CBI
THE VOICE OF BUSINESS

A BETTER OFF BRITAIN

IMPROVING LIVES BY MAKING GROWTH WORK FOR EVERYONE


Immediate Steps
Productivity
Skills
Education
Rainy Days

Key facts and

£363

The tax reduction for a dual earner household as a result of raising the employee NICs threshold to £10,500 by 2020/21

73%

The contribution of labour productivity to UK economic growth, 1998-2007

33.8%

Average share of net income spent by an average working couple on childcare costs in the UK

£144bn

The amount that may be added to UK GDP per year by achieving current US levels of productivity in four high employment sectors

£3,430

Average saving per year made by a family with a one year old through the introduction of 15 hours of free childcare

1 in 3

Workers are still "stuck" in the lowest earnings group after 14 years

Acknowledgements

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stats

50%

Of jobs will require level 4 skills (higher education) or higher by 2022

1 in 5

The number of people who have no savings whatsoever

£98

Per week by moving from a level 3 skill job (A levels) to a level 4 skill job

£1,300

The value of accessible rainy day savings of the UK median saver

£71pw

By the age of 25, children from the poorest backgrounds earn £71 less per week than those children from wealthier backgrounds

48% vs 77%

Aged 16 children from disadvantaged backgrounds are much less likely to achieve at least five A*-C grade passes including English and Maths

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Foreword

This report is business' blueprint for improving living standards in the UK. It is an agenda about individual people. It is also an agenda that will help business do what it does best – create the jobs and growth in the economy that can raise living standards and pay. These two things are not in opposition, and never should be.

A healthy economy is one that can maintain and enhance the living standards of its citizens. Business themselves benefit from the stable business environment that these societies deliver.

But our economy could be healthier and stronger than it is right now. The squeeze on household budgets over the last few years – in the pay packet and at the till – has taken its toll. Falling real wages – a requirement during the recession to help businesses preserve jobs – cannot go on forever.

Yet it wasn't the recession alone that caused the issues we face today. They are deep-set in our economy. We've got the lowest social mobility in the OECD and this has far too great an influence on whether you find a job, are able to hold onto it or see your wages rise. That's bad for people and bad for companies, as we don't make the most of our potential.

Making growth work for everyone is about more than just getting back to where we were. We need a plan to ensure that the growth of the British economy is strong, sustainable and inclusive.

That doesn't mean any plan will do – indeed some of the ideas being widely pitched at the moment may do more harm than good in the long-term. So our plan is focused on improving things for a generation, not just for an election.

We set out immediate steps that can ease the squeeze on household budgets – things like easing the high cost of childcare and letting people keep more of what they earn from a day's work.

And we show what action is needed right now to sustainably set living standards on a better future path for all. To give every young person an education that helps them build their careers right from the start, and support people to climb the career ladder and increase their earnings throughout their working life. We show how business can play its part too – through sharpening their focus on skills, progression and increasing productivity, as well as helping their staff build up savings for a rainy day.

Business wants to help build a more prosperous Britain where everyone has the chance to get on in life. We have a lot going for us already. Youth unemployment is falling, and more and more of the jobs we're creating are highly-skilled and better paid. But our ambitions must be higher and our goals must be greater – our economy must work for more people.

Getting there won't be easy, and we shouldn't settle for sticking plaster solutions. A better off Britain needs a focus on forging a future of shared prosperity – where growth works for everyone. This is a future for all of us and it needs to start here.

John Cridland

John Cridland
Director-general

Business wants to help build a more prosperous Britain where everyone has the chance to get on in life.

Executive summary

This report sets out business' blueprint for an economy where growth benefits all. As we recover from the recession and attempt to chart a successful route through the changing global economy, we need immediate relief for the hardest pressed and action right now to set our living standards on the path to a better future.

People face huge challenges in the post-crisis UK

Living standards are a key topic of debate as we approach the 2015 General Election. This is not a surprise given that the average household has seen its income drop by 6% from where it stood before the crisis, allowing for inflation. Pay restraint has helped keep many people in work during the crisis and protected them from unemployment, which is a positive. Losing a job in the family is one of the worst things that can happen to a family's living standards. But given earnings were growing faster than inflation for half a century, it's no surprise that the squeeze on earnings has been a shock for many. Particularly hard hit by this change have been those on the lowest incomes, working families – who have faced significant rises in costs such as childcare – and younger workers who have struggled to make their way in their careers.

As the recovery continues, and company profitability rises, it is likely the pay squeeze will end – indeed, private sector wages have been rising more quickly in recent months. But we should not pretend that the recovery will mean that everyone will automatically benefit from growth – or that there aren't big longer-term issues in our economy that are holding back living standards for many.

We've got the lowest social mobility in the OECD and who you are – the background you come from – still has far too great an influence on whether you find a job, are able to hold onto it or see your wages rise. And globalisation and technological progress are changing the shape of our economy so that the jobs of today look different to the jobs of the past – and many of the jobs of tomorrow still haven't been imagined yet.

Making growth work for everyone is the right thing to do – and good for business

The key question that might be asked of this report is "Why does this issue matter to business?"

Ensuring the squeeze on earnings ends as fast as is possible would have some immediate benefits. Workers are also consumers. But to be successful in the longer-term, companies in the UK also need to make the most of British potential. Research from the IMF shows that nations with higher inequality tend to enjoy shorter periods of growth, and also tend to grow more slowly. Whether we're trying to sell more abroad or innovate more at home, getting the most out of the talent we have is a must.

Yet the 'quick fix' approaches that are often put forward are in fact more likely to damage progress than help us achieve this. Our flexible labour market is one of our economy's key strengths and has helped deliver jobs and pay rises over the past decades. We must not undermine our strengths. Instead of offering sticking plasters, such as greater welfare spending or unsustainable rises in the minimum wage ahead of the ability of businesses to pay for it, this report sets out a long-term plan to prepare British people to be successful today and tomorrow in the global economy we inhabit, as well as providing short-term relief to the hardest-pressed groups right now.

Immediate steps to help those on low incomes and working families will help ease the squeeze

The past few years have been extremely difficult for many and we need to do more to help ease the squeeze. This is about helping those hardest hit: those on the lowest incomes and working families.

Businesses spend the same share of their income on employing people now as they have for pretty much all of the last 60 years. But less and less of this money is ending up in their employees' pockets. Instead it goes towards other benefits, like pensions, or is taken by government in National Insurance Contributions (NICs).

To give immediate relief and ease the squeeze we need to make sure more of what business spends on employing people ends up with their staff. In the short-term, that means government should cut employee NICs, through a staged increase in the level at which employees start to pay the tax. This could put an extra £363 per year into the budget of a two-earner family. This approach would provide much needed relief for those on the lowest incomes too – and would make more difference to them than raising the personal allowance threshold further, as many of the very lowest paid already pay no income tax. Over time employer NICs should not fall behind, but our current priority is easing the burden on lower-paid employees first.

Our second proposal helps working families. Childcare costs have risen by 27% since 2010 and two earner families in the UK are the hardest hit in the OECD from paying for the costs of care. Paying for childcare has a big impact on household budgets in the UK. Our reforms are designed to ensure it is easier for parents to afford childcare and, for those that want to, also remain in work throughout their child's young life, by extending the right to free care, with the aim of going further in time. This has three benefits: reducing cost to families, 'closing the gap' between maternity leave and supported childcare to increase the ability of parents to remain in higher paying jobs with more development potential, and – with the right quality in the system – boosting child development.

For business:

- Challenge outdated assumptions around flexible working in firms and, where possible, adopt a presumption in favour of flexibility from job advert onwards, to help employees manage their work-life balance effectively, including childcare costs.

For government:

- Reduce National Insurance Contributions (NICs) for employees. Start with raising the threshold for employee NICs to £10,500, the level of the income tax personal allowance in 2015/16, in steps up to 2020/21.
- Close the gap between free provision of childcare and statutory maternity pay by offering 15 hours of free childcare to all children aged one and two and by extending statutory maternity pay from 39 to 52 weeks. Aim to further increase the number of hours of free childcare in time.

RECOMMENDATIONS

Wages can only rise with productivity and competitiveness – that is the challenge for business

Productivity – how much value each worker adds in every hour he or she works – determines how fast our economy grows. Between 1998 and 2007, improvements in labour productivity accounted for almost three-quarters of the UK's economic growth. And over this period real wages rose faster in the UK than in other advanced economies. Because the truth is that pay can only rise with productivity.

But the UK at the moment could do better. UK productivity would be 16% higher now if the pre-2008 trend had continued. We are also behind some of our key competitors.

Productivity is complex. Improving it so we can raise wages requires a big effort. The first step is to get a better understanding of the issues we face and how we can address them. To do this, government should ask the Office of Budget Responsibility (OBR) to help by providing robust data on productivity, in particular on what is happening in different sectors. This will help inform debates in business on how we can raise productivity and help government better understand how it can use its policy levers to drive productivity growth in firms – be that through housing or transport policy. It will also help government to simplify and improve the support it offers businesses, especially smaller ones.

But the lead on raising competitiveness must rest with business on the ground. How we define productivity and competitiveness varies by firm and sector. It is relatively easy to measure the value of goods being produced by a machine and the staff time required to run it – but how do you measure productivity in a service environment, like a hotel, where the definition of added value will be different again? Only businesses themselves can make these decisions.

Our research suggests productivity improvements are possible not just in our industrial strategy sectors but in areas like retail and transport services too, which are hugely valuable engines of job creation for the UK. Businesses need to be looking to investment, innovation, management quality, skills and job design to ensure we are as competitive and productive as we can be, which will help pay to rise with productivity.

For business:

- Take a long-term approach to raising employee value-added, and make it a firm priority, working within the company and together in supply chains, local areas and sectors. Address areas like management skills, job design, innovation and investment.
- Sector bodies should support firms in this endeavour.

For government:

- Ask the Office of Budget Responsibility to report regularly and in-depth on the UK's productivity performance, including sectoral trends and any government-inspired barriers, in the manner of the Australian Productivity Commission. With the support of business leaders, use this data to guide policy and address issues raised.
- Simplify the support network for smaller and medium-sized firms to improve take-up and enhance productivity potential. This should focus on four areas: access to government procurement; UKTI's role in supporting exports; simplification of business support, including for lower paying sectors, and access to finance.

RECOMMENDATIONS

Help people to earn more through better ladders into higher-paid work

The skills you have are a big part of how much you earn. Our research backs this up and shows that skills help improve living standards as they play a crucial role in someone's ability to stay in work and to see his or her pay rise.

That's always been the case. But it's becoming even more important in today's economy. The number of jobs requiring no formal qualification has nearly halved over the past ten years – and in eight years' time, by 2022, half of all jobs will require workers to have completed some form of higher education. Jobs are becoming more highly-skilled. What's happened, as part of that, is that many 'middle pay, middle-skilled' jobs that we rely on to give people good incomes have just become a little more skilled.

To ensure people can access these new middle-skilled, middle pay jobs we need to act. At the moment too many people are stuck in low pay and are unable to access these higher-paid opportunities – because they lack the skills needed to fill these middle-skilled roles.

The skills shortages many firms report reflect this and show how difficult it is to get to these jobs through vocational education at the moment. Further and higher education institutions need to do more to ensure the vocational courses they offer create ladders into these jobs. That will help us equip more young people – and adults re-training – to access these opportunities. Adult retraining is particularly important, as it helps answer short-term skills needs and ensure that, as well as giving a leg-up to the young, we are also ensuring economic change doesn't leave people behind.

But companies cannot expect the skills system to get the job done on its own. Once you're in work, it's also progression to higher-paid jobs within your firm that improves your standard of living. So we need to see more chief executives make 'growing your own' a board-level priority, and equip and incentivise line managers in their business to develop staff more effectively. Better vocational education also means more engagement from business with colleges, universities and private skills providers. The best examples of this in the UK are great – but they need to spread, with people development a key part of the business education agenda.

RECOMMENDATIONS

For business:

- Work with higher and further education institutions to create 'learn-while-you-earn' routes into the new middle-skills (level 4).
- Make a board level commitment to helping staff develop their careers and incentivise line managers to make this a priority.
- Provide line managers with the tools to deliver better staff development and succession planning through management education in business schools, and greater HR support.

For government:

- Help more people gain the new middle-skills they need (level 4) by encouraging more co-working between higher and further education institutions and building an emphasis on vocational alternatives to degrees as a key part of the system.
- Give workers the confidence to study part-time by making the scale of financial support for courses better known, and change the rules that prevent people from retraining in lower or equivalent qualifications that are more in demand through fear of fees or unaffordable loan commitments.
- Launch a new government strategy for adult retraining.
- Encourage further specialisation in the further education sector and ensure colleges are delivering courses that are in demand in the economy by rewarding them on employment outcomes, not bums on seats.

Education is the best long-term tool to boost growth and living standards through social mobility

Schools are crucially important in determining people's ability to build better living standards for themselves in future. They equip young people with knowledge and skills. But they're also the main way to make our society more mobile and ensure your background doesn't completely dictate your future living standards.

At the moment, a child from one of the most disadvantaged backgrounds earns an average of just under £2 an hour less than those from the highest income family backgrounds by the time they have started their career. That's no surprise, when average GCSE results still rise with parental income. So if we care about the living standards of future generations – and every single person in them – education is the place to start.

While some promising steps have been taken recently – with the pupil premium and a new focus on character education being examples – progress overall on a new approach to our schools system has been too slow. At the moment gaps in performance between children from disadvantaged and better off backgrounds still widen rather than close in too many of our schools.

To set up all young people for success in working life there are three things government can do. Firstly, it can ensure schools are incentivised to develop rigorous, rounded and grounded young people – and make sure they are measured against that criteria. This is a menu for greater social mobility as it will help young people develop the attitudes and behaviours they need to succeed in work and wider life. Secondly, government needs to follow this up by ensuring that schools help young people gain real life experience of the world of work. This will also specifically benefit those from disadvantaged backgrounds, who often have fewer family contacts to talk to about the world of work. And, finally, we need to develop better and less exam-dominated plans for all our 14-18 year olds, whether their pathway to higher-paid work is academic or starts with the rigorous new vocational A-level we are calling for.

Again, companies themselves can do more – not just engaging with schools, but also opening their doors wider to a broader mix of candidates when they hire or offer opportunities like internships.

For business:

- Step up and offer valuable, inspiring and engaging work experience opportunities for young people from a wide socio-economic background and increase commitment to collaborating with and supporting schools.
- Ensure doors are open to talents from all sources through a stronger focus on achieving the widest socio-economic spread when hiring or offering internships.

For government:

- Ensure we develop rigorous, rounded and grounded and socially mobile young people through a new statement of what schools should deliver and a new Ofsted inspection regime to deliver accountability through the narrative reporting that is widely used in business.
- Set out a plan for 14-18 education, peaking with academic or vocational A-levels, and moving away from GCSEs.
- Reinstate the duty on schools to provide work-related learning at Key Stage four and introduce a national network of Local Brokers to support schools in delivering it.

RECOMMENDATIONS

Making sure people have a buffer for when a rainy day comes

The crisis eroded savings in many families, but as the recovery takes hold and earnings rise this presents an opportunity to help more people build up buffers for when a rainy day comes.

Savings can help people 'bridge the gap' when something bad happens, and avoid getting into debt. They mean that people are better able to cope – without a big drop in their living standards – when things go wrong. Our focus group was clear that they wanted to save and recognised its importance, but lacked the ability to. So while much of the focus of the debate on living standards revolves around pay and income, we should not ignore the importance for families of building up assets over time in employment.

Companies already do a lot in this area through wider benefits packages that are not often recognised in the public debate around wages – for instance through the ongoing roll-out of pension provision to every British worker unless they opt out. But there are opportunities to go further, with the right support from government. We look at the potential of a range of options including corporate Individual Savings Accounts (ISAs), and capital share schemes (such as SIPs, SAYE, CSOPs or EMIs) or employee share ownership. There are also lessons to learn from the process of automatic enrolment to pensions about what might work in the future. And government can support people in building assets and reducing the cost of living through other policies, such as building more homes.

For business:

- Play a stronger role in helping employees build up buffers by considering a wide range of workplace savings options.

For government:

- Raise demand for corporate Individual Savings Accounts (ISAs) by allowing people to save into both an individual and a corporate cash ISA.
- Simplify the legal, tax and regulatory framework to tackle barriers to the uptake of capital share and employee share ownership schemes among business.
- Work with the insurance industry to review options on using the auto-enrolment reforms flexibly to deliver support during working lives.
- Help more people onto the housing ladder and reduce the cost of renting a property by building 240,000 new homes every single year within the next decade.

RECOMMENDATIONS

CHAPTER 1

People face huge challenges in the post-crisis UK

The financial crisis and slow recovery from the recession have left us with a shared challenge. Most people are feeling squeezed, with working families being hit particularly hard. This will get better as the economy recovers, but there are deeper, more structural factors to address if we are going to build a better UK. The path ahead isn't clear. Economic change has altered skills needs and raising productivity has proved challenging. Even before the recent crisis, the UK had issues to face. An individual's background determined too much of the outcome they achieved in life – with the UK the country in the OECD with the strongest link between the income of parents and their children. There is much to do – but we can build a society where everyone has the opportunity to participate in, and benefit from, growth.

Living standards have been squeezed

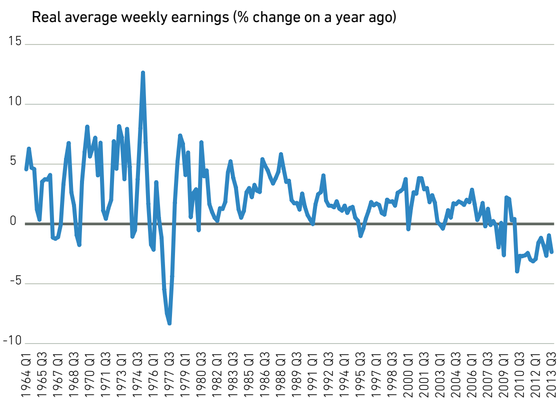
The living standards of most households in the UK have been under mounting pressure. By 2013/14 the average household's income had fallen by more than 6%, allowing for inflation.[1] That has been a shock after years of rising living standards. It has left many people under financial pressure – and unclear of what the future holds.

The average couple without children saw their household income fall by £1,404 per year between 2009/10 and 2012/13, while couples with two children lost £2,132 per year.[2] The main driver of the drop in household incomes has been wages not keeping pace with rising inflation. Pay had risen faster than the cost of living for most of the past half century with average earnings outstripping rises in prices by an average of 1.2% a year in the early 2000s (Exhibit 1).[3]

But the recession changed that. And in the period from 2010 onwards, real earnings – pay adjusted for changes in prices – were falling by 2.2% a year.[4] This prolonged decline in the purchasing power of employees has squeezed living standards and hit demand for the products and services of British businesses.

For businesses however, pay restraint has been essential. Put frankly, the impact of high inflation abroad and fierce global competition has sapped firms' ability to offer pay rises, especially as many firms worked with their staff to protect jobs during the crisis. While many firms told the CBI's *Employment trends survey* of their aim to match inflation in their next pay round, often this has just not been possible.[5]

Exhibit 1: Wage growth has fallen behind rising prices since the recession



Source: ONS, *An examination of falling real wages 2010-2013*, January 2014

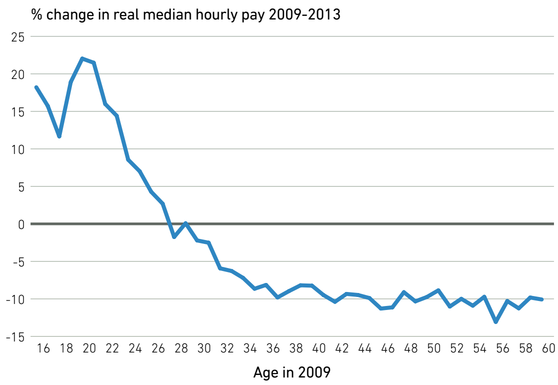
Things have been particularly difficult for the lower-paid, young people and working families

While most people have felt squeezed during the recession, it's fair to say that the hardest hit groups among those with jobs have been lower earners, young people and working families. A drop in the real value of wages affects anyone, but it is much tougher for those who are already on low pay. While the National Minimum Wage (NMW) has afforded some protection to the very lowest paid – rising faster than average earnings during and in the aftermath of crisis, and returning to growing faster than inflation this year – the lower-paid are hit much harder by rising prices.[6]

Things have also been difficult for young people, not just because many of them have struggled to find work, but also for those in work who saw their earnings increase less quickly than they'd expected. Workers under the age of 30 often see a period of rapid pay growth as they build experience and skills early on in their careers. But, while this group was one of the few that saw real wage rises between 2009 and 2013 (Exhibit 2, page 14), its pay growth was much lower than the growth past generations suggested could be expected in those early years of someone's career. By the time those young people were aged 21, in 2013, they earned on average 12% less than their 21 year old counterparts did in 2009. The average hourly wage for a 21 year old in 2013 was £7.14 compared to £8.10 per hour for a 21 year old in 2009 (both figures are in 2013 prices). This means the percentage gap in pay between these two groups was larger than the equivalent difference between workers in their mid-30s, 40s, or 50s (Exhibit 3, page 14).

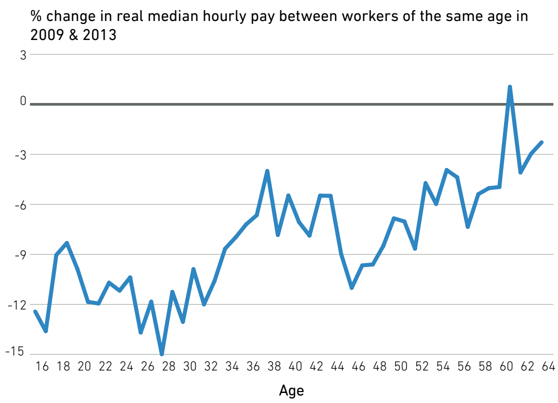
A drop in the real value of your wages is a big shock for anyone, but if you are on lower pay already it is much tougher.

Exhibit 2: Younger workers were most likely to increase their pay during the squeeze



Source: ONS, *Wages over the past four decades*, July 2014

Exhibit 3: But the pay of younger workers was also further behind that of the workers who had been the same age in 2009



Source: ONS, *Wages over the past four decades*, July 2014

Note: For example, the median worker aged 22 in 2013 earned 12% less than the median worker aged 22 in 2009

While the story for young people is about unmet expectations, many working families have really struggled to make ends meet. Middle income families have seen their earnings grow less quickly over the last decade than earners at the bottom or top of the income distribution.[7] And over the past five years, families have also seen their real incomes fall while childcare costs have risen substantially. The cost of sending a child under two to nursery for 25 hours a week has risen 27% between 2010 and 2014.[8] In a family with two young children on average earnings where one parent works part-time and another full-time, both parents now lose around a quarter of their income to childcare costs. Added to this, affording a home to raise a family if you were not on the property ladder in 2008 has also become more challenging too.

27%

The cost of sending a child under two to nursery rose by over a quarter between 2010 and 2014

Most people appreciate that the country has been through a major economic crisis and that this has been an intensely challenging period. But all of us expected the squeeze on living standards to start getting better as the economy recovers. This has not yet been the case. Pay growth continues to be low, with average weekly pay currently growing at 0.7%, which is a whole percentage point below the rate of inflation (1.7%). Where pay settlements have been made these have averaged at 2.5% in 2014, but this hasn't helped recover lost ground.[9] With average earnings at £450 per week, this means the average worker took home £4.50 less in real terms each week in 2014 than they did in 2013.[10]

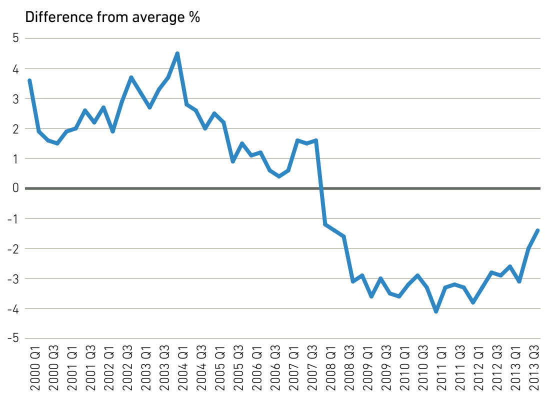
But paying more is not yet an option for many firms

The reason why pay hasn't improved is because firms have struggled to raise prices in a competitive market. They have faced inflation on the cost of the products and services they buy to do their work, but demand for their own goods and services has been uncertain.[11] This has led to persistently narrow profit margins, restricting the ability of businesses to pay more. Exhibit 4 shows how margins have changed relative to their average since 2000 and, while margins have seen a bit of a recovery very recently, they remain far below pre-recession levels. Echoing this, the Bank of England's regional agents found that margins were below a sustainable level for around one-third of businesses.[12] Clearly this is a factor which has limited businesses' ability to increase wages as quickly as hoped.

And while some firms have built up cash reserves during the crisis, the total employment costs to firms as a percentage of their income remains above its long-term average.[13] Building cash buffers has been firms' response to protect their business – and their employees' jobs – from economic uncertainty and to guard against unexpected changes in financing conditions. Weak demand for firms' products and services has also deterred investment which is needed to raise performance and pay in the future. Successive reports on the cash position of UK plcs also show that the cash on balance sheets clusters in sectors like oil and gas, rather than in lower paying sectors.[14]

Under these circumstances, any rise in pay must be associated with improved productivity, the value an employee adds in each hour he or she works. For pay to rise, productivity has to rise. This isn't about working harder, so much as finding new, better and quicker ways of doing things. And over the past few years progress on that front has been slow.

Exhibit 4: Profit margins remain below pre-recession levels



Source: Bank of England, *Inflation report*, May 2014

The recession itself caused a collapse in UK productivity as firms scrambled to save jobs. With GDP falling by six percentage points during the recession but employment only falling by 1.9 percentage points, the result is that more people are now producing the same output – so each individual's value-added has fallen. And lower productivity means lower pay growth, as the two are linked.

The wage squeeze, and shorter working hours for less pay in some firms, have been tough – but they kept people in work. And that meant fewer families facing the catastrophic loss of income which losing a job in the family entails. But with the number of people in employment in the UK now higher than it was before the crisis, and the employment rate back to its pre-crisis level (73%), it is time to focus on how we can help productivity recover. Indeed, there is considerable debate about whether productivity will even recover to where it was before the crisis, as our economy changes shape in terms of sectors and capital intensity.[15] Yet for businesses to raise pay sustainably, we must make progress on this.

This is not just about recovery – there are long-term issues to face up to

Resolving this problem and making the best of our collective and individual potential is about more than merely recovering to where we were in 2008 on pay growth. The world economy is developing faster, skills needs are rising and our productivity challenge endures.

And it is not as if the UK was performing adequately back then. Businesses were already talking about skills shortages – and were worried about innovation. At the same time, too many people were excluded. It is notable that opportunity exists unequally across the regions and nations of the UK (Exhibit 5). But even within each area we have been beset by stubbornly low levels of social mobility. As we showed in our 2012 report on education, *First steps*, gaps in performance between children from high and low income backgrounds open up at a very early age and embed through years in the education system.[16]

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In no other country in the OECD is the link between the pay of parents and their children as strong as it is in the UK

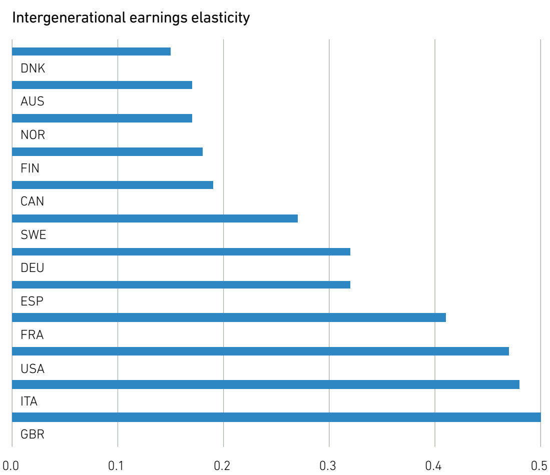
By the time these young people make it into work, they are already likely to be on very different tracks. As a result, babies born in the UK will see their lifetime income more heavily influenced by their parents' income than anywhere else in the OECD (Exhibit 6). This means many people's talents remain untapped and we waste valuable potential which could otherwise have given British businesses a winning edge. It is a structural problem that the UK must address – and one which will help us navigate cyclical issues – like the path of the recovery – better.

Exhibit 5: Opportunity falls unequally across the UK's regions and nations

Regional differences cut across many of the issues we look at in this report. A balanced economy needs businesses investing and exporting from all parts of the country, making the most of the private sector potential that exists there.[17] The UK is built upon a diverse range of local economies, each with their own strengths and challenges.[18] Local economies must play to these to be successful. In a knowledge economy such as the UK, the skills of people within each of these economies are an integral part of this competitiveness.

This report sets out principles that are important in every part of the UK. But each local economy has its own strengths and faces its own challenges, so some of our recommendations will be more pressing in one area than another. It is also the case that our recommendations cut across the responsibilities of the UK government and national devolved assemblies or parliament. Where responsibility is devolved, this report sets a principle that should inform solutions in each nation.

Exhibit 6: The link between parental and children's earnings is stronger in the UK than the rest of the OECD



Source: OECD, *Economic Policy Reforms 2010: Going for Growth*, Chapter 5, 2010[19]

Note: Countries with higher 'elasticity' values, have greater persistence of earnings across generations, and lower levels of intergenerational earnings mobility

The situation today is stark. By the time a child from a low-income background starts school they already lag up to one year behind their peers from better off households in terms of their vocabulary.[20] And later, at age 25, they earn on average just under £2 less per hour than those peers.[21]

Norway, Finland and Denmark are three of five countries that have got this right – there parental income has the smallest impact on the incomes of their children. But while our low level of mobility needs to be addressed, that doesn't mean the UK needs to become more like Denmark. Countries like Australia and Canada also achieve high levels of mobility with social models much more like the UK.

As well as being less socially mobile than other countries, we are also less mobile than we used to be. Between 1958 and 1970 – a period often seen as offering new opportunities for people to progress – mobility in the UK fell.[22] What's more, there was no sign of mobility improving in the period from 1970 to 2000.[23]

And it's not just parental income that tends to impact children's outcomes in life. Challenges in making the transition to work from education, in building skills to increase income and regional disparities all have a role to play.[24] Clearly, there is a lot to address if we are going to build a working culture where people have the opportunity to develop, and to see their pay grow. Without action on productivity, skills and progression in work, we will be failing to make the best of the potential we have. That would be damaging for people, companies and the economy, but it is not inevitable. We have the opportunity to take concerted action now to prepare the way for a more prosperous future.

"Between 1958 and 1970 – a period often seen as offering new opportunities – mobility in the UK fell and didn't improve in the following 30 years."

Making growth work for everyone is the right thing to do – and good for business

The challenges that we face in ensuring growth benefits the whole of the UK should worry us all. They certainly worry the business community. And they require leadership from politicians and businesspeople alike if we are to resolve them. The 'easy options' that might get a good headline, or appeal to a particular political base, are too often likely to do more harm than good. What we need is a structured programme of action ***now*** *that delivers the short- medium- and long-term support that people need to make the most of our economy and contribute the most to it.*

Addressing the squeeze and ensuring growth is more inclusive is important to businesses

Businesses appreciate that times have been extremely tough – and they know there are many thorny long-term structural challenges we need to address. Tackling these issues is good for business as much as for individuals – firms across the UK stand ready to help make a difference and create a more sustainable, stronger society.

Firstly, ensuring the squeeze on earnings ends as fast as is possible would have some immediate benefits. Workers are also consumers. Helping more of the unemployed into work – and boosting low earners' pay potential sustainably – can therefore help boost growth by raising demand for UK firms' products and services. This will only be possible if earnings growth is built on solid economic ground.

0.5pp

An increase in the Gini coefficient of five points decreases growth on average by 0.5 percentage points

More widely, businesses and society don't operate in isolation, their fortunes depend on one another. Cohesive societies – where everyone has the opportunity to achieve their best – help create stable political and regulatory environments in which firms can do business. This can create a virtuous cycle, with society supporting business success and thriving businesses in turn being good for society – creating jobs, delivering pay rises and paying the country's way globally. Making the most of the potential of the British people is good for companies, and good for people's incomes.

So, secondly, addressing the longer-term structural challenges we set out in our first chapter that are putting a brake on living standards can make a real difference to businesses too. Finding smarter, more productive ways of doing things and raising skills across the workforce will give firms that extra edge and help drive growth.

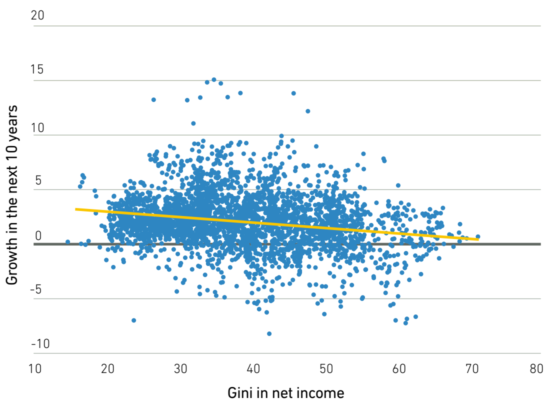
Thirdly, with an ever-rising retired population, we simply cannot afford not to make the most of our existing workforce. In 2012 there were 3.55 people aged 19-64 for each older person in the UK in 2012, a figure that will fall to 2.51 by 2030.[25]

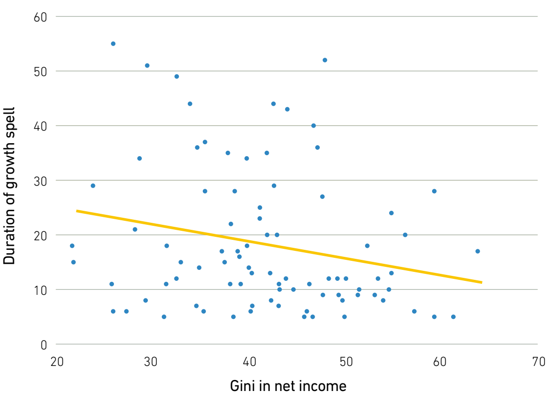
Finally, if we get this right and get better at making the most of all of our people, we will also avoid some of the negative economic costs associated with less inclusive societies. The cost of unemployment, for example, will fall. And by this we mean not just the direct cost of extra welfare spend, but also some of the more indirect costs, like the scarring effects that unemployment early on in working life has on the future prospects of young people.[26]

Failure to tackle these issues can cause economic damage

There is a substantial prize if we crack this – the promise of stronger and more sustainable growth which itself means stronger firms and more opportunities for individuals to improve their living standards. Evidence is building, from the IMF and others, that societies where more people share in prosperity tend to have higher GDP growth per capita and experience longer spells of growth than less inclusive economies (Exhibits 7 and 8).

Exhibits 7 and 8: Societies that start off more equal tend to have higher future growth rates – and they also tend to grow for longer[27]





Source: Reproduced from Ostry, JD. Berg, A. & Tsangarides, CG. *Redistribution, inequality and growth, IMF staff discussion note*, 2014

The IMF has found this using the Gini coefficient which measures inequality within a country on a scale from 0-100. A Gini of 0 means incomes are equally distributed across the population, while a Gini of 100 means all income goes to one person only. Their estimates suggest that an increase in the Gini coefficient of five points, for example from 37 (the inequality level of the US in 2005) to 42 (the inequality level of Gabon in the same year) decreases growth on average by 0.5 percentage points per year. They also find that a one Gini point increase in income differences is associated with a six percentage point higher risk that a growth spell will end the next year.

The study concludes that too uneven a spread of the value generated by an economy is bad for growth, but that the effect is even higher among OECD countries such as the UK.[28] This adds to the economic imperative to ensure everyone benefits from future growth.

Standard & Poor's, the credit rating agency, has also recently expressed similar concerns stating that income inequality can hamper growth, citing the US as an example.[29] After downgrading the US growth forecast they warned that higher-levels of income inequality can dampen social mobility and produce a less-educated workforce that will struggle to compete in a changing global economy.

But redistribution is not the answer...

It is important to note that traditional 'answers' to the question of inequality are not likely to be effective. Our welfare system is important in helping many people make their first steps in work. But more benefit transfers or higher taxes at the top are unlikely to solve the issue. As work by the IMF shows, political efforts to achieve a lower level of inequality can only go so far. In countries with an already high level of redistribution, like the UK, further redistributive efforts can actually increase the probability of a growth spell ending.[30] Instead the goal must be creating a society where growth has the potential to benefit all through a concerted effort to create more opportunities for people to increase their earnings and by growing the economy. Put simply, getting more people into better paying, more skilled roles through improving productivity and skill levels creates a virtuous cycle for people and companies.

...and neither is attacking our flexible labour market

Getting to a world of more opportunity and higher pay growth will be difficult and it won't happen overnight. That doesn't mean we should succumb to quick fixes, like more regulation or higher minimum wages, which help some immediately at the expense of others – but ultimately make it more difficult for firms to create opportunity (Exhibit 9). It means business needs to work together and with government to find solutions that can make a difference now and work for the longer-term.

In the aftermath of the economic crisis, calls to restrict the UK's flexible labour market have multiplied, be it concern over zero-hour contracts or the fact that the number of people who are working part-time but would rather work full-time has risen. Flexibility has become the scapegoat, when in fact it has helped firms in the UK create a record number of jobs, above inflation pay rises in the decades before the recession and, in recent years, kept people in work, protecting them from unemployment. Regulating a labour market that works isn't the answer hard-pressed families need. Instead, we should be supporting them to do better in it.

"Flexibility should be the foundation for a UK where growth benefits all."

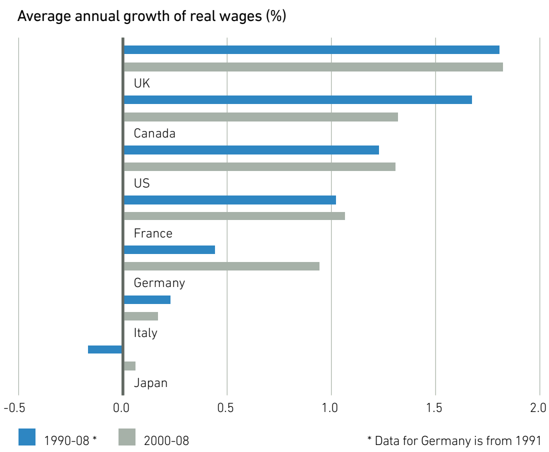
Exhibit 9: Politicising the Low Pay Commission and a higher minimum wage would do more harm than good

Some of the solutions proposed to tackle low pay include raising the National Minimum Wage (NMW) without regard to affordability, or even a move to so-called living wages. Indeed, the Labour Party has said that, it would increase the NMW to £8 per hour by the end of the next parliament.

Of course tackling low pay is important, but the dangers involved in setting NMWs politically are huge. The Low Pay Commission (LPC) already recommends NMW rates which set the wages of the lowest paid at the highest possible level without increasing unemployment. Introducing an inflexible target would cripple the ability to make this important independent evidence-based judgement. Uncertainty in predicting economic growth and wages mean that a target could be either too high or too low – both outcomes that would hurt the lowest paid, as set too high it would cost jobs and set too low it could have helped lift the wages of the poorest further.

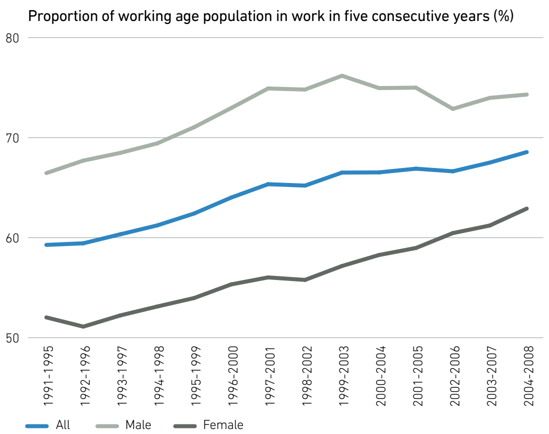
Flexibility has underpinned Britain's competitiveness as a place to create jobs for several decades, and has a strong record on improving living standards too. Pay has risen faster than the cost of living throughout most of the last 50 years – and between 1990 and 2008 pay grew faster in the UK than in any other advanced economy (Exhibit 10). Britain also has a strong record on creating jobs, with its employment rate before the crisis catching and then overtaking the US. The employment rate is now 73% across the UK, and is over 70% in three quarters of the UK's 12 regions, while the proportion of workers employed for five years in a row has also been rising (Exhibit 11).

Exhibit 10: Real wages have risen faster in the UK than in other advanced economies



Source: CBI analysis of OECD

Exhibit 11: Over time the share of people that stayed in work for five years has risen



Source: Analysis by Dr Abigail McKnight (LSE) of BHPS data, 1991-2008

Firms are clear flexibility has helped them do this. More than nine in every ten respondents (97%) to the *2013 CBI/Accenture Employment trends survey* stated the UK's flexible workforce is either vital or important to their competitiveness, including prospects for business investment and jobs growth.[31]

And during the crisis, flexibility allowed firms to keep people in work. Shorter working hours and lower pay in some firms was a painful experience. But unemployment peaked at 2.7 million, much lower than the three million or more that many predicted. This was substantially below the job losses we could have seen had this recession followed the pattern of the 1980s.

In terms of long-term pay and jobs growth, and short-term adaptation to a challenging environment, our flexible labour market works. Flexibility should therefore be the foundation for a UK where growth benefits all, and tacking away from it would make efforts to tackle the issues we face less likely to be successful. Even so, flexibility will not, on its own, be enough to meet the challenge. It is necessary, but by no means sufficient, to meeting the challenge we face.

The right answer is a programme of immediate action with short-, medium- and long-term pay-offs

Living standards have fallen for over six years and we need to do more to ensure growth benefits all. We need to move on from short-term approaches to longer-term strategies that will really address the challenges people face.

This report sets out business' plan for how we can do just that. It seeks to **both** alleviate the short-term squeeze **and** tackle the more persistent long-term issues which have put a brake on rising living standards and growth.

Because making a difference to longer-term issues will take time we need to make progress on all of the fronts we outline now, rather than later. Together, the actions we propose will help the UK move towards a stronger and more sustainable society, a society where growth can make a difference to everyone.

It's time to move on from debating solutions to doing things that can make a real and positive difference.

Firstly, we need to take **immediate action to reduce the burden on those on low incomes and working families**. These are things that can be done now – on tax and childcare – that will help, without throwing the recovery off course.

Then we need to put in place a plan to raise pay on a sustainable basis – this can only be done by **improving the UK's productivity performance**. This will boost growth and help ensure there is more scope for pay rises – and it is an area where business has to be in the lead. We can foster a better national debate, and support firms and sectors to do more.

Ensuring people are equipped to progress in their careers through creating **more and better ladders into higher-skilled work** is also vital. This should include building a better understanding of the skills needs of the UK, better practice within companies on career paths and a focus on both retraining for adult workers and apprenticeships.

A greater focus on making more of our talents by **addressing the performance of our schools system** to end the drag on living standards intergenerational inequality presents. Too little progress has been made since the publication of the CBI's report *First steps* in 2012 – it is time now to step up.

Finally, **we need to develop ways for people to build financial resilience** for when they fall on hard times. If people have the resources to cope with a rainy day, they will be less vulnerable to drifting into unsustainable debt, and the negative impact that has on people's living standards.

IMMEDIATE STEPS

IMMEDIATE STEPS TO HELP THOSE ON LOW INCOMES AND WORKING FAMILIES WILL HELP EASE THE SQUEEZE

CHAPTER 3

Immediate steps to help those on low incomes and working families will help ease the squeeze

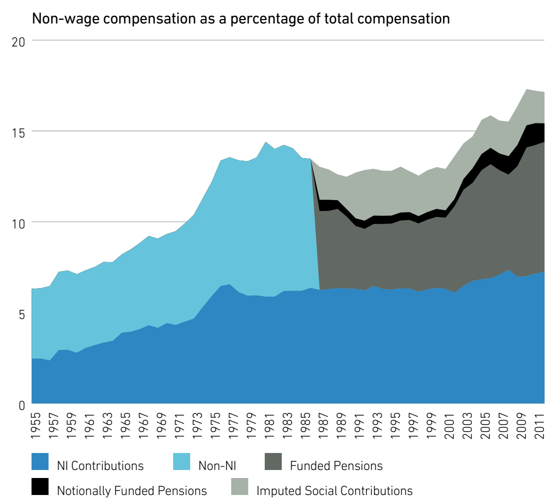
Most of the solutions to ensuring that we can grow the economy and ensure people see the benefits of it in jobs and pay are long-term in nature, and we turn to them later. But there are things we can do now that will help. We can address the fact that people don't see enough of what companies pay to employ them, and we can address the massive drag on families' incomes that childcare represents. There are also some key steps that businesses can take to help support families.

Employees – and low earners in particular – must see more of what business spends on them

Businesses are spending the same share of their income on employing staff as they did over half a decade ago. The share of company income taken by workers is remarkably stable. But an increasing share of this money is failing to end up in the pockets of employees. Action to address this now could make a critical difference in easing the pressures on working households.

The share of business income that is being spent on employees today – through wages, pension payments and National Insurance Contributions (NICs) – remains just above its long-term average of 72.7%. Yet the make-up of this share has dramatically changed over time (Exhibit 12). More of the money businesses spend on employing staff is now going to the Exchequer (via higher NICs) or ending up with former employees via defined benefit (DB) pensions.[32] As well as National Insurance now being the biggest business tax, rising NICs also represent a substantial share of employee incomes.

Exhibit 12: Pensions and taxes have risen as a proportion of the cost of employing workers



Source: Analysis by Oxford Economics of System of National Accounts data

Policymakers need to address this. While the Conservatives and Liberal Democrats have committed themselves to rises in the point at which employees start paying income tax – which would be helpful – our priority is National Insurance. Raising the threshold at which NICs are paid for employees would help put more money into people's pockets, especially low earners, who would benefit more from such a move than by further rises in the personal income tax allowance for example.[33]

For lower earners, raising the NICs threshold would increase the amount of disposable income they have available to meet household bills and other living costs – such as childcare, a key cost burden for families, which we discuss later. On the employer side, payroll taxes present an extra cost on employment, so the higher these costs are, the greater the disincentive for hiring people and raising their pay.[34]

Some progress has been made

The government has already implemented a number of small reforms to NICs over the course of this parliament. These have included the announcement of an Employment Allowance worth £2,000 for every employer on their NICs bill from April 2014 and an exemption from employer NICs for workers aged 21 and under is soon to be introduced. The CBI has welcomed these measures as a way to address youth unemployment, and targeted NIC cuts are useful for smaller businesses who face tight budgets, but they are small steps. A more ambitious plan is needed.

A cut in employee NICs would give immediate help to those on the lowest incomes

It is now time for government to go further – particularly when it comes to employee NICs. That is why we call on the next government to introduce a 'roadmap' setting out further reductions in NICs for employees. This is an important step in relieving the squeeze as it will help boost the incomes of low-paid working people, who have been among the hardest hit by the crisis.

We recommend the government raise the threshold for employee NICs in a series of steps to £10,500, the planned level of the income tax personal allowance in 2015/16. This would be above and beyond the current government policy of uprating the threshold in line with inflation.

We estimate that a staged introduction up to 2020/21 would benefit workers to the tune of £560 million per year, costing the Exchequer a total of £4.1 billion in the short-term, falling to £2.9 billion over the six years. A breakdown of these costings is illustrated in Exhibit 13 (page 26).

And while any reduction in taxes affects the Exchequer, we believe a higher NIC starting threshold for employees would be partly offset by higher income from increased consumption. Indeed our modelling suggests that a cut in NICs worth £4.1 billion can be expected to result in £1.4 billion of additional economic activity, boosting tax receipts by £550 million over the six years. Higher after-tax incomes will also reduce forecast spending on Universal Credit by £690 million over the same period. As a result our proposed £4.1 billion cut has a more modest cost of £2.9 billion to the public finances after accounting for economic growth as a result of increased consumption.[35] In addition to this the government could also consider the case for abolishing the arbitrary age cap (currently employees aged over 65 do not pay NICs) – this is a quirk in the current system and addressing it could help raise between £500m and £1bn in the next financial year towards funding the cut we propose.[36]

£363

Raising the employee NICs threshold would leave extra money in family budgets each year

Raising the threshold for employee NICs would put about an extra £363 per year in a working family's budget if both parents are in employment.[37] And it disproportionately benefits low-paid workers. Those earning the minimum wage would see their net income increase by 1.3%.[38] At a time when household budgets are under intense pressure, this would bring some much needed relief to those in work. It would also send a message about the value of employment.

Exhibit 13: Estimated cost and benefit of a NICs reduction roadmap[39]

YEAR	1	2	3	4	5	6
Tax reduction for dual earner household	£71	£143	£214	£285	£352	£363
Cumulative cost to implement	£560m	£1.13bn	£1.69bn	£2.26bn	£2.82bn	£2.88bn

Source: CBI calculation of costs and benefits and analyses of OBR forecasts

...and we shouldn't let employer NICs fall behind over time

In this report, we call for a rise in the NICs threshold for employees to deliver more money into workers' pockets. But over time, we also need to bear in mind the effect of employer NICs too, as it is a tax on jobs. It cost UK employers £61.7 billion in 2013/14, which combined with employees' contributions raised £106.6 billion that year for the government. This was up from £60.2 billion and £104.2 billion respectively in 2012/13.[40] Rising NICs have led to them being one of the largest sources of government revenue. Immediate action on employee NICs will help address the squeeze in incomes – while action over the longer-term on employer NICs will give employers greater scope for job creation and pay rises.

And there is solid international evidence that reducing employer NICs can lead to these benefits. The 'New Jobs Tax Credit', a reduction in the US equivalent of employer NICs, introduced in the late 1970s, for example enabled firms aware of the policy to hire 3% more workers.[41] While in northern Finland a similar scheme led to higher employment growth in the regions it was implemented in of 6% and faster wage rises of 8.7%.[42]

Action to tackle the burden of childcare costs on families is long overdue

Reducing the amount employees spend on NICs is one way to tackle the squeeze on living standards. But we must also do more to address the costs faced by the hardest hit families. The major – and fast rising – additional cost facing low and middle income families is childcare. And it is not only squeezing incomes, but also holding the UK back from making the most of its talent which could have serious knock-on effects on growth. Childcare matters because addressing its cost will help reduce burdens on families in the short-term, as well as boost incomes in the longer-term as mothers in particular face a lower wage impact because fewer of them will spend periods away from the labour market or 'trade down' in the type of job they do. This will also have a positive tax impact for the government, of course. Finally, access to structured childcare settings helps close the early gap in attainment between children of different socio-economic backgrounds.

£110

Sending a child under two to nursery for 25 hours a week costs, on average, £110 a week

> *I would like my employees to see more of what I spend on them. Raising the National Insurance threshold for workers is a sensible first step that will provide immediate relief. Raising the threshold for employers in the medium-term would also help, freeing up cash to invest in training or the reward package and stimulating employment.*

David Frankish, Chief Executive, NFT Distribution and CBI Councillor in the East Midlands

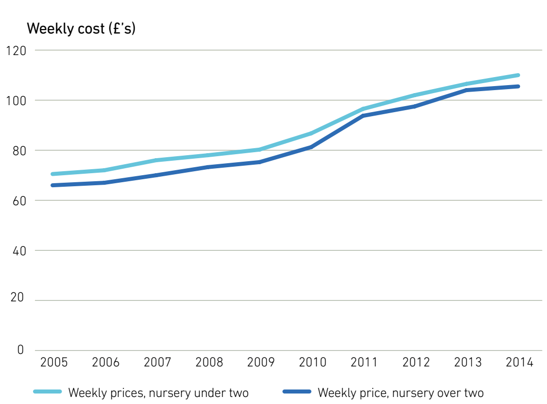
To date, successive governments' well-intentioned actions on childcare mean we have ended up with a complex system that wastes valuable financial resources. The best way forward from this is the gradual introduction of a more streamlined and universal childcare system for young children, over time as the Budget allows. This is not just about spending more, it is also about spending existing budgets more wisely. Here, we set out a close to fiscally neutral first step that government could take straight away, but we should aspire to creating a much more comprehensive system over time.

Such an ambition from business should come as no surprise. At the moment it makes no sense in many families for both parents to work because the cost of childcare is simply too great. More than that, as our 2012 report, *First steps*, showed, access to structured childcare for children from the most deprived backgrounds is by far the best way to ensure these children do not fall behind before they go to school. We acknowledge that this is a significant commitment, but public policy should prioritise the group that is hardest hit and on whom our current and future growth depend – working families. Childcare is the area to do this.

Rising childcare costs are creating a trade-off between work and care...

The cost of childcare in the UK is high and rising fast. The cost of sending a child under two to nursery part-time (for 25 hours) is now on average £110 a week (£5,710 a year), an increase of 27% since 2010. For a child over two, the cost is slightly less at an average £106 a week (£5,487 a year), but this still represents an increase of 31% over the same period (Exhibit 14).[43] Having one child in nursery part-time therefore represents nearly a quarter (24%) of average weekly earnings in the UK, with this 27% rise in costs coming against a background of very low wage rises.[44]

Exhibit 14: The average cost of childcare has rocketed in recent years

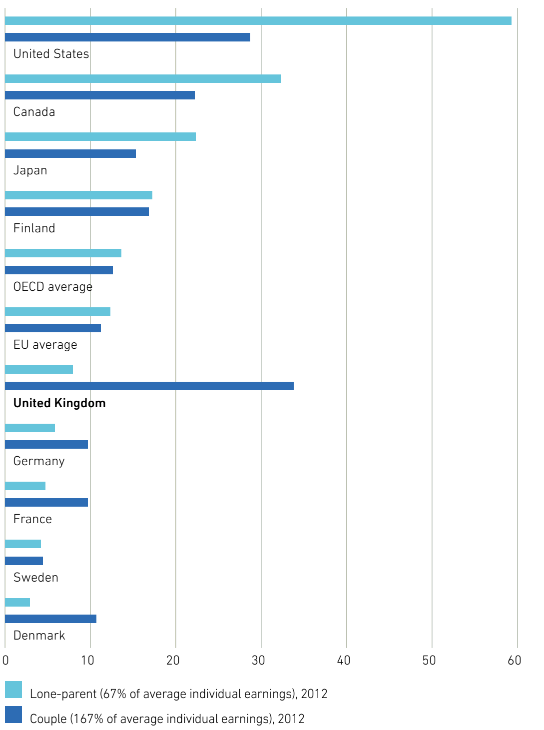


Source: Family and Childcare Trust, *Annual Childcare Costs Survey, 2005-2014*

...especially for middle-income earners who particularly feel the pinch

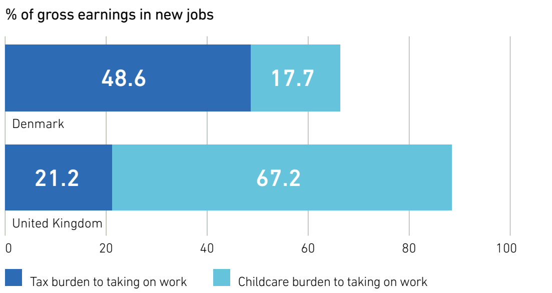
While the cost of childcare is generally high in the UK, the cost to parents varies according to the make-up of the household with middle-income families the hardest pressed. For low-income lone parents (a single parent working full-time for less than two-thirds of the average wage) about 8% of their net income goes on childcare. This proportion significantly increases to over a third (33.8%) for a working couple where one earns average earnings and the other earns two-thirds of average earnings – combined earnings of 167% of the average individual UK wage.[45] Internationally, this puts the UK highest among comparator OECD nations for childcare costs for middle-income working families (Exhibit 15).

Exhibit 15: Dual-earner families in the UK spend a much higher share of their income on childcare than their counterparts internationally



Source: OECD, Family Database, data from 2012

Exhibit 16: The burden to work for families in the UK is substantially higher than in Denmark



Source: OECD, Family Database, data from 2012

To put it more starkly, both the UK and Denmark – which has universal childcare for children aged between six months to ten years old – spend a lot on childcare, about 1.1% of GDP in the UK and 1.3% of GDP in Denmark.[46] But for Danish families, childcare costs only take up 11% of household income for a working couple where it is assumed that one earns average earnings and the other 67% of average earnings, compared to the 33.8% we pay in the UK. This is because Denmark devotes a much greater proportion of the money their government spends on parental leave and childcare services rather than cash benefits. In the UK much more is spent on cash benefits, but childcare is too often low-quality and expensive.

Taken together, the tax and childcare cost burden middle-earning UK families face when one parent returns to work is higher than in Denmark, one of the countries with the highest tax rates in the EU (Exhibit 16).[47]

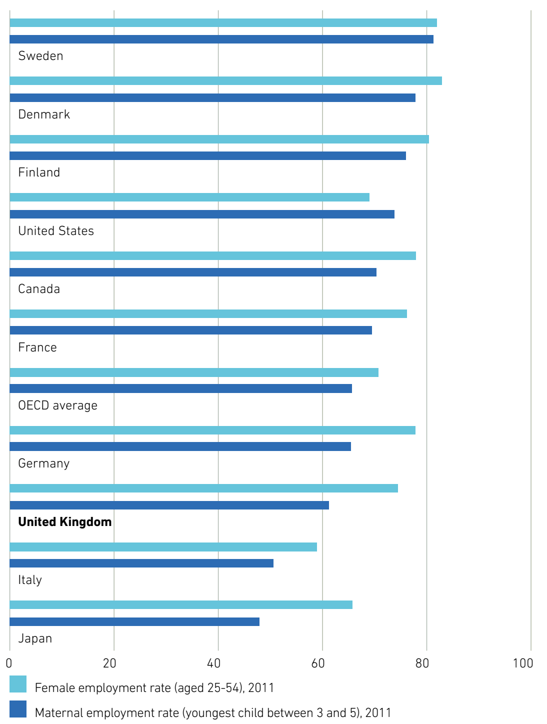
Addressing this will help us make the most of our talent

The lack of affordable childcare means we are simply not making the most of all of our talent, which, as we highlighted in Chapter 2, is crucial for the sustainable growth of our economy. Research has shown that 43% of parents of children aged between three and four who would like to work or work longer hours cite the affordability of childcare as a barrier, rising to half among parents with a youngest child aged two or under.[48]

Helping more mothers into work could also help close the 'maternity gap' with our key competitors. The employment rate for mothers with their youngest child aged three to five years old stands at 61% in the UK, below the OECD average of 66% and well below Denmark's maternal employment rate of 78% (Exhibit 17).[49]

Tackling the cost of childcare is therefore not just going to provide a much needed boost for working families' incomes, it will also help more parents get back into work, take on more hours or switch to full-time employment. This in turn will boost pay and reduce our welfare spend. The IPPR estimates that if 300,000 more women with children under the age of five worked full-time that it would raise almost £1.5 billion in extra tax revenue and save on spending on benefits and tax credits.[50] This is without even taking account of the long-term positive impacts good-quality early years childcare can have on children's outcomes in life, especially on closing gaps between the performance of children from low and high income backgrounds. This will help children from lower income backgrounds achieve higher pay when they embark on their careers as we set out later in this report.

Exhibit 17: The UK's 'maternity gap' is larger than in our key competitors



Source: OECD, Family Database

> *Addressing the cost of childcare is the right thing to do, but the right way forward is not another scheme.*

We need a simple new approach to how government support is offered

The current provision of childcare support is complex and wastes resources. A new, simpler approach based on the CBI's call for a path towards universal childcare is necessary. This should start with extending the 15 hours of free provision available to three and four year olds and some two year olds to all one and two year olds. It also means closing the remaining gap between maternity pay and the time when free childcare becomes available through the extension of statutory maternity pay to 12 months. In time, a further extension to 25 hours for all one to four year olds should become possible, and further underpin the position of working families.

Successive governments have sought to address the rising cost of childcare. As a result, there are now a number of childcare incentives in place (Exhibit 18). And while action to provide extra support for childcare is welcome – including accepting the CBI's call for an early year's pupil premium – the continuous layering of different policies has now made it complex and costly for tax payers. In addition, there is currently no coherent evidence demonstrating the impact of established schemes.[51]

Addressing the cost of childcare is the right thing to do – but the right way forward is not another scheme. We need to be smarter with what we already have. Simplifying existing incentives into a more integrated solution should be the next government's priority.[52] Exhibit 19 sets out our plan for how to move towards a more universal system.

Exhibit 18: To their detriment, the current childcare incentives are too disparate

Early childhood education and care (ECEC): Since 2010, the government has rolled out 15 hours of free provision of early education for all three and four year olds, and 20% of two year olds. This was extended to around 40% of two year olds from lower income backgrounds from September 2014, at a cost of £2.2 billion annually.

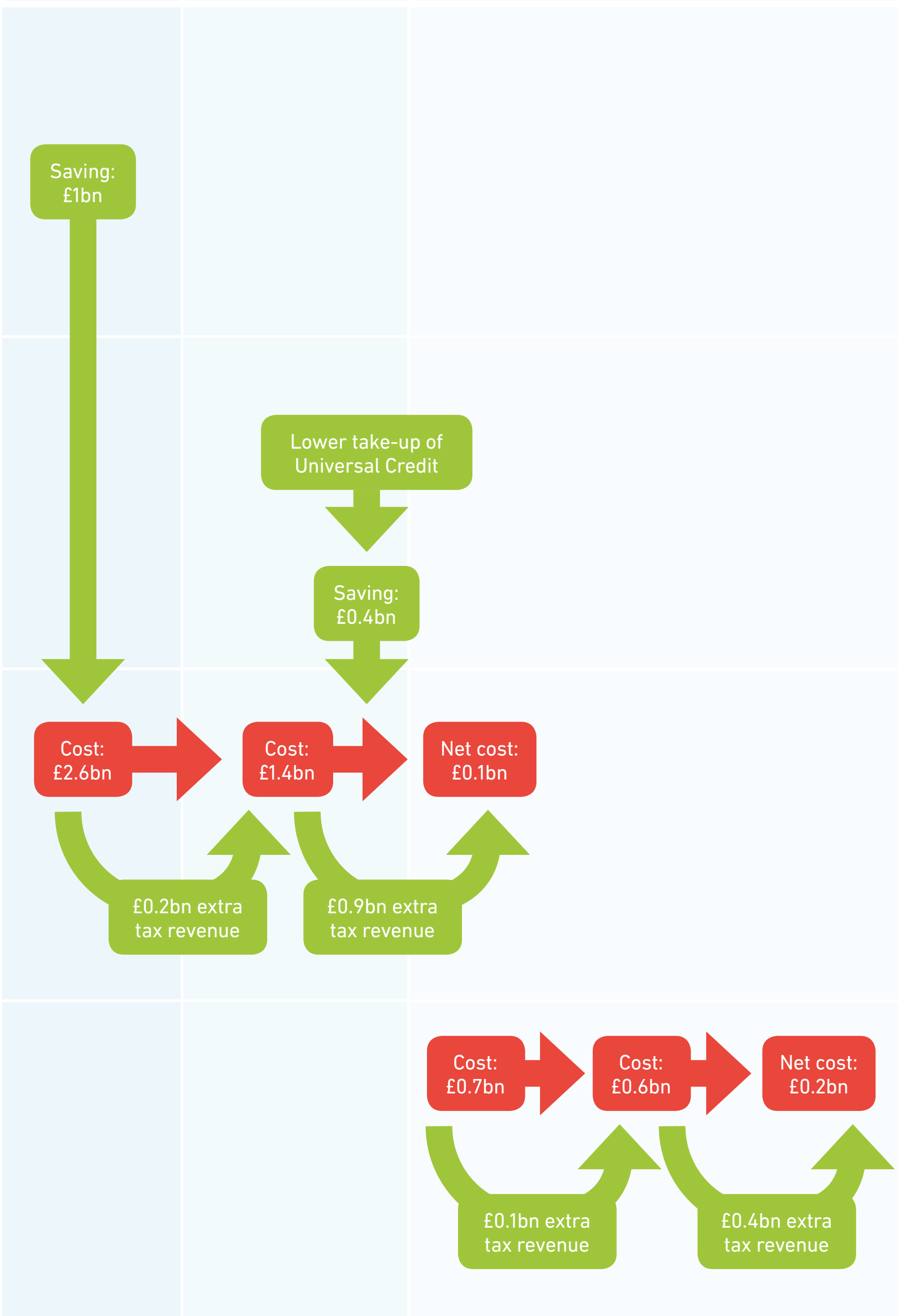
Employer-supported tax-free childcare: Eligible employees can sacrifice up to £2,915 of their gross salary in exchange for childcare vouchers on which no NICs or tax is paid. This scheme will be closed to new entrants from autumn 2015 and will be replaced by tax-free childcare.

Tax-free childcare: This system will replace government-provided tax relief on childcare vouchers offered by employers from autumn 2015. Originally, it was planned that parents would be able to claim up to 20% of childcare costs up to a cap of £6,000 per year, but Budget 2014 increased this cap to £10,000 per year – a maximum of £2,000. The scheme is estimated to cost £1.5 billion per year.

Universal Credit: From 2016, all families entitled to Universal Credit can claim back up to 85% of childcare costs for children up to 16 (or 19 if the child is living at home, taking a non-advanced course at school or college, or is taking part in approved training). This will taper off as income improves. It is claimable as soon as a person moves into work, up to a month before the job starts, and up to two months after a job finishes. HMRC costs the existing coverage (where both parents or a single parent pay income tax) at £1.2 billion per year.

Exhibit 19: Estimated cost of our childcare proposal[53]

Current support	CBI proposals	Short-term	Medium-term	Long-term
Employer supported tax-free childcare: scheme where a maximum of £2,915 can be salary sacrificed in exchange for tax-free childcare vouchers From 2015/16: Tax-free childcare – parents can claim back up to 20% of childcare costs up to a cap of £10,000	From 2015/16: Parents can claim back up to 20% of childcare costs up to a cap of £2,915			
Universal Credit: eligible parents will be able to claim up to 85% of childcare costs from 2015	Remains unchanged			
Early childhood education and care (ECEC): 15 hours of universal childcare for young children aged between three and four and 40% of two year olds from low income backgrounds	Extend ECEC coverage to all one and two year olds			
Statutory maternity pay (SMP): currently 39 weeks (first six weeks at 90% of salary)	Expand SMP from 39 weeks to 52 weeks			



Over half of parents with children under the age of two struggle to take up a job or work more hours because of childcare costs.

...starting with extending free provision to all one and two year olds

The first priority for getting towards a more universal system should be making the 15 hours of publicly-funded childcare currently available for three and four year olds and some two year olds to all one and two year olds. With over half of parents with children under the age of two struggling to take up a job or work more hours because of childcare costs this would be a substantial help.

Our proposal means extending the offer of the early childhood education and care incentive (ECEC) explained in Exhibit 18 (page 30). This would cost £2.6 billion in additional public spending in the short-term, falling to £1.4 billion in the medium-term (Exhibit 19, page 31).

However, the change could be close to fiscally neutral and funded through reallocation of resources pledged to future policy plans. Instead of the government's plans to raise the qualifying cap for the tax-free childcare scheme to 20% of childcare costs up to £10,000 (Exhibit 18, page 30), maintaining the current cap of £2,915 would generate a net saving of £1 billion, which can be used to extend the ECEC. Maintaining the cap at a lower level would still give families on average earnings and above enough help with wraparound care for children from the age of five up to the age of 12 through the tax-free childcare scheme.

And, critically, those most in need would still be able to qualify for the childcare element of Universal Credit for children up to the ages of 16 or 19. Yet we expect that making 15 hours of free care available to one and two year olds would lead to reduced demand and substantial savings in the Universal Credit scheme reducing its costs by around £0.4 billion. Together, this cost saving and maintaining the current cap in the tax-free childcare system could help make the change close to fiscally neutral.

The cost will also be partially offset by higher income tax and NICs receipts as more parents move into work or work more hours. In the short-term, since parents in part-time work will mostly be below the personal allowance thresholds, increased tax revenues will not be a significant help with funding the initial on-going cost of our proposed scheme. But in the medium-term, childcare that bridges the gap between maternity leave and the school age could have a more substantial impact on our economy's output, individual progression in work and therefore tax revenues as more parents return to full-time employment, which is why over a number of years the cost of the scheme would fall to £1.4 billion ('medium-term dynamic cost').

We estimate that the employment rate among women would increase by approximately 0.9% in the short run (one to two years) in England.[54] In the medium-term (five to ten years), the introduction of universal childcare for children between one and four years old could lead to cultural change, eventually resulting in an increase in the female employment rate of 2-6%. A 2% increase in the female employment rate would reduce the current gap between male and female employment rates from 10% (78% male, 68% female) to 8%.[55] For a family with a one year old child, the new free 15 hours of childcare would on average be worth £66 per week, accumulating to £3,432 per year.[56] However, care must be taken as the new offer is implemented to avoid negative effects on the childcare market (Exhibit 20).

Exhibit 20: Provoking the right response in the childcare market

Introducing a new approach to childcare such as a universal 15 hours has to be done with care, to ensure that the childcare market responds in the right way. Deliberately or by accident, the government must not open itself up to piling pressure on nurseries, nor making childcare more expensive due to increased demand. This will require careful management of the introduction of the new offer.

The risks that need to be managed are attested to by the creation of thousands of new places by the last government through Sure Start. In practice, the net benefit of this change was not as great as hoped, because many of these places replaced private provision that had been undercut. This must be avoided – it should be as easy to access private providers as the public sector with the new funding, and there should be an expectation that funding levels for the 15 hours, and charging above the cost of public sector provision, reflects the true cost of care. This will avoid the nationalisation of childcare, and ensure that there is an incentive for new places to be created.

…and closing the gap between free provision and the end of maternity pay over time

As the economic benefits of extended free provision to one and two year olds start kicking in and help to pay for the extension of the scheme, we can then go further. In time, this will mean finding the resources to take the next step – raising the allowance to 25 hours for all children between one and four.

But more immediately, closing the gap between the start of free provision and the end of maternity leave by extending SMP from 39 to 52 weeks to match maternity leave should be a key goal. This will support families to use their leave entitlement and provide a vital link with the new childcare system. OECD analysis of paid maternity leave suggests that a 13 week extension of SMP from 39 week to 52 weeks could increase the female employment rate by 0.6% in the medium-term again helping us make more of the talents we have.[57]

SMP is paid at 90% of the mother's salary for the first six weeks and the lesser of £138 or 90% of salary for the next 33 weeks (although most large employers' arrangements are more generous than this). An employee is therefore covered for nine months (39 weeks) by SMP and entitled to take another three months of unpaid leave.

Changing this and extending SMP from nine to 12 months would cost approximately £700 million. For a mother receiving the £138 SMP rate an extra 13 weeks of SMP would be worth £1,796. In this respect it is a more effective way to support women to keep in contact with the labour market and smooth their return to work than other measures. Extending free childcare to six month olds, for example, would cost £1.5 billion in comparison and put a significant additional strain on nurseries which are already finding it hard to adjust to providing extra places for the 40% of two years olds who are now qualifying for free care.[58] Together, the extension of free childcare to one and two year olds and the extension of SMP will help us move away from a situation where many women can't afford to return to work until their children are at least three years old.

…alongside efforts to raise the flexibility and quality of childcare places to ensure we help more children succeed

These proposals will help us aim higher. They will help improve the situation of many working families and help us make more of the UK's talent. But childcare can help us tackle other longer-term issues too. The quality of early years care has a significant impact on children's educational performance, which in turn determines many of their outcomes later in life. So as part of overhauling the current system to deliver our proposals we cannot ignore quality.

Recent coverage around the issues in meeting demand for high-quality childcare places resulting from the current government's plans to expand free childcare is concerning in this respect. If we struggle to deliver good quality childcare to the greater proportion of two year olds that now qualify for it, expanding it to the remaining two year olds and one year olds will be difficult.

That doesn't mean we should shy away from doing better. And the experience of Denmark suggests that as the new system embeds free childcare, rather than cash benefits, this might in itself help drive improvements in the quality of provision. But getting there required support from all Danish parties and long-term backing from both business organisations and trade unions. So if our ambitious plan is to work, future investment by this and the next government will be required as well as innovative solutions to ensure all children can be catered for in the new system.

This must also include a greater emphasis on flexibility. Fewer workers have nine to five jobs in today's labour market than in the past, but a nine to five approach still predominates in childcare. Nurseries are increasingly offering eight to six, but we need to see more provision of wraparound care in schools through breakfast and afterschool clubs. As we said in our report *Building on Progress: boosting diversity in our workplaces* the Department for Education should look at what more can be done to support schools setting up this provision. Our proposals deliberately maintain some funding for the tax-free childcare plan to ensure parents can access support for wraparound care.

In many cases the issue is now not whether flexibility is possible, but what the structural changes that will enable flexibility are.

There is more business can do to support working families

As we have already set out, forcing unaffordable pay rises on business could help some hard-squeezed working families but put others at greater danger of unemployment. Instead firms must work to boost productivity now, to help raise pay sustainably in coming years, an issue we look at in the next chapter. But that doesn't mean there aren't things business can do to make a difference immediately. Helping more families to work flexibly is one such thing.

More openness around expecting and welcoming flexible working proposals from staff from job advert onwards will help those with caring responsibilities to maintain contact with the labour market as well as help reduce nursery costs. Yet, despite some good initiatives, there is still a stigma attached to flexible working in too many workplaces.[59]

Barriers to flexible working include rigid job design, demand from other colleagues during 'regular' working hours, a presenteeism culture, and a lack of role models who undertake flexible working on a regular basis. Whilst not all of these can be wished away, there are workarounds that businesses can explore, like job sharing. In many cases the issue is now not whether flexibility is possible, but what the structural changes that will enable flexibility are. The onus should be on business to challenge outdated assumptions of traditional working patterns, as a benefit for both the firm and the employee.

RECOMMENDATIONS

For business:

- Challenge outdated assumptions around flexible working in firms and, where possible, adopt a presumption in favour of flexibility from job advert onwards, to help employees manage their work-life balance effectively, including childcare costs.

For government:

- Reduce National Insurance Contributions (NICs) for employees. Start with raising the threshold for employee NICs to £10,500, the level of the income tax personal allowance in 2015/16, in steps up to 2020/21.
- Close the gap between free provision of childcare and statutory maternity pay by offering 15 hours of free childcare to all children aged one and two and by extending statutory maternity pay from 39 to 52 weeks. Aim to further increase the number of hours of free childcare in time.

PRODUCTIVITY

WAGES CAN ONLY RISE WITH PRODUCTIVITY AND COMPETITIVENESS – THAT IS THE CHALLENGE FOR BUSINESS

Wages can only rise with productivity and competitiveness – that is the challenge for business

Immediate action to relieve the hardest-pressed families is necessary, but we should be looking to build a more sustainable answer to the living standards challenge. Real income changes will come with greater UK competitiveness, as we lift productivity in British firms based on innovation, investment and people development. This will help us work smarter – and add more value in each hour we work. Despite the fact that productivity defines how much companies can pay people, it has had little attention to date in the living standards debate. We need a better informed debate in government, to underpin long-term decision making. But we also need to acknowledge that productivity varies from sector to sector – so businesses themselves need to take more of a lead, helped by a simplified business support landscape.

Productivity and competitiveness define what firms can pay

Productivity – how much value each worker adds in every hour he or she works – is a key determinant of how rapidly the economy grows. Between 1998 and 2007, improvements in labour productivity accounted for almost three-quarters of the UK's economic growth.[60]

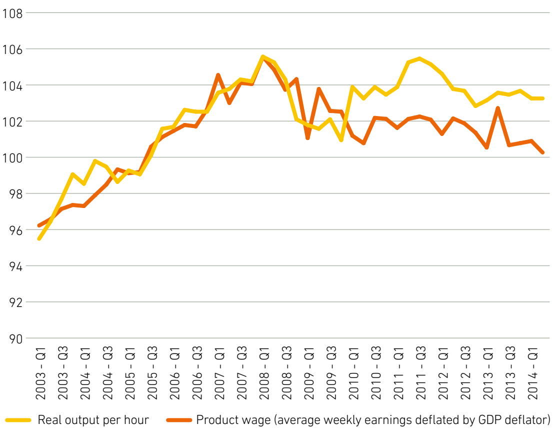
The pace at which labour productivity rises is therefore one of the most important drivers of improving living standards. As Nobel laureate economist Paul Krugman said, *"Productivity isn't everything, but in the long run it is almost everything."*[61]

But productivity improvements don't just improve living standards by helping to drive growth, they also determine what businesses can afford to pay staff. What businesses can spend on employing somebody is intrinsically linked to the value each employee adds in every hour he or she works, as we showed in *Making Britain work for everyone: facing up to the challenges in our labour market* (Exhibit 21). Higher productivity enables businesses to afford higher pay. This is the only way to secure long-term, sustainable wage growth in a sector.

This doesn't mean making people work harder to increase their pay. It's about finding new approaches that add more value or simplify things so that firms are more effective and their employees can work smarter and reap the financial rewards from it. Exhibit 29 (page 48), provides one example of this. It shows how by training bus drivers to drive more fuel-efficiently Arriva helped to increase their drivers' hourly value-added. And Exhibit 30 (page 49) shows how team working and joint problem solving 'The Unipart Way', combined with considerable training and development for managers, has helped Unipart deliver efficiencies worth millions of pounds, and enabled the firm's staff to get much more involved in solving customers' problems.

A focus on productivity does neither mean jobs have to be lost, nor necessitate a shift from a high employment UK to a lower employment – but more productive – nation. The best productivity improvement strategies result in wins for employees and companies alike, as firms can do more. That should be our focus.

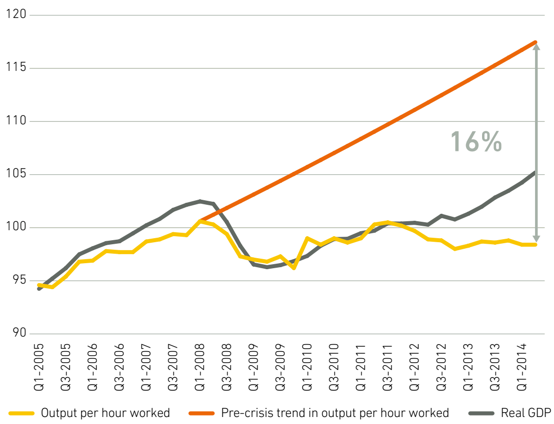
Exhibit 21: There is a strong link between the cost of employing workers and productivity (2005 = 100)



Source: CBI; ONS, Labour productivity, Quarterly National Accounts, Labour Market Statistics.

Note: We measure the value an employee adds through the price their firm can charge for it. We deflate wages on the basis of these prices, the GDP deflator.

Exhibit 22: UK productivity remains substantially below its pre-crisis trend (2011 = 100)



Source: CBI; ONS, Labour productivity, Quarterly National Accounts.

Note: Trend growth is defined as the average for 1998-2004, as per IMF methodology, discounting the three years running up to the crisis.

At first glance, the UK has scope to up its game…

As we highlighted in Chapters 1 and 2, the UK's productivity has fallen in recent years due to a number of factors. These include changes that are expected to have long-term impacts on productivity in key sectors like financial services (e.g. more regulation) and a wish by businesses and employees to preserve jobs at the expense of wages, in reaction to the crisis.

But this lower productivity is what lies behind slow wage growth in large part. It has been a major drag on the living standards of many people across the UK because it has curtailed the ability of firms to deliver pay rises. Alongside the fall in productivity in the years since the financial crisis, real pay – pay which takes account of inflation – has fallen. Output per hour worked is still 2.2% lower now than it was before the onset of the crisis. And productivity is a troubling 16% lower than it would have been had productivity continued to grow at the same pace as before the recession (Exhibit 22).[62] This is because, while the UK economy is producing just a little more now than it did before the crisis, more people are at work to produce it.

To achieve increasing prosperity in the years ahead we must move the UK – and the firms within it – back onto the path to higher productivity. Increasing firm productivity is crucial in unlocking better living standards – simply raising pay won't help. If the cost to a firm of employing someone grows faster than the value they add to the business – be that the number of widgets they produce or the added value customer service they deliver – their job could suddenly be at risk. That's why our plan for higher pay looks at boosting productivity across the UK through improving firm effectiveness and not higher pay minima, which would increase earnings for a few, raise unemployment and fail to tackle the underlying problem. Exhibit 23 (page 40) sets out the UK's productivity challenge in further detail.

Exhibit 23: The UK faces not just a productivity puzzle but a productivity challenge

Productivity in the UK has lagged behind other large developed economies, like the US, France or Germany. Over time we have made some progress in closing these gaps, but the recession has now thrown us even further behind. Why productivity hasn't recovered to where it was before the crisis is the greatest current puzzle in economics – and some believe it could have harmed our productivity long-term.

From the 1970s up to the 1990s UK productivity, alongside that of other European countries, started to catch-up with productivity in the US. However faster productivity growth in France and Germany meant that while we were catching up with the US the UK's productivity gap with the continent widened. Since the mid-1990s and up to the financial crisis the UK fared a bit better, when as in the US, labour productivity accelerated, a phenomenon that is widely put down to advances in information and communications technology.

However, since 2008 the UK has ceded this ground. Productivity growth has been exceptionally weak – output per hour is 16% lower than where it would have been had it grown at the same pace as during the years running up to the crisis. The difficulty in explaining this poor performance has been dubbed the 'productivity puzzle'. Some of this may be because the data were wrong. According to the Bank of England around a quarter of the shortfall to our pre-crisis trend is due to so called 'measurement errors' of official data, including changes to trend growth rates in some sectors. The recent detail set out by the ONS on revisions to GDP data suggests this could be the case.[63]

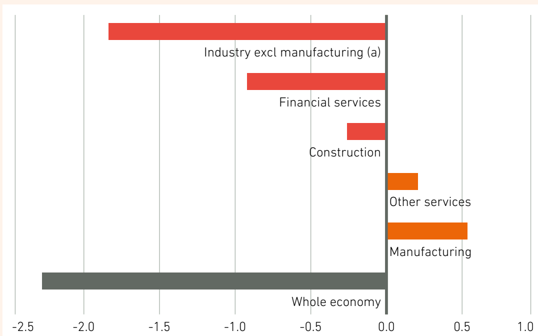
But even if we account for such mis-measurement, a sizeable gap is left. The Bank suggests that around half of this remaining gap can be explained by short-term (cyclical) and some longer-term (structural) factors. Short-term factors, which will dissipate in time, include the fact that firms kept people in jobs despite the downturn, facilitated by employees accepting low or no pay rises rather than losing their jobs.

Longer-term factors include concerns that lower pay has led firms to hiring more staff rather than making investments, which help drive long-term productivity growth.

They also include economic uncertainty and the fact that impaired access to finance during the crisis may have limited the potential for some firms to grow their business in the recovery. But even this still leaves around half of the shortfall in productivity unexplained.

Taking a sectoral approach to the problem, Ian McCafferty, for example, an external member of the Bank's Monetary Policy Committee and former CBI Chief Economic Adviser believes that 60% of the decline in productivity seen since 2008 is likely to be of a more lasting, structural nature.[64] If this is the case, we need a deeper and more meaningful economic debate about how to tackle it than we have yet had. And policies which attempt to raise wages without addressing it are deeply misguided.

Contribution to change in labour productivity between Q1 2008 and Q2 2014 (percentage points)



Source: ONS, Labour productivity

Note: (a) Includes agriculture, mining and quarrying (including offshore oil & gas) and utilities.

...but measuring productivity is complex, and it varies from sector to sector

One of the greatest challenges in raising the question of productivity and competitiveness at the UK macroeconomic level is that so much of what influences productivity performance happens at the microeconomic level, within firms and sectors. Unlike say, the unemployment figures, which offer a clear statement on the number of unemployed people each month, productivity data is much 'muddier' and more open to influence from all sorts of factors. For instance, the shifting sectoral make-up of the UK economy can change productivity data, and force us to delve deeper to understand international comparisons.

As we have already seen, some of the UK's current productivity gap with other nations can be explained by poor data measurement. This is something that businesses recognise – an old-fashioned time and motion approach to measuring productivity is not likely to be effective in capturing the real value employees add through their work, whatever the sector.

16%

Productivity growth has been weak since 2008 and is 16% behind the pre-crisis trend

This observation is a bit less true in a field like manufacturing, of course, where the value of the goods produced in each hour is easily measurable. But how do you measure the value-added of customer experience in retail or in hospitality? For instance, what is the value to a hotel of having a staffed gym versus one which is unmanned? A lot will depend on the job design, skills and approach of that staff member – but it is not easy to capture in the way that production data is for manufacturers. Nevertheless, progress can be made. The John Lewis Partnership, for example, improved the value-added and job design of their drivers by retraining them to fit kitchen appliances on delivery, after the installation of comprehensive route planning software meant their drivers' job became more automated.[65]

At the macroeconomic level, government needs a deeper understanding of the issues – this can be delivered by the OBR

While real progress on productivity on the ground has to be made by businesses themselves, what government can do at the macroeconomic level is acknowledge the challenge and deliver policy that helps to boost firm effectiveness. This ranges from ensuring minimum wage rises are linked to the ability of firms to pay, to seeking to ensure policy encourages the kind of investment and innovation that boost productivity, and the removal of government-inspired barriers. To do this well, government itself needs better data and understanding of the realities of productivity in the modern British economy.

Better and more nuanced data on productivity will not only help achieve a more rounded discussion in politics of how we can raise pay (as pay and productivity are linked). It will also help government understand which of the levers it has will make a real difference. This is not a political challenge – a social partnership approach is not what we need – it's one about helping with cold, hard facts on productivity trends, challenges and sectoral patterns to raise understanding and build consensus.

The Bank of England is already doing good work on this – but we believe that more can be done. The work done by the Australian Productivity Commission on a technocratic basis in putting productivity front and centre of government thinking, highlighting data and sectoral trends, and in working with business to help remove government-inspired barriers to competitiveness is instructive (Exhibit 24, page 42). We need a similar home for this debate in the UK.

Such a job would best be undertaken by the Office for Budget Responsibility (OBR). Its terms of reference[66] already make it responsible for both fiscal and economic forecasts. Productivity and competitiveness play a crucial role in driving our ability to lift real pay over time – which is itself a driver of higher tax takes, and so a smaller deficit. The Treasury should thus seek additional support from the OBR on the productivity question. It's important that the OBR works closely with a group of business leaders to ensure its work on productivity is well grounded – and to get a sense-check from business when it comes to identifying and removing government-inspired barriers to firm competitiveness. Over the longer-term such a collaboration will help produce better public policy on competitiveness.

The Productivity Commission is an invaluable independent institution and a real asset to public policy development and reform in Australia, which is widely respected on a bipartisan basis.

Scott Barklamb, Executive Director of Policy and Public Affairs, Australian Mines and Metals Association AMMA

Exhibit 24: Australia's Productivity Commission – supporting a national debate

Australia's Productivity Commission (PC) was established as an independent authority in 1998 to provide the government with research and policy advice on a host of economic, social and environmental issues affecting the welfare of Australians. The PC does not manage any government programmes. Nor does it have any formal powers. While it rightly recognises that businesses and workers are responsible for driving productivity improvements, its work proceeds from the reality that government policies and the regulatory environment can have an important influence on employers' and employees' decisions.

One of the Commission's primary functions is therefore to carry out public inquiries on key policy or regulatory issues, like childcare or public infrastructure. In addition to this role the PC increasingly performs a more general research function. Examples of these include reports on issues like geographic labour mobility or regulatory engagement with small business, the kinds of issues that can have an economy-wide impact on productivity, but may fall 'between the cracks' of government departments. In both cases, the PC provides Australian businesses with a valuable opportunity to highlight some of the competitiveness challenges they encounter and argue their case for reform.

Alongside this the PC reports annually on industry and productivity performance generally, including the performance of government services. The annual '*Productivity Update*', for example, details trends across all major market sectors, with in-depth reviews of the drivers of productivity developments in specific industries. Comparable research in the UK is produced on a more sporadic basis and is not nearly as comprehensive, particularly at industry level. These information gaps must be filled if policymakers and business leaders are to build a solid foundation for improved productivity and hence for sustainable real wage growth.

Australian employers are very positive about the PC and believe on balance it has performed an important role providing expert analysis to the government on questions of microeconomic reform.

Progress on productivity on the ground must be made by businesses themselves

While a better understanding of the challenges we face at a macroeconomic level will help, the real progress on productivity and competitiveness has to be made inside businesses. In doing this, there are lessons we can learn from the UK's industrial strategy.

The industrial strategy is designed to create a forum for business leadership, enabled by government policy, in key sectors which will drive exports and growth in high-skill jobs in the UK. It is right, of course, that the scope of industrial strategy does not extend beyond this – we don't need every sector to be covered, as the value of the strategy itself would be lessened.

Nevertheless, some of the lessons of business leadership and co-ordinated action we look at in this chapter can be carried across from industrial strategy into the other, more domestically-focused sectors. There is real value in a sectoral discussion on what productivity is for a sector, how to enhance that value-add, and what business and government action is needed. After all, many of these sectors – like retail, care and hospitality – employ many people and are vital parts of our economy and society. They provide great jobs and routes into work. Innovation, investment and people development are just as important for firms in these sectors as in our export champions.

Such initiatives have happened in the past. The North-East Productivity Alliance, which grew out of Nissan at Sunderland working with the old Regional Development Agency, helped firms in manufacturing – and, later, in other sectors too – make real changes that improved productivity, for example through support in improving management practices.[67]

We can do this again – and public money or government action does not need to be the driver. We need to look to business leadership. A prescriptive or standardised approach to adopting best practice is unlikely to work. We need company- and sector-specific solutions. There are multiple ways of doing this – at local level, like in the north-east of England; within a sector, such as hospitality; or down a supply chain in areas like basic manufacturing. It is not for government to occupy the front rank in this process. It must be business-led. A central strategy for raising productivity in the hospitality sector, for instance, would struggle for traction.

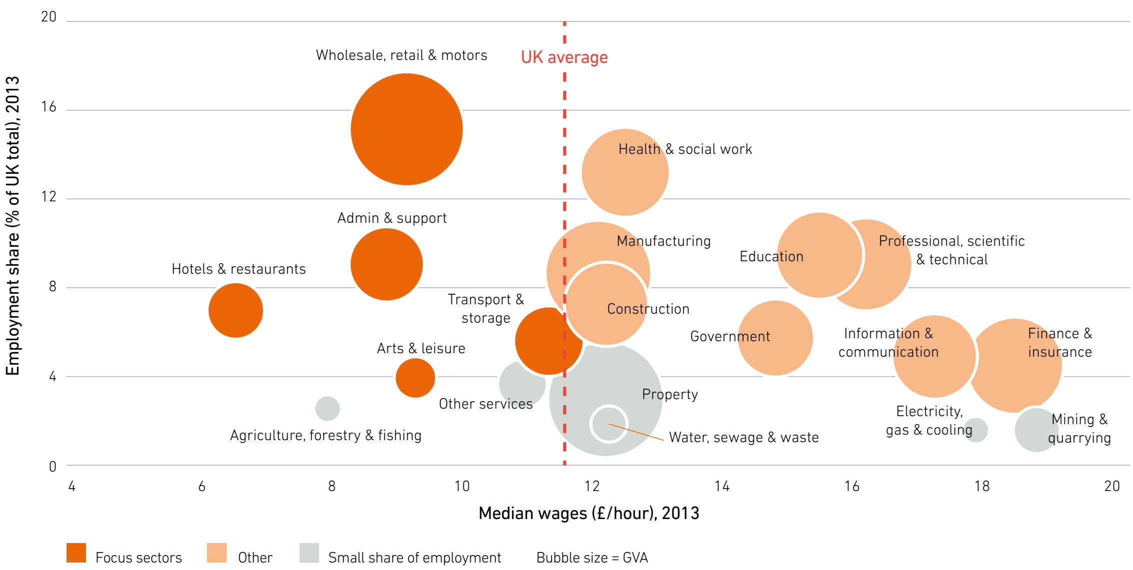
We need to see more businesses taking the lead – working on their own or together in supply chains, local areas and sectors to raise productivity through a focus on key areas like management skills, job design, innovation and investment. Sector bodies have a key role to play here too, supporting firms in this endeavour.

Progress could make a real difference in some key sectors

There are a few sectors in the UK which employ a large number of people but are characterised by lower than average labour productivity, largely because of their labour intensity. There is much to gain in focusing on the added value employees in these sectors could create for their employers as a way of boosting company performance and therefore wages.

Taken together, sectors spanning accommodation and food services; the wholesale and retail trade; admin and support; arts and entertainment; and transport and storage employ 30% of people in the UK and just over 60% of those on lower earnings (Exhibit 25, page 44).[68] It is important to note, however, that there is a wide range of practice within these sectors – larger retailers, for instance, tend to pay more and have more generous wider reward packages than the smaller firms that make up the majority of businesses in the sector. We need to acknowledge this subtlety in our thinking.

Exhibit 25: A small number of sectors employ a large number of people at entry level



Source: ONS, Annual Survey of Hours and Earnings, Quarterly National Accounts, Labour Market Statistics.

Note: The focus sectors: productivity below UK average, wages below UK median. These sectors employ at least 0.5 million people.

Because of their labour intensive nature, these sectors also have relatively low average productivity levels and lower rates of productivity growth (Exhibit 26). Between 1997 and mid-2014, sectors in which the median wage was either at or below the UK average accounted for only 25% of overall growth in labour productivity.[69]

Benchmarking these lower productivity sectors internationally shows that higher productivity performance is at least theoretically possible, and if delivered this would improve firm effectiveness giving businesses the ability to improve pay. Four of the five sectors described above – retail and wholesale; transport and storage; admin and support; and arts and leisure – account for almost one-third of the UK's productivity gap with the US.[70] While international comparisons on productivity are difficult, there is clearly some scope for progress.[71]

Raising our productivity to the current level of the US could be worth £144 billion

There is a substantial prize if we get this right. We estimate that if we achieved the same levels of productivity as the US does at the moment in these four sectors we may be able to boost GDP by 9% or £144 billion.

More importantly, for the individuals working in these sectors, that could translate into a real annual increase in earnings of 2.4% per year if productivity is raised to current US levels over the next decade.[72]

Investment and innovation are the places to start...

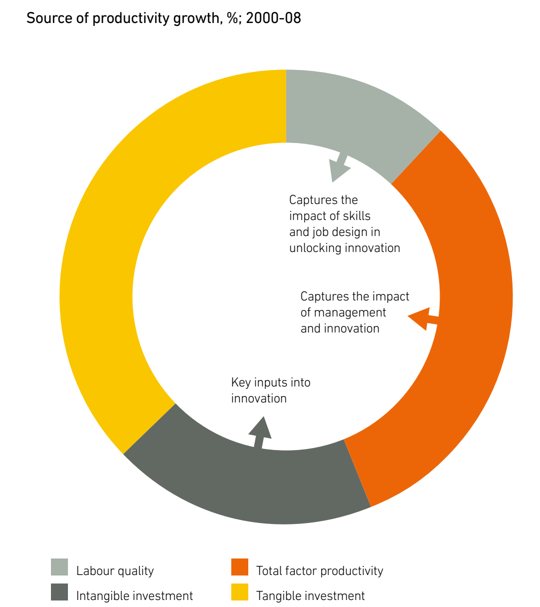
Clearly there is no magic wand that will achieve this overnight. And the nature of added value in UK service sectors may mean that both the path and the outcome for businesses in Britain might be different. Nevertheless, there are some indications that investment and innovation are the places to start looking for progress – and sector bodies can lend a helping hand by spreading best practice.

Investment and innovation have played a major role in driving productivity growth across the UK in recent years.

Exhibit 26: Labour intensity has meant that these high employment sectors also have below average productivity

Source: ONS, Labour Productivity, Quarterly National Accounts.

Exhibit 27: Innovation explains a large proportion of UK productivity growth



Source: NESTA, *UK Innovation index: Productivity and Growth in UK Industries*, (2012)

Investment and innovation have played a major role in driving productivity growth across the UK in recent years (Exhibit 27). They're important for raising productivity and pay in lower productivity, high employment (LP-HE) sectors too.

For many, it is manufacturing that springs to mind when we think of business investment. But buying new things like ICT or acquiring new offices – or as economists call it 'capital investment' – has been just as important for driving firm effectiveness or productivity growth in the services sector.[73]

Capital investment has been a major driver of labour productivity growth in some LP-HE sectors over the past decade.[74] In the UK's wholesale and retail trade sector, for example, investment in ICT was an important driver of improving firm performance in the years leading up to the financial crisis. This achieved some catch-up with peer countries, notably France and Germany.[75] There may be lessons to learn here for other LP-HE sectors.

The use of 'big data' by UK retailers also helped squeeze costs and generate sales. And international comparisons also show that UK firms have been at the forefront of the shift towards multi-channel shopping.[76] Indeed a study by the Oxford Institute of Retail Management found the development of e-commerce and e-business technologies over the past decade as having had a 'transformational' impact on productivity of UK retailers.[77]

…but this is about more than processes – management, skills and job design have key roles to play

Productivity improvements based on innovation don't just materialise from buying or developing a new technology. The process is more complex than that – which is why big, government-led initiatives in this field are so often ineffective. Improving is about managing the process of change, how jobs are done and developing skills levels – whether the process involved is new or long-standing. This need for a focus on added value, staff engagement and skills is evident in our case studies from Arriva and Unipart (Exhibits 29, page 48 and 30, page 49). The ability of staff and management to deliver really matters – and US firms currently tend to be much better at ensuring the investments they make into new machinery or skills feed through into company performance.[78]

Some of this is due to barriers firms face that government can address. In retail, planning laws in the US, for example, allow bigger and more efficient stores to be built. By contrast, the UK's planning rules are said to have restricted productivity in the retail sector.[79] Similarly, a lack of investment in infrastructure has had implications for the transport sector.[80]

10–15%

The share of the gap in productivity between the US and the UK explained by management quality

Exhibit 28: ICT uptake and changes in business organisation need to go hand-in hand

The fact that productivity improvements have been slow in many sectors underlines that innovation is as much about organisational change as technology.

Evidence that better management practices are associated with higher-levels of productivity, especially in the manufacturing and retail sector is strong. But the UK performs relatively poorly compared with its peers on management practices, which are estimated to account for a significant share of our productivity gap with the US.[81]

One way in which management innovation can improve productivity is the way in which ICT is used. This is illustrated well in a study undertaken by the Centre for Economic Performance at the LSE which looked at the role of management practices in driving productivity improvements from investment in ICT in the UK plants of US multinationals, non-US multinationals and plants owned by domestic firms.[82]

The authors found that US multinationals in the UK were better able to increase firm effectiveness from ICT investment than non-US multinationals, which in turn were more productive than UK owned domestic plants, particularly in major ICT-using sectors such as wholesale and retail. The US productivity advantage was apparent even when allowing for differences in the use of machinery in production and the number of people employed, suggesting that it is the way that US firms use ICT that matters. This means improving management practices will help firms make more of their investments and innovation.

But areas like management development and accountability are also important. Indeed, there is strong evidence that productivity improvements in services sectors tend to arise only when investment in new equipment and software is accompanied by these other changes. Economists are only just beginning to develop the techniques to try to capture the importance of these 'softer' forms of investment in 'intangibles', which really make the difference in service sectors.[83] Nonetheless, there is some evidence that in the distribution sector, for instance, investment in organisational change has helped the UK catch up with international competitors.[84] So far, however, the contribution of investment in 'intangibles' to productivity growth has been considerably greater in higher productivity sectors, such as financial intermediation and manufacturing, than in LP-HE sectors.[85] These sectors may be able to benefit from similar approaches to these higher-productivity sectors – and among themselves. What has worked in distribution, for instance, may also work in transport services or wholesale.

Clearly, there is more to do. Management quality in particular has been found to be so important to raising productivity that it has been estimated to explain between 10-15% of the gap in productivity between the US and the UK (Exhibit 28). One member of our steering group noted a discussion they had with a retail manager who said that the company's focus on management development was excellent, but because only current store sales mattered to performance metrics, it always 'played second fiddle'.

Some larger firms are making progress on this – but businesses of all sizes can do more to ensure the long-term enablers of success are focused on as clearly as the short-term need to maintain performance. Sectors can work with business schools to ensure management education takes account of this. There is plenty for businesses in these sectors to address – and we should focus on creating an enabling environment for them, at sector and government levels, learning the lessons of industrial strategy.

In the UK's wholesale and retail trade sector investment in ICT was an important driver of improving firm performance in the years leading up to the financial crisis.

Exhibit 29: Innovation has helped improve customer service and drive growth at Arriva

Arriva is one of the largest providers of passenger transport in Europe, with its operations in 14 countries responsible for more than 2.2 billion passenger journeys every year. In the UK, the company employs around 26,000 people, and operates over 6,000 buses and almost 400 trains. In this case study we focus on Arriva's UK bus division, which employs three-quarters of the firm's UK workforce, considering some of the ways that Arriva UK Bus has sought to manage the challenging economic conditions of recent years.

Between 2010 and 2012 a combination of higher fuel prices, reduced reimbursement rates for concessionary fares for the over 60s and reduced footfall in many high streets created difficult trading conditions which required an innovative approach. A classic response could have been to rely on fare increases, service cuts and cost reductions to manage the financial challenges. Arriva sought a more innovative approach. The company's biggest costs are the wages and associated overheads of its drivers, mechanics, administrators and managers, together with the cost of training. However, it was also appreciated that employees are also the company's biggest asset and needed to be kept engaged if changes were to be made whilst raising the level of service to customers. Every employee went through a programme called '*the Big Picture*' to explain the challenges facing the business, the financial realities and the strategy of adjusting to difficult economic conditions.

Arriva has deployed new fuel-efficiency technology...

Following a thorough review of costs particular attention was given to fuel efficiency given that the division uses around 170 million litres of diesel a year for its fleet. During 2007-08 the company trialled a telematics system called '*EcoManager*', which provides drivers real-time feedback of fuel consumption through a dashboard-mounted display. Complemented by training this has been invaluable in helping drivers to adjust their driving style and cut fuel consumption. The system has demonstrated improvements in fuel economy of typically 3-4%, rising up to 12% at some depots.

Following on from its success with EcoManager, to enhance its role as an environmental champion, in December 2013 Arriva bought a controlling stake in Zeta technologies, a leading eco-technology innovator that develops and supplies a range of products to reduce fuel consumption and vehicle emissions. Trials of one of the company's products, '*Econospeed*', which automatically controls throttle, top speed and acceleration, have demonstrated fuel savings of around 7%. The technology will be fitted to 3,000 buses in the fleet by March 2015.

... and has focused on customer service, to boost passenger volumes

Besides cost control, the other important route to offsetting financial headwinds has been the drive to increase customer numbers. The key is offering an attractive service in terms of punctuality, reasonable fares and customer-focused employees. Much effort has been channelled into making the most of the revolution in smart phones, apps and websites to make it easier for customers to find information, receive service updates and to buy tickets that can be delivered to phones. In 2013 a new app was launched which allows the user to see the exact location of the bus they are waiting for, show where the bus is on its journey in relation to stopping points and the app will also plan out the whole journey too.

Another initiative has been to fit free WiFi to all new buses and to start retrofitting existing buses. This gives bus passengers a key advantage over anyone in a car by using travelling time productively and enjoyably and has proved to be very popular.

WiFi has also been a key feature in another project which has been aimed at offering a premium service branded as Sapphire aimed at enticing people out of their cars. The Sapphire buses have WiFi, screens showing the next bus stop, extra comfortable seating and extra emphasis on quality and customer care backed up with a no quibble refund policy. The first four routes were launched in 2013 and have been joined by 11 more this year. Every route has seen increases in passenger numbers of between 9% and 18%. Market research has confirmed that the majority of these new passengers were former car users.

The financial challenges of 2010-2012 have prompted a different, innovative and ambitious approach and provided the UK Bus division a platform for growth. When even committed car users can be won over to buses, something has definitely changed for the better.

Exhibit 30: Applying 'lean' processes has been part of Unipart's success

Unipart Group is one of Europe's leading manufacturing, logistics and consultancy groups. From its beginnings in the automotive industry — the company was a management buyout from British Leyland — Unipart Group has diversified into warehousing, fulfilment and engineer support services, reverse logistics and end-to-end, global supply chain solutions that include sourcing, procurement and technical services. Unipart operates in global markets as varied as manufacturing, mobile telecoms, rail, retail and technology. This gives the company sight across a number of sectors. The company operates a highly decentralised organisation structure with separate business units, each responsible for its own performance.

The Unipart Way is all about enabling people to be innovative

The key to the successful development of Unipart Group has been the company's use of 'lean' processes and techniques that it learned from the best companies in the world and has adapted over 25 years. The company's culture has evolved into what it calls 'The Unipart Way', a philosophy of working underpinned by key tools and techniques. The Unipart Way enables people at every level of the organisation to eliminate wasteful activities from business processes and ensure continuous improvement and innovation.

...by empowering staff to solve problems and enabling management to give adequate support

One of the stand-out features of The Unipart Way is the high level of engagement with employees, which helps to ensure that problems are identified and solutions delivered at a local level. Unipart utilises a number of methods to encourage employees to undertake team working and joint problem-solving, and to identify solutions that can improve products and processes. This includes monthly employee forums held at site and business unit level, and '*Our Contribution Counts Circles*', a programme of structured problem-solving for teams in which employees identify problems, their causes and develop solutions. All employees are encouraged to participate in these groups at least once a year. Given this approach to leadership, Unipart invests considerable time and money in training and developing not only its managers, but also employees and team leaders, in collaborative working practices, providing a pipeline of talent to fill future leadership roles.

This has helped deliver change and reduced client costs in fast moving sectors

One of the most important benefits of Unipart's approach has been the ability to manage change successfully. In few sectors does this matter more than in the fast-moving mobile phone industry. Indeed, one of the best examples of the benefits of The Unipart Way has been the long-standing partnership between UTL and the mobile phone operator, Vodafone. When UTL first began collaborating with Vodafone, the mobile phone repair industry was small and fragmented. As UTL took increasing responsibility for the distribution, repair and refurbishment of Vodafone handsets and accessories, the company took the decision to build a single-site repair centre at Nuneaton, in the West Midlands, which is now the largest in the UK.

Using the Unipart Way, UTL's managers and employees continuously reassess work processes to reduce the amount of times a product has to be handled, redesigning workstations to cut out unnecessary actions and overhauling IT systems so that tasks can be performed with the fewest number of steps. The site has also become renowned for a novel approach that seeks to reduce client costs through innovative services such as remote diagnostics and repair.

It has also contributed substantially to the group's wider success

Having been applied across Unipart sites globally and for a wide range of customers, The Unipart Way has helped to deliver efficiencies worth millions of pounds annually, and generated innovative ideas by engaging people in deeply understanding their customers' needs. Unipart measures this engagement on an annual basis and has achieved consistently high engagement scores across its sites.

This level of deep engagement is evident in the company's achievements. Both UTL and Unipart Aftermarket Logistics (UAL) have won best in class awards in their respective industry sectors. Unipart is consistently ranked as one of the UK's most responsible companies and has achieved the 'best of the best' award for excellence in health and safety and environmental management. This year it was named the top company for graduates in a national poll.

Those achievements are mirrored by Unipart's own internal award programme, *Mark in Action*, which recognises those employees who are nominated by their customers for going 'above and beyond' in delivering outstanding personal customer service. *Mark in Action* is one of the longest running programmes of its type having just celebrated its 25th year with over 2,600 award winners during that time. It is a clear indicator that the Unipart culture of engagement continues to thrive at every level of the organisation bringing benefits to employees and customers alike.

Helping improve performance through supply chains should also be a focus

Progress by firms working on their own and with sector bodies in high employment sectors to improve productivity and competitiveness will help to raise performance, and the ceiling to pay growth for many working families. But we can also make progress on productivity and competitiveness in other sectors, including those covered by the industrial strategy. A wide range of issues, including relatively low management performance has led to lower than expected productivity in some parts of our manufacturing supply chain. Addressing this through peer support – and making it a more explicit part of the industrial strategy – could help lift pay (Exhibit 31).

Since the publication of *Future champions* in 2011, the CBI has been very clear that better support for, and championing of, the UK's *'Mittelstand'* – medium-sized businesses (MSBs) – should be at the heart of our economic plan. But while the overall performance of medium-sized firms is good, we tolerate a long tail of underperformance. Productivity per worker in medium-sized firms with 50-249 employees, was about £5,000 less per year than in larger firms (250+ workers).[86] And, in the face of recession between 2008 and 2009, productivity decreased by 10% in medium-sized firms, but by only 1.2% in larger businesses.[87]

Manufacturing is a case in point. The sector as a whole was responsible for 11% of UK productivity growth between 1998 and 2013 and 11% the UK's Gross Value-Added (GVA), but mid-sized manufacturing firms are only two-thirds as productive as their larger counterparts.[88] This gap is particularly pronounced in those parts of manufacturing that exclude electrical machinery. Among 'high-tech' manufacturers – those producing electrical machinery or telecommunications services – the productivity gap between MSBs and larger firms is nearly non-existent and has been closing over time (Exhibit 32).[89] So while the UK's MSBs overall punch above their weight, representing just 1% of UK firms but employing 16% of workers and accounting for 22% of the UK's total revenue, there is more to be done on productivity in our supply chains starting with a more explicit focus on the issue as part of the industrial strategy.[90]

Exhibit 31: Pulling together: strengthening the UK's supply chains

The CBI's report *Pulling Together—strengthening the UK's supply chains* highlights the need to strengthen the supply chains underpinning key sectors of our economy.

Stronger UK supply chains would ensure that the UK gains maximum value from the presence of high-profile companies that form 'anchor points' of manufacturing activity in the UK – with benefits for everyone. Businesses recognise that a stronger domestic supply chain helps to guarantee security of supply, makes it easier to advance technology through collaborative innovation, and enables a faster response to changing market conditions and customer needs. Stronger UK supply chains would also contribute to rebalancing the economy by improving the trade deficit and boosting growth in more regions of the country. Creating new high productivity jobs will also support higher wages.

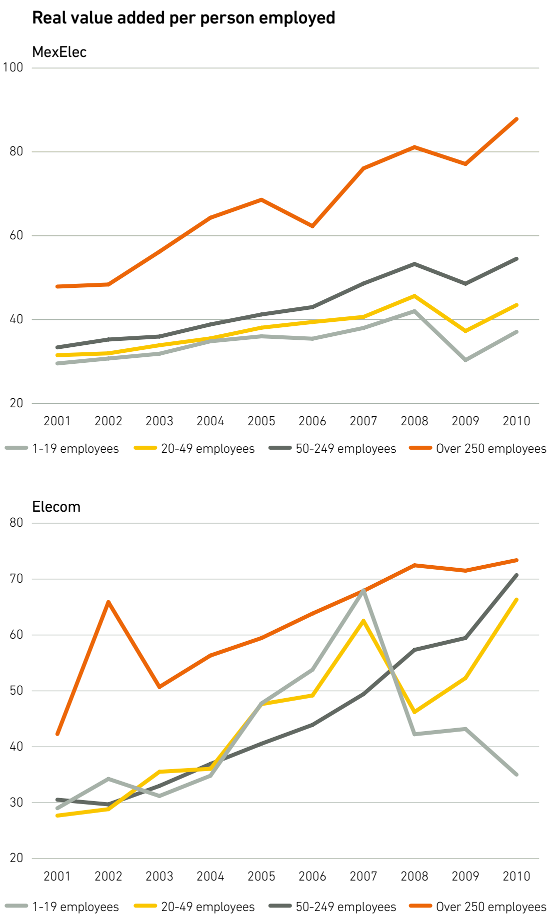
The UK is well placed to be the destination of choice for supply chains driven by innovation, quality and service, and can build on existing strengths like its world-leading research and science base. However, the report identifies a number of actions that should be taken if UK supply chains are to fulfil their potential. These are grouped under six themes, and are designed to:

- Raise the level of public and private investment in R&D
- Ensure an adequate supply of specialist skills
- Tackle regulatory bottlenecks to ensure a flexible and dynamic business environment
- Protect and enhance the UK's materials supply base
- Support investment in new technology and process improvements
- And derive the maximum social value from public procurement through support for supply chains.

Getting this right could boost the economy by as much as £30 billion by 2025, creating over 500,000 jobs.

> *Anchor firms have a key role to play through passing on their expertise and working with suppliers in their sector.*

Exhibit 32: The 'productivity size gap' is especially large in manufacturing, excluding electrical machinery



Source: ONS, *Micro-data Perspectives on the UK Productivity Conundrum – An Update*, 2013

Note on sectors: MexElec comprises manufacturing excluding electrical machinery; EleCom is an amalgam of electrical machinery plus post and telecommunication services and designed to proxy the 'hi-tech' industries.

The quality of operational management among some basic manufacturers is one of the reasons for the relative underperformance of some firms in the UK's supply chains. Firms with good management practices tend to be highly efficient and improvements in management in turn lead to growth in productivity.[91]

On the whole, UK medium-sized manufacturers have struggled to build management skills by comparison with our competitors.[92] This is something the leadership of businesses in these sectors acknowledge and want to deal with. A survey undertaken for *Future champions* highlighted that 'better management skills' were perceived as the most important driver of growth among MSBs, ahead of access to new skills, capital or export markets.[93] The CBI itself has since sought to support medium-sized firms in this endeavour. We have now delivered over 50 'M-Club' master classes for medium-sized firms across all parts of the UK covering issues from innovation to succession planning.[94]

The fact that higher-levels of education and skills among managers within firms tend to go hand in hand with better management scores is also likely to have something to do with this. The UK suffers a relative skills gap here. In 2011, for example, 41.2% of managers in medium-sized UK retail and manufacturing firms had a higher education qualification. This compared to 60.1% in the US and 60.5% in Germany.[95] Ensuring that effective management development takes place in our medium-sized firms – and that the skills system is positioned to deliver courses that help build management quality on a part-time basis – should be a key goal as we seek to boost productivity, and therefore pay.

Exhibit 33: Sharing in Growth: spreading best practice through the supply chain

Sharing in Growth is an innovative and ambitious £120 million programme to raise the capability of approximately 40 firms in the UK's aerospace supply chain, so that they can share in the anticipated growth of this global market. The programme was created in 2013 with £50 million from the Regional Growth Fund and with industrial knowledge and leadership from Rolls-Royce. It provides intensive, high-impact training to ambitious companies that have the potential to grow their businesses and compete internationally.

Each of the 40 participating companies undertakes a bespoke £3 million programme to assess current strengths and weaknesses, and equip managers and workers alike with the skills they need in order to update and expand their operations. The initiative has brought together a team of over 100 people, drawn from the aerospace industry, specialist training firms, resource specialists and technology-focused research institutes. Each provides expertise in leadership and key business processes, such as strategy, supply management, value improvement, finance, manufacturing capability and lean operations.

The programme aims to address the root causes of competitive disadvantage, whether this is on the basis of cost, product quality or delivery. A typical programme is expected to last for four years. During the first three months participants undergo a full 'diagnostic' review of their business: its demand and supply relationships, cost competitiveness, performance, management skills and financial strength. This is coupled with leadership training and business strategy workshops, culminating in agreement on a road map to address barriers to growth. The majority of the training is then delivered in years one and two, while years three and four focus on sustaining and embedding the improvements in skills and capability, with support from industry specialists.

Among the many beneficiaries of the programme is McBraida Plc, a machined-parts supplier to the UK and international aerospace industries. The company operates along the supply chain, from design and procurement, to manufacturing and delivery, supplying original equipment to the aerospace and marine sector. According to Mark Green, Group Operations Director: *"The diagnostic process, rather than just being a value stream of production, is a much more holistic business overview, including of all business functions. The process challenges you to understand your core skill competencies, products and where waste is found. By the end of the diagnostic you will have set a baseline of company competence and mapped out the journey ahead."*

Many UK manufacturers are already getting this right. That is why the role of large, world-class companies in spreading their own good practice to their suppliers can be so important. They know their sector and the firms in their supply chains well, so could make a real difference to better management. And that will, of course, bring long-term benefits to anchor firms, the large companies at the end of the supply chain. This is particularly important for living standards – research by the ONS found that wages fell in every year between 2002 and 2010 in the least productive manufacturing firms.[96]

So anchor firms have a key role to play through passing on their expertise and working with suppliers in their sector. Enabling such peer learning to raise productivity should be a key part of the UK's industrial strategy. Addressing the management gap and helping our manufacturing MSBs achieve their potential could also create more higher-skilled, higher-paid jobs for those on low earnings to move into. Alongside this it will help strengthen the UK's supply chains and make them more competitive at a time when many companies are deciding whether to re-shore. Exhibit 33 outlines how Rolls-Royce is doing this as part of the 'Sharing in Growth' programme in the UK aerospace industry.

Government can help by simplifying their work for smaller businesses

Alongside tasking the OBR to deliver a better evidence base on productivity, one further area where government may be able to help businesses achieve greater productivity advantages is amongst smaller firms. How government supports productivity development amongst smaller firms, who typically have lower productivity performance than both medium-sized and larger firms is crucial. Small firms (10-49 employees) were on average £3,000 per year less productive than medium-sized firms (50-249 employees) on an output per worker basis in 2012.[97] There are four things that government can do to address this challenge that would really help, covering procurement, exporting, the support landscape and access to finance.

> *Research by the ONS found that wages fell in every year between 2002 and 2010 in the least productive manufacturing firms.*

Role number 1: ensuring small and medium-sized firms benefit from government procurement

The first role of the government in supporting small and medium-sized firm growth and efficiency improvements should be ensuring these firms benefit appropriately from government purchasing through supply chains as well as being direct suppliers in their own right.

This is an easy way for the government to support the growth of these firms directly. Yet, in comparison with their peers in many other developed countries, the UK's small and medium-sized firms operate in an environment of relatively weak public procurement support. In the US the Small Business Administration is held to ensuring 23% of federal government procurement contracts are awarded to small businesses, a target that has been regularly met. The average figure for the EU is even higher, at 34%.[98]

In the UK, the government has set an ambitious target to raise the share for small and medium-sized firms in direct and indirect public spending – i.e. through supply chains – at 25%. However, these firms received just 10.5% of direct spending from government contracts in the financial year 2012/13. For the whole supply chain, including sub-contractors, the figure was lower still, at 9.5%.[99] So there is more to do in ensuring small and medium-sized firms benefit from government purchasing.

The UK also falls short when it comes to mobilising its R&D budgets to fund innovation by small businesses compared to the US. In the US the Small Business Innovation Research programme (SBIR) awards around 4,000 contracts a year, worth $2.5 billion (£1.5 billion). Meanwhile the UK's Small Business Research Initiative modelled on the US's SBIR had only awarded 1,300 contracts since April 2009 worth £130 million, albeit the March 2013 Budget signalled intentions to increase the value of contracts in 2014/15 to £200 million.[100] OBR data should position ministers to press government departments to ensure smaller businesses are at the table when it comes to procurement contracts and R&D support.

Between 4% and 10% of all non-exporting small and medium-sized firms — or between 25,000 and 150,000 firms — could potentially export successfully.

Role number 2: support more firms to export by increasing awareness of the help available

We need to export. As the CBI set out in its 2011 report *Winning overseas* and 2013 reports *The only way is exports* and *Go your own way*, a real rebalancing of the UK economy requires more of our medium-sized firms in particular, but also small firms, to be selling abroad.[101] The CBI has led the way on this, working with UK Trade and Investment (UKTI) to pioneer the first MSBs trade missions, with visits to Turkey, Brazil and Russia in the past three years.

Firms that export successfully face competitive pressures that lead them to become more productive – and are therefore able to pay more. Some of this is due to the fact that exporters are able to tap into larger markets which has productivity benefits, and some due to their exposure to new ideas and stronger competition.

But looking at small and medium-sized businesses' current exports performance suggests there is scope for change. Only around 20% of all UK small and medium-sized firms export their goods or services, below the EU average of 25%.[102] More detailed data from the BIS Small Business Survey shows that the proportion of UK firms exporting increases with size from 16% of zero-employee businesses to 40% of medium-sized businesses (50-249 employees).[103] This doesn't need to remain the case. A recent UKTI study estimated that between 4% and 10% of all non-exporting small and medium-sized firms — or between 25,000 and 150,000 firms — could potentially export successfully.[104]

The main barriers to getting more small and medium-sized firms exporting are fairly well understood. These include gaining access to overseas contacts, dealing with unfamiliar bureaucracies or cultures, different regulatory or product standards, and the internal capacity of firms to research and exploit export opportunities. There is a clear role for government in helping these firms overcome some of these barriers. However, to date very few small and medium-sized firms that export have called on government support (16%). And of those that have, only 21% found accessing it easy.[105]

While UKTI and UK Export Finance (UKEF) have made considerable efforts to raise awareness of their offering to small and medium-sized companies, with real and welcome results, it is clear that there is still more to do to showcase the services on offer and improve accessibility. Supporting UKTI by profiling the importance of exporting, and directing companies towards UKTI and UKEF should be a key government goal.

10.5%

In 2012/13 SMEs received 10.5% of direct spending from government contracts, compared to an average of 34% in the rest of the EU

Role number 3: simplify and steady the support landscape

This links to the third area where government could make a real difference, by simplifying the existing complex business support system for smaller firms – something the CBI has called for on numerous occasions. For businesses that want to grow, the trick is identifying and accessing the most appropriate services for them. That is why it is important the support landscape is easy to understand.

A simple support system is something that is important for all types of firms that want to grow or improve their productivity – whether they are manufacturers, service companies, large or small. But smaller firms are particularly affected. That's why the government has an important role to play – the different government departments need to work together to simplify and steady the existing support landscape.

The current complex landscape of support is costly. The 2008 Richard Report estimated that the administrative costs associated with the multitude of available schemes for small businesses alone represented 34% of direct enterprise spending in the UK.[106] Following the report the government has moved to shake-up the support system. Notably it has introduced business-led Local Enterprise Partnerships (LEPs), which aim to provide more focused support on a regional basis, and it launched the British Business Bank, which intends to consolidate at least some government financing schemes under one roof.

34%

Over a third of direct enterprise spending goes on administrative costs arising from the complex system of support for small business

But more needs to be done as can be seen from the 'GRANTfinder' service which identifies 891 support schemes for small business alone.[107] Finding a way to consolidate this multitude in a way that gives businesses the support they need could therefore help free up valuable resources to make existing services better and provide support to LEPs. Making the new system last will be part of its success, as part of the confusion has also been that the UK support system has undergone a lot of change (Exhibit 34).

This need for simpler support is as valid in labour intensive service industry sectors as it is in manufacturing. Boosting productivity in these service sectors is often more about helping firms absorb existing innovations than creating wholly new ones. To do this we need good support services. This is particularly the case because the real challenge in these sectors is often in smaller and medium-sized companies, rather than the major chains – and as we noted above smaller and medium-sized firms can often do with a helping hand.

The ability of firms in labour-intensive services sector firms to access advice easily, particularly on how to do some of the things we spoke about earlier in this chapter, like making the best use of ICT, is paramount. And the benefits are proven: a study by Manchester Business School for NESTA found that technology and innovation advisory services provide positive benefits for participating firms, including cost reductions, higher productivity and quality improvements.[108]

Yet at the moment too many services firms fall through the cracks when it comes to the provision of support services. Not only is UK public sector support for innovation highly fragmented and spread across multiple government departments and schemes (Exhibit 35, page 58), most services are directed towards either manufacturing firms (e.g. via the Manufacturing Advisory Service) or high growth smaller firms (e.g. through the Growth Accelerator). We need an offer that works for all sectors.

Exhibit 34: The UK business support system has undergone a lot of change

Main Schemes	Period	Geographic remit	Administered by	Delivered by	Cost to client
Small Firms Service (SFS) and Business Development Service	1973-1988	Central and regional offices	Civil servants	Referral and market consultants	Free advice, subsidised consultants
SFS and Enterprise Initiative	1988-1993	Central and regional offices	Civil servants	Referral and market consultants	Free advice, subsidised consultants
Business Link	1993-2005	County and districts level	Government agencies, partner bodies, and franchisees	Internally, Partnership Brokers Accreditation Scheme (PBAs), and some referral	Complex mix with some fee targets
Regional Development Agencies (RDAs) and Business Link	2005-2010	Regional and county level	RDAs, partner bodies, and specialist contractors	Internally, PBAs, and some referral	Complex mix with some fee targets
Local Enterprise Partnerships in England	2010-	City-region and county level	Local strategy boards	Partners and private sector	Existing supplier fees, with some subsidies

Source: Federation of Small Business, *Enterprise 2050: Getting UK enterprise policy right*, 2014

At the moment too many services firms fall through the cracks when it comes to the provision of support services.

Exhibit 35: Support for innovation in the UK is fragmented

Organisation	Innovation support schemes
HM Treasury	Patent Box R&D Tax credits (large and small company schemes)
Department for Business, Innovation and Skills	Innovate UK: Catapult Centres; Collaborative R&D; Demonstrators; Eurostars; Feasibility Studies; IC Tomorrow; Innovation and Knowledge Centres; Innovation Platforms; Innovation Vouchers; Knowledge Transfer Networks; Knowledge Transfer Partnerships; Launchpad; Missions; Small Business Research Initiative; Smart National Physical Laboratory: Technology Innovation Fund
Department of Energy and Climate Change	Low Carbon Innovation funding Office for Low Emission Vehicles Energy Technologies Institute
Department of Health	Health Innovation Challenge Fund Innovation, Excellence and Strategic Development Fund National Institute for Health Research: Invention for Innovation (i4i) Programme
Ministry of Defence	Centre for Defence Enterprise Defence, Science & Technology Laboratory
Research Councils	Rainbow Seed Fund Follow On Fund Funding for applied and collaborative research Collaborative training
Other related initiatives	Devolved Administrations' schemes Local schemes University Enterprise Zones Higher Education funding bodies' support (including Higher Education Innovation Fund, UK Research Partnership Investment Fund) Government enterprise support schemes (eg, Regional Growth Fund, Growth Accelerator, Manufacturing Advisory Service, Enterprise Investment Scheme, Enterprise Finance Guarantee) UK Trade & Investment services (eg, Export Marketing Research Scheme) Various other departmental initiatives

Source: Tera Allas, presentation for Government Economic Service seminar in July 2014, http://www.slideee.com/slide/science-innovation-and-the-economy-uk-challenges-and-opportunities

Role number 4: work with others to address external financing pressures

Getting the right funding structure to grow your business is one of the most important pre-conditions for investment that boosts productivity. Lack of access to finance has been a barrier to growth for small businesses in particular, both during and after the credit crunch.

Some of this was cyclical, and as the recovery grew stronger, so did credit conditions. In the second quarter of 2014 £7.4 billion of new small and medium-sized firm borrowing was approved, 16% more than in the same quarter last year and the highest quarterly amount since 2011. This increase in borrowing was broadly based across industry sectors and geographical regions.[109]

However, UK companies are still facing structural challenges in accessing finance. The business community in the UK continues to rely heavily on bank finance almost to the exclusion of other sources – bank finance does the heavy lifting for everything, even where it isn't necessarily fit-for-purpose for the job at hand. Around three quarters (75%) of all credit intermediation comes from banks. This compares with around 25% in the US, where corporate bond and equity markets are broader and deeper.[110] Alternative sources of finance need to be explored and developed to enable firms to get the right type of funding at the right time, with productivity improvements reaped through growth ultimately translating into higher pay.

There is now a much broader range of alternative sources of finance starting to come to market and the CBI successfully lobbied for an increase in liquidity on the AIM market through the abolition of stamp duty on share transactions. But one area where more progress could be made is on the relative shortage of appropriate risk capital – a point the CBI has raised previously in its 2012 report *Financing for growth* and 2014 report *Slice of the pie*. For small firms, this means access to the kind of venture capital funding they need, while for MSBs access to the capital markets for long-term funding is the vital issue. The British Business Bank should be able to explore these paths as well as support and advise companies on appropriate steps to secure the right finance package for them.

"Real income changes will come with greater competitiveness, as we lift productivity in British firms based on innovation, investment and people development."

This advice will help smaller firms who often do not have the resource and skills to explore options – only 25% of small and medium-sized firms have a formally qualified financial manager for example. Furthermore, small and medium-sized businesses often avoid using external, independent advisers to guide them through financial decision-making, with 84% not consulting external advisers before making such decisions.[111]

25%

Only a quarter of small and medium-sized firms have a formally qualified financial manager

Initiatives aimed at reducing information asymmetries in the lending market, for example by boosting lenders' access to small and medium-sized firms' credit data and thus allowing for better credit assessments will help. And there are private sector initiatives underway to kick-start growth in the UK private placement and retail bond markets to help MSB's access a wider range of finance. The CBI itself has helped on a practical level here. Our online '*FindmyFinance*' checker helps firms navigate the growing world of alternative sources of finance.

But there are a wide range of other issues government could 'give a push' to. For instance government support for the development of a securitisation market for small and medium-sized firm loans would allow us to unlock institutional investment. Ensuring regulations promote the growth of corporate venture capital by harmonising rules with the regime for venture capital would also help. And finally considering introducing an incentive for businesses to invest in their supply chains to bolster the supply of corporate venturing.

RECOMMENDATIONS

For business:

- Take a long-term approach to raising employee value-added, and make it a firm priority, working within the company and together in supply chains, local areas and sectors. Address areas like management skills, job design, innovation and investment.
- Sector bodies should support firms in this endeavour.

For government:

- Ask the Office of Budget Responsibility to report regularly and in-depth on the UK's productivity performance, including sectoral trends and any government-inspired barriers, in the manner of the Australian Productivity Commission. With the support of business leaders, use this data to guide policy and address issues raised.
- Simplify the support network for smaller and medium-sized firms to improve take-up and enhance productivity potential. This should focus on four areas: access to government procurement; UKTI's role in supporting exports; simplification of business support, including for lower paying sectors, and access to finance.

SKILLS

HELP PEOPLE TO EARN MORE THROUGH BETTER LADDERS INTO HIGHER-PAID WORK

CHAPTER 5

Help people to earn more through better ladders into higher-paid work

Raising productivity will boost firm performance, and allow pay to rise. But our ability to raise productivity rests on skills, which are also the only way each person can break away from lower-paid work. Our economy needs more skilled workers too – with the middle-skilled jobs of tomorrow requiring higher skills than before. So better routes to answering the skills needs of the UK – through formal training and in-company progression are essential. This should include career paths for less skilled workers and a focus on retraining for adult workers to offer opportunity and meet our immediate skills needs, as much as apprenticeships for the young.

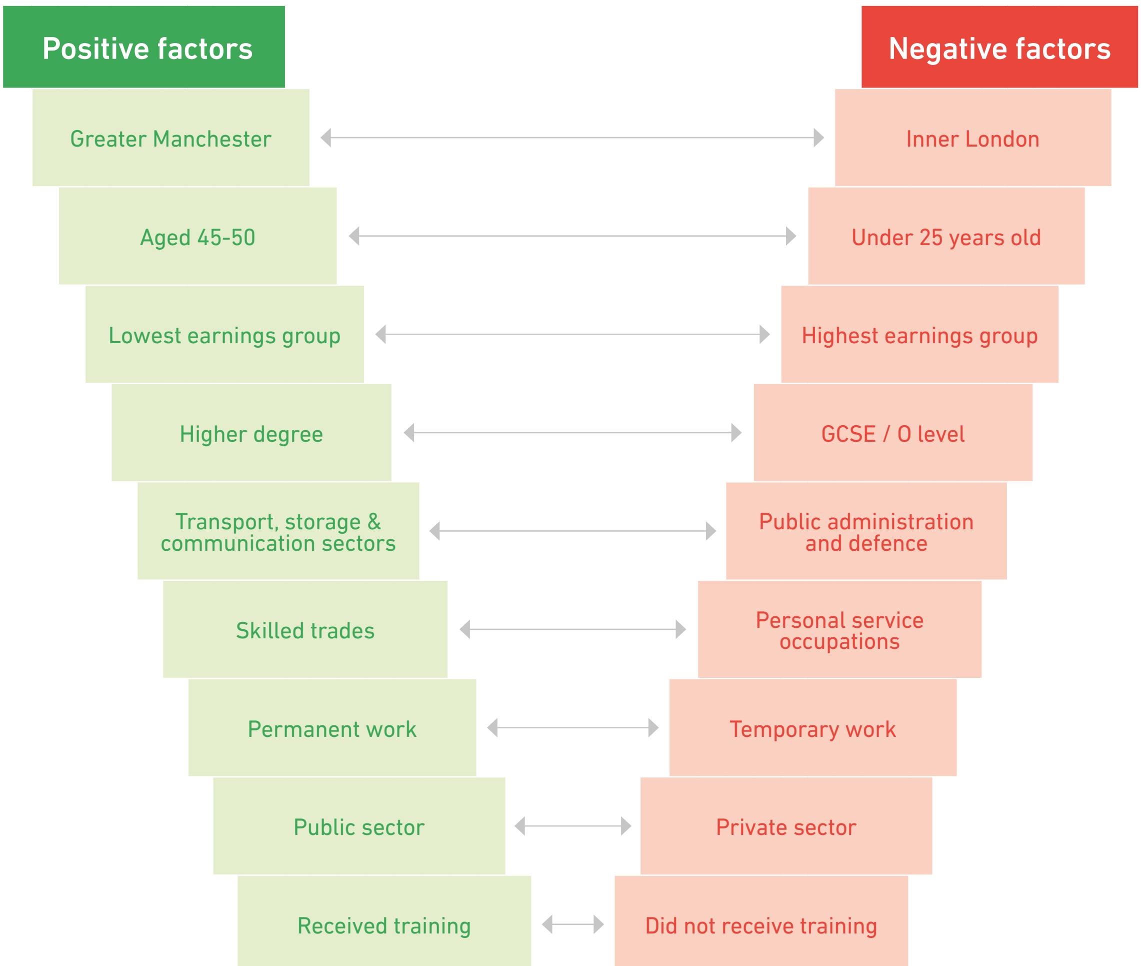
Skills are the currency of the 21st century labour market

In the same way that productivity sets a limit on pay rises at a company level, skills set a similar limit for each person. The higher and more relevant your skills, the better your chance of staying in work. And the higher your skills, the bigger the likelihood of increasing your earnings. Skills present a win-win for individuals and firms. They help improve individual living standards, but they also make firms more productive and perform better, increasing the potential for pay to rise.

Analysis commissioned for this report shows this to be true. People with higher degrees have a much greater chance of remaining employed over a five year period than those just qualified to GCSE or O Level.[112] Experience, people's place of residence and their position in the earnings distribution also mattered (Exhibit 36). This is important because staying in work is the first step to improving your living standards. A spell of unemployment makes it 7% less likely that your pay keeps up with the cost of living and 12% less likely that your pay grows at all.[113] This emphasises that a high employment rate should be a goal of government policy when it comes to pay.

Skills are also amongst the most important factors determining the pace at which individuals' earnings grew over the 16 year period between 1991 and 2007, alongside avoiding lengthy periods of unemployment – which you tend to avoid better if you are highly-skilled. Working in higher-skilled occupations also made you more likely to receive a pay rise (Exhibit 37, page 64).

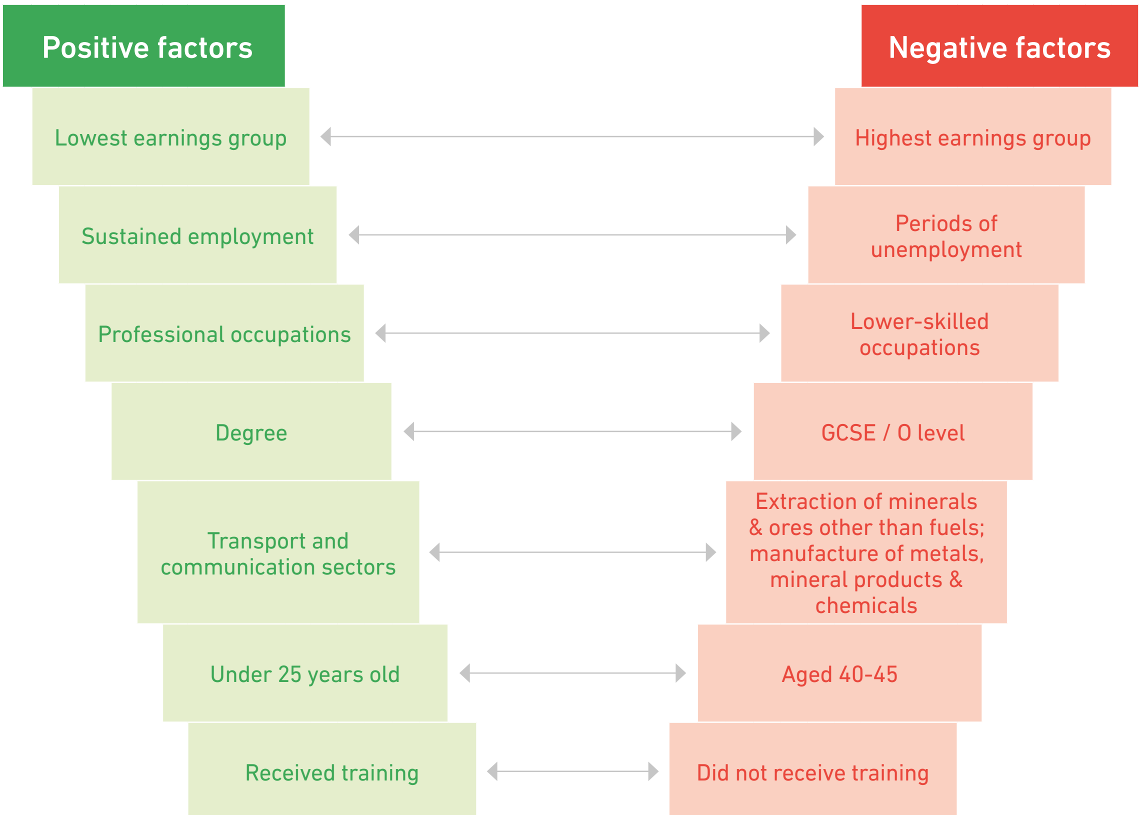
Exhibit 36: Experience and qualifications are key to staying in work



Source: Analysis by Dr Abigail McKnight (LSE) of BHPS data 1991-2008

A spell of unemployment makes it 7% less likely that your pay keeps up with the cost of living and 12% less likely that your pay grows at all.

Exhibit 37: Pay growth is driven by qualifications and work continuity



Source: Analysis by Dr Abigail McKnight (LSE) of BHPS data 1991-2008

The move to higher skills has also led to higher pay for many. The average earnings of full-time employees have more than doubled since 1975 after adjusting for inflation.

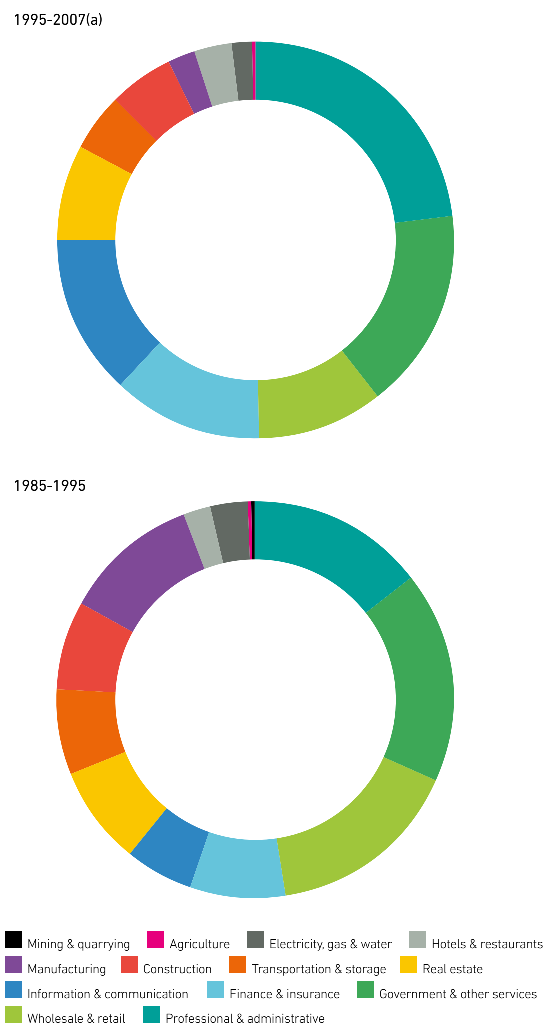
The UK economy is creating more higher-skilled, higher-paid jobs

With skills of crucial importance to an individual's ability to do well in our economy, it's good news that our economy is creating a lot more highly-skilled jobs. The reasons for this are two-fold. Firstly, globalisation makes competing on cost alone undesirable to the UK as there are jurisdictions around the world that can do that more easily – the UK has to compete on quality.

Secondly, increasing technological change means that the level of skills required to do different jobs is rising, while other jobs have been lost as new automated processes require lower labour input. Both of these factors mean that the shape of the UK's economy is constantly evolving – and with it the kinds of jobs that are being created are becoming more highly-skilled and higher-paid. This means our economy's expectations of individuals are changing. Ensuring they can make the most of this means being clear about this reality.

Exhibit 38 illustrates some of these shifts by showing different sectors' contributions to the overall output growth in the late 1980s and the mid-2000s, illustrating the growing importance of highly-skilled sectors like professional services, the financial and insurance sector, and ICT. These shifts affect businesses of all sizes, from the smallest to the largest, and mean only 19 of the current FTSE 100 companies have been present constantly for the last 30 years.[114] In manufacturing too, we have seen substantial moves to higher skills – such as in the automotive or aerospace sectors.

Exhibit 38: The sectors driving economic growth have changed substantially over the last 37 years



Source: McKinsey analysis of EU KLEMS data

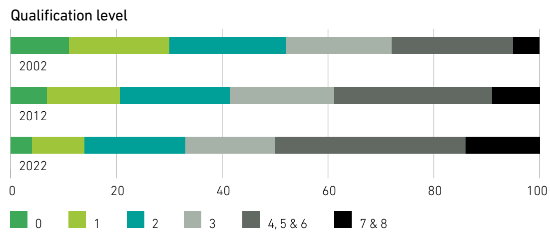
Note: (a) The mining and quarrying sector made a negative contribution to GVA growth during this period of 2.1%

By 2022 half of all jobs will require workers to have completed some form of higher education.

The UK's transition to a higher-skilled economy – spurred by globalisation and technological change – has led to high demand among businesses for people with higher-level skills over many years now. This means that over the past four decades, the proportion of lower-skilled jobs has edged down and the average job has become higher-skilled. As Exhibit 39 shows we are increasingly expecting more and more of people. The number of jobs requiring no formal qualifications has nearly halved over the last ten years and in eight years' time, by 2022, half of all jobs will require workers to have completed some form of higher education (level 4 and higher) – whether that is a degree, a higher apprenticeship, a Higher National Certificate (HNC), or a Higher National Diploma (HND) in college or university. That means within the space of twenty years, between 2002 and 2022, an extra two people in every ten will need higher skills.

The move to higher skills has also led to higher pay for many. The average earnings of full-time employees have more than doubled since 1975 after adjusting for inflation and employees aged 21 in 1995 typically earned 40% more by the age of 39 than workers who were 21 in 1975.[115]

Exhibit 39: In the next eight years half of all jobs will require higher qualifications (level 4 and above)



Source: UKCES, Working Futures 2012-2022; Ofqual[116]

Note: Lower level GCSE (D-G) = 1, Higher-level GCSE (A*-C)=2, The diploma = 1-3, A-Level = 3, Apprenticeships = 1-4, Certificate of higher education = 4, Diplomas of higher education, foundation degrees & HNDs = 5, Bachelor degrees = 6, Master degrees & postgraduate certificates = 7, Doctorates = 8.

This kind of change makes stepping up into new 'middle-skill' jobs more difficult

While the UK's transition to a more highly-skilled economy has led to higher pay for many it has also made it more difficult for many people on low pay to access higher-paid work. This is because today's mid-level jobs require higher skills than ever before. The new 'middle-skills' are now foundation degrees and things like HNCs, rather than simply A-levels, or an equivalent level 3 vocational qualification.

Nowhere is the evidence of this clearer than in engineering. As our report earlier this year, *Engineering our future* pointed out,[117] companies tend to find that graduate recruitment is less of a problem than recruitment of technicians with level 4 skills. Companies have shortages of key skills in middle-pay jobs with good progression, and we need to understand why these are not being filled.

The answer lies in the idea of the 'hourglass' – that middle-skilled jobs have been replaced by higher-skilled ones. Yet this reading of the scene is too simplistic, and does not explain why companies all over the country report skills shortages below honours graduate level – amongst them skilled technicians. The truth is that an hourglass has formed to some extent – but not because middle-skill, middle-pay jobs are disappearing. They are just slightly higher-skilled than they might have been in the past, lengthening the path to these jobs for people entering the labour market at low-skill levels. This change has slowed traditional in-company routes to progression because the skills jumps to move up have become bigger. And our systems – in businesses and education alike – are not well set up to help people make this jump into higher-paid work.

1 in 3

A third of workers are stuck in the bottom pay group, even after 14 years

This is already a problem – too many lower-paid workers are stuck

The justification for setting a minimum wage that maximises employment is that having a job is the best route to help someone progress in skill and responsibility so they can earn more in the future. For that reason, progression needs to be a focus for business and government to avoid workers getting stuck on low wages. A job should be an opportunity for a worker to progress, either within their firm or – if opportunities are limited – to use their work as support while gaining the skills required for a different role. This will often be the case in some sectors, where there are limited possibilities for pay progression (Exhibit 40, page 68).

In these sectors, productivity growth would help to lift pay as we set out in Chapter 4 – but the number of available higher-skill roles means that many will have to change sectors as they progress – putting a premium on finding a way to ease that transition for people. Progressing from a job in the bottom earnings decile to a job in the median earnings decile in the bottom ten paying sectors in the economy does make you better off. It leads to an average pay rise of £1.39 per hour. On an average working week of 37.5 hours that is £52 extra per week and an extra £2,707 per year. But for many, progression beyond this may mean looking elsewhere.[118]

Exhibit 40: In some sectors opportunities for mass pay progression are limited

Sector	Number of employees (000s)	Pay at 10th percentile	Pay at median
Food and beverage service activities	942	£5.20(a)	£6.50
Accommodation	279	N/A(b)	£7.10
Security and investigation activities	92	£6.40	£8.40
Activities of households as employers of domestic personnel	50	£7.00	£8.80
Residential care activities	689	£6.30	£7.80
Crop and animal production, hunting and related service activities	110	£6.30	£8.60
Services to buildings and landscape activities	406	£6.20	£7.30
Retail trade, except motor vehicles and motorcycles	2,143	£6.20	£7.50
Gambling and betting activities	109	£6.30	£7.90
Manufacture of wearing apparel	19	£6.20	£8.20
Total	**4,839**		
Average difference between 10th percentile and median		**£1.39**	

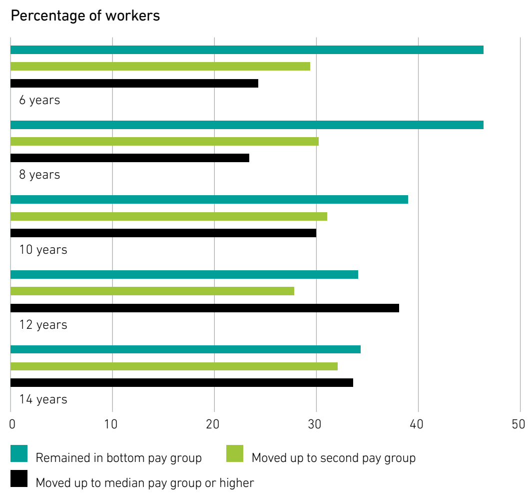
Source: McKinsey analysis of ASHE, 2013

Note: (a) The adult rate of the NMW at the time of this survey was £6.19. Pay at lower percentiles can appear below the adult rate of the National Minimum Wage because lower rates apply to workers under the age of 21 and apprentices, (b) Data is excluded where the quality of the estimate is too low

And at the moment, there simply isn't enough of this progression going on. Research undertaken for this report illustrates this. Over time, most workers do progress out of the bottom earnings group (Exhibit 41). After six years, more than five in every ten workers had managed to escape the bottom earnings group, rising to six in every ten workers after 10 years and almost seven in every ten workers after 14 years – with an increasing number moving into average pay (median pay group). But if you have been in a low-paid job for longer, then you are less likely to get out.

This is a concern. Not only have those on the lowest pay been among the hardest hit by the downturn, but the living standards crisis is even more potent if you can't see better prospects around the corner. For business it's a real worry as it means we are not making the most of all of our talents. And, as we showed in Chapter 2, this can cause serious economic damage. Our vocational skills system needs to be primed to deliver these routes to progression for people, and for our economy.

Exhibit 41: A third of workers are stuck in the bottom pay group, even after 14 years



Source: Analysis by Dr Abigail McKnight (LSE), of BHPS data 1991-2008

We need concerted action to ensure the skills system matches up to economic need

Skills are only valuable if they are the right ones. So it's crucial that the courses that are on offer to help people are the right ones. This is a challenge to business, educational institutions and government alike. Businesses shoulder the burden of paying for vocational training at higher-levels, so making sure we monitor course quality closely is vital. But government and educational institutions must also react – by focusing on real economic need, rather than 'bums on seats'. What is on offer must be closely aligned with the skills that are in demand amongst employers, if we are to make sure people can make the most of the opportunities our economy offers. At the moment this isn't the case in the way it should be.

More vocational routes to the new 'middle pay' jobs are necessary

A priority for any government should therefore be to address the fact that the new middle-level skills are level 4 and ensuring that level 4 vocational skills can be delivered at a large scale so we can create ladders into higher-paid work.

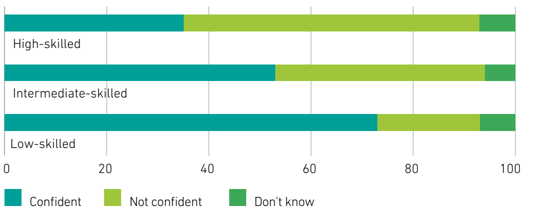
The delivery of level 4 qualifications in our skills system is confusing and, perhaps as a result, there isn't enough emphasis of delivery of these types of qualifications. Regulatory and funding bodies are almost entirely separate. In England, for instance, level 4 qualifications are delivered under the auspices of both the Higher Education Funding Council in England (HEFCE), and the Skills Funding Agency (SFA), with different systems, funding streams and support networks. Some progress was made a decade ago with the birth of the foundation degree, and increased delivery of higher education in colleges, but there is much further to go. Further education (FE) and higher education (HE) providers, and employers need to be thinking about paths to level 4 skills.

So far too little progress has been made on this. The government-funded apprenticeship system for example needs to be focused not on English and Maths training for over-25s, but on solid pathways that will help them and other age groups progress towards level 4.

It's not just that the current system is confusing, we also don't deliver enough work-based routes into level 4 qualifications. Analysis of the English skills system by the UK Commission for Employment & Skills (UKCES) shows that while the number of students taking level 4 qualifications continues to rise, growth in provision is dominated by traditional undergraduate degrees. At the same time, the much smaller number pursuing work-based routes – such as higher apprenticeships, HNDs or foundation degrees – has remained broadly flat. The size and growth of level 4 provision in the UK highlights the fact that – with the notable exception of Scotland – we lack the kind of deep infrastructure which other countries have evolved for advanced work-based learning.[119] Our relatively poor performance on intermediate (level 3) skills internationally also acts as a barrier for people trying to find the path to level 4.

With this in mind, it's not surprising that firms are far from confident that they will have access to the skilled employees they will need in the future. In recent years policies pursued by successive governments have pushed colleges and private providers towards a focus on lower level and remedial skills, and away from this vital need. Perhaps reflecting this while nearly three-quarters (73%) of firms are confident that their demand for lower-skilled employees can be met, only just over a third (35%) are confident about the supply of workers with higher skills (Exhibit 42, page 70).

Exhibit 42: Employers are not confident they can find the skills they need in future



Source: CBI/Pearson, Gateway to growth, education & skills survey, 2014

A future government should therefore focus on ensuring this is addressed. This means looking at the divide between HEFCE and the SFA to encourage more co-working between institutions and more cohesive alternatives to degrees for working students. It also means ensuring the focus of professional and technical education is at levels three, four and five.

£5,070

The extra amount the average worker with a higher education qualification earns compared to one with A-levels

Businesses, too, can support this in the type of training programmes they offer and through effective co-working with both HE and FE providers to ensure level 4 qualifications help provide routes into in-demand, higher-paid roles. Making our disjointed system work better has the potential to make a real difference, as it will help open up routes to progression and higher-skilled, higher-paid jobs.

This could make a big difference to living standards, with average pay for somebody with level 3 qualifications (A-level equivalents) at £10 per hour and average pay for somebody with what is called 'higher education' (a level 4 qualification) at £12.60 per hour. For somebody working an average week of 37.5 hours this would be worth an extra £97.50 per week or £5,070 per year.[120]

We need to enable people of all ages to learn – not just the young

The skills challenges we face today are often discussed in terms of youth unemployment and apprenticeships. That's not a surprise, as it is a big challenge. The CBI is strongly supportive of the development of higher apprenticeships and reforms to increase the standing and business-relevance of the entire apprenticeship system.

But the need for education, and the need for progression, does not end at age 24. Whether it is dealing with the effects of economic change on a small coastal town, support for a parent coming back to the labour market, or just helping someone who has been stuck in low pay – adult retraining and learning matters too.

At the moment, talking about adult retraining is to set one's face against the political wind, but it is an issue that cannot be ignored. At 25, young people today have 43 years of working life ahead of them – we can't leave them on their own.

And yet, the past few years have seen a collapse in provision for this group. Levels of part-time study in our colleges and universities, for instance, have seen a catastrophic fall. And when someone has a mortgage to pay and children to feed, part-time is the only option available. A similar effect can be observed in many colleges. And while there have been significant numbers of over 25s taking slots on level 2 apprenticeships, there has been little in the way of progress towards the intermediate and higher-skills levels we need.

Government must work with business to address this and improved financial support has a key role to play. In particular, government must ensure that the scale of existing financial support is better known and expanded in sensible loan-based ways. But it is also important that rules around equivalent and lower qualifications are not stopping people from retraining through fear of fees. Government needs to develop a strategy for adult skills that it focuses on as diligently as it does with its apprenticeships strategy.

Doing better at this also means firms upping their game as part of a wider business commitment to progression, which we discuss later in this chapter. An area which remains an underdeveloped market in the UK, but is crucial in helping more people make the leap to higher skills, supported by their employer, is 'learn-while-you-earn'. Business and provider collaborations to develop 'learn-while-you-earn' courses like higher apprenticeships and part-time study alongside work needs to be a future priority if we are to help more people develop their skills and careers as a route to higher living standards.

So more businesses developing effective co-working with FE and HE providers that supports a 'grow your own strategy' is important. This is something the CBI's *Tomorrow's growth: new routes to higher skills* report looked at. Exhibit 43 summarises this work and the barriers we need to overcome to make progress, Exhibit 44 (page 72) shows how Asda is doing this successfully through its degree programme with Middlesex University and Exhibit 45 (page 73) illustrates how the Association of Accounting Technicians is helping many adults retrain into highly-skilled roles.

Exhibit 43: Tomorrow's growth: new routes to higher skills[121]

To respond to the higher-skills challenge and give people the tools to improve their pay through better skills, we need to expand and better promote apprenticeships and 'learn-while-you-earn' courses such as part-time degrees and higher apprenticeships.

The UK has a strong track record on higher-skills achievement, but we need to quicken the pace if we are to ensure international competitors do not overtake us. More partnership-based provision, with greater levels of business involvement in colleges and universities, and the development of more flexible degree programmes is key to addressing this.

There are already many good examples of collaboration between businesses and higher education institutions on courses, even since fee reforms were enacted. But our analysis suggests that there remain some significant barriers to developing the market which need to be tackled:

- Financial support for those studying part-time
- Access and visibility of information to learners of all ages
- Alignment of incentives and goals with the desired growth of the market
- A lack of focus on the end goal of sustained employment.

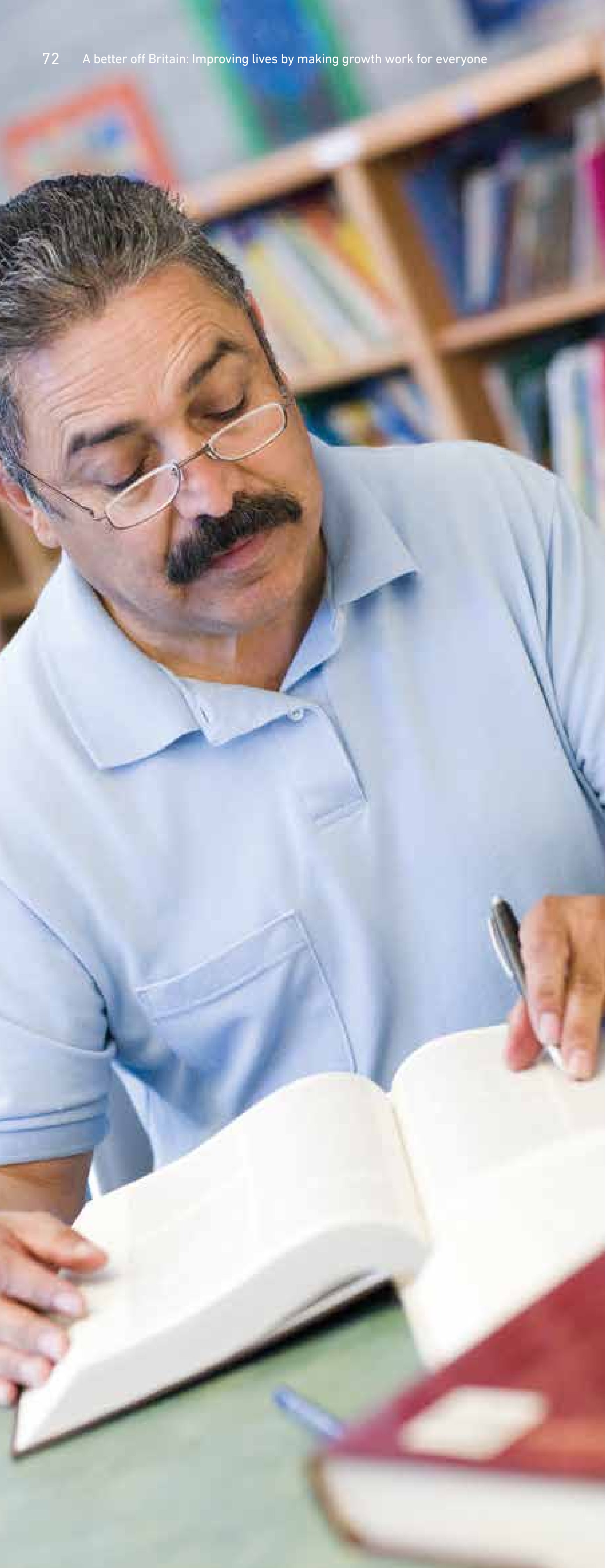


Exhibit 44: The Asda degree represents an important part in the retailers 'grow your own' strategy

In 2013 Asda and Middlesex University launched two three-year work-based degree programmes designed to develop the retailer's future leaders. Thirty spaces on courses in retail operations and in distribution are funded by Asda for colleagues who continue to hold salaried positions while they are studying.

On the Retail Operations programme students learn about merchandising, the retail environment, managing and developing people and managing retail operations. Those on the Distribution programme study specific modules on supply chain management and logistics.

The scheme was rolled out in 2013 following a successful pilot in 2012. This business-university collaboration is already benefitting Asda as shared modules across the courses are helping the retailer's top talent build networks and further understanding across the organisation. The value to the students is equally clear with half of the first batch of students promoted already.

"Government must start rewarding colleges based on what matters – employment outcomes."

We need college provision at lower levels to align with the needs of the labour market

In the state-funded part of the vocational education system – the earlier stages of the pathway to higher-skills – colleges are primarily rewarded based on how many qualifications their students gain rather than the impact of the course on their future employment and earnings. It is time for this to change – government must start rewarding colleges based on what matters, employment outcomes. This ought to lead to greater specialisation, and higher quality, in our FE sector as some leading colleges are already showing us.

And such a change should be in the wider interest of the college sector, too. At the moment, colleges are reliant on government funds that have been cut repeatedly in recent years. A move to outcome-focused funding would help the best colleges achieve much greater financial stability – and allow them to grow – while ensuring that underperformance is tackled effectively where it occurs.

Outcome-focused funding will change the picture on vocational education fundamentally. At the moment too many people are learning things that don't help them get a job – or get a better job. For example, in 2010/11 there were more than twice as many vacancies in automotive industries and the construction sector as there were people completing relevant qualifications. Meanwhile there were five people for every job in hair and beauty (Exhibit 46, page 74). This is unhelpful, because it means a great number of hairdressers will find it difficult to move into work, when – with the right support – they likely could have completed a qualification in another industry where there is a genuine gap and the promise of higher pay. Equally, it explains why we have persistent skills vacancies in our economy – the closing of which would bring wider benefits to our economy.

Exhibit 45: How the Association of Accounting Technicians helps career changers like Sara

The Association of Accounting Technicians (AAT) is a good example of adult retraining that works, with AAT offering routes into higher-skills for many career changers. Its accounting and finance qualifications range from level 1 to 4 and so far in 2014 64% of AAT prospects described themselves as 'career changers'. Sara Morris was one of them. Below we describe her story.

Sara Morris on her career change with the AAT:

"I had spent most of my working life running pubs with my ex-husband. However, the breakdown of my marriage encouraged me to re-evaluate my life and my employment prospects. I needed to find a new career, which would allow me to look after my two small children.

I had always looked after the books in the pub and so accountancy seemed as though it would offer me the chance to build on the skills I'd already learnt. Once my studies had started, I found a part-time position as a purchase ledger clerk.

I left school at the age of 16 and so had never been to university or college. Studying for the AAT Accounting Qualification helped me grow in confidence. Qualifying gave me such a sense of achievement and was a huge turning point in my life.

I now work as a school business manager, a relatively new role within the education sector. The variety within the role suits me and it also complements my voluntary role as a chair of governors. The education sector is changing so much currently with funding reforms and schools becoming academies and I am enjoying being part of it.

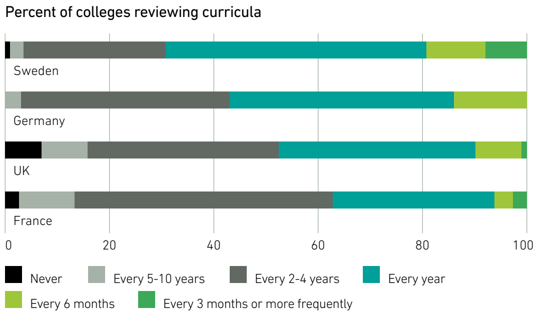
I have subsequently gone on to further studies and am continuing to develop my skillset. As the education system continues to change, more and more schools are looking for AAT qualified school business managers and I feel lucky to have found a vocation where my skills are in demand and that I find so rewarding."

Exhibit 46: We fail to train people in the skills our economy needs

	Vacancies per skill achievement (all ages)	Vacancies per skill achievement (16-18 year olds)
Automotive industries	2.4	3.7
Building services engineering	1.8	6.8
Construction	2.2	6.2
Land-based & environmental industries	1.9	3.3
Health & safety	0.2	15.8
Creative & cultural industries	0.8	1.1
Marketing & sales	142	1,034.3
Fashion & textiles	10.3	53.6
Hospitality, leisure, travel & tourism	0.4	0.8
Supporting teaching & learning in schools	1.2	61.7
Hair & beauty	0.2	0.3

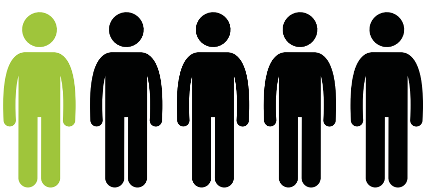
Source: Gardiner, L. & Wilson, T. *Hidden talents: skills mismatch analysis*, CESI, June 2012

Exhibit 47: UK further education colleges review their curricula less frequently than those in Germany or Sweden



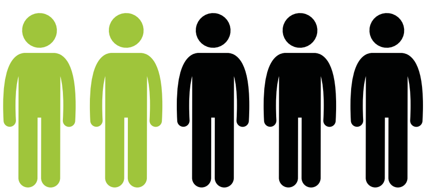
Source: McKinsey, Education to employment survey, Aug-Sept 2013

Colleges therefore have an important role to play in helping more people train for in-demand, higher-paid work. Over time, a more destination-based funding system, with stronger employer links ought to deliver a system more relevant to businesses, and therefore to learners. The Government is already driving at this through its idea of lead national colleges for key sectors, and giving businesses greater control over apprenticeship funding. These are initiatives that deserve support because we need to see change. On average, providers in the UK are less responsive to changes in the jobs market than those in countries like Germany and Sweden (Exhibit 47).



Hair & beauty – 1 job, 5 people

Automotive industries – 5 jobs, 2 people



Hospitality, leisure, travel & tourism – 2 jobs, 5 people

Construction – 4.5 jobs, 2 people

+26%

34% of firms plan to increase their training budget in the coming year and 8% plan to reduce it, a positive balance of +26%

But colleges cannot be expected to do all of this by themselves, they need support from business to make it work. The only way to make sure people are learning the things that will get them a job, or help them move into a better job, is for the people hiring them – business – to be involved in the qualifications themselves.

Over the last two years the government has laid the foundations for a more demand-led system, giving employers greater control over funding, for example through the UKCES Employer Ownership Pilots and the new apprenticeship 'trailblazers'. But there is still a long way to go, in particular on avoiding the new system overloading businesses with red tape. For employers the most important next steps are basing qualification design on employers' needs and industry standards, and raising awareness among businesses about current initiatives and how to get involved in the great work that is going on.[122]

There are already some very successful examples of partnership between businesses and education providers.[123] But these are still not the norm and building such relationships is more difficult for smaller firms in particular. Ensuring colleges are incentivised to specialise and align their courses to emerging labour market needs through a funding system that rewards employment and business outcomes will build the foundation for more of these links.

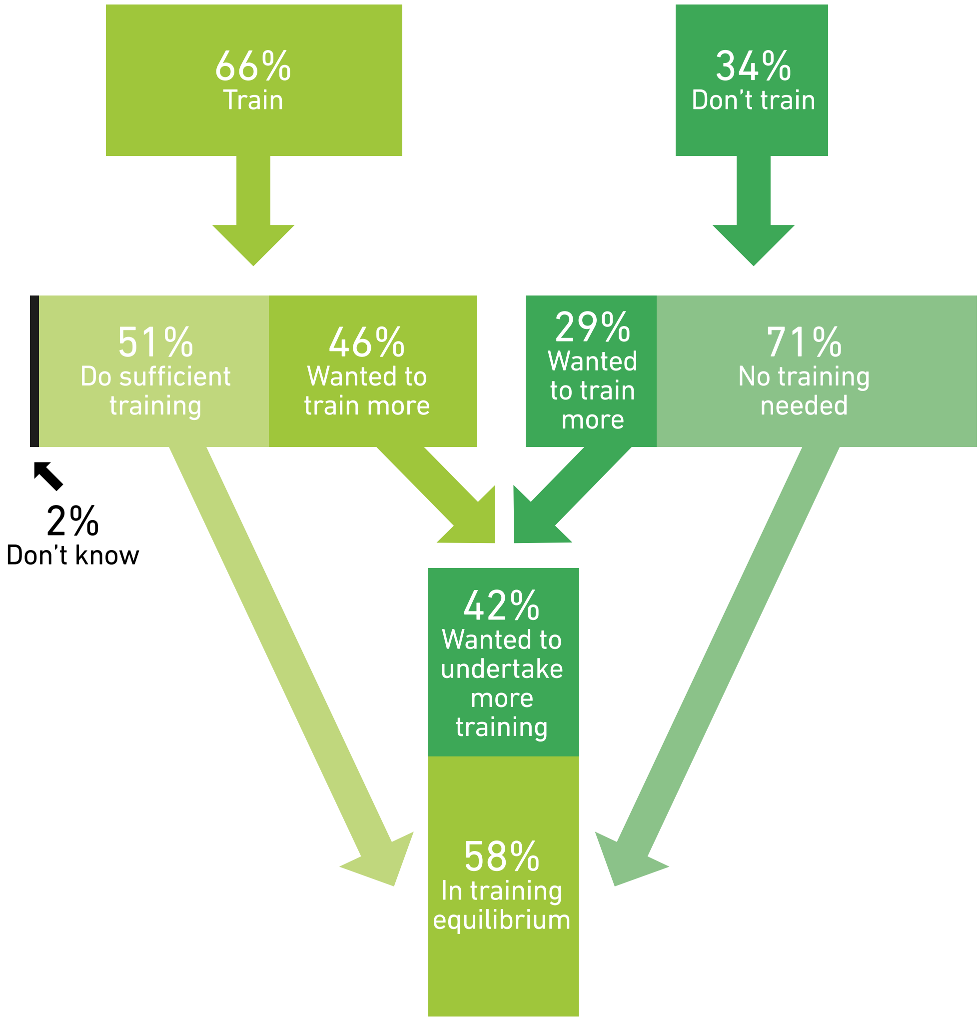
Helping more workers progress has to be a board level priority

The answers to this conundrum are not all about the skills system, however. In large part, they are about the development of people in the workplace during their careers – the opportunities they have and the encouragement they receive. And businesses realise they need to do more in this regard to help people build themselves a path to better pay, and higher productivity for firms.

This commitment from business can't be an easy line about people being our greatest asset. While line managers will always be the ones in the position to help someone develop, a real sense of direction and importance of the issue is required right from the top. This is a boardroom issue, and it is chairmen and chief executives of firms around the country who need to take the lead. For too long, these issues have been allowed to drift in many firms to becoming a human resources (HR) process when the ambition, supportive environment and opportunities that our focus group identified as essential to the delivery of better progression require leadership from the top. The CBI is therefore calling on all firms to make helping staff progress through their careers a board-level commitment.

With skills crucial to both pay progression and business success, a commitment to training represents the first step towards a more upwardly mobile workforce. Most large firms already do this well, with somewhat less training happening in smaller firms – perhaps a reflection of the fact that resources and budgets can often be tight in smaller companies. The latest figures from UKCES show that 93% of businesses employing 25 or more staff provided training in 2013.[124] Only businesses with fewer than five employees were less likely than average to train. In total, firms spent £42.9 billion on employee training and development, and – encouragingly – 42% of respondents wanted to do more (Exhibit 48, page 76).[125] A similar finding emerges from the CBI's education and skills survey, with 34% of respondents planning to increase their training budget in the coming year while only 8% plan to reduce it – a positive balance of +26%.[126]

Exhibit 48: There is appetite among employers to train more



Source: UKCES, Employer Skills Survey, 2013

Note: All establishments 75,255

> *Making the most of your talent reaps benefits not only for employees but for organisational performance too. Progression planning is no longer just an HR issue, it's a business strategy issue too.*

Larry Gould, CEO, thebigword

Exhibit 49: Focus group feedback – progression requires ambition, a supportive environment and opportunities

In today's jobs world there is no straightforward recipe for making progression happen, but there are a number of things that make it a lot more likely – ambition, a supportive environment and the right opportunities. This was the finding from a focus group we held to support this research with employees from CBI member companies that had managed to significantly progress within their firms.

In a 21st century jobs market where skills needs are rising and there is no longer a job for life, staying with the same firm for your whole working life and following a clearly set out career path within it is simply not the reality for the majority of people any more. This means careers are now what the group described as a 'jungle gym'.

That requires a lot more work and commitment from both employees and businesses. This means individuals that have the most success at progressing are those who are confident, take risks, push their own boundaries and have a natural curiosity for what's next. The group was clear that schools have an important role to play in building that kind of mindset early on alongside an understanding that learning doesn't end in school or university.

While it is the responsibility of each and every one of us to take charge of our own career, individuals were clear that they had needed help in pursuing their career and it was clear from the group that having a supportive environment mattered substantially. The factors participants identified ranged from business practices to the personal behaviour of mentors and line managers.

Business practices which were identified as helping facilitate progression include advertising upcoming opportunities internally first, clarity on possible career pathways and what it takes to move on up, a flexibility on the side of the employer to mould jobs to people rather than try and fit a person into a job, a commitment to in-house training and flexibility in recognising non-formal skills. A real commitment to helping manage career breaks when staff are off to have a baby or have to leave work due to other caring requirements can also make a genuine difference.

Businesses also have a significant impact on progression through line management, the group said. For starters it was recognised that progression works best where managers themselves have an incentive to focus on progression. This is about managers' objectives as much as about somebody moving on being seen as a positive within an organisation, rather than a concern that you are losing your best staff. But simply ensuring line managers focus on development won't be enough. Trust in manager-employee relationships is crucial – having somebody who believes in you who you trust can make all the difference. That then means 'taking a gamble on you' will pay off.

Of course alongside ambition and a supportive environment having the right opportunities available is a crucial prerequisite. Participants felt that opportunities could vary substantially across the UK's regions which meant sometimes moving somewhere else was the only way to progress. And naturally growing – and larger – firms were able to offer more opportunities in this respect. Mobility – a willingness to move – was felt to be important.

But while a willingness to invest in training is an important starting point, it is not enough on its own. Development isn't all about spending money on formal training courses. Indeed it is now believed that training courses are only responsible for about 10% of learning in companies, with 70% of learning happening through 'learning on the job' and 20% through mentoring and coaching.[127]

This was also reflected in the focus group we held as part of the research for this project with employees from CBI member companies that had done well in their careers, having built up from a lower starting point. Formal training did feature among the things mentioned by participants in helping them in their career, but it was certainly not the predominant theme. Instead, three key themes emerged – the importance of individuals being ambitious and driving their own career development alongside hard work, coupled with a supportive environment within the business they were working in and opportunities to progress (Exhibit 49, page 77).

As Exhibit 49 sets out a supportive business environment is about two things: the right business practices, and line managers that invest in their relationship with staff and are incentivised to make progression a priority. For firms to get this right they need a commitment from the very top of their organisation, which then needs to ripple through the organisation with the right tools and incentives for line managers. This isn't about managing people's progress for them, it's about empowering them to take charge of their own careers by encouraging them to think about their potential and helping them to better understand the options open to them.

Exhibit 50: Helping staff understand the options open to them underpins an effective learning and development strategy

The Midcounties Co-operative trialled a game style development board as a way of communicating their learning and development strategy to their 9,500 employees. The board shows the possible journey within the business from joining as an apprentice, to the training programmes for senior leadership roles.

The boards are used as a prompt for discussions about development at annual reviews, and to ensure they're tools that can be used at any time and not only once a year there are large versions displayed prominently around staff facilities and are available on the company intranet.

Previously a simpler arrows based visual had been used to represent the learning and development strategy, but this new, more engaging visual was found to help staff engage with the opportunities open to them. First created as a generic development tool, boards are now being developed for the company's various business areas. As part of the company's learning and development strategy, the development boards have contributed to a significant increase in the number of hours that employees are spending on training and development each year.

> *Much of our ability to raise productivity rests on skills and they are the only way to break away from lower-paid work.*

This sort of organisational commitment to development works best when managers are judged against their ability to spot and nurture talent as much as their ability to lead high-performing teams. This is an important change for many businesses to implement – some still tend to focus managers' reward on outcomes rather than in combination with other measures like their team's development. To ensure we can make progress the CBI therefore calls on more businesses to incentivise their line managers to make staff development a priority.

Putting staff progression into the framework of objectives and reward that managers have right across the business will help, but managers also need support to do this. It is not easy. So businesses must also equip line managers with the tools to deliver, both in terms of management education, working with business schools, and through greater HR support for talking about progression.

While most businesses have a learning and development strategy for example, a common challenge managers face is engaging individuals in understanding what the organisation's strategy means for them. Communicating this innovatively can make a big difference to whether these strategies feel real or distant to workers.

The experience of the Midcounties Co-operative (Exhibit 50) shows one novel approach through the use of so called 'development boards' which help illustrate their development programmes for staff ranging from the newest recruits to senior managers in an engaging way. L'Oreal has taken company thinking about progression even further by organising career workshops to help staff integrate at L'Oreal and think about where their current careers may take them in future (Exhibit 51). Spreading this kind of thinking more broadly would help many more people find a path to progression. A resilient and healthy workforce, building blocks of an upwardly mobile workforce, is also good for business (Exhibit 52, page 80).

Exhibit 51: Career workshops – a way to help staff think about where their career might take them

Employees at L'Oreal are empowered to take part in designing their own career path.

This starts at integration through L'Oreal FIT (Follow Up and Integration Track) and is equally supported at every stage of an employee's career. Employees in particular are able to participate in the following:

- Get one to one support from their managers and HR but equally from a mentor
- Get opportunities to learn about the different roles across the business through regular career workshops or round tables with senior members of the organisation
- Attend different training sessions to help them develop their skills, but equally create networks with colleagues that can support career progression
- Receive transparent feedback during both mid-year and year end reviews to understand strengths and areas of development and discuss the next career steps transparently with management
- Learn on the job through opportunities to observe and experience different situations
- Participate in work shadow experience to understand how other functions work

Exhibit 52: A different example of supporting progression: workplace health

We should acknowledge that progressing in your career isn't easy, and it requires both resilience and an ability to do your best. As we have set out, a focus on this by management can really help. But there are other things too that businesses can do to help, focusing on employee health in particular.

A productive workforce is one that is physically fit and psychologically resilient. However, research from BUPA indicates that only two in five are currently working at peak physical performance. This also affects productivity, with a worrying number (27%) of workers rating their current level of productivity as five or below on a scale of one to ten.[128] Therefore taking health, wellbeing and engagement of staff more seriously can reap real benefits for business and employees alike.

The CBI's 2014 report, *Getting better*, illustrated that businesses are increasingly doing more in this area and that this can drive higher engagement among staff and lead to real productivity benefits. Indeed, raising engagement to drive productivity was highlighted by CEOs in the 2014 CEO Challenge study as a major focus, part of ensuring organisational excellence. But as ever there is scope to go further, particularly among smaller and medium-sized businesses where management time is in short supply.[129]

Part of this is because it is often hard to demonstrate the benefits of programmes in practice for businesses, despite the increasing amount of research on these areas. But the reality is that a less healthy and engaged workforce is a cost for business as much as employees. Estimates put UK firms' failure to unlock these benefits at £6 billion in 2012, equivalent to 0.4% of GDP.[130] The number of factors that can be attributed to improved productivity and competitiveness, make it harder to identify the benefit of a single initiative. But the evidence indicates that successful implementation of workplace health initiatives comes from a joined-up approach from management with full engagement of all stakeholders.

RECOMMENDATIONS

For business:

- Work with higher and further education institutions to create 'learn-while-you-earn' routes into the new middle-skills (level 4).
- Make a board level commitment to helping staff develop their careers and incentivise line managers to make this a priority.
- Provide line managers with the tools to deliver better staff development and succession planning through management education in business schools, and greater HR support.

For government:

- Help more people gain the new middle-skills they need (level 4) by encouraging more co-working between higher and further education institutions and building an emphasis on vocational alternatives to degrees as a key part of the system.
- Give workers the confidence to study part-time by making the scale of financial support for courses better known, and change the rules that prevent people from retraining in lower or equivalent qualifications that are more in demand through fear of fees or unaffordable loan commitments.
- Launch a new government strategy for adult retraining.
- Encourage further specialisation in the further education sector and ensure colleges are delivering courses that are in demand in the economy by rewarding them on employment outcomes, not bums on seats.

EDUCATION

EDUCATION IS THE BEST LONG-TERM TOOL TO BOOST GROWTH AND LIVING STANDARDS THROUGH SOCIAL MOBILITY

CHAPTER 6

Education is the best long-term tool to boost growth and living standards through social mobility

This report is about why growth for everyone makes economic and business sense, alongside being the basis of opportunity and fairness in the UK. Nowhere is this truer than in our schools. That's why school reform has been a major feature of the CBI's work since our Annual Conference in 2012, and the launch of the CBI's First steps campaign. For too long, education has been unacknowledged as a key plank of the growth strategy – despite the fact that it is the greatest single tool for advancement of individual people and whole countries that there is. It is time to quicken our step on schools reform to make a real difference to living standards in the long-term.

The size of the cake we have to share rests on the quality of our schools

In 2012, when the CBI published *First steps*, we took a clear stand on the importance of education to growth. Our work showed that while the UK's school systems were gently improving, systems across the world were improving faster. It showed that while too many schools in the UK were focusing only on teaching to the test, the best systems in the world achieved rigour while also nurturing the aptitudes, attitudes and behaviours that will set young people on the path for success in work and life.

Our conclusion was that there was much more to do. And the prize is huge – raising achievement in UK schools to the level of the best in Europe could add one full percentage point onto growth in each and every year. That would mean £8 trillion added to GDP over the lifetime of a child born today. In terms of money to share, and job opportunities created, this would represent a massive step-change.[131]

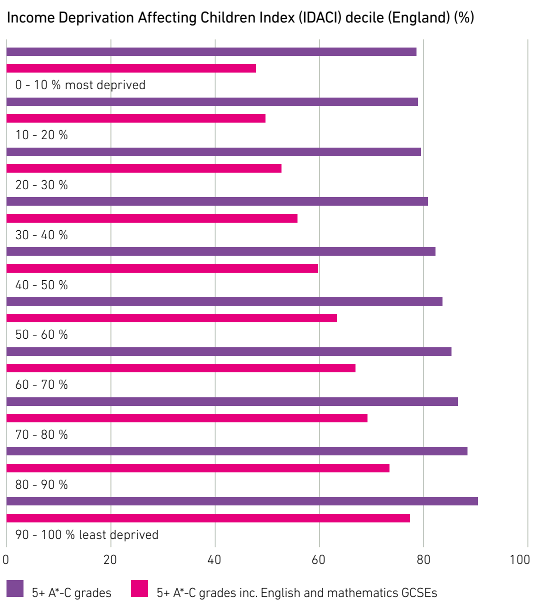
It is also the best tool to boost social mobility

Since the Ruskin College speech given by Jim Callaghan in 1976, politicians have sought to ensure our education system is focused on improving outcomes for all children. Callaghan's criticism, that schools were *"fitting a so-called inferior group of children with just enough learning to earn their living in the factory"* was far-sighted, as he appreciated both that the make-up of the economy was changing and that the factory these schools had in mind was one of the 1950's, not the turn of the millennium. His injunction that *"In today's world, higher standards are demanded"* reflects this.[132]

It might be said that businesses are fond of saying that schools are failing, but that is certainly not the position of the CBI. All our work focuses on supporting high performance. In fact, the experience of preparing our *First steps* report was of discovering a whole army of brilliant schools, staffed with brilliant teachers and led by inspirational heads, who understood that when businesses talk about the skills needs of today it is because skills needs are constantly moving on. The sad thing is that so many more schools continue to labour under a teach-to-the test regime, led by heads who are reactive to a poorly targeted accountability regime.

More than anything, the problem was that poor schools tended to be clustered in poor areas. 79% of pupils from an immigrant background whose mother had low education were in disadvantaged schools in the UK, compared with 55% across the EU, and 56% of all pupils in the UK.[133] This is a widely accepted measure of the equity of a school system. While London in particular has made some progress, we are still not in good shape when it comes to our school system challenging rather than embedding the status quo (Exhibit 53).

Exhibit 53: Background still matters far too much to a pupil's achievement in school

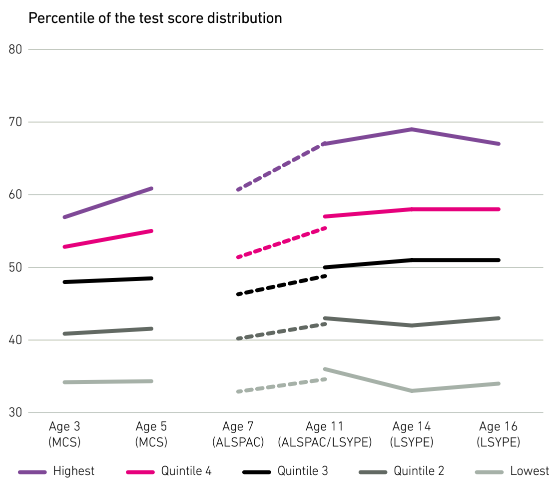


Source: Department for Education, Achievement at GCSE and equivalent for pupils at the end of Key Stage 4 by IDACI decile of pupil residence 2012-13

We need action to close the gap – from nursery to FE and HE

As early as age three there is already an attainment gap between children (Exhibit 54). Children from the poorest fifth of families have a 45% chance of being read to daily, by comparison with 80% of those from the wealthiest 20%. Likewise, at age four there can already be a gap in vocabulary of a year between children, based on background. And that gap widens during primary schooling – with a quarter of children in England, predominantly those from disadvantaged backgrounds, already behind at age five, failing to make sufficient progress up to the age of 11 to reach the levels of attainment expected in reading, writing and maths.[134] By the time they take their GCSEs, only 47.8% of children from the most deprived backgrounds achieve at least five A*-C grade passes including English and mathematics, compared to 77.4% of children from the least deprived backgrounds.[135]

Exhibit 54: Our school system is not closing the gaps

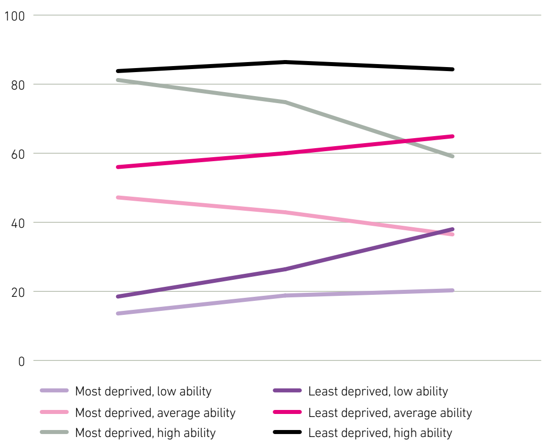


Source: Goodman, A. & Gregg, P. *Poorer children's educational attainment: how important are attitudes and behaviours?*, 2010

In the wider education debate the CBI has found a lot of support, but there has been little in the way of action.

This isn't only a result of children from more disadvantaged backgrounds starting school behind their peers. As time goes by, children from disadvantaged backgrounds who were initially judged to be more able are increasingly overtaken by others who were initially assessed as being less able (Exhibit 55). For example, better off children who are behind at age seven are more likely to go on to achieve – although even these only have a one in four chance of getting five good GCSEs, including English and Maths.[136] The impact of this underperformance at school can be seen in the wages of 25 year-olds, where those from the highest income family backgrounds earn on average just under £2 per hour more than those from the poorest backgrounds.[137] On an average working week of 37.5 hours that means those from the poorest backgrounds earn an average £71 less per week and £3,700 per year.

Exhibit 55: The most talented, most deprived children do worse than the less deprived children of moderate ability by Key Stage 4



Source: Progress made by high-attaining children from disadvantaged backgrounds Research Report, Centre for Analysis of Youth Transitions, 2014. Page 25

£2

By the age of 25, children from the poorest backgrounds earn just under £2 per hour less than children from wealthier backgrounds

Not enough progress has been made on our call of 2012

The relatively poor performance of our education system, and the need to raise levels of ambition and aspiration for all young people, were the catalyst for the CBI's schools campaign. There is nothing inevitable about the pattern of performance experienced by schools in the UK. Other high-performing education systems have shown that it is possible to reduce attainment gaps and raise standards on a broad basis.

First steps showed that change is possible – but it pointed to the need for a real system change, starting with being clearer about what we are asking schools to deliver in terms of rigorous, rounded and grounded young people, changing accountability to match this and moving away from the cult of the average (Exhibit 56).

Exhibit 56: First steps: A new approach for our schools

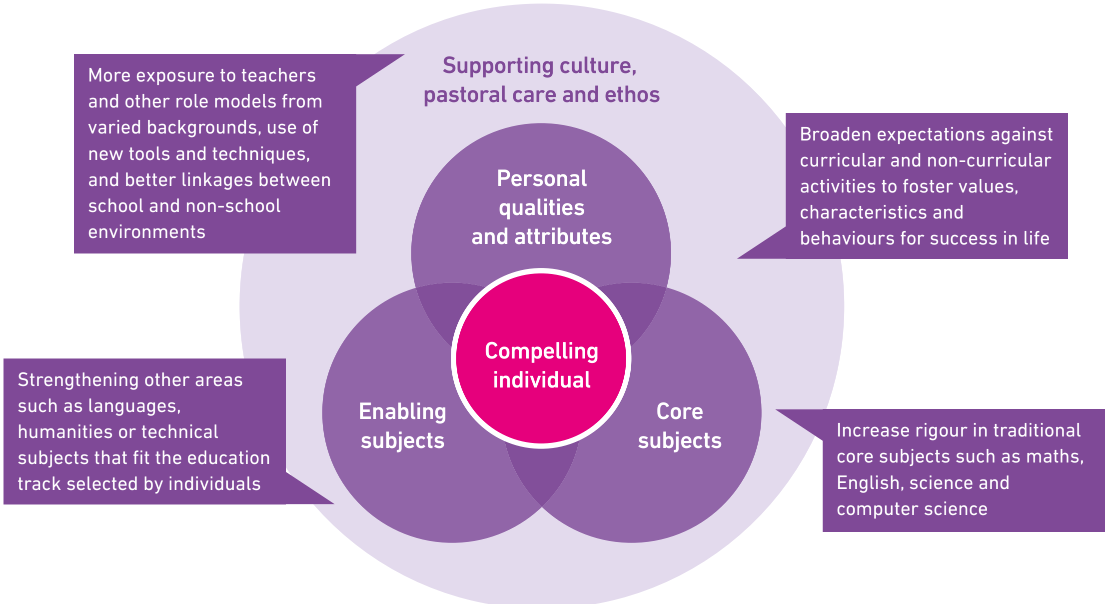
In November 2012, the CBI published *First steps*, which set out businesses' priorities for the education system. Working with teachers, headteachers and business, we set out a pathway for reform that includes:

- Reform of the Ofsted framework so that academic progress and the development of character are both prioritised by schools
- Acceleration of the programme of decentralisation of control to schools to empower teachers and school leaders
- A sharper focus on teacher quality and leadership skills
- Work to close the attainment gap at primary school by focusing early years' provision in those areas of greatest need
- Aligning the curriculum and examination systems at secondary with the goal of producing rigorous, rounded and grounded young people. This includes a move away from high risk exams at 16 towards a broader educational outcome at 18, a call for English and maths to be taught in some form until 18 and the delivery of gold standard vocational qualifications
- Encouraging greater – and deeper – business engagement in education.

This is what the best systems globally do. They start with a clear idea of what their system should deliver – across **both** academic and character. Everything they do is then aligned to meet this goal (Exhibit 57, page 86). In the UK, this has not been the case – with successive governments introducing a patchwork of reforms which have confused schools and alienated teachers.

Some of the key aims of our report are in action – we strongly supported the devolution of powers to heads and governing bodies, called for greater business engagement with schools and a new primary curriculum, and sought the creation of the early years' pupil premium. We agree with high aspirations for every child. Perhaps most importantly, the distortive targeting of school achievement on the GCSE C-D grade boundary, driven by the 5 A*-C accountability measure has been dispensed with.

Exhibit 57: Successful schools balance a number of important outcomes



Source: CBI, *First Steps: A new approach to our schools*, 2012

So far, so good. But much of what we set out in *First steps* has been left on the shelf. We swiftly need to address:

- How to develop accountability measures that reflect the goals of helping young people become rigorous, rounded and grounded through a new statement of outcome goals and a revised Ofsted inspection approach, harnessing more narrative reporting.
- A reassessment of why we examine in the way we do between 14 and 18 and the utility of peak level examinations at 16 at all. It is time to move away from GCSEs and move swiftly to develop the vocational A-level to sit alongside academic courses.
- Better investment in school leadership and teaching quality through the development of more school-led improvement networks and the creation of a national college of teaching.

To be frank, progress on these areas has been mixed. In the wider education debate we have found a lot of support, but there has been little in the way of action. It is to be hoped that the Secretary of State's speech at the recent Conservative Party conference is a sign of progress to come: *"For too long there has been a false choice between academic standards and activities that build character and resilience. But the two should go hand in hand."*[138] Likewise, Shadow Secretary of State, Tristram Hunt has said, *"We want our young people to have a sense of moral purpose and character, as well as to be enquiring, reflective and passionate learners."*[139]

On vocational education, the call for a gold standard vocational qualification to sit alongside A-levels has led to the creation of Tech-levels and Applied General qualifications – which will sit alongside many existing vocational qualifications. While the introduction of more rigorous vocational qualifications is a step forward, too few businesses are engaged in the process or even aware of them, and the approach is too complex. Just 3% of employers we spoke to are engaged with the process and only a further 9% considered themselves well aware of them. Worryingly, half of employers were not aware of the new qualifications and another third (35%) only had a little awareness.[140]

These new qualifications leave the vocational qualifications landscape confusing for both employers and young people – particularly when compared alongside the stability of A-levels. This is why the CBI is calling for vocational A-levels instead: different courses, differently examined from more academic counterparts, but at the same level of rigour and with the same trusted brand building on progress made by the creation of Tech-levels. The CBI is also calling on the government to speed up its implementation of the vocational UCAS-style system announced earlier this year. This has the potential to significantly raise awareness of vocational routes and help build parity of esteem with more traditional academic options.

This is important as the A-level and university path doesn't suit everyone. Yet, while vocational pathways to higher-skills are emerging, they are doing so from a significantly lower base (Exhibit 58). If we are to deliver an education and skills system that allows every young person to fulfil their potential, then we need more vocational pathways, opening up new routes to higher-skills for young people who would otherwise have been locked out of higher-skilled jobs.

Exhibit 58: The number of people starting their career via higher-level vocational pathways is rising

	Intermediate level	Advanced level	Higher level
2009/10	190,500	80,700	1,500
2010/11	301,100	153,900	2,200
2011/12	329,000	187,900	3,700
2012/13	292,800	207,700	9,800
2013/14 (August to April only)	213,500	96,800	4,300
% change 2009/10-2012/13	**154%**	**257%**	**653%**

Source: Skills Funding Agency, Apprentice ships starts 2005/06 to 2012/13 and provisional quarter 3 2013/14

If we are to deliver an education and skills system that allows every young person to fulfil their potential, then we need more vocational pathways.

> *For too long there has been one route pushed through the system: GCSEs, A-levels and then university for the higher achievers.*

We have to help people find their way towards work while they are still in school…

As part of the systemic reforms called for in *First steps*, support in developing career ambitions has an important role to play in raising aspirations, and addressing intergenerational inequality. The skills, knowledge, behaviours and attitudes developed in school need to be underpinned by a network of support when it comes to finding out about what possibilities the future holds. For too long there has been one route pushed through the system: GCSEs, A-levels and then university for the higher achievers. College and vocational has been a second choice option.

CBI teams have visited companies and colleges across the country where great vocational learning has been taking place, and in every case, the most common refrain is that no one advised students to look at doing their course, despite the fact that it is a stepping stone to a great career. Better careers advice and more opportunities to gain insights into the world of work are needed to help young people shape their ambitions. And they need better guidance about the different routes into their target careers. This is particularly important for young people from disadvantaged backgrounds who don't have the social networks that enable others to find their way without help from the school.

Work experience has a critical role to play here as the more exposure young people have to the workplace, the greater their employability prospects. But over half of employers report a lack of work experience and work readiness as an area of weakness among school leavers.[141] The abolition of the requirement for schools to provide work-related learning at Key Stage four has resulted in many schools no longer providing work experience at Years 10 and 11. This particularly hurts the prospects of young people from disadvantaged backgrounds because they are least likely to hear about the 50% of work placements advertised by word of mouth.[142]

Reinstating the duty on schools to provide work-related learning at Key Stage four is an important first step, but this is a challenge for business too. Employers must step up and offer valuable, inspiring and engaging work experience opportunities for every young person. This will require us to be more creative in how we define work experience – to include a mixture of inspirational business speakers, work-based projects and visits to industry, as well as the more traditional two week placement within a business.

...and deliver effective practical advice on how to get there

As well as first-hand experience of the world of work, young people need high-quality careers guidance. There are many different career paths in the UK today and these are constantly shifting. Those entering the workforce are highly unlikely to find 'a job for life'. The onus will be on them to drive their own career progression – drawing on behaviours such as grit, tenacity and resilience, qualities we want the school system to develop in young people. So while developing a sense of direction is more challenging for young people, it is also more important.

Like so many areas of our education campaign, this is about aspiration. Programmes like *Inspiring the future*[143] give young people the chance to see individuals from a similar background to their own succeeding and looking to the future. That is a powerful image. Good work experience, combined with high-quality advice and multiple employer interactions will help lift eyes to the horizon. Evidence suggests, for instance, that young people who remember taking part in at least four employer engagement activities at secondary school are less likely to not be in education, employment or training once they leave.[144]

It also has real business benefits in helping employers build the diverse workforces they want and need to give them a competitive edge. Over two-thirds (69%) of firms report insufficient numbers of people from diverse backgrounds in their sector or profession as an obstacle to developing as diverse a workforce as they would wish.[145] The effects of this are most clearly seen in the different university study choices of men and women. In 2011 only 13% of accepted places in engineering, 18% in technology and 22% in mathematics and computer science were taken by women. Meanwhile women took 89% of places on nursing courses and 85% on education courses.[146] Careers guidance must help open the eyes of every young person to the potential for them to be successful in a diverse range of occupations. Above all, it must help them to break out of stereotypical career routes based on their background.

However, careers support in schools remains on life support. The responsibility for providing high-quality careers advice was recently transferred to schools – but to date this has not worked, and it remains to be seen how effective the new statutory guidance for schools will be in driving up standards. Young people need a new deal – a new system of careers provision that has a strong business voice at its heart. But this can't be left to schools or business alone – this needs leadership from government. Earlier this autumn the CBI set out a vision for a national guarantee of quality careers support and work experience, mandated by national government but run locally and supported by Local Brokers (Exhibit 59). Action to apply a fresh approach is urgently needed – it is to be hoped that recent signs of an increasing focus on careers from the Department for Education will continue.

Exhibit 59: Extra support for young people – the role of Local Brokers

The starting point for meaningful and inspirational careers advice with real business involvement should be a Local Broker. They would provide a single point of contact for business and foster greater links between schools and employers providing young people with regular touch points with industry.

To ensure all young people benefit, a network of Local Brokers will need to be nationally mandated and funded by the next government but locally run. We're not prescriptive about this local structure – what matters most is that young people have the chance to benefit and explore the world of work. However, to ensure every young person has the opportunity to interact with business, Local Brokers should be shared between schools so that those without business links have the chance to build them. And, to ensure schools are rewarded for working with their Local Broker, this should become one of the broader outcomes Ofsted uses to assess school performance as currently insufficient emphasis is placed on this.[147]

> *The principles for improving gender equality are equally applicable to opening new opportunities for other groups from disadvantaged backgrounds.*

It's time for businesses to ensure their doors are open to talent from all backgrounds

Business also has an important role to play in ensuring individuals from more diverse backgrounds have the opportunity to succeed. And building a more diverse workforce is ultimately good for business too. Diverse workforces help firms better understand their markets and help them make more rigorous decisions. So it's no surprise, that over the past couple of decades the business approach to diversity has changed radically.

More and more businesses are now following the lead of firms like Channel 4 and are actively challenging any unconscious biases they may have. Channel 4 for example reassessed application rules that may unfairly punish some applicants and took recruitment out onto the road in areas where applicants find it difficult to imagine a career in the media, whether that is Bradford or Truro.[148]

The greatest steps forward have been made with the aim of supporting women in work. Businesses must now take the next step and apply these successful principles and practices to improve the outcomes for other diversity strands, including socio-economically disadvantaged groups. This will ensure talent from all sources has the chance to thrive and contribute to the success of UK firms.

Key to the progress that has been made on the 'women on boards' agenda has been its voluntary basis – businesses themselves are in the driving seat, and the goal is aligned with their needs. This has given businesses scope to try out different approaches and find out what works in their particular context. Significant progress has been made – there are no longer any all-male boards in FTSE 100 companies for example – but businesses acknowledge that there is still a long way to go.

In July, the CBI set out how a voluntary approach can make further progress on gender equality throughout the workforce, not just at the top – particularly in closing the gender pay gap (Exhibit 60). The principles for improving gender equality are equally applicable to opening new opportunities for other groups from disadvantaged backgrounds. Barclays, for example, has put this into practice. It created new routes into its business for workers without qualifications, and is helping them to gain new skills that allow them to move up over time (Exhibit 61, page 92).

Exhibit 60: Building on progress: boosting diversity in our workplace

Business has come a long way over the past couple of decades in changing workplace culture, and their experience has been that diverse groups of staff provide a more rigorous, challenging framework for critical decision making. There remains however, a long way to go and business must continue to drive the diversity agenda. Developing a talent pipeline without obstacles requires business and government to take targeted actions at each stage including:

- Businesses setting diversity policies meaningful in their own context and aspirational diversity targets at all levels
- Government committing to a Davies-style push to close the gender pay gap through a business-led approach and setting a national level target
- Tackling occupational segregation through better careers advice and targets for female participation in STEM subjects at school and university

People can see the value of the programme – increasing diversity, injecting new ideas and life into the business and genuinely helping people. That's why it's grown so rapidly.

Lynne Atkin, HR Director, Barclays UK Retail & Business Banking

Exhibit 61: Barclays is creating new routes into the business and progression opportunities for young people without qualifications

The Barclays Apprenticeship Programme aims to extend opportunities to young people in the disadvantaged position of not being in education, employment or training. The programme is also designed to help the bank build a more diverse workforce, improve staff retention and ensure that employees have opportunities to build careers with progression. Young people aged 16-24 are recruited for entry level permanent jobs and once they have completed their apprenticeship they have opportunities to gain further qualifications, including through a sponsored degree programme. More than 1,500 apprentices have joined Barclays in this way since April 2012 with the target of 2,000 by the end of 2015. Barclays is positively impacting society and addressing youth unemployment head-on. One of the key achievements to date is that three quarters (76%) of apprentices were claiming benefits before starting.

Being a household name, Barclays is taking a leadership role in helping to link these young people with employment opportunities within their SME clients. Its LifeSkills programme offers support to other businesses wanting to offer work experience and apprenticeships, and seeks to match young people who have received pre-employment training with local vacancies.

RECOMMENDATIONS

For business:

- Step up and offer valuable, inspiring and engaging work experience opportunities for young people from a wide socio-economic background and increase commitment to collaborating with and supporting schools.
- Ensure doors are open to talents from all sources through a stronger focus on achieving the widest socio-economic spread when hiring or offering internships.

For government:

- Ensure we develop rigorous, rounded and grounded and socially mobile young people through a new statement of what schools should deliver and a new Ofsted inspection regime to deliver accountability through the narrative reporting that is widely used in business.
- Set out a plan for 14-18 education, peaking with academic or vocational A-levels, and moving away from GCSEs.
- Reinstate the duty on schools to provide work-related learning at Key Stage four and introduce a national network of Local Brokers to support schools in delivering it.

RAINY DAYS

MAKING SURE PEOPLE HAVE A BUFFER
FOR WHEN A RAINY DAY COMES

Making sure people have a buffer for when a rainy day comes

So far, we have discussed the short-term steps a government might take to improve living standards and looked at areas where action now will allow pay to rise in the longer-term and boost people's chances of progressing to higher-skill, higher-paid work. But the path of life is varied, and from time to time something will happen that knocks a family out of rhythm. It doesn't even need to be something as substantial as the loss of a job for one of the adults. Perhaps the family car has coughed its last, or the fridge has packed up. For people living one day at a time financially, one-off unexpected costs can kick-start a cycle of debt. So we need to do more to help in this area too. It is right that people build up savings, have a stake in the wealth of our society and that they are able to use those savings as a back-up when a rainy day comes.

Having a buffer to fall back on helps when things go wrong, but saving in the UK is low

Having assets – such as savings, a pension pot and a home – makes a big difference to living standards and how people feel. It gives you the peace of mind that you are able to replace the washing machine when it breaks, never mind more serious issues. It also enables people to invest in their own development, for instance through part-time study. Over recent years it has been difficult for many people to save, but people know this is an issue and want to do more. We must help them do that.

The squeeze on household incomes has understandably made it increasingly hard for people to build assets, and spells of unemployment during the recession have meant that savings have been eaten up in many families. So as economic growth gains traction in the years ahead, we have to do more to help people accumulate resources that can act as a buffer in future difficult times.

Savings are the starting point for this. They provide not just a crucial safety net, but help people obtain other assets which can act as buffers as a family becomes more prosperous, like property or shares. And having more assets will in turn help people improve their standard of living, for instance by getting onto the housing ladder. In the past, many workers also had a substantial investment in their defined benefit pensions, but these schemes have largely closed now.

£1,300

The value of accessible rainy day savings of the UK median saver

Addressing the level of savings in the UK is therefore a must, and as we return to growth, now is the time to help more people save. Yet, we are starting from a low base. One in five people report having no savings whatsoever.[149] And the government estimates that the median UK saver has just £1,300 of accessible rainy day savings.[150] We do not compare well internationally either. The UK's household 'net saving rate', which measures net household disposable income minus consumption as a percentage of household income, has been lower than in most of our key competitors since the turn of the century.[151] In 2012, the UK had a net saving rate of 2.4% (up from 0.1% in 2000) compared to the Euro area average of 7.0% (down from 8.2% in 2000). And it's significantly lower than in Germany or France, who had rates in 2012 of 10.3% and 11.7% respectively.[152]

As Scottish Widows says in its 2014 Savings Report, most people want to be in a position to save. This was also a strong theme from the focus group we held in Birkenhead with support from Mustard Market Research with people who were unemployed or working in low-paid occupations. Exhibit 62 summarises what some of the participants said and highlights that some, even where they were in a position to save, worryingly felt it didn't pay to save. Some of this may be a reflection of current low interest rates, but changing this attitude – or changing the reality that it does not pay to save – is an important challenge.

Exhibit 62: What focus group participants said about the importance of savings[153]

"...more important than you think..."

"...security of having a few bob in the bank, allows you to get credit or an overdraft if you're in trouble..."

"...I'd like to say I save but I am not in a position to do so even though I work..."

"...we don't know how to save because we've never had to, 25-30 years ago, that generation all saved, now we don't, it's worrying and I'd like to..."

"...it's not worth saving now, I used to be a regular saver for my two lads, but they're grown up now and what do you get out of saving?"

We need a stronger political and economic focus on encouraging people to save when they are able to.

Business can help address the savings issue – as they have in the past

We need a stronger political and economic focus on encouraging people to save when they are able to. And what business, supported by government, can do is help make this more attractive. In the past, this has included pioneering occupational pension savings. Today, alongside pensions, Corporate Individual Savings Accounts (ISAs) are a great vehicle that firms who can afford to use to help people save. Government must remove barriers to individuals taking them up by allowing employees to save in both a corporate ISA and a personal ISA if they remain with their employer.

Corporate ISAs can help individuals 'auto-save'

Corporate ISAs are a tax-efficient workplace savings vehicle. Employees contribute to their account through monthly contributions from their pay. In other words, once enrolled in a scheme individuals 'auto-save' into an ISA, in a similar way to workplace pension schemes. Savings into ISAs can be made up of cash, stock and shares, or a mixture of the two up to an annual limit which the government sets every year.[154]

Corporate ISAs are not a new phenomenon but not many businesses offer them. Yet in lower paying roles in particular, they are likely to be more attractive to employees than additional saving into a pension plan. Money in an ISA can be instantly available if necessary. To date, it is mainly larger businesses that have offered corporate ISAs, as they are able to use their size and clout to negotiate better deals for their staff. But employers of all sizes should be able to offer them – and we should be looking for many firms to do so. Deducting regular contributions directly from payroll is not an onerous commitment, indeed many small firms already do that for employees paying back student loans. This makes corporate ISAs a relatively low-cost option. There is currently also some legal and financial complexity about implementing ISAs, and in particular, how they can be integrated with employee benefit packages in a way that drives engagement.

Government can help by allowing individuals to save both into an individual and a corporate ISA

In making this happen government has a role to play too. At present it is possible to save into only one type of cash ISA per tax year. This means that if an individual opens a cash ISA at the beginning of the tax year personally, they would not be able to save into another cash ISA with their employer. Changing this would make it more attractive for employees to save in these schemes, and for companies to promote them.

Employee share ownership and capital share schemes can help employees build buffers

Corporate ISAs could help more employees save. Share schemes and employee ownership represent other ways of helping staff build up buffers – and they are also good for business success as they can increase staff engagement. Different models will work for different firms, but as with corporate ISAs, there is more government can do to help with take-up and support businesses who choose to go in this direction.

Employee share ownership and employee share schemes represent a lower-tax way of rewarding employees and helping them build-up buffers. Both of these schemes can make a real difference to individual living standards, much to the contrary of proposals to put employees on boards (Exhibit 63).

Exhibit 63: Why mandating employees on boards is not the answer

Making employee representation on boards mandatory is not the right approach needed to make a real difference to living standards, despite often being proposed as a solution.

With post-crisis regulation clearly setting out a number of requirements for the skills and experience that board members must have, it is increasingly challenging to put together a board that has the mix of skills that is best placed to steer the company towards the long-term success that benefits both the company and its employees. This mix will be different for every company, as ethos and business strategy vary by firm.

Of course, it is vital that employees' voices are heard in all organisations. Good corporate governance acknowledges and addresses the interests of all stakeholder groups – employees being one of the most important ones. New reporting rules in the UK have already shifted the focus more towards the non-financial performance of companies and this includes social and employee matters. With the link between motivated employees and good company performance being clear, investors have a clear interest in holding companies to account for the way in which they handle such issues and now have more information available to them to do so. This will be key in creating material and sustainable change.

It is right that people build up savings, have a stake in the wealth of our society and that they are able to use those savings as a back-up when a rainy day comes.

Exhibit 64: Key characteristics of tax-advantaged employee share schemes

Share Incentive Schemes (SIPs)	Save-as-you-earn (SAYE)	Company Share Option Plans (CSOPs)	Enterprise Management Initiatives (EMIs)
• Open to all employees after an optional probationary period • Discount on price • Administered by a trust • Minimum holding period for full tax benefits • Shares can be transferred into ISAs • Voting rights optional for businesses • Corporation tax deduction available to businesses with SIPs • Expensive to set up and run	• Open to all employees • Option granted following qualifying period • Discount on price • Shares must be bought from special savings account • Shares can be transferred into a stock ISA • Tax advantages	• Discretionary (not all employees need to be offered same terms) • Option granted without discount on price • Right to exercise can be conditional of business outcomes • Tax advantages	• Discretionary • For companies with assets of £30 million or less, and fewer than 250 employees • Tax advantages • Companies that work in 'excluded activities' aren't allowed to offer EMIs (e.g. shipbuilding or banking)

Source: HMRC, https://www.gov.uk/tax-employee-share-schemes/overview and http://www.hmrc.gov.uk/shareschemes/

In businesses with employee participation in share schemes, the workforce has a significant financial interest in the business, and also has a say in how it is run.[155] There are various approaches to this, up to and including the full employee ownership model used by the John Lewis Partnership. Under share schemes, businesses can offer some or all of their employees shares in the company. This means that when the business performs well, the value of the shares increases, giving employees a direct benefit from company performance. These schemes also have the potential to help improve people's lives more widely: the evidence is that participants in share schemes develop a greater level of knowledge and understanding of how they can manage their personal finances more effectively, as well as improving wealth, health and well-being.[156, 157]

Currently a great number of different share schemes exist, with some of these schemes having tax advantages such as exemptions from paying NICs or income tax. Exhibit 64 compares these tax-advantaged share schemes.

These schemes aren't just good for employees though, if used well they have the potential to lead to greater business success too. A range of qualitative studies link employee ownership and share schemes to higher productivity and better organisational performance. In 2013, the Employee Ownership Index, which monitors the performance of firms with some form of employee share ownership, delivered average returns of 53.3% compared to the 20.9% average return of companies in the FTSE all-share index. Research also highlights the benefits for businesses as the result of improved employee engagement, employee loyalty and ownership succession.[158] For example, organisations in the top quartile of employee engagement scores had 18% higher productivity than those in the bottom quartile.[159] Exhibit 65 (page 100/101) outlines the case of two businesses that have gone through the process and the benefits they have seen, Starbucks and the John Lewis Partnership.

Exhibit 65: Giving employees a stake in business success can make a difference to living standards and contribute to organisational performance

John Lewis Partnership

The John Lewis Partnership is the largest employee owned company in the UK, with 91,000 permanent staff and annual gross sales of over £10 billion. Each staff member is a Partner, meaning that they share in the benefits and profits of the business. Last year alone, the Partnership created 6,300 net new jobs; staff shared a £200 million bonus, and absenteeism was 3.4% (compared to 7.8% for the retail sector).

John Spedan Lewis gave the Partnership to his employees in 1929, with the goal to balance the happiness of Partners with a successful business. This combination of commercial acumen and corporate conscience was ahead of its time, but has proved a success, with reports of higher productivity and wellbeing of staff, and better organisational performance.

The Partnership is often cited as a unique set-up, but its approach has been successfully adapted by firms of all sizes and sectors. Shares are held in a trust, and the beneficiaries of that trust are the employees of the company, the Partners. They share the profit, and have oversight of management decisions through a number of democratic bodies. The business cannot be sold, which creates a stable, long-term structure. There are several models of employee ownership however, and many other businesses are either substantially or wholly owned by the people who work for them.

"Employees with a stake in the business are more interested in making it a success, and experience higher-levels of wellbeing and job satisfaction. Productivity is higher and staff turnover lower, helping us deliver sustainable growth, employment, and better business performance."

Sir Charlie Mayfield, chairman, John Lewis Partnership

Starbucks' Bean Stock Scheme

In 1991 Starbucks introduced Bean Stock, a benefit scheme, which turned eligible Starbucks employees into partners by providing them the opportunity to share in the financial success of the company through shares of Starbucks stock. Howard Schultz, chairman and CEO, *"[...] wanted [partners] to have a chance to share in the benefits of growth, and to make clear the connection between their contributions and the growing value of the company."*[160]

This program was the first of its kind in the retail industry. It started with 700 partners in just over 100 stores in the US and Canada and now includes over 125,000 eligible Starbucks partners in 21 markets around the world.

In 2010, Bean Stock was redesigned to reward partners with restricted stock units (RSUs). An RSU gives partners the right to receive shares of Starbucks stock after a specified period of time (also known as vesting). This has encouraged partners to act like owners of the business, and has been a key factor driving organisational performance as well as attracting and retaining talent. When RSU grants vest annually, partners receive actual shares of Starbucks stock.

For example, partners hired by the 1st May in any given year are eligible to receive an award of RSUs in November with 50% vesting after one year and the remaining 50% vesting after two years. Over the past five years, the value of Starbucks shares has increased by over 750% (from c. $9 to c. $77), providing partners with significant capital growth. Since the program's inception, partners around the world have received more than $1 billion in pre-tax gains thanks to Bean Stock.

Bean Stock has made a real difference in the lives of Starbucks partners. There are many examples of long-term Starbucks store partners building significant gains to put deposits on their first homes or travel abroad. The scheme has been imperative in making employees feel like a material part of the company wherever they are based as well as proving that hard work can pay off.

Bean Stock is just one of the ways we show our commitment to investing in our most important asset, our people. It's great to see Starbucks partners around the world benefitting from the scheme in life-changing ways.

Mark Fox, managing director, Starbucks UK

Government needs to ensure that legal, tax and regulatory frameworks support businesses who want to do more

Government can help more businesses and individuals harness these schemes by tackling current barriers to take-up. There are a number of structural and informational barriers that can hold back businesses from moving towards employee ownership or share scheme models. These include a lack of awareness, lack of resources, financial constraints (e.g. the absence of a tax incentive), and the regulatory burden.[161]

The way government can help make a real difference to uptake is by simplifying the legal, tax and regulatory framework around these schemes. Addressing the following three barriers would make a real difference:

- More flexibility in regulation for firms who are looking to diversify their shareholder mix, making it easier to adopt employee ownership or Employee Share Ownership Plan (ESOP) models – in privately-held firms as much as listed ones.
- Internationally consistent voluntary employee share ownership frameworks, allowing businesses that operate globally to adopt tax-advantaged status for existing share schemes.
- Assessing the difficulties some smaller businesses have with these models when trying to access finance at an affordable rate, which has been cited as a factor stifling growth.[162]

Auto-enrolment opens up new possibilities that could be explored in time

Government must ensure its policy decisions help individuals build up financial resilience both in terms of long-term saving and the ability to navigate life's challenges. Earlier, for instance, we identified housing as a key area of cost and opportunity, and Exhibit 66 highlights this. But we can do more.

Exhibit 66: Housing policy has an important role to play in helping people build assets and in reducing the cost of living

Government can and should do a lot more to help individuals build up assets which can act as buffers during their working life across a range of government policies. Housing policy is one example. For the majority of families across the UK their home presents their single largest asset. Yet, owning your home is becoming more and more difficult for many hard-working families.

As a country we have historically built far fewer houses than we need, which has meant house prices have risen to unsustainable levels. Our recent report *Housing Britain: building new homes for growth*, estimates that if house prices had instead risen at the rate of inflation individuals across the UK would have had £3.2 billion worth of extra spending power.

So building more homes is a crucial must, not just because owning a house gives you something to fall back on, but also because if we build more homes the cost of housing – whether you buy or rent – will eventually become more manageable meaning people have more money in their pockets. That's why the CBI has called on the government to double the number of new homes built to buy and rent, which will mean building 240,000 new homes every single year within the next decade. Other recommendations of the report which will help us do that are listed below:

- Providing a clear and sufficient pipeline of land, including a commitment to developing ten new towns and garden cities by 2025
- Retaining and improving the National Planning Policy Framework to ensure the UK has a flexible and workable planning system
- Developing innovative financing in order to build new homes, for example via British Business Bank support for SMEs in the housing market
- Underpinning investment by a simpler and competitive tax regime, for example through progressive reform of Stamp Duty Land Tax when public finances permit
- And a focus on well-designed homes built by a skilled and diverse workforce.

One area that we could explore is whether the move to most workers having pension savings opens up new possibilities, once the reform is fully rolled out towards the end of the next Parliament. Auto-enrolment will see nine million eligible workers saving for retirement – many of whom will save into a pension for the first time – thereby increasing savings rates. We are moving into a world where a very high proportion of employees have a pension pot – in many cases small, but not insignificant. This policy is essential in ensuring people are able to maintain their living standards when they leave the workforce. For the first time, the relatively cash-poor will have pension pots, as well as the more cash-rich.

Making more of pensions wouldn't mean allowing people to raid their retirement savings, which would damage the long-term sustainability of the pot. Instead, government should work with the insurance industry to look at ways in which the auto-enrolment framework could support people during working life. A very wide range of options include New Zealand-style early access, the kind of 'loan-back' arrangements used in the USA and South Africa to allow people to take a low-cost loan from their pension, and the use of the automatic enrolment framework to address protection against unemployment or ill-health through new insurance products.

An extensive study will be required to make an informed choice of approach and, importantly, we would need to ensure that the right regulatory framework was established, to avoid the risk of fraud. Nevertheless, the right policy might increase lower-paid employees' confidence in saving through the workplace. Knowing you will be able to access support when you really need it will help. This is important because the average size of a defined contribution pension pot at the moment is just £15,000,[163] smaller than it should be. It also gives the pensions industry a business opportunity to innovate appropriate products to meet consumer demand. Importantly, it may help build trust in an industry that is seen as quite opaque to most people.

RECOMMENDATIONS

For business:

- Play a stronger role in helping employees build up buffers by considering a wide range of workplace savings options.

For government:

- Raise demand for corporate Individual Savings Accounts (ISAs) by allowing people to save into both an individual and a corporate cash ISA.
- Simplify the legal, tax and regulatory framework to tackle barriers to the uptake of capital share and employee share ownership schemes among business.
- Work with the insurance industry to review options on using the auto-enrolment reforms flexibly to deliver support during working lives.
- Help more people onto the housing ladder and reduce the cost of renting a property by building 240,000 new homes every single year within the next decade.

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71 This includes retail and wholesale, where a gap exists not just with the US but also with Germany and France, albeit this gap is somewhat larger in wholesale than retail.

72 This figure is reached by calculating the additional output per hour that would be generated if UK productivity in each of our labour intensive sectors was on a par with their US counterparts, multiplied by the number of hours worked, and then attributing around 60% of the gain to workers in line with employees' compensation share of business income. 2.2% has been the UK economy's nominal growth rate between 2009 and 2014 and 3% the nominal annual pay rise for the median worker lifting productivity in labour intensive sectors to the US level could bring.

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