person	At least one young person (16-24)
16-17	14%	

<sup>13</sup> FSB, Small Business, Big Heart, February 2019. Available here <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-small-business-big-heart.pdf?sfvrsn=0>.

18-20	<b>33%</b>	<b>58%</b>
21-24	<b>46%</b>	

Of the 58 per cent of businesses that report an increase in their wage bill since April, only four per cent responded by hiring more workers under the age of 24 (excluding apprentices). This suggests that, at present, a rising NLW is not increasing demand for younger workers. However, six per cent of small business owners say that, if the NLW were to increase to £8.67 next year, they would hire more workers under the age of 24 (excluding apprentices).

Figure 4 - Young people employed in small businesses by sector  
Source: FSB survey, 2018



**Question Seven:** You've stated you employ 21-24 year olds. Please indicate the most common level of pay that you provide to your staff of this age:

All interviews (496 responses)	Total
£7.70 (National Minimum Wage for this age group)	<b>19%</b>
Above £7.71 but below £8.21	<b>18%</b>
£8.21 (National Living Wage)	<b>17%</b>
Above £8.21	<b>43%</b>
Don't know/not sure	<b>1%</b>

Small businesses that employ 21-24 year olds are more likely to pay their staff the NLW or above, with 60 per cent of respondents saying they pay 21-24 year olds the NLW or above.

**Question Eight:** You've stated you employ 18-20 year olds. Please indicate the most common level of pay that you provide to your staff of this age:

All interviews (332 responses)	Total
£6.15 (National Minimum Wage for this age group)	24%
Above £6.15 but below £8.21	46%
£8.21 (National Living Wage)	10%
Above £8.21	16%
Don't know/Not sure	5%

71 per cent of small businesses report they pay 18-20 year olds either the NMW rate of £6.15 or under the NLW. Around one in four small businesses pay 18-20 year olds the NLW or above. Small businesses based in the South East are more likely to pay 18-20 year olds the NLW or above.

**Question Nine:** You've stated you employ 16-17 year olds. Please indicate the most common level of pay that you provide to your staff of this age:

All interviews (164 responses)	Total
£4.35 (National Minimum Wage for this age group)	27%
Above £4.35 but below £8.21	65%
£8.21 (National Living Wage)	5%
Above £8.21	2%
Don't know/Not sure	1%

92 per cent of small businesses report that they pay 16-17 year olds either the NMW rate of £4.35 or under the NLW. Only 6 respondents pay the NLW or above to 16-17 year olds.

**Question Ten:** For what reason(s) do you pay your staff under 25 below the National Living Wage?

All interviews (356 responses)	Total
Lack of experience	56%
Affordability	51%
Staff require more supervision	44%
Staff require more training	42%
Lower levels of productivity	29%
Due to probationary period	15%
Other	10%

71 per cent of FSB small business employers say they pay 18-20 year olds below the NLW. Many small businesses cite a lack of experience (58%) as a reason for not paying those aged 18-20 the NLW. Our evidence suggests that for those small businesses employing staff that are both under 25 and over 25 in the same role and with the same level of experience, the small business employer generally pays both individuals the same amount.

**Question Eleven:** Imagine that you employed a 21 and a 26 year old in the same role and the same level of experience. Would you pay them the same?

All interviews (1162 responses)	Total
Yes	73%
No	19%
Don't know	9%

**Question Twelve:** How would your business react if the law was changed to make it compulsory to pay at least the National Living Wage (£8.21) to the following age groups:

(All of those who pay 20-24 below £8.21 or don't know the amount (194 responses))	Reaction if the NLW applied to those aged 21 and over	Reaction if the NLW applied to those aged 23 and over
Raise prices	52%	47%
Reduce number of employees through redundancies	17%	17%
Recruit fewer workers	46%	41%
Reduce hours worked by staff	41%	44%
Reduce the rate of basic pay growth for the rest of the workforce	31%	28%
Hire more workers aged 21/23 and under (excluding apprentices)	20%	18%
Recruit more apprentices	7%	8%
Cancel/scaled down plans for investing in/expanding the business	40%	37%
Cut back on training expenditure	18%	22%
Increase share of workforce on non-guaranteed hours contracts, e.g. zero hours contracts	13%	10%
Reduce pension contributions to a minimum of three percent for employers	9%	11%
Invest in machinery/automate certain processes	7%	9%
Other, please specify	11%	9%
None of the above/it wouldn't have any effect	8%	12%

The most common response if the NLW were to be extended to either 21 or 23 year olds would be for businesses to raise prices (52% for NLW at 21 and 47% for NLW at 23). 17 per cent of respondents say they would make redundancies. In addition, our anecdotal evidence suggests some businesses would consider closing down – with respondents stating that further squeezes on margins would force their businesses to close.

### **Apprentices**

FSB's anecdotal evidence suggests many small businesses choose to pay above the Apprentice Minimum Wage (AMW) in order to attract high-quality candidates and to make opportunities as accessible as possible in recognition of the cost of travel, for example. While the AMW will have some bearing on employers' decisions around whether

to employ apprentices, ultimately we believe that the majority of small business owners do not see this as a deterrent to taking them on.

However, apprenticeships reforms over the last few years have significantly impacted small businesses. FSB's *Fit For the Future: Making the Apprenticeship System Work for Small Businesses* report published in April 2019 finds that 41 per cent of small businesses that employ apprentices say that their costs related to recruiting and training apprentices has increased in recent years. 46 per cent of small businesses in rural areas are more likely to report increased costs than those in urban areas (40%).<sup>14</sup>

FSB research shows that 92 per cent of all apprenticeships offered by smaller businesses in England are held by 16-24 year olds. Of those small firms that provide apprenticeships, 30 per cent have employed apprentices whose highest educational achievement is GCSE Maths / English grade C or lower (or equivalent), i.e. those with low levels of educational attainment. Therefore, any Government policy which limits the ability of small businesses to offer apprenticeships will impact efforts to drive forward social mobility.

### FSB recommendations for young people and apprentices

FSB evidence shows that the majority of small businesses are paying staff aged 21-24 the NLW or above. However, we recommend the LPC take a cautious approach when removing the 21-24 age band. We advocate for its abandonment over a gradual period, with an initial move to 23, after which the LPC should assess the impact on the labour market and on employment levels for young people before a move to 21 is made. This will enable small businesses, especially those businesses with a higher proportion of young workers, to adjust to the change.

It is our view that the eligibility for the NLW should not fall below 21. In addition, we recommend maintaining the 18-20 and 16-17 year old youth rate bands. Our evidence suggests that small businesses are more likely (68%) to consider paying the NLW to staff aged over 21. Furthermore FSB members continually comment on the lack of employability skills amongst young people, especially those who have recently left further education. The ability of employers to train young people provides young people with the opportunity to improve their employability and transferable skills. Therefore, to ensure those aged under 21 have the opportunity to gain employment and develop their skills set, we advise the LPC to maintain the youth rate bands for those under 21.

The FSB believes that gradually bringing the apprenticeship rate more closely in line with the under 18 rate would boost the apprenticeship 'brand' among young people and help small businesses attract the best young recruits. However, in the near term, extra care must be taken to ensure the level set does not adversely affect the take up of apprenticeships.

### Compliance and enforcement

Understanding employment law can be particularly challenging for small businesses who do not have a HR or legal department. With small businesses being such a wide and disparate group, promoting awareness of rights and responsibilities can be a challenge.

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<sup>14</sup> FSB, *Fit For the Future: Making the Apprenticeship System Work for Small Businesses*, April 2019. Available at <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-apprenticeships-report.pdf?sfvrsn=0>.

FSB has consistently highlighted to our members that all employers have a duty to meet their legal obligations, and those firms that advertently fail to, for example, pay their staff the minimum wage will be undercutting others and damaging trust in the business community, the vast majority of who abide with the NMW legislation.

Small businesses have continued to raise that they have experienced a more adversarial approach from HMRC in relation to compliance issues. This is disappointing as it is our view that a partnership approach to compliance, rather than presenting a series of sanctions to a smaller employer is the most effective way to achieve good compliance.

We remain concerned that some small businesses may inadvertently find themselves non-compliant with the minimum wage legislation due to lack of awareness of changes. It is often the additional features of minimum wage legislation, such as the accommodation offset or application of sleep-in rates, which can cause confusion for small businesses. The National Minimum Wage Regulations 2015 came into force in April 2015 and consolidated and restructured all of the previous regulations governing the NMW with the aim of making the legislation in this area easier to understand.

However, despite intended aims, the 2015 regulations have not provided the clarity sought by small employers: the regulations concerning calculations are still exceptionally complex, especially for those who lack support and thus are more likely to make mistakes, even if doing so is unintentional. Where a breach has been made the consequences are substantial and can result in significant back pay and fines having to be paid and a business being labelled as 'non-compliant' - associated reputational damage. Furthermore, the above can adversely impact on the ability of employers to recruit good quality staff.

To ensure firms do not unintentionally fall foul of the new rules, we are calling on Government to enact a campaign of targeted communication along with the publication of appropriate guidance. We also recommended that HMRC takes extra efforts to facilitate compliance through clear communication when making changes to the minimum wage rates. This guidance would help reduce the numbers of non-compliant businesses.

It is FSB's view that HMRC's current 'naming and shaming' scheme is ineffective and requires urgent review. The lists are long, diluting the value of a public list, and the £100 threshold is too low. Best practice in exercising reputational penalties has been demonstrated by the Pensions Regulator, which names and shames only the most egregious non-complaint employers. This increases the effectiveness of the list and does not punish employers that unintentionally failed to meet a particular test.

To ensure firms do not unintentionally fall foul of the new rules, we have called on the Government to enact a campaign of targeted communication along with the publication of appropriate guidance. We also recommended that HMRC take extra efforts to facilitate compliance through clear communication when making changes to the minimum wage rates. This guidance would help reduce the numbers of non-compliant businesses.

At the same time, risk based and proportionate measures should be robust to eradicate the small number of employers who seek to exploit workers. Exploitative employers are found across all sectors and all types of businesses, such employers do not only undermine the quality of goods and services, reduce business confidence, but they also impact negatively on the quality of work across the UK. Where an employer is found to be in deliberate breach of the law, enforcement should be tough in order to punish, provide justice for the worker and encourage compliance amongst employers.



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Federation of Small Businesses