An independent study of the business benefits of implementing a Living Wage policy in London

Final Report

for

GLA Economics

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Under its remit of economic and social development within the Greater London area, the Greater London Authority (GLA) seeks to promote a Living Wage policy throughout public and private sector organisations in London, known as the London Living Wage (LLW). London Economics were appointed by the GLA to investigate the experience of organisations that have adopted the LLW (in terms of both benefits and costs) in order to form quantitative evidence of the impacts of the LLW.

Methodological Approach

To undertake a balanced assessment of the outcomes associated with the implementation of the London Living Wage, we undertook several elements of research activity.

In the first instance, we assessed the economic and policy literature associated with minimum/Living Wages and assessments of the economic impact of Living Wage initiatives (predominantly from the United States).

In terms of qualitative research, we collected qualitative evidence of productivity and efficiency benefits, in addition to barriers and costs of LLW implementation through a number of face-to-face interviews with LLW employer organisations (Buyers and Contractors), LLW employees, trade unions, academic experts and one non-LLW adopting organisation. A separate semi-structured interview questionnaire was designed and utilised for each group.

London Economics also sought to gather employment and financial data (specific to LLW contracts) in order to undertake quantitative analysis of the impact to organisations of implementing a Living Wage policy in London. In collecting and analysing this data, we sought to explore the actual recorded outcomes that might have occurred over time and since the implementation of the LLW in each organisation. We also sought to understand whether any change in business performance might be linked to the implementation of the LLW.

This study was ambitious in its objectives. However, limitations on the possible analysis imposed by data constraints have meant that the report and its findings are subject to some important caveats, as detailed in the main report text.

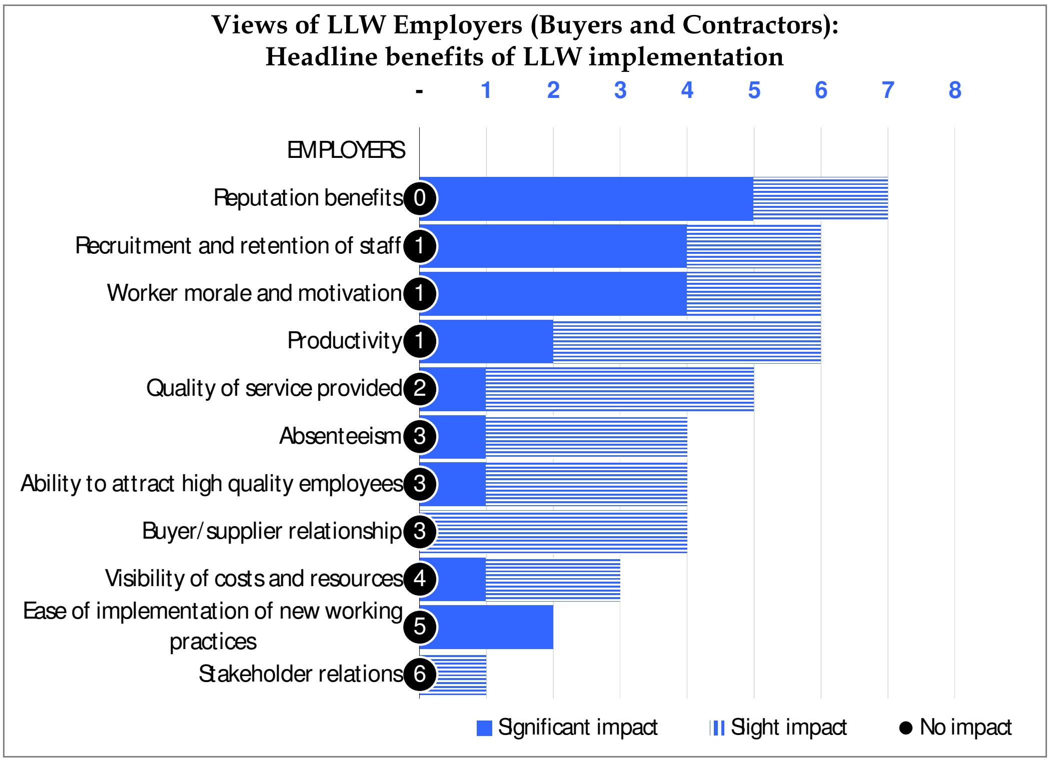
Findings of literature review

The findings of our review of the existing literature in the area of minimum wages and Living Wages may be summarised as follows:

- Living wage provisions are not generally associated with job losses or worker displacement
- There is some evidence of productivity increases (often not statistically significant) associated with higher effort, lower staff turnover, reduced absenteeism, increased stability of workforce, and improved worker morale, motivation and commitment
- Increased cost pressure leads firms to seek efficiency and cost savings elsewhere, such as reorganisation of workflows and substituting FT workers for PT workers (saving NI, training, etc)
- Increased training of staff and higher service quality
- Some evidence of 'ripple effects' to maintain pay differentials

Benefits of LLW implementation

Our study found clear evidence that employers have benefited across a wide range of areas after implementing the LLW. The following graphic summarises the views of employers surveyed relating to the benefits experienced. The most significant impact noted was recruitment and retention, improved worker morale, motivation, productivity and reputational impacts of being an ethical employer.



To fully understand the nature and drivers of these headline benefits experienced by organisations that have implemented the LLW, we investigated each of these benefit areas in greater detail. Following this in-depth research, the following are amongst the most significant benefits identified:

Recruitment and retention of staff

- Significantly lower rates of staff turnover
- Substantial cost savings on recruitment and induction training
- Employees more likely to stay with organisation
- Increased tenure of workers and continuity of workforce

Recruitment and retention is an area in which the LLW has made a significant impact, and reflected in particularly strong support from Contractors, as the direct employers of most LLW workers. All but one employer with employees affected by the LLW reported a positive impact in general on recruitment and retention within their organisation with two thirds reporting a significant impact.

Absenteeism and sick leave

- Lower rates of absenteeism and sick leave

For the majority of firms, the Living Wage has had an impact on reducing absenteeism and sick leave. One Buyer reported that following the introduction of the Living Wage into contracted-out services, absenteeism had been fallen by approximately 25%.

Productivity

- Evidence of enhanced quality of work
- Widespread efficient work reorganisation

More than 80% of employers believed that the LLW had enhanced the quality of the work of their staff. Employees (almost 75%) also reported increases in work quality as a result of receiving the LLW.

Worker morale and motivation

- Significantly boosted worker morale and motivation

Worker morale and motivation is one impact of the London Living Wage that employers feel is significant with all reporting some positive impact.

Reputational benefits

- Significant benefits for LLW organisation's Corporate Social Responsibility reputation and public image

Nearly 70% of both Buyers and suppliers felt that the Living Wage had increased consumer awareness of their organisation's commitment to be an ethical employer.

Employee benefits

- Substantial financial and welfare benefit for employees

All employees reported that this wage difference has not only made them far happier in their work but has improved their standard of living enabling them to better manage their bills, have a better standard of family life and pay for education and training. The following quotes are instructive:

> *"It is interesting that some people want to improve the standard of low paid jobs thanks to the Mayor of London. Now I can manage my bills and transportation easier but my main worry is still the cost of living. In London the cost of living is higher than the low paid jobs are being paid."*
>
> *"The cost of living is more expensive...with the Living Wage I can give my daughter more things...it also gives us more motivation to keep cleaning."*
>
> *"Being paid the higher wage means I can pay to go to college – I'm studying in the evenings to be a computer programmer."*
>
> *"I'm starting college in the evenings to be an accountant".*
>
> *"The Living Wage means that my children can enjoy trips outside of London."*

Implementing change in workplace

For employees, approximately half felt that the Living Wage had made them more willing to implement changes in their working practices; enabled them to require fewer concessions to effect change; and made them more likely to adopt changes more quickly.

Barriers and costs of LLW implementation

In the course of our research, we also investigated the implementation costs experienced by the surveyed employers. Views on perceived barriers to more widespread adoption of the LLW were also sought. Finally, we considered induced impacts within the organisations and the strategies used to recoup the potential increased wage costs as a result of LLW implementation.

The main **barriers/difficulties** in deciding to implement the LLW perceived by Buyer organisations surveyed were:

- Re-negotiation of employee/Contractor contracts
- Issues of maintaining pay equivalence

- Increased wage costs
- Impact on profits, prices or share price
- Ensuring Contractors pay LLW

Our research also sought to identify and quantify the **costs** experienced by Buyer and Contractor firms. Significant costs experienced by Buyers include:

- Increased price/costs of contracted services (for Buyers)
- Increased costs from renegotiation of existing contracts (for Suppliers)

Costs experienced by Contractors are:

- Increased labour costs
- 'Ripple' wage increases to maintain wage differentials.

We found evidence of little or no impact on business performance of London Living Wage implementation. All LLW employers reported no change in sales/turnover. Half of employers also saw no change in their profits, with two seeing a slight decrease and one a slight increase. The majority also experienced no change in prices or output.

Conclusions on potential benefits of LLW implementation

Our findings indicate that there is some evidence of significant financial and non-financial benefits achieved by those employers that have implemented the London Living Wage. Although some organisations indicated that there were non-trivial implementation costs, the absence of any evidence of substantial negative impacts on business performance on an on-going basis suggests that there is a likely positive net benefit of London Living Wage implementation for a typical firm.

In general, both Buyer and Contractor organisations are very supportive of the London Living Wage initiative, owing to the range of benefits that they reap – especially in relation to recruitment and retention of staff, worker morale and their enhanced reputation as a socially responsible organisation. These benefits identify that there is a real business case for organisations to implement London Living Wage provisions. Finally, one finding speaks volumes: All Buyers and Contractors reported that they would, if faced with the same choice today, implement the London Living Wage.

1 Introduction and background

Under its remit of economic and social development within the Greater London area, the Greater London Authority (GLA) seeks to promote a Living Wage policy throughout public and private sector organisations in London, known as the London Living Wage (LLW)[1].

As a result of the GLA's campaign, there exists a growing number of organisations that provide all staff, including contracted support staff, with the pay and conditions of the LLW. London Economics were appointed by the GLA to investigate the experience of these organisations, in terms of both benefits and costs, in order to form quantitative evidence of the impacts of the LLW on organisations. This report represents the output of this study.

1.1 Research objectives

The GLA seeks quantitative evidence of the benefits and costs of implementing a Living Wage policy, as an indication of the benefits and costs that organisations considering the LLW may realistically expect to experience. Accordingly, our overall objective in this research is to provide a quantitative study of the potential efficiency benefits of implementing a Living Wage policy in public and private sector organisations in London.

The specific objectives of this study were to develop:

- A body of evidence concerning efficiency gains arising from implementing a Living Wage policy or Living wage provisions;
- Potential metrics for efficiency gains, particularly qualitative gains where no immediately obvious measure of performance presents itself;
- An analysis of the results to assist the GLA in making judgements about the scale of efficiency gains that organisations implementing Living Wage provisions through procurement and their Contractors implementing a Living Wage can realise, if these exist;
- An indication of data gaps requiring future work; and
- A summary of the wider social costs and benefits, which may be used to guide further study.

1 In fact, the policy may also be referred to as a Living Wage for London (hence, LWL), but for the purposes of this report the acronym LLW is used.

1.2 Background and context

Although the United Kingdom has a National Minimum Wage (NMW) policy aimed at preventing the exploitation of the lowest-paid workers in society, this does not ensure any minimum standard of living for workers. Moreover, the NMW is a national average pay rate, so variation in the cost of living regionally means that the standard of living that the minimum wage 'buys' differs regionally. As London has a substantially higher cost of living than other areas in the UK, the standard of living afforded by the NMW in London is significantly lower than the average. The 2008 London Living Wage rate takes into account improved data on private rents, and has also improved estimates of the cost of rented accommodation available to households without children.

In recognition of this fact, and the desire to ensure a minimum acceptable quality of life for workers in London, the GLA is committed to the promotion of the widespread adoption of a Living Wage policy in London.

A Living Wage is defined by the Family Budget Unit (University of York) as "a wage that achieves an adequate level of warmth and shelter, a healthy palatable diet, social integration and avoidance of chronic stress for earners and their dependents"[2]. Whilst focused on wages, the concept of a Living Wage also covers holiday entitlement, sick pay and support for union recognition. It requires employers ensure the following conditions for all of their staff, including contracted support staff:

1. Paid at least the Living Wage;
2. Eligible for at least 20 days paid holiday a year plus bank holidays;
3. Eligible for at least 10 days full sick pay per year; and
4. Allowed free access to a trade union.

However, this report is primarily concerned with the benefits to organisations associated with implementing the London Living Wage rate, not the conditions identified as above points 2, 3 and 4.

In 2004, GLA Economics set about determining a realistic Living Wage in London and to examine related poverty issues. Since 2005, GLA Economics has published an annual report, which considers the issue of a Living Wage in London, based on costs of living and the threshold that might be considered as constituting 'poverty level' wages in London. The value of the Living Wage for London was most recently estimated in July 2008 at £7.45 per hour[3]. This means that any wage below £7.45 per hour (including accounting for benefits) results in an income at or below the poverty line level in London.

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[2] GLA Economics (2007) *A Fairer London: The Living Wage in London*, (p.7).

[3] GLA Economics (2008) *A fairer London: The 2008 Living Wage in London*, available from: http://www.london.gov.uk/mayor/economic_unit/docs/living-wage-2008.rtf. The LLW has been

The GLA has conducted many studies of low pay in London, with the most up-to-date statistics indicating:[4]

- 15% of full-time employees in London receive less than the LLW of £7.45 per hour, of which, 5% receive wages that are below the LLW but above the poverty threshold wage of £6.50 per hour, whilst the remaining 10% receive wages that are below the poverty threshold wage.
- 45% of part-time workers in London receive less than the LLW, of which: 11% receive wages that are below the LLW but above the poverty threshold wage, whilst the remaining 34% receive less than the poverty threshold wage.

Therefore, they conclude, taking account of both full-time and part-time workers in London, around 1 in 7 employees receive less than the £6.50 poverty threshold wage and 1 in 5 employees receive less than the £7.45 LLW.

In terms of the patterns within the population of low paid workers, the GLA found that low pay more frequently affects less well qualified, young, black and ethnic minority and disabled employees. The research also found that a higher proportion of those living and/or working in Outer London are on low pay than in Inner London.

1.3 Caveats

This study has been ambitious in its objectives. Although every effort has been taken to ensure that the research and analysis undertaken are as robust, in-depth and wide-ranging as possible, the report and its findings are subject to some important limitations and caveats. These should be borne in mind in consideration of the results.

The LLW is still a relatively recent phenomenon, with the first LLW report and rate calculation published in 2005. Despite ongoing growth, the number of LLW employers is still relatively small, so the possible sample for research is limited. Furthermore, some of these organisations have only recently implemented the LLW provisions, so experience of some longer-term benefits (e.g. employee turnover) will be limited and may be illustrated in our results.

The quality of data returned has been less than hoped for, for a number of reasons:

- The data responses from organisations implementing the LLW were less comprehensive than hoped, limiting the possible analysis. Even

calculated annually by GLA Economics since April 2005 as £6.70; £7.05 in May 2006; and £7.20 in April 2007. Please see Annex 1 for a description of the method of calculation of the LLW.

4 *GLA Economics (2008) A fairer London: The 2008 Living Wage in London.*

amongst the largest organisations implementing the LLW, information systems are not currently in place to record some of the detail required for certain desired analysis.

- Application of the LLW conditions tends to be implemented in relation to selected contracts by Contracted suppliers. It has not been possible in some cases to distinguish between LLW contracts and non-LLW contracts in the data returned, thus blurring the LLW effect within these organisations.
- No existing data sources enabled the distinction of LLW employers from non-adopters. As a result, these sources could not be used to verify the evidence of our research findings based on interview and data responses from organisations and employees surveyed.

However, through requesting this information, the GLA has been able to identify the necessary criteria required by Contracted Suppliers to enable comprehensive data analysis of the LLW policy in future contracts

1.4 LLW/NMW and industry characteristics

The National Minimum Wage (NMW) was originally determined prior to its introduction in 1999, at a level for adults set at £3.60 per hour. The Low Pay Commission (LPC) conducts an annual review of the rate involving wide-ranging consultation and consideration of the effects on the economy, as well as on specific sectors and groups of workers. The LPC then reports its recommended up-rating to the Government. Following annual review and up-rating, the current national minimum wage rates are:[5]

- £5.73 an hour for workers aged 22 and over;
- £4.77 an hour development rate for 18-21 year olds; and
- £3.53 an hour development rate for 16-17 year olds.

The estimates of the minimum hourly wage to avoid poverty in London (the LLW) are significantly higher than the current NMW level. The LLW for 2008 is 30% greater than the NMW in place. It also shows that the percentage difference between the two has been falling annually, most likely due to the high rate of growth in the NMW over the period, as the NMW was set at a conservatively low level when first introduced in 1999.

In terms of the pattern of sectoral concentration, GLA Economics found that lower paid jobs in London tend to be concentrated in lower level occupations (particularly in sales, customer service and manual trades) and in the Hotels and Restaurants, and the Wholesale and Retail sectors, especially among

[5] http://www.hmrc.gov.uk/nmw/#b

employees working part-time, on which point they also note that women are more likely to work on a part-time basis than men.

Further research undertaken by GLA Economics sought to quantify the impact of worker characteristics on the probability of being low paid. The results of the research show that individual and job characteristics (e.g. age, level of qualifications achieved, and occupational level) have significant impacts on the likelihood of being low paid in London. The characteristic of working in an elementary occupation was found to be the most important factor, especially for female employees (13 times more likely than female managers or senior professionals).

1.5 Employers paying LLW

There is already a number of organisations in London that have implemented a Living Wage policy, including the GLA Group, paying their staff a minimum of the LLW as calculated by the GLA. These organisations are presented in Table 1. In addition, *London 2012* is set to be the first ever Living Wage Olympics. It is the experience of some of these organisations having already implemented the LLW that we shall draw on for our analysis.

Table 1: Organisations who are implementing the Living Wage in London

Public Sector	**Private Sector**	**Third Sector**
Greater London Authority	KPMG	ACEVO - Association of Chief Executives of Voluntary Organisations
Transport for London	HSBC	The Big Issue
London Fire and Emergency Planning Authority	Morgan Stanley	Child Poverty Action Group
London Development Agency	Citigroup	Westway Development Trust
Metropolitan Police Authority	Deutsche Bank	**Higher Education and Think Tanks:**
Metropolitan Police Service	Royal Bank of Scotland	The London School of Economics
St Barts and the London Hospital	PricewaterhouseCoopers	Queen Mary University of London
London Councils	Lovells	IPPR – Institute for Public Policy Research
	Credit Suisse	SOAS – School of Oriental and African Studies
	Macquarie	
	UnLtd	
	Barclays	

Source: GLA Economics (2008) A fairer London: The 2008 Living Wage in London.

It is fundamentally clear that for profit maximising firms, wages above the market rate (as in the case of LLW) would only be paid if the economic benefits exceeded the additional costs of provision. These benefits may be financial or non-financial (reputational effects for instance). Therefore, it is important to understand what existing evidence there may be in relation to the economic benefits associated with its provision, and to supplement this by new findings from qualitative and quantitative research.

2 Review of economic theory, literature and existing data sources

The first step of our analysis was to scope and review relevant economic theory, as well as evidence from existing literature and sources of existing data. This desk-based research provides a key input into the identification of the appropriate metrics for our data collection exercise and the subsequent identification of evidence gaps.[6]

2.1 Economic theory of Living Wages

Standard competitive models of the labour market predict that the imposition of a binding (above market clearing rate) minimum wage, as a Living Wage, should induce firms to reduce the amount of low wage labour they employ. An individual's wage in a competitive labour market should equal the marginal product of their labour. If the Living Wage is set above the competitive wage, then the labour cost of the worker will exceed their marginal product and employment will tend to fall. Employers generally will substitute capital for labour. The magnitude of the reduction in employment depends on the disparity between the minimum wage and the competitive wage, and the elasticity of demand for labour.

However, this simplistic, one-stage perspective does not allow for the potential of the wage increase to foster an efficiency or productivity gain. Such a gain can occur if the worker increases his/her marginal product of labour to bring it back in line with the now increased minimum wage. This efficiency/productivity gain may come through one of two channels:

- **Effort intensification** - an increase in the *quantity* of labour output per hour, e.g. workers may voluntarily increase work rate in response to higher wages, as predicted by efficiency wage theory; and
- **Enhanced quality** - an increase in the *quality* of labour input per hour, for example through education, training and further skills development.

The impact of a Living Wage will depend on the level at which the wage is struck. For segments of the labour market (e.g. skilled labour), the Living Wage will be set below the market-clearing equilibrium level, and so there will be little or no impact. For workers paid below the Living Wage level, then the impact will 'bite'.

[6] A sample questionnaire is provided in Annex 3.

A Living Wage increases the unit cost of labour for low-paid workers. This has the direct impact of increasing the unit costs of labour for the proportion of firms' employees that are paid less than this value.

The imposition of a Living Wage increases production costs, which must be absorbed somewhere by the firm or consumers. Theory tells us that there are a number of firm-level responses to this, including:

- Reduce the number of employees (dismiss any workers whose marginal product is below the wage, substituting capital for labour);
- Reduce the hours being worked;
- Reduce the level of profits being made;
- Pass the cost on to customers by raising prices (depending on the price elasticity of demand;
- Offset the wage increase by cutting back on non-pay elements, such as health insurance, safety or employer provided training;
- Evasion and avoidance strategies (e.g. relocating out of the region[7]);
- Efficiency gains / productivity increases.

Efficiency wages

The central efficiency wage hypothesis holds that employees' effort level, and thus their productivity, depends positively on their wages. Workers can choose their level of effort and they put in more effort when they are motivated to do so. In the absence of suitable motivation, workers will 'shirk' and operate at low effort levels. One way for employers to provide motivation is to pay more than other employers. Therefore, the theory of efficiency wages points to the incentive for employers to pay their employees more than the market-clearing wage in order to increase their effort, productivity and/or efficiency.

The direct implication of paying efficiency wages is that wages are set above the market rate, or above the necessary rate. However, efficiency wage theory argues that this makes sense for the employer, as paying efficiency wages has a double-reinforcing effect:

- Higher wages induce workers to put in more effort; and
- Higher wages generate involuntary unemployment and make the threat of being fired credible, with a probability of being fired as loss-making for the employee.

[7] As suggested by Brenner, M.D. (2003) "The Economic Impact of Living Wage Ordinances", Political Economy Research Institute (PERI), University of Massachusetts Amherst, Working Paper Series, Number 80.

A further incentive foreseen by the efficiency wage hypothesis is to minimise labour turnover, due to the high cost of replacing workers (search, recruitment, and training costs)[8].

Therefore, to summarise, payment of efficiency wages:

- discourages shirking by raising the cost of being fired;
- encourages worker loyalty and reduce labour turnover;
- raises group output norms;
- improves the applicant pool; and
- raises morale.

However, economic researchers do not agree on the impact of efficiency wages on employment levels.[9] Some researchers argue that efficiency wages result in a fall in employment, whilst others hold that it has a marginal, if not positive, effect. For example, a model put forth by Manning[10] (1995) portrays a firm's reaction to an increase in the minimum wage as an outward-shifting marginal revenue product of labour curve. The outward shift represents an increase in the value of the employee's work as a consequence of the extra effort, validating the payment of a higher wage. However, the effect on employment will depend on the extent to which the curve is shifted. It may lead to a mitigated reduction, no change, or even an increase in the level of employment.

One point to consider in the discussion of the LLW as an efficiency wage is that in the situation where the LLW becomes very widely adopted, then the market-clearing rate will approximate the LLW (as is the case with the NMW). The LLW will no longer represent an efficiency wage; rather, any efficiency wage will lie above the LLW.

2.2 Economic and social literature review

A brief overview of the literature on minimum and Living Wages is presented here, with a more detailed review presented in Annex 3. As the United States has been a forerunner in this area, there are many studies and much evidence from such initiatives in America. Nonetheless, we have made

8 One of the first implementers of an efficiency wage was revolutionary industrialist Henry Ford, who significantly increased wage rates (doubled in most cases) through the introduction of the 5 dollar day in 1914, motivated by concerns of high turnover and low worker morale. Evidence suggests that there were substantial queues for Ford jobs and significant increases in productivity and profits at Ford (Raff, D. and Summers, L. (1987) "Did Henry Ford pay efficiency wages?", *Journal of Labor Economics*, Oct 1987)

9 Metcalf, D. (2007) "Why Has the British National Minimum Wage Had Little or No Impact on Employment?", *CEP Discussion Paper No 781.*

10 Manning, A. (1995) 'How do we know that real wages are too high?', *Quarterly Journal of Economics*, CIX, November, 1111-1125.

a deliberate attempt to seek evidence in other regions in Europe and worldwide, with a particular emphasis on the LLW in London.

London Living Wage

Despite a significant amount of research into the patterns and characteristics of low pay in London, no study of the productivity and/or efficiency effects of the LLW has yet been completed. This is likely to be due to the fact that the Living Wage is still a relatively new concept in London. Notwithstanding this, there have been some interesting studies completed in relation to other aspects of the LLW.

Wills (2006) has conducted numerous studies into low-paid employment and the Living Wage in London. Her findings highlight the influence of the Buyer firm in changing the terms and conditions of subcontracted employment and the importance of involving the full range of stakeholders in achieving the adoption and implementation of the LLW, including the workers themselves.

Other studies have focused on the employee impact. Sokol *et al*[11] found that improved pay and conditions of the LLW at the Royal London Hospital resulted in higher worker commitment, an improved atmosphere and a 'sense of belonging', with 94.4% of workers surveyed indicating their intention to remain long-term. Contrary to standard economic model predictions, they also found little evidence of reduced hours (only 6.7% of workers), but found that 25% worked *more* hours.

A gloomier picture is painted by the results of the London Business Leaders' Panel survey by London Chamber of Commerce & Industry[12] (LCCI) in 2008. The LCCI estimated the costs of implementing the LLW as £3,000 per full-time employee. If forced to pay staff the LLW, respondents indicated that:[13]

- 42% would consider job cuts
- 49% would cut back on investment and expansion
- 26% would reduce their training budgets
- 23% would face a bill of £10,000 or more

A previous case study of KPMG by SERTUC[14] found that after LLW implementation, employee turnover rate was halved, training costs reduced, staff continuity increased, and there was "a much more motivated

[11] Sokol, M., Wills, J., Anderson, J., Buckley, M., Evans, Y., Frew, C. and Hamilton, P. (2006) *The impact of improved pay and conditions on low-paid urban workers: the case of the Royal London Hospital*. Queen Mary University of London, April.

[12] The London Chamber of Commerce and Industry (LCCI) is a business representative organisation with 3,000 member companies which together employ 500,000 people across a wide range of sectors.

[13] London Chamber of Commerce & Industry (2008) *London Living Wage would cost the capital jobs and investment - London Business Leaders' Panel survey*, Available from: http://www.londonchamber.co.uk/lcc_public/article.asp?id=957&did=47&aid=2955&st=&oaid=-1

[14] SERTUC (2007) *London Living Wage - a working guide for trade unions*, p.9. Available from: http://www.tuc.org.uk/extras/livingwage.pdf

workforce". LLW implementation costs were financed largely in this case by service efficiencies.

National Minimum Wage

The Low Pay Commission found that the minimum wage has so far not affected aggregate employment, though during 2006, employment fell in the low-paying sectors as a whole, and in retail and hospitality in particular. In their 2007 report, the LPC also found that productivity grew steadily from Q3 2005 to Q3 2006 and attribute this growth to output growth accelerating faster than employment growth during this period.

A review of the literature by the LPC found little evidence of an impact of the NMW on productivity. Where a positive impact was found, it was not shown to be significant.

Metcalf[15] presents a comprehensive review of academic studies of the evidence of the link between minimum wages and productivity. Despite being extensively analysed, little or no evidence of any employment effects have been found, citing the following reasons:

- An impact on hours rather than workers;
- Employer wage setting and labour market frictions;
- Offsets via the tax credit system;
- Incomplete compliance;
- Improvements in productivity;
- An increase in the relative price of minimum wage-produced consumer services; and
- A reduction in the relative profits of firms employing low paid workers.

The literature does predict that if labour productivity is to be increased, it will be through one or more of the following mechanisms:

- Capital-labour replacement or capital deepening;
- Increase the quality of capital through technology;
- Intensification of effort: monitoring or motivating workers to put in extra effort;
- more attention and adjustment to work organisation to improve the capital/labour mix; and
- Quality of labour: Investment in education and training to improve the quality of labour.

[15] Metcalf, D. (2007) Why Has the British National Minimum Wage Had Little or No Impact on Employment? April 2007, Paper No' CEPDP0781.

International experience

It is important to note in relation to wider evidence of Living Wages that the definition and nature of the concept can differ, with important implications on the comparability across initiatives. For example, as American Living Wages are often a regional *statutory* obligation, the efficiency wage effect will be drowned out in US studies. As Krugman notes *"Surely the benefits of low turnover and high morale in your work force come not from paying a high wage, but from paying a high wage "compared with other companies"*.[16]

Due to a longer history of the implementation of Living Wages, the bulk of research into the impact of a Living Wage has been focused on the United States. A seminal paper by Card and Krueger in the early 1990's challenged the prevailing logic at that time, by finding that the rise in New Jersey's minimum wage in 1992 did not lead to reduced employment in the fast-food industry. The logic of this effect was argued to be due to reduced turnover and less vacancies, leading to greater worker productivity by improving morale and overall job satisfaction. These benefits combine to yield efficiency gains offsetting the increased labour costs.

Further research on the impact of Living Wage mandates in the United States found the following summary of evidence:

- Evidence from empirical studies in tends to show that Living Wages tend to result in only modest cost increases for employers, though for some organisations (dependent on workforce characteristics), the cost increases can be significant.
- Consistent with Card and Krueger and evidence in relation to the UK's NMW, US evidence to date indicates that Living Wage ordinances do not adversely affect employment. Employment even sometimes grows, and there is often a shift to employing more full-time workers.
- There is some evidence of a positive effect on productivity by reducing turnover and improving morale, but also some evidence that firms appear to be taking a hit in terms of lower profits.

2.3 Review of secondary data sources

There is a wide range of existing data sources available. Accordingly, in parallel to the desk based secondary research, we also undertook an assessment of all existing secondary data that has been collected that could have been of assistance for the evaluation of LLW impacts. A full review of each data source is presented in Annex 2.

16 The Living Wage, by Paul Krugman, 1998: Review of Living Wage: What it is and why we need it, by Robert Pollin and Stephanie Luce. Available from: http://economistsview.typepad.com/economistsview/2006/06/paul_krugman_th_2.html

We concluded that despite being widely used and quoted for low pay analysis, the utility of these datasets for the current research objective is limited by the fact that none allow the identification and isolation of employers/employees that pay/receive the LLW. This issue is noted also in the wider economic literature. Brenner (2004) notes "the most fruitful avenue for evaluating the economic impact of Living Wage ordinances is at the local level, using various primary data collection methods." Therefore, it is not possible to conduct a comparative analysis of these two groups, as would be required to determine the marginal impact of the LLW for an organisation.

2.4 Potential metrics for LLW impact research

Based on the expected impacts of the LLW from the theory and desk based research, we formulated the following list of metrics for possible investigation and developed the consultation documents and data requests to assist in gathering information on these particular metrics.

- Impact on employment
    - Number of employees, by location and employment status
    - Number of hours worked (Basic, Overtime) per employee
    - Level of supervision (staff and hours)
    - Level of employee turnover
    - Average tenure of employees
    - Number of man-hours lost through absenteeism
    - Number of man-hours lost through sick leave
    - Number of man-hours lost through industrial disputes
    - Training and development per employee
- Impact on organisational performance
    - Output
    - Wage and salary costs (pay and non-pay benefits)
    - Recruitment costs
    - Financial performance (sales, profit, capital)
    - Capital investment
    - Number of customer complaints
- Cost of implementation of LLW
    - LLW implementation costs
    - Implementation costs borne by contract service Buyer
- Productivity and efficiency indicators
    - Output per employee
    - Capital per employee
    - Profit per employee
    - Gross value added per hour
    - Capital : Labour ratio
    - Total Factor Productivity
    - Incidence and intensity of training

3 Approach and method statement for primary research

In this section, we outline the approach and methodology that was employed for the primary research that was undertaken for this study, which has been the first such attempt to collect information of the impact (realised and potential) of the LLW in the United Kingdom. The primary research undertaken is composed of qualitative and quantitative elements. In the subsequent subsections, we outline in detail the approach used to conduct each strand of this research.

3.1 Qualitative research: Consultations

The main method used to identify and collect qualitative evidence of productivity and efficiency benefits, in addition to barriers and costs of LLW implementation was a consultation process of face-to-face interviews with:

- LLW employer organisations (Buyers and suppliers)
- LLW employees
- Trade unions
- Academic expert
- Non-LLW adopting organisation

A structured interview questionnaire was designed and utilised for each group (examples of the structured questionnaires are presented in Annex 3). Depending on the group, the interviews typically lasted between 30 minutes and one hour, with anonymity guaranteed.

3.1.1 LLW employers

The case studies consider the organisations implementing the Living Wage policy in two groupings:

- *Buyers* – organisations that have implemented the LLW policy for their own employees and/or with their contracted staff
- *Contractors (suppliers)* – organisations that are contracted to supply services to Buyers and have implemented the LLW policy

The case study research represents the findings of five Buyer organisations, five Contractor organisations and one employer (neither Buyer nor supplier).

Buyer and Contractor organisations were surveyed on different topics (the Buyer questionnaire being shorter, as most Buyers are only affected by the

LLW through their Contractor agreements and have no LLW employees on their own payroll). However, one Buyer has employees of its own, and so was additionally surveyed on the same (more detailed) topics as the Contractors. Additionally, one LLW employer is neither a 'Buyer' nor 'Contractor'. Therefore, on employment-related questions, we have aggregated the responses under the heading 'Employer', as all responses were given in respect of the organisation as a LLW employer rather than being a 'Buyer' or a 'Contractor'.

3.1.2 LLW employees

The views of employees receiving the Living Wage and working within organisations implementing the Living Wage policy have also been sought to bring together a coherent and complete qualitative picture of the efficiency benefits and costs of implementing the Living Wage policy in public and private sector organisations in London.

3.1.3 Other parties consulted

Trade Unions

Interviews with two trade unions representing public (UNISON) and private (UNITE) sector employees were also conducted and their interview responses are woven into the analysis that follows.

Non-LLW adopting organisation

The research also looked to work with organisations that may have been approached to implement the Living Wage but had decided against doing so. This sought to understand what the perceived costs associated with the implementation of the Living Wage policy might have been and how these assessments compared with those organisations that had implemented the LLW policy.

Academic expert

To augment the evidence gathered from our own primary research, we also consulted an academic expert in regard to Living Wage research, with first-hand experience of Living Wage implementation in London.

3.2 Quantitative research: Employer data records

Whilst the qualitative research provides support and confirmation of the anecdotal evidence from organisations who have implemented LLW, this study is the first to attempt to gather employment and financial data (specific to LLW contracts and divisions where possible) to enable quantitative analysis and evidence to be formulated on the impact to organisations of implementing a Living Wage policy in London.

Further to the face-to-face interview consultation with LLW employers, organisations were also asked to complete a data request. The data request was designed to obtain all relevant information from the LLW employers, whilst imposing the minimum burden on the research participants (e.g. a separate version of the data request was designed for each employer type to ensure relevance of questions).

The analysis involves a detailed examination of the specific employment and workforce management records of the companies that have agreed to take part in the consultation exercise.

In collecting and analysing this data, we sought to explore the actual recorded outcomes that might have occurred over time and since the implementation of the LLW in each organisation. We were trying to understand the number and sectors of the employees affected by the provisions (in absolute terms and relative terms to total number of employees/payroll), as well as the effect on the employer in terms of workforce management. We also attempted to understand whether any change in business performance might be linked to the implementation of the LLW (such as reductions in absenteeism or improved recruitment and retention). We believe that this detailed and forensic analysis of recorded employer outcomes may provide a quantitative indication of both the appropriate metrics when considering the implementation of the LLW, but also an assessment of the likely short term and longer term benefits that might accrue[17].

[17] Note that for an accurate assessment of the LLW, it is crucial to understand what would have happened in the absence of the LLW (the counterfactual). For instance, it is likely that a rise in employment may have occurred even without the introduction of the LLW, given the nature of the London economy at the time. To understand the appropriate counterfactual, it would have been necessary to identify a number of 'similar' employers that did not implement the LLW and understand how these organisations fared pre and post the introduction of the LLW against those implementing the LLW. This was not possible given the difficulty in identifying comparable organisations that had not implemented the LLW and the potential difficulties in collecting information from them.

4 Evidence of benefits of LLW implementation

The findings of the case study research help to investigate how and why companies have implemented the Living Wage policy and how this implementation has impacted in terms of benefits, costs and barriers. This section presents the findings of our research in terms of evidence of benefits of the LLW, presented by theme with a combination of both qualitative and quantitative evidence.

Headline benefit themes considered in our research were:

- Recruitment and retention of staff;
- Absenteeism;
- Productivity;
- Worker morale and motivation;
- Ability to attract high quality employees;
- Easier implementation of changes;
- Improved stakeholder relations;
- Improved Buyer/supplier relationship;
- Improved visibility of costs and resources; and
- Reputational benefits, such as Corporate Social Responsibility

Amongst the 11 organisations consulted, it is generally the norm that the Buyer organisation does not implement LLW provisions for their own employees, but through the Supplying organisation. This is primarily due to the high value-added nature of the private sector Buyer organisations, and the use of outsourcing.

4.1 Organisations implementing the LLW

The Buyer organisations were a mix of both London-based, UK and/or global operations, representing both the public and private sector. With the exception of one organisation, all Buyer organisations had wage rates for their internal employees set above the London Living Wage pay rate. It was only contracted services such as cleaning, catering and security where wage rates were affected by the introduction of the Living Wage. For one of the UK-wide buying organisations the implementation of the LLW had a knock-on effect on pay rates across all of their national contracts with all employees now paid above the minimum wage through an apportioned wage system.

For one of the London-based Buyers, the implementation of the Living Wage led to previously contracted services being brought in-house.

The Contractor organisations were largely UK-wide operators representing cleaning/maintenance sectors. For Contractors providing these contracted services to Buyers, payment of the Living Wage is only made to employees working on the Living Wage Buyer contract. In that respect the vast majority of the costs associated with the implementation of the LLW are contract driven and picked up by the Buyer.

The latest figures from the Greater London Authority (GLA) suggest that between 15% and 19% of London's workforce is low paid and earning less than the 2006 Living Wage of £7.05 per hour. This amounts to estimates of between 480,000 and 540,000 workers in London (GLA, 2008).

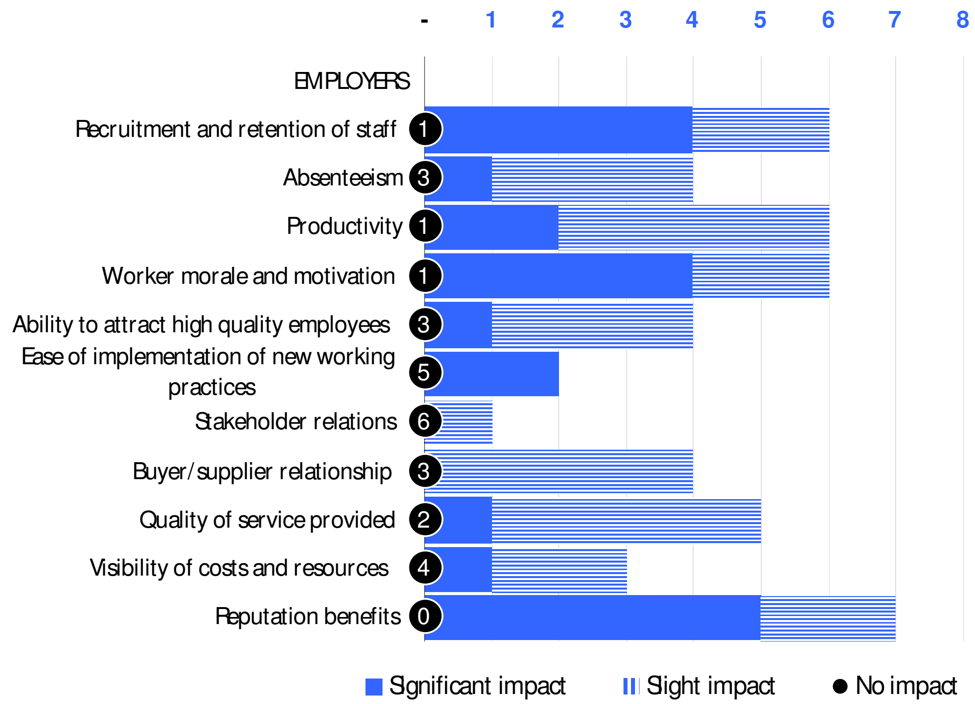
4.2 Headline benefit themes

In the course of our stakeholder interviews, LLW employers were questioned as to their experience of a range of key benefit themes believed to be associated with the payment of the LLW. Employers were asked whether they had experienced an impact in the area or theme in question, positive or negative, and if so, whether the impact was slight or significant. No respondents noted a negative impact in any of the key theme areas, which was to be expected.

The analysis of responses is presented in the graphic overleaf[18]. It shows that some benefit themes have been more strongly experienced than others. The most significant impact noted was reputational impacts of being an ethical employer, recruitment and retention, worker morale and motivation, and productivity.

[18] As with all graphics that follow, the number of respondents indicating that they had not experienced an impact is presented in the black circles. Given the small sample size, in general, respondent counts are used rather than proportions.

Figure 1: Views of respondents: Headline benefits of LLW implementation



Source: London Economics consultation with LLW stakeholders

We now delve a little deeper into each of these benefit 'themes' to examine the evidence of LLW benefits, both from our qualitative analysis of interview findings and quantitative analysis of responses to our data requests.

4.3 Recruitment and retention of staff

Recruitment and retention is an area in which the LLW has made a significant impact, and reflected in particularly strong support from Contractors, as the direct employers of most LLW workers. All but one employer with employees affected by the LLW reported a positive impact in general on recruitment and retention within their organisation with two thirds reporting a significant impact. Employers reported the LLW had had the most significant impact on:

- lowering staff turnover;
- reducing expenditure on induction training of new staff; and
- enabling greater continuity of the workforce.

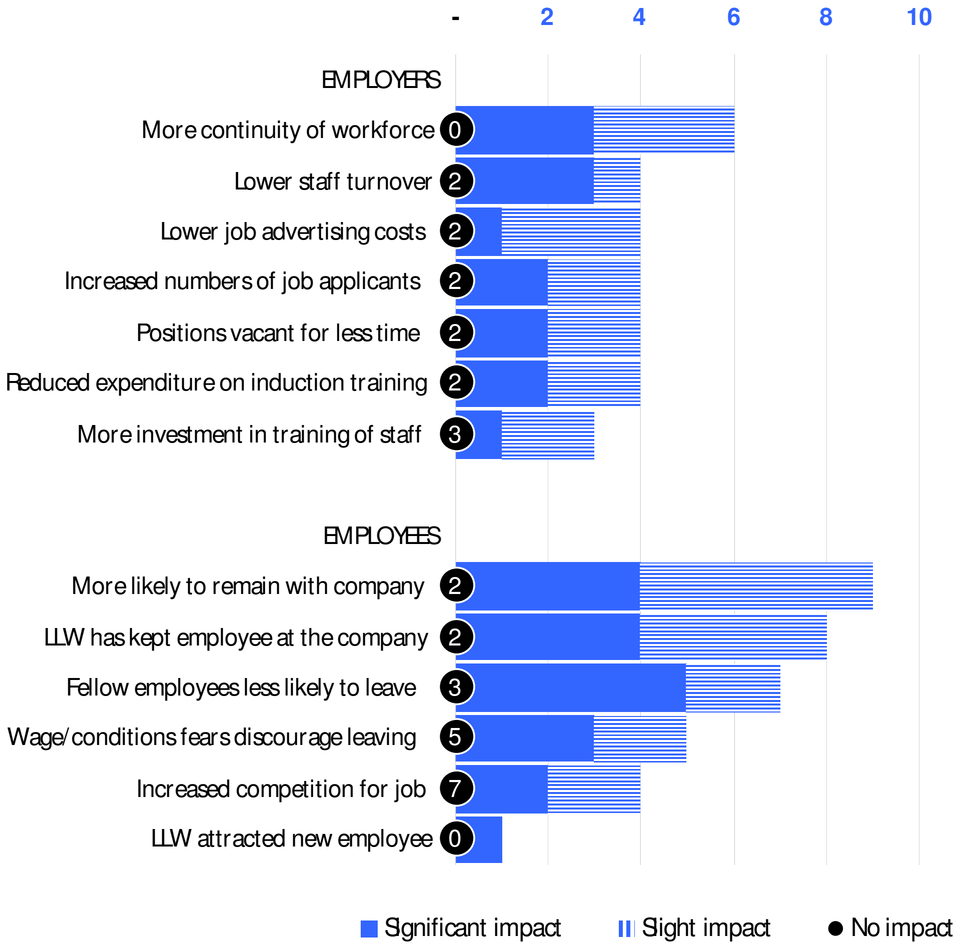
In terms of staff turnover, one Contractor estimated that staff turnover on their Living Wage contract was between 1% - 2% compared to between 25% -

30% on other contracts. In cost savings terms, they estimated that it currently cost approximately £500 per person to advertise for and start a new employee in a job and that the significant reduction in turnover had resulted in substantial cost savings[19]. Lowering staff turnover, whilst leading to cost savings in terms of staff retention, was also reported by employers as having the additional commercial benefit of improving the customer outlook. One Buyer reported that staff turnover on their contracted-out services has fallen with the introduction of the Living Wage from 20%-25% per annum to approximately 7%-10% per annum. Buyers also reported that the lower staff turnover has lead to a building of relationships between internal Buyer staff and Contractor staff. For employees, more than four fifths of those interviewed reported that they were either slightly or significantly less likely to leave their company in the future as a result of receiving the Living Wage, with just under three quarters reporting that the introduction of the Living Wage had kept them working with their employer. Nearly two thirds highlighted that they thought other workers employed on LLW contracts seemed to leave less or were less likely to leave their jobs.

Employers' assessment of the impact of the LLW in increasing the number of job applicants or reducing the time for which jobs are vacant is mixed, although in the main the impact has been positive. Indeed whilst the majority of employees reported that they had not noticed any increase in competition for their job since the uptake of the Living Wage by their employer, a small minority reported that competition had increased for their job significantly. The effect of the Living Wage on lowering job advertising is also mixed with one third reporting no impact and half reporting only a slight impact. However, one Contractor reported that they now did not have to advertise at all for staff on their Living Wage contract.

[19] Note that the 2008 CIPD Survey of employee turnover and retention indicates that the estimated average cost associated with employee turnover stood at £2,750 for manual/craft workers and £4,250 for workers in service occupations (customer, service, protective and sales). See the following link for further details: http://www.cipd.co.uk/subjects/hrpract/turnover/empturnretent.htm

Figure 2: Views of respondents: Impact of LLW on recruitment and retention of staff



Source: London Economics consultation with LLW stakeholders

4.3.1 Quantitative findings

Labour turnover and tenure

Labour turnover is high amongst the organisations examined (which is a dominant characteristic of the sectors undertaken). In general, employee turnover is usually in the range of 30%-50% per annum but often significantly higher (61.9% in one case). Therefore it is clear that recruitment and retention are key issues and a source of substantial benefit for LLW employers.

- In one particular case, a catering Contractor witnessed a fall in labour turnover from 61.9% to 24.4% per annum following the introduction of the LLW.

- A fall in the rate of labour turnover was also achieved by another LLW Contractor employer, from 33.3% to 27.3% per annum (a decrease of 18.2%) in the year following implementation.

- In one case, the average length of tenure of employees increased from 2 to 3 years after the LLW was paid, showing how the LLW can engender increased staff loyalty.

Recruitment costs

- Following the implementation of LLW, one organisation experienced a fall in their level of vacancy advertising expenditure of nearly half (-42.0%), despite the number of vacancies increasing (by 12.9%). This trend owes to a fall in the advertising expenditure per vacancy (which fell by 48.6%). This suggests that the organisation saved on vacancy advertising expenditure due to the fact that less advertising effort was required to fill the vacancies that did arise following LLW implementation.

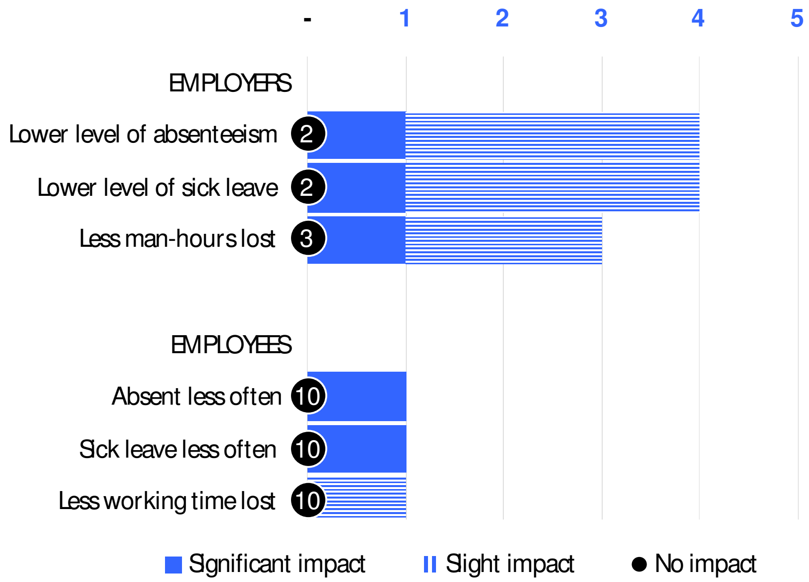
- At one Contractor, vacancy advertising costs remained constant, but due to a fall in labour turnover and resultant vacancies, the advertising cost per vacancy rose by 16.7%.

4.4 Absenteeism

In the sectors covered by the London Living Wage, attendance is generally very high as they are almost all working on or around the poverty level and any reduction in hours worked (e.g. for sickness or ill-health) results in a reduction in income.

Despite the relatively high attendance rates, for the majority of firms, the Living Wage has had an impact on reducing absenteeism and sick leave. One Buyer reported that following the introduction of the Living Wage into contracted-out services, absenteeism and sickness has been fallen by approximately 5%. One employer reported that they run a scheme whereby every month and quarter any wages saved as a result of less absenteeism or sickness is translated into vouchers and presented to the employee(s).

Figure 3: Views of respondents: Impact of LLW on level of absenteeism



Source: London Economics consultation with LLW stakeholders

4.4.1 Quantitative findings

- One Contractor experienced a fall in absenteeism both in absolute terms, and also on a per worker level. The total number of man-hours lost through absenteeism fell from 1,044 to 786, a decrease of 25.0%; and the number of man-hours lost per worker as a result of absenteeism fell from 9.9 to 7.1, a fall of 28.4%, in the year following LLW introduction.

- The level of man-hours lost through sick leave also fell for the same Contractor, from 6.2 to 5.9 man-hours, a decrease of 4.5% in the period of LLW implementation.

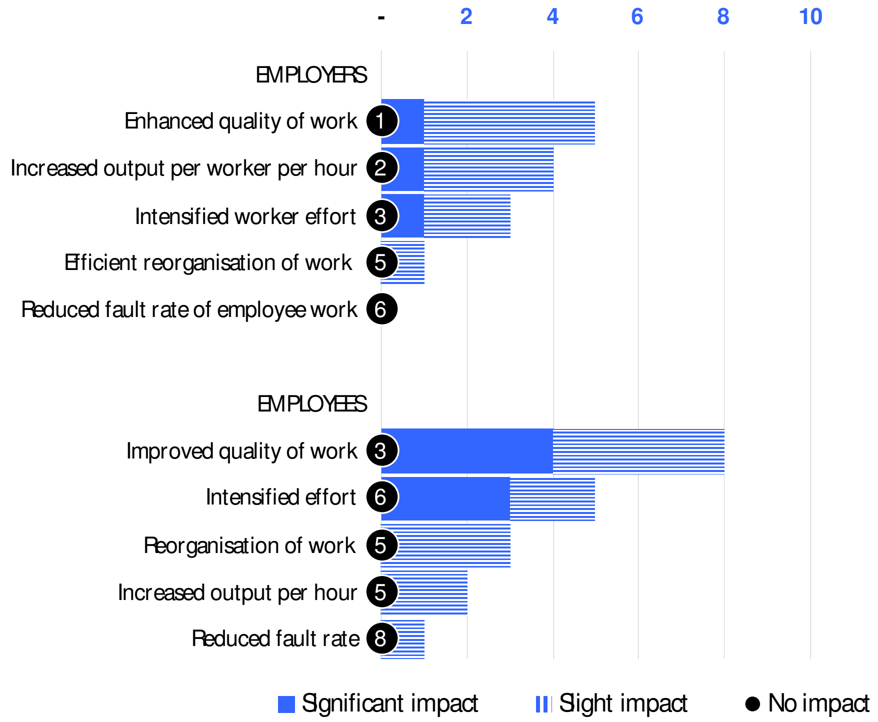
4.5 Productivity

Employers with employees receiving the Living Wage generally report that the Living Wage has had a positive impact on productivity within their organisation. Five out of six employers find that the Living Wage has enhanced the quality of the work of their staff. One Buyer reported that information from their Performance Management System showed that the contracted-out cleaning services have improved by 16% since the introduction of the Living Wage. Employees too report that the Living Wage has positively impacted on their quality of work with just fewer than three quarters reporting increases in work quality.

The effect of the Living Wage on other measures of productivity such as increasing the output per worker per hour and increasing the work rate of staff is mixed. **Two thirds of employers reported an increase in output per worker per hour and half of them reporting an intensified work effort. For one employer they reported that whilst output per hour had increased, that increase had not been intentional and was driven by increased worker morale.** For employees the picture is also mixed with approximately half reporting that the Living Wage had increased their work rate. The majority felt that their output per hour had not changed with the introduction of the Living Wage.

Employers clearly reported that the Living Wage had made no difference to the fault rate of employee work and had not lead to a reduction or elimination of inefficient working practices through work re-organisation. A small number of employees did detail that their working practices had been re-organised. Indeed, in one case whilst the Buyer organisation met the increased wage costs of implementing the Living Wage, the Buyer did discuss with the Contractor ways of gaining higher productivity. In this case there was a level of working practice re-organisation with the removal of desk bins to one central bin area reducing the time taken for cleaning staff to empty bins and also a reduction in cost of plastic bin liners.

Figure 4: Views of respondents: Impact of LLW on productivity



Source: London Economics consultation with LLW stakeholders

4.5.1 Quantitative findings

- In the year following the roll-out of LLW in the organisation, one Contractor experienced an increase of 5.3% in the level of sales/turnover per employee.
- The value of the service contract per worker increased by 3.1% in the year following the LLW introduction for one Contractor firm (though this may reflect increased labour costs).
- There was no increase in productivity, defined as the number of square feet cleaned in one hour, following LLW implementation, though this seems to reflect a fixed target set by the Contractor rather than actual worker output.
- One employer, a LLW employer since 2004, saw turnover per employee fall in the first year following implementation (-8.1%) but increase in the following two years by 4.6% and 1.2%, respectively.

4.6 Worker morale and motivation

Worker morale and motivation is one impact of the London Living Wage that employers feel is significant with all but one reporting an impact and the majority of those a significant impact.

The response from employers on other measures of the impact of the Living Wage of staff morale such as "more positive atmosphere, conducive to productive work"; "enhanced work ethic / staff commitment to work"; and "higher employee satisfaction" is mixed and highly dependent on the view employers have on the working practices that already existed. Approximately half of employers reported no impact on these measures and the other half a significant impact. For employees, the position is a little more clear-cut with almost all employees reporting that the London Living Wage had impacted on their morale, and for the vast majority the LLW had a significant positive effect on:

- Being more motivated to work
- Feeling more pride and have higher morale about their work
- A more positive atmosphere, conducive to productive work
- Having an enhanced work ethic / commitment to work
- Generally being more happy with the job

Only one or two employees reported that there had been no impact for them across these five areas. Just fewer than three quarters of employees felt that the London Living Wage would make them likely to be more attracted to their job.

> *"People really take ownership of the building and working here...It has really made a difference having people that know the building as well as being able to clean."*

Figure 5: Views of respondents: Impact of LLW on worker morale and motivation

Source: London Economics consultation with LLW stakeholders

4.7 Ability to attract high quality employees

In general employers did not feel that the London Living Wage had any significant impact on their ability to attract higher quality employees to jobs with two thirds reporting no or only a slight impact. Many employers reported this lack of impact being as a result of the service-related industries in which they operated – industries that are often low-skilled and transient.

No employers reported that the Living Wage had had a significant impact on:

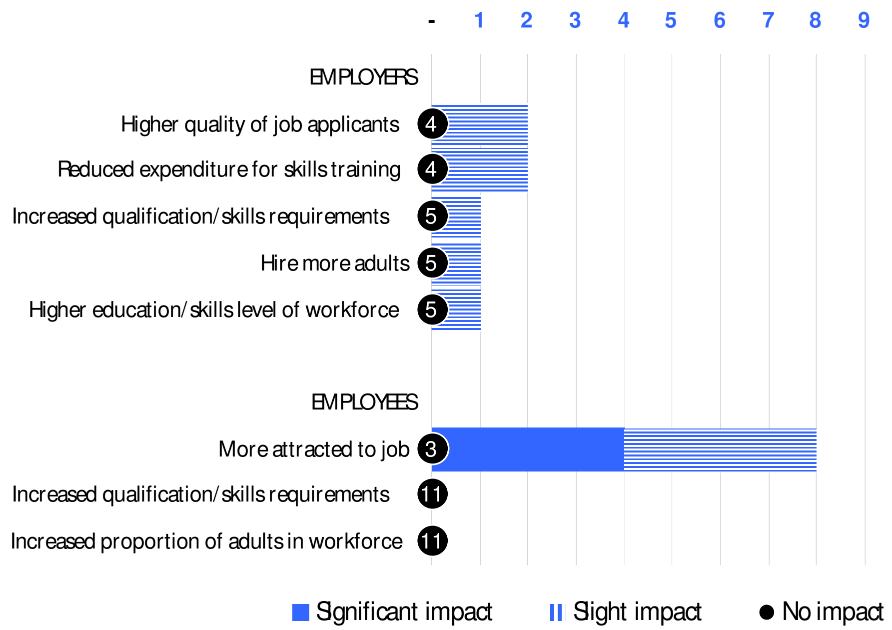
- Increasing the quality of job applicants
- Increasing qualification / skills requirements for new hires
- Hiring more adults rather than teenagers or apprentices
- Increasing the skills level of the existing workforce
- Reducing expenditure need for skills training

This was mirrored in the views of the employees, with all employees reporting that the Living Wage had not lead to increased qualification/skills requirements for their jobs or had resulted in their organisation hiring more adults rather than teenagers or apprentices.

One third of employers reported that the Living Wage did have a slight impact on increasing the quality of job applicants and reducing the expenditure needs for skills training.

In some cases, the reduction in staff turnover lowered training costs as with fewer staff to provide initial induction training, training could now be managed in-house.

Figure 6: Views of respondents: Impact of LLW on the ability to attract high quality employees



Source: London Economics consultation with LLW stakeholders

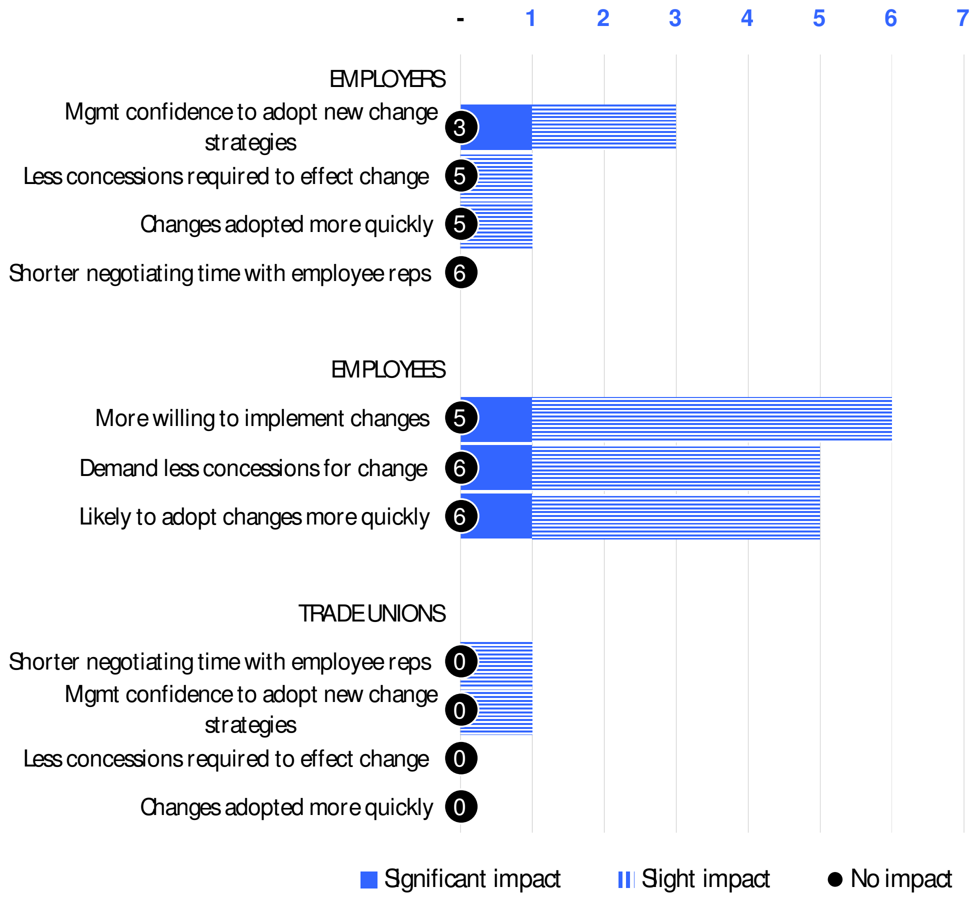
4.8 Ease of implementation of new working practices

In general, employers did not feel that the Living Wage had enabled the implementation of any new working practices any easier with over two thirds reporting no impact. However, it should be noted that there were few employers who reported the adoption of any new working practices in the first place. All employers reported that the Living Wage did not have an impact on shortening negotiating times with Trade Unions or employee groups. However, this is as a result of the organisations interviewed. These organisations had few employees affected by the Living Wage (being mainly Contractors) with little existing involvement with Trade Unions.

Half of employers felt the implementation of the LLW had given management more confidence to adopt new strategies requiring a change in working practices, however there is little evidence to support this is the case.

For employees, approximately half felt that the Living Wage had made them more willing to implement changes in their working practices; enabled them to require fewer concessions to effect change; and made them more likely to adopt changes more quickly. Again, in bold to highlight positive benefit. However, the majority report this impact to be slight.

Figure 7: Views of respondents: Impact of LLW on ease of implementation of new working practices



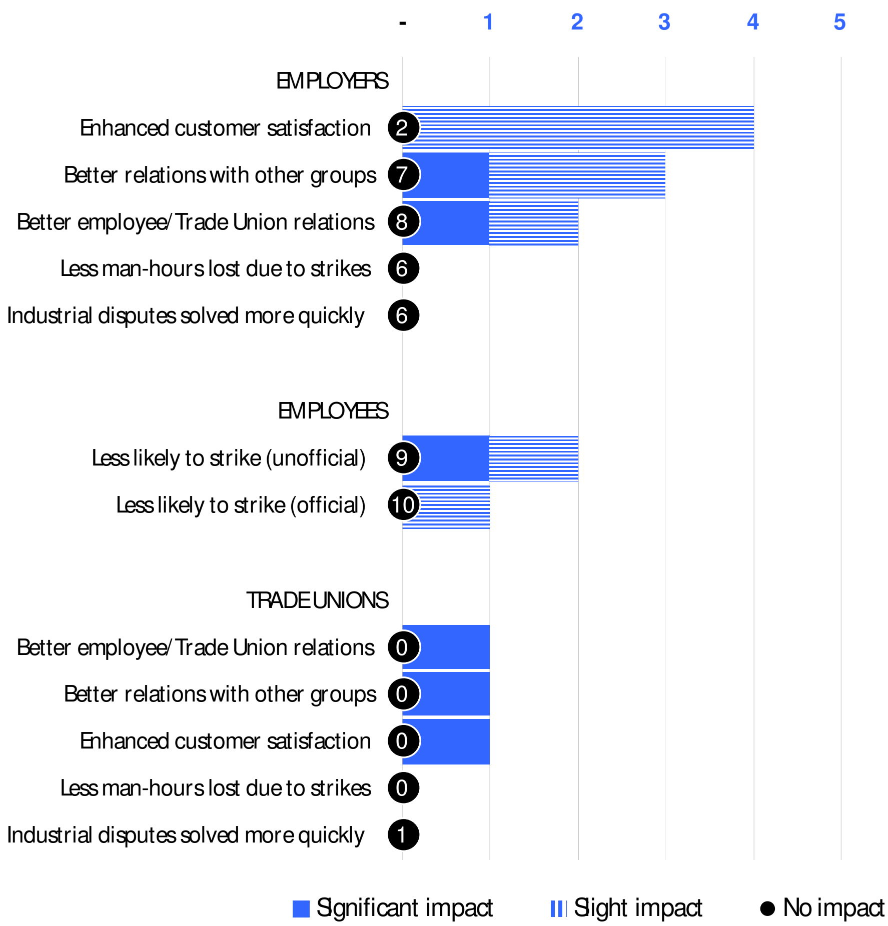
Source: London Economics consultation with LLW stakeholders

4.9 Stakeholder relations

For the majority of both Buyers and suppliers, the LLW had little or no impact on stakeholder relations with only a minority of Buyers and Contractors feeling an impact on their relationships. However, where a positive impact was felt, particularly with Trade Unions, the impact was that the Living Wage had led to a discussion between those organisations and Trade Unions for the first time. This is a view echoed by the Trade Unions.

In terms of the impact of the Living Wage on consumer, community and/or other groups, one third of Buyers and suppliers reported an improved relationship. Of those employers who reported that the LLW had enhanced the quality of their work, all reported that the Living Wage had led to higher customer satisfaction and fewer complaints. With a very low level of Trade Union membership amongst workers in the contracted industries, nearly all employees reported no impact on their likelihood of striking.

Figure 8: Views of respondents: Impact of LLW on stakeholder relations



Source: London Economics consultation with LLW stakeholders

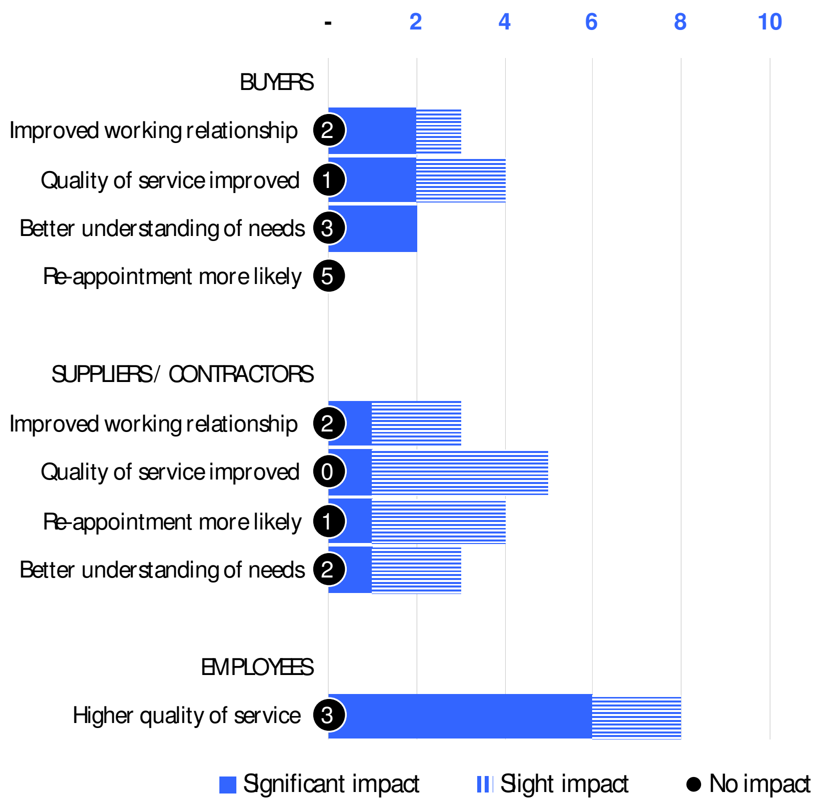
4.10 Buyer/supplier relationship with Contractors

In terms of the Living Wage leading to improvements in the relationship between Buyers and suppliers/Contractors, it is (as would be expected) wholly dependent on the relationship that already existed. Buyers and corresponding Contractors largely reported similarly in terms of whether or not joint problem-solving in relation to negotiation and implementation of the LLW had improved their working relationships.

The development of a better understanding of client needs as a result of LLW negotiations was dependent on how closely each party had previously worked together. For some there was more learning and understanding as a result of the LLW negotiation process than others.

All but one of the Buyers and suppliers reported that the Living Wage had impacted on the quality of service provided with approximately two thirds reporting this impact to be slight and just under one third to be significant. Indeed, most employees felt that the level of service they provided had been changed as a result of the Living Wage with over half reporting the impact to be significant.

Figure 9: Views of respondents: Impact of LLW on the Buyer/supplier relationship



Source: London Economics consultation with LLW stakeholders

4.11 Visibility of costs and resources

Less than half of organisations with LLW employees felt that the Living Wage had an impact on the visibility of costs and resources. Four organisations felt there had been no impact. Almost all employers felt that the Living Wage had not led to any increases in:

- Performance monitoring and/or supervision of staff;
- measures taken to control labour costs (e.g. treatment of absence, paid breaks, staff meals, overtime)
- Measures taken to control non-labour costs (cost of supplies, distribution and marketing costs)
- Increased hiring of full-time rather than part-time staff

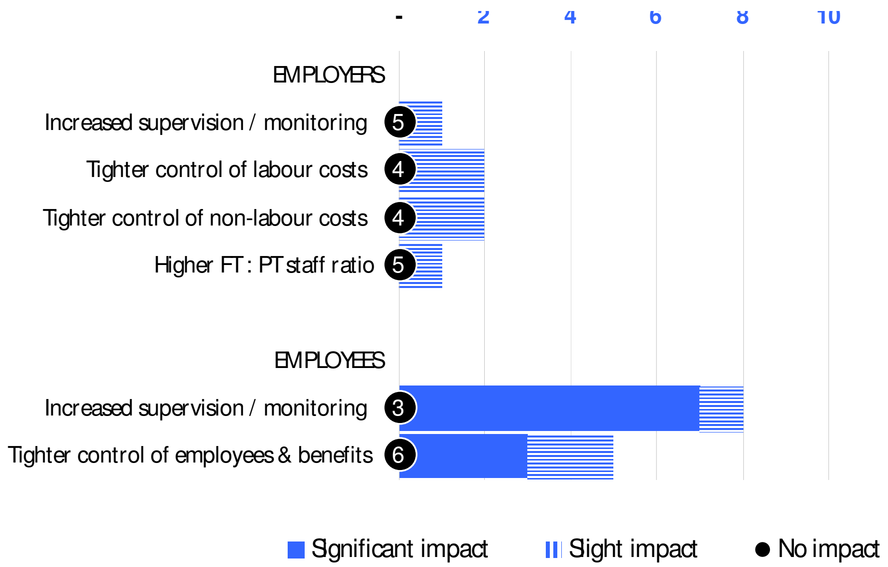
However, for employees the view is a little more mixed. Three quarters of employees reported that there was a greater level of performance monitoring and/or supervision of their work since receiving the Living Wage. The majority felt that the impact had been significant.

> *"I'm better off but the company also expects more...Managers say you are paid more so work more."*

However, over half of employees did not feel that the introduction of the Living Wage had led to any tighter controls over absence, paid breaks or overtime rates. For the remainder the Living Wage had led to tighter controls particularly over the availability of overtime. In these cases, whilst the Living Wage resulted in better pay per hour, it also resulted in a reduction in overtime availability, thus making the overall impact of receiving the Living Wage less significant than it might have been in terms take-home pay.

Looking at visibility in terms of monitoring the payment of the Living Wage by Contractors, there was evidence of both formal and informal monitoring mechanisms in place. Some Buyers monitor informally by asking the contracted staff directly whether they have been receiving the Living Wage including any increments. Others request formal monitoring updates including quarterly and annual financial statements, monthly supplier reviews and payroll reconciliations. Some Contractors provide formal accounts annually (whether requested by the Buyer or not) with many Contractors operating an 'open door' policy allowing Buyers free access to their records if required.

Figure 10: Views of respondents: Impact of LLW on the visibility of costs and resources



Source: London Economics consultation with LLW stakeholders

4.12 Reputational benefits

Employers reported that the Living Wage had generally induced positive reputational impacts on their organisations with just under three quarters reporting the impact to have been significantly positive. **Nearly 70% of both Buyers and suppliers felt that the Living Wage had increased consumer awareness of their organisation's commitment to be an ethical employer.** It is likely that the value of the Living Wage in these terms will be dependent on the position of organisations within the private and public sector markets. For some the impact had been little or none where they are viewed as already having to be an ethical employer.

In terms of the Living Wage enhancing the likelihood of consumers buying from one organisation over a competitor's, both Buyers and suppliers felt that the Living Wage has not really impacted. This is as a result of a number of factors: some public services do not sell goods that consumers have any choice in buying; and for many operating within service sector industries, contracts are awarded on lowest possible price. There is also no choice for those offering contracted services to Buyers signed up to the Living Wage as contracts are only offered to those who will comply with Living Wage policy.

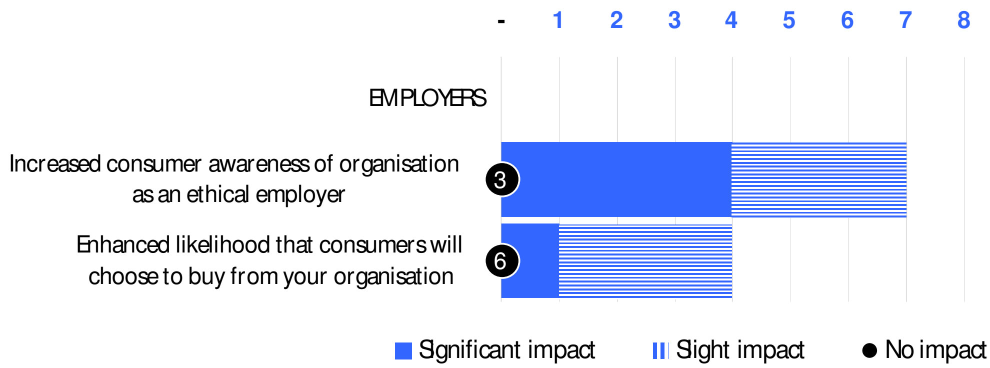
Contractors/suppliers often use the contracts they operate that pay the Living Wage as exemplars, mentioning them as a point of reference when bidding for other contracts to raise awareness of the Living Wage.

In terms of reputational benefits, many employers reported that the benefits are good when people actually know about the Living Wage. There is a feeling that there are few people that are aware of the LLW policy. One employer talked about a local London news report they had recently listened to commenting on the poor pay and conditions of low paid workers in London and arguing that their pay should reflect the high cost of living in London. In this report there was no mention of the London Living Wage policy. The lack of knowledge of the Living Wage makes it harder to implement.

Many employees feel that the Living Wage is important in terms of reputational benefits. One employee reported:

> *"It feels good that the company is a Living Wage employer – it shows they look after their employees. It tells you that this company is doing things properly and that they treat their staff well."*

Figure 11: Views of respondents: Impact of LLW on the organisation's reputation



Source: London Economics consultation with LLW stakeholders

4.13 Other impacts of LLW

4.13.1 Gender balance

Quantitative findings

- One Contractor consulted noted that the gender balance on their LLW contract was 60% female / 40% male in 2007 and that this ratio has "not changed a great deal over the three year period [covering LLW implementation]".

4.13.2 Full-time: Part-time staff ratio

Quantitative findings

- The proportion of full time workers increased slightly from 66% to 68% at one employer organisation in the year following LLW implementation, with the ratio since increasing to 69%.

- A similar increase in the proportion of full-time workers was seen by a Contractor firm, with the ratio increasing from 26% to 30% in the year following LLW introduction.

- In a third example, another employer increased the proportion of full-time workers among its Contractor staff. In the year after LLW adoption, the proportion of full time workers increased from 95% to 97%.

4.13.3 Impact on employees

In monetary terms, the majority of employees estimated that for them the Living Wage had made a difference of between £1,001 and £5,000 per year to their pay. For three employees that wage difference was between £1,000 and £2,000 per year and for a further four the difference was between £2,001 and £5,000.

All employees reported that this wage difference has not only made them far happier in their work but has improved their standard of living enabling them to better manage their bills, have a better standard of family life and pay for education and training.

> *"It is interesting that some people want to improve the standard of low paid jobs thanks to the Mayor of London. Now I can manage my bills and transportation easier but my main worry is still the cost of living. In London the cost of living is higher than the low paid jobs are being paid."*
>
> *"The cost of living is more expensive...with the Living Wage I can give my daughter more things...it also gives us more motivation to keep cleaning."*
>
> *"Being paid the higher wage means I can pay to go to college – I'm studying in the evenings to be a computer programmer."*
>
> *"I'm starting college in the evenings to be an accountant".*
>
> *"The Living Wage means that my children can enjoy trips outside of London."*

Quantitative findings

- In all cases, the introduction of the LLW led to a significant increase in wages of for the lowest earners who were previously earning the national minimum wage prior to LLW implementation. In one case, this increase was as large as 32.7% year-on-year.
- In the case of one Contractor, the LLW contract pay rate represents a premium of 31% over non-LLW London contracts. In another case, LLW contract workers receive a 30% premium over their non-LLW contract colleagues..
- In more than one case, the minimum wage paid is set above the level of the LLW (e.g. one firm paid £7.15 and another £7.50 in 2007 when the applicable LLW, set in 2006, was £7.05).

4.13.4 Impact of increased take-up of LLW

Buyers and suppliers were asked whether an increased take-up of the LLW would have an impact, specifically:

- Whether the strength of any benefits would be reduced if the number of organisations implementing the LLW increased substantially
- Whether an increased take-up of the LLW would mitigate some of the costs/barriers associated with its implementation

The view amongst Buyers and suppliers was split. Half felt that the benefits would be reduced if significantly more employers operated the Living Wage. Indeed there were some employees who felt that the benefits of the Living Wage in terms of motivation impacted significantly initially but that the effect wore off over time. However, half of employers did not feel that the benefits would be reduced, with one employer reporting that with so few organisations operating the Living Wage, it would take a significant expansion to make a difference. Another organisation noted that there would be a chance that those not paying the Living Wage could risk being left behind with lower quality staff. There is only a limited number of really good quality staff and so there is a possibility of non-LLW companies not being able to claw back the difference between LLW and non-LLW staff.

In terms of an increased take-up of the Living Wage mitigating some of the costs and/or barriers, again the view was split. Half of both Buyers and suppliers felt that increased take-up would not mitigate costs or barriers, (particularly costs). However, there were many who felt that barriers would be reduced: "If more organisations took part, the level of trepidation would reduce". This is certainly a view echoed by the Trade Unions in the sense that existing LLW employers can provide blueprints or models for other organisations to adopt.

One organisation also noted:

> *"The Living Wage is not an insurance policy in that if you pay a little more, then the issues you have will go away. It is only one aspect of managing people motivationally – it is part of a whole programme of activity."*

4.14 Other issues raised

The timing of the release of changes in the LLW rate has been raised as an issue by several participants. It has been suggested that the release date for new wage rates should be several months in advance of implementation to better coincide with budget planning cycles. Publishing the new rate halfway through a financial year has been raised as causing budgeting and administrative difficulties.

5 Evidence of barriers and costs of LLW implementation

This section presents the findings of our research in terms of evidence of barriers and costs of the LLW, once again represented by theme with a mixture of both our qualitative and quantitative evidence.

In respect of the cost evidence below, it should be noted by the reader that the timing of implementation of the LLW can have an impact on implementation costs. The GLA are of the view that the implementation of the LLW should be at the pre-tender stage of a contract, rather than mid-contract. If the LLW is implemented mid-contract, existing contracts need to be re-negotiated to include LLW provisions, requiring potentially difficult and costly negotiation (potentially affecting the relationship between Buyers and suppliers). On the other hand, if the LLW conditions are agreed as part of the original contract negotiations, it saves these additional negotiation costs, reducing the overall cost of LLW implementation.

5.1 Organisations declining the LLW

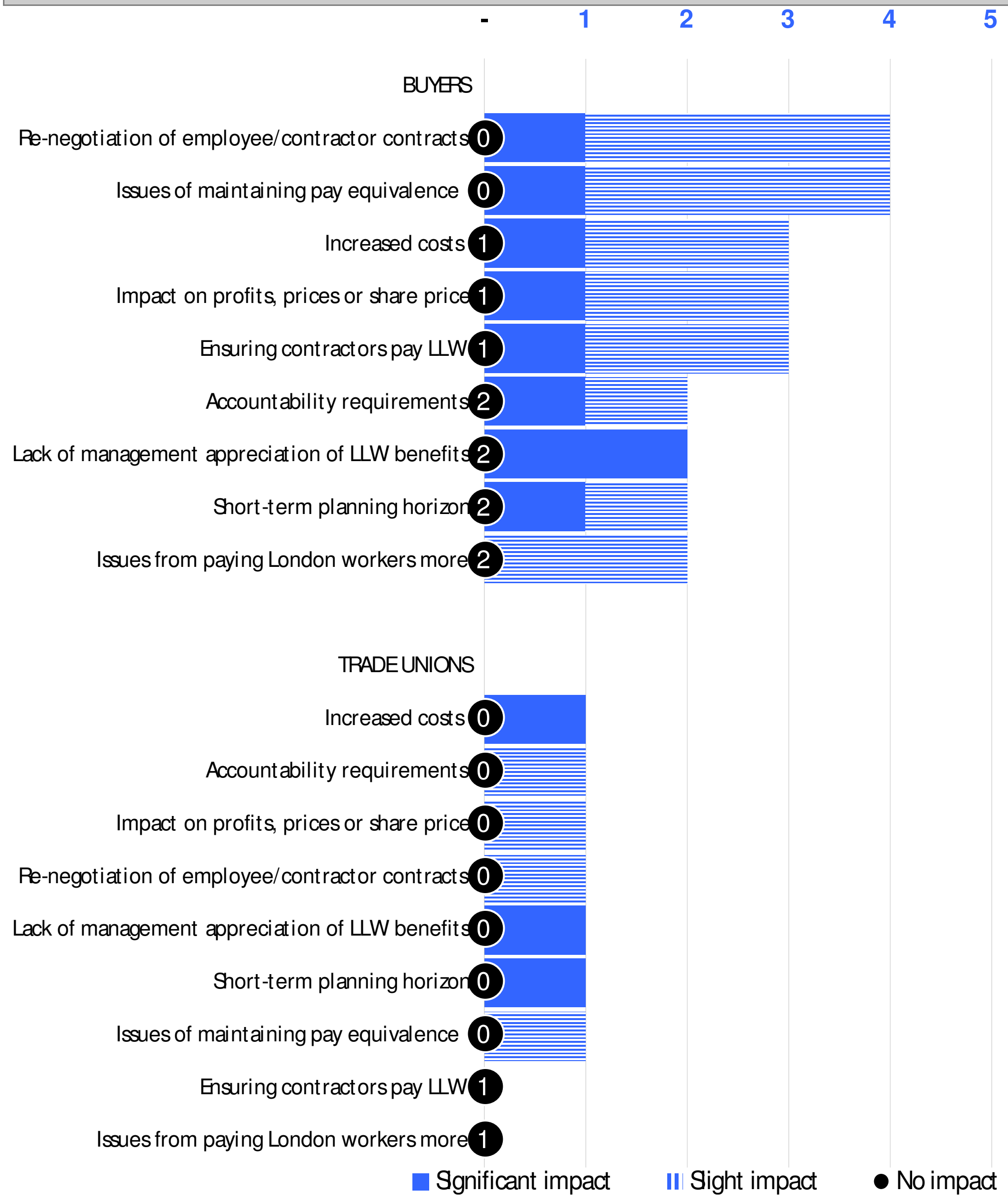
Whilst the motivational factors, impacts and benefits of the decision by LLW employers to adopt the LLW are the primary focus of this study, the reasons preventing non-LLW employers from committing to the LLW initiative are also of significant interest. Accordingly, in the process of our primary research for this study, we have sought to investigate such views. In this respect, we secured participation and consulted with a firm in the hospitality sector that had considered implementing the LLW, but had ultimately decided against it. The firm was unable to fully provide the Living Wage as the costs would have to be directly passed on to consumers making the firm vastly less competitive versus their competitors. However, the Living Wage posed some questions for the firm over the welfare and conditions of their staff and the firm wanted to benefit from the retention and maintenance of standards that they felt paying the LLW would have brought. As a best-options measure, the firm brought in an elevated wage rate half-way between the LLW rate and the minimum wage. The firm also introduced a range of non-wage benefits including:

- English language courses
- National Vocational Qualifications
- Customer services standards training
- Health and safety training
- Meal provision when on duty
- Uniform laundry service

5.2 Barriers to LLW implementation

As highlighted in the review of LLW agreements and existing literature, the Buyer organisation tends to have a driving role in the decision to implement the LLW. The Buyer's Contractors must implement the LLW by association. Accordingly, we surveyed the Buyer organisations as to their perceptions of the main barriers/difficulties in deciding to implement the Living Wage. The views expressed are summarised in the graphic below.

Figure 12: Views of respondents: Barriers to LLW implementation



Source: London Economics consultation with LLW stakeholders

All Buyers reported that the need to re-negotiate employee and Contractor contracts was likely to present some difficulty or could be seen as a potential barrier by employers. Indeed, for some Buyers themselves, the renegotiation of contracts, particularly those that were longer-term contracts, posed some challenges. However, the likelihood of this issue being a significant barrier is small with all Buyers rating the cost effect of re-negotiating contracts as slight.

All Buyers also reported that the implementation of the LLW had had some effect on maintaining pay equivalence with same grade workers and pay differentials with higher grade workers. However, for three quarters of respondents this effect was only slight.

Three quarters of Buyers reported increased costs; the impact on profits, prices or share price; and difficulties ensuring Contractor staff are also paid at LLW, would affect the likelihood of other organisations taking up the Living Wage, irrespective of whether the effect of these factors was real or perceived.

In terms of the effect of the Living Wage on accountability acting as a barrier, the results are mixed with half reporting no effect. The same is also seen in terms of a lack of management appreciation of the benefits of LLW. This was reported as a significant barrier by half of Buyers with the other half reporting no effect.

Half of Buyers felt that issues relating to paying London workers higher wage rates than the same grade of workers in the rest of the country (for UK-wide organisations) would have no effect on LLW take-up, as most organisations are used to operating London pay weightings. Of the half who thought it might cause an effect, all felt the effect would be marginal.

An additional barrier was reported by a Buyer organisation. Specifically, for some public sector organisations, there is a view that the LLW conflicts with regulations relating to 'Best Value' in the sense that the payment of the LLW increases the labour cost under a contract for no apparent gain in the services purchased with taxpayer resources. However, the organisation in question overcame this perceived challenge by introducing LLW over the first year of a three year contract against an agreed training and development plan. The result was the ability to recruit better quality staff for the extra payment. This had a beneficial impact for the Contractor in that staff were now properly trained in their tasks and so provided a better standard of service (and in addition, as a result of the increase in training, the cost of insurance reduced). This issue of a potential conflict between Best Value and the LLW is one that has also been noted by the experience of Trade Union bodies in discussions with public sector employers.

Buyers and suppliers were also asked about the current economic climate as a barrier in terms of:

- If faced with the same choice today, would the decision to implement the Living Wage be repeated
- Whether the condition of the economy has impacted on the cost of implementing the Living Wage
- Whether there is a commitment to increasing the Living Wage in line with future LLW calculations

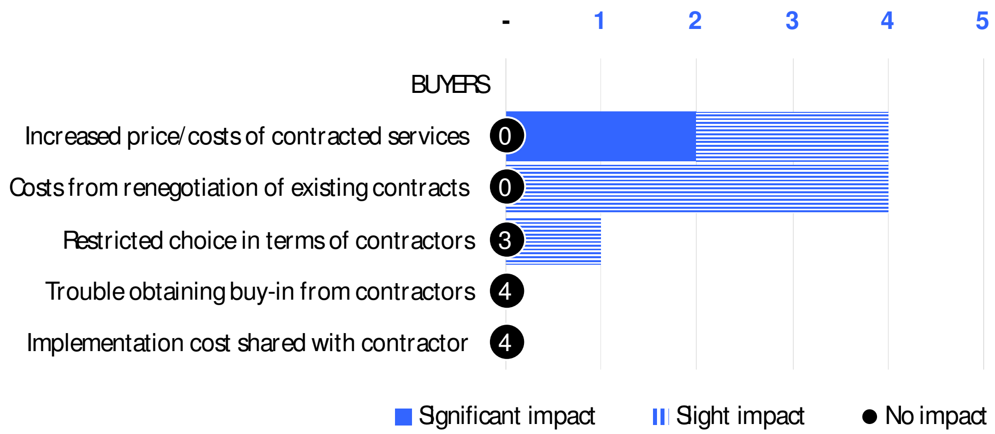
All Buyers and suppliers reported that they would, if faced with the same choice today, implement the Living Wage. One Buyer reported whilst they would repeat their decision because of the overwhelming benefits, the challenging economic climate would have made it more difficult to convince higher management to increase costs when the overall business case focuses on cost control. Another organisation also reported that the costs of the raw ingredients for catering and the costs of power for cleaning services has increased dramatically in recent times and that this does put pressure on budgets. However, the benefits outweigh the costs.

None of the Buyers or suppliers reported that the condition of the economy had impacted on the cost of implementing the Living Wage. All reported their commitment to increasing the Living Wage in line with future LLW calculations.

5.3 Costs of LLW implementation

The Buyer organisations consulted were also questioned as to their experience of the implementation costs of the LLW. The views received are summarised in the following graphic. The Buyers surveyed clearly pointed to an increase in the contract price for contracted services as being the most significant cost of LLW, followed by the slightly weaker effect of the costs of renegotiating contracts. Interestingly, Buyers do not note that requiring all bidders to pay the LLW does not lead to a reduction or narrowing of the pool of bidders. This suggests that the LLW requirement is not a significant barrier for potential LLW Contractor employers.

Figure 13: Views of respondents: Costs of LLW implementation



Source: London Economics consultation with LLW stakeholders

5.3.1 Quantitative findings

- One Contractor provided a detailed breakdown of labour costs, showing that nearly all elements of labour costs had increased following LLW adoption, with the total labour bill increasing by 7.7%. It is important to note however that this employer decided to pay above the GLA's LLW rate, which would have inflated the implementation cost. Whilst bearing this point in mind, we see that the bill for basic hours and holiday pay (possibly linked to the LLW employment conditions) both increased by 8.0%. Other increases of note were national insurance (+10.3%) and employee liability insurance (+7.4%).

- Through raising workers' wages to £7.05 in 2005, one small employer estimated that the cost of implementation was £6,100, with the long-term the impact estimated to be 0.7% of payroll costs. It should be noted that this uplift to £7.05 was above the LLW rate, leading to a higher implementation cost.

- A response from a Contractor/supplier indicated that the cost of implementing the LLW in the first year was £2,000 per employee, with the cost of implementing the following year's LLW up-rating at £704.69 per employee. They also note that the increase in employee holiday entitlement to 4 weeks per annum, across the national contract, cost less than one per cent (0.96%) of the contract value. The same respondent also estimate the 'ripple' wage increases necessary to maintain wage differentials to be £731 per employee receiving a differential-related wage increase. In this case, 100% of the

Contractor's costs of implementing the LLW were funded and borne by the Buyer organisation.

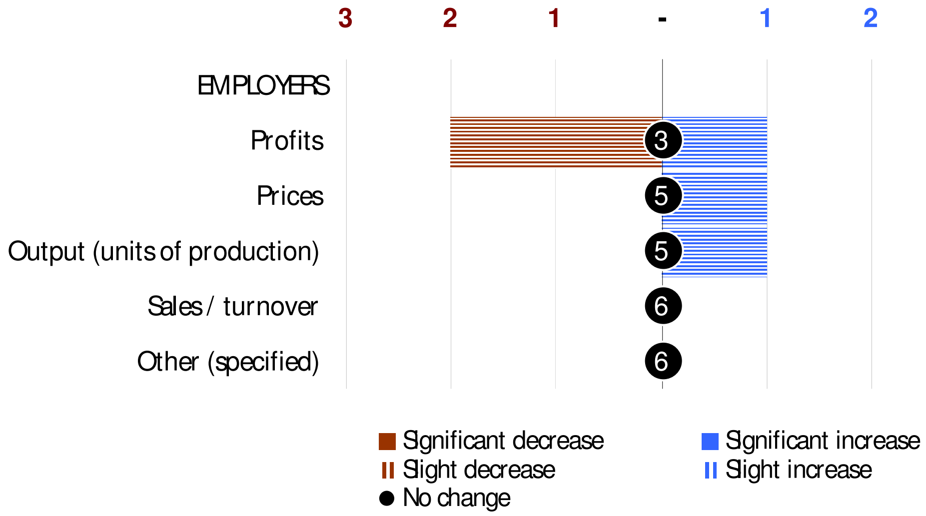
- A Buyer organisation surveyed experienced a 10.1% increase in the total annual price of its catering service contract following renegotiation to incorporate payment of the LLW.
- On the other hand, the same Buyer organisation saw a saving of 3.0% following the renegotiation of its cleaning service contract to include LLW conditions.
- Apart from an increase in the contract price, one Buyer indicated that the other costs of LLW implementation were negligible (internal management and administration time).
- The per hour unit charge for contracted services increased 26.7% in one case, representing a significant cost increase for the Buyer organisation. This compares to a 4.0% year-on-year change the year prior to the implementation.

5.4 Impact on business performance

For Contractors (employers with employees receiving the LLW) to large organisations, the impact of the Living Wage on business performance in terms of sales and turnover, profits, prices and output is fairly minimal. Employers with employees receiving the LLW reported:

- Payment of the Living Wage had not resulted in any change to their sales or turnover.
- The majority also reported that the payment of the Living Wage had not led to any negative change in their profits, though two respondents noted a slight decrease.
- Five employers reported the introduction of the Living Wage did not result in any change in prices or output. There was one case where both of these areas saw a slight increase.

Figure 14: Views of respondents: Impact of LLW on business performance



Source: London Economics consultation with LLW stakeholders

In terms of the increase in the wage bill as a result of the Living Wage, for many suppliers of contracted services, the cost of the increased wage bill was met by the service Buyer. One Contractor estimated the total cost of implementing LLW to their organisation to be between £1,001 and £2,000 per employee, however, this cost was met by the Buyer. In only one case did a Contractor (rather than Buyer) absorb the full cost of the increased wage bill. This resulted in an increase in their wage bill of between 10% and 20% and a slight decrease in profits. In one other case, profits for a Contractor increased as the increased contract price resulted in an increase in management fees, which were proportionally linked to the wage bill. For one further Contractor the wage bill uplift to the LLW rate was negotiated and paid for by the Buyer for existing contract employees. However, employee numbers have increased and these additional employees are not currently covered by the uplift agreement with the Buyer. This has led to an additional cost to the Contractor of £3,000 per month equivalent to an increase of approximately 15% to the wage bill.

In terms of the effect of the LLW on wage differentials, two organisations had employees affected (approximately 5% and 11% of employees). For one of the organisations effected the cost of maintaining this wage differential was between £501 and £1,000 per affected employee.

Looking at the costs to the Buyer of contracted services, all Buyers reported that the implementation of the Living Wage had led to an increase in contract prices and/or cost of contracted services.

All Buyers reported that there had been a slight increase in the costs arising from re-negotiating and re-drafting existing contracts. However, no Buyers reported any problems in obtaining buy-in from Contractors. In addition, nearly all Buyers reported that the LLW has not led to a restricted choice in terms of Contractors, with only one reporting that the Living Wage had had a slight effect on restricting the choice of Contractors. One Buyer reported that even unsuccessful bidders for their contracts were really pleased to be bidding for LLW contracts and that they viewed the LLW positively.

In terms of contract costs, there were difficulties reported by Buyers associated with the blanket implementation of the LLW across all contracts. These difficulties occurred where the Buyer was a small part of a larger consortium that does not operate the LLW; where there is a community element to the contract; and where the contracts were very small (for example where a Contractor would come in to do a single piece of small site maintenance).

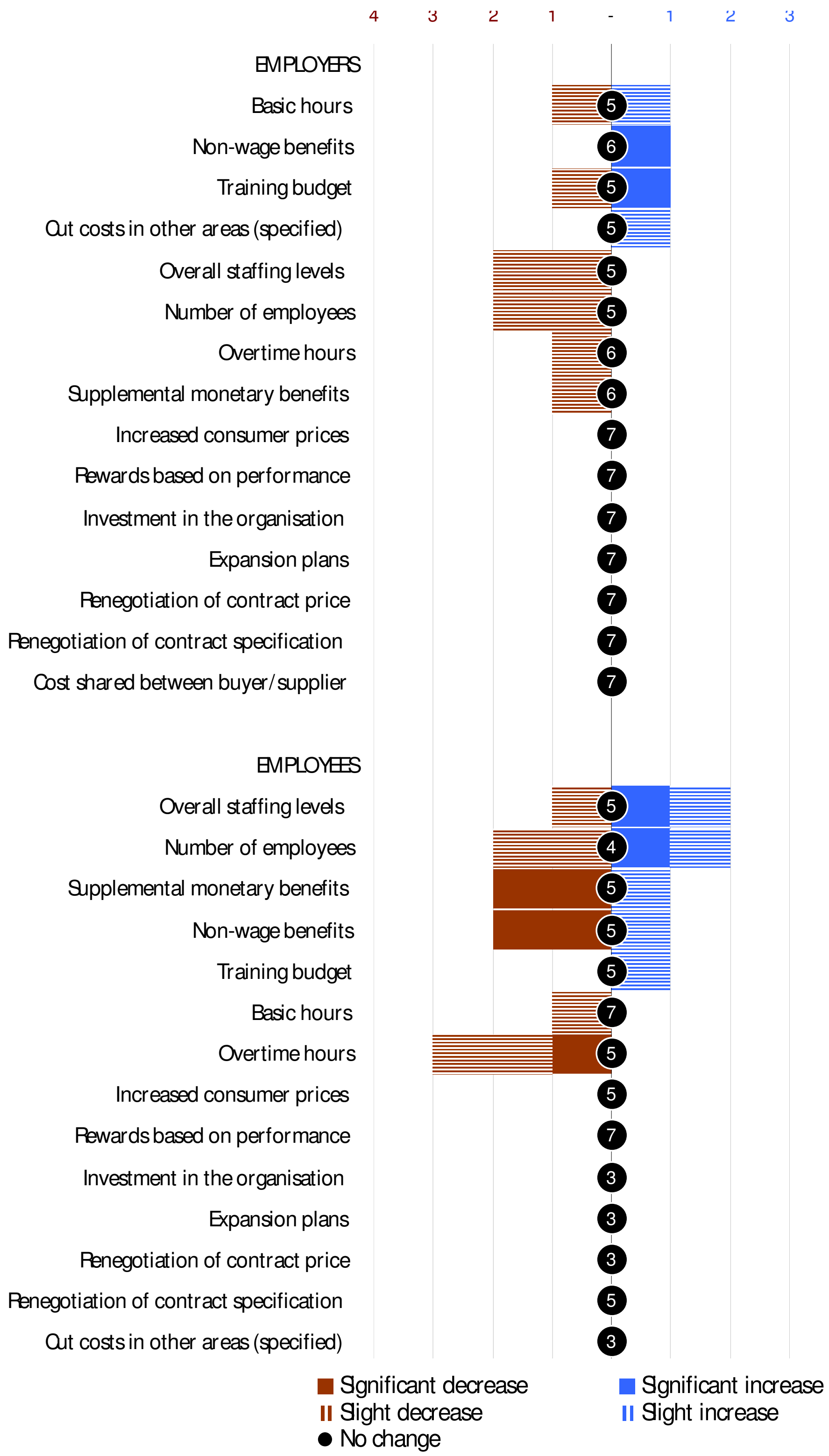
5.4.1 Quantitative findings

- Compared to the year prior to LLW contract implementation, one Buyer organisation experienced a 10.5% increase in turnover and a 19.8% in profit. The implementation of the LLW did not result in negative business performance results.
- Another employer witnessed a drop in turnover (-1.1%) and profits in the year after implementation, though turnover recovered to rise above the pre-LLW level in subsequent years. Profits have since increased but remain below the pre-LLW level.

5.5 Methods used to recoup any cost increase

For the majority of employers with employees in receipt of the LLW, there has been no attempt to recoup the additional wage costs. In general the additional wage costs are picked up within the contract price and so are passed back to the Buyer. In only one case did a Buyer organisation discuss with their Contractors ways of recouping the additional wage costs through the use of efficiency measures.

Figure 15: Views of respondents: Cost recovery strategies



Source: London Economics consultation with LLW stakeholders

No change was reported by employers with employees affected by the LLW in respect of:

- Costs passed on to consumers through price
- Rewards based on performance
- Investment in the organisation
- Expansion plans
- Renegotiation of contract price
- Renegotiation of contract specification
- Sharing of implementation cost between Buyer and Supplier of contracted Contractor

Looking at overall staffing levels and employee numbers, a small number of employers reported that staffing levels had decreased slightly as a result of moving staff from part-time to full-time contracts.

There was also a slightly negative effect reported by one employer in relation to basic hours, overtime hours and overtime rates. In this case, employees reported that whilst they received more money per hour as a result of the Living Wage, the availability of overtime hours had shrunk and so in effect lessened some of the monetary impact of the London Living Wage for them.

For Contractors there were no changes in non-wage benefits such as meal vouchers and paid breaks. However, in cases where large employers had brought previously contracted out services in-house, the non-wage benefits were significantly positive as previously contracted staff now received full employee benefits.

In terms of training budgets, for the majority of employers with LLW employees training budgets were not affected by the introduction of the Living Wage. In one case an employer reported a slightly negative effect on training budgets as the cost of training was reduced following the introduction of the Living Wage. Specifically, the reduction in staff turnover had led to move away from more intensive induction training to lighter touch refresher training. In one case, a significantly positive effect was reported on training budgets and this related to a case where contracted out staff had been brought in-house and so had access to the full employee training programmes.

5.5.1 Quantitative findings

Number of employees and hours worked

- The number of employees has increased steadily (between 1.0% and 7.7% annual change) since LLW introduction in 2004 for one employer organisation, with the number of LLW employees increasing 31.6% between 2004 and 2007.

- One Contractor has seen the number of employees employed in total increase by 1.6%, with the number of LLW employees increasing by 4.8% in the year following the LLW implementation. Total hours worked also increased the year following LLW implementation by 3.4%, reflected in an increase of 1.8% in the number of hours worked per employee. This was mainly due to an increase of 8.7% in basic hours.

- Another Contractor also increased the number of workers on its LLW contract, both in terms of workers paid above the LLW (+44.4%) and those paid at the LLW (16.7%). The number of hours worked on the contract also increased significantly in the years following the LLW introduction (30.0%). The number of basic hours per week worked by each employee however remained constant.

Employee training budget

- Following the LLW introduction, one organisation increased expenditure on up-skill training per existing employee by 59.2% and has increased this further in subsequent years. Meanwhile the level of induction training per new hire employee remained relatively constant.

- One Contractor's data response shows that following LLW implementation, the firm increased the training budget for its employees by 4.8% compared with the previous year. Running ahead of inflation, this change represents a real increase in the level of training for employees, including up-skill training.

Other elements

- One Buyer organisation agreed productivity improvements with its Contractor supplier which it notes helped finance the LLW.

- One long-standing LLW Buyer firm noted no cost savings reaped but that they had paid implementation costs (the increased labour costs of £500 per year) for its security Contractor.

5.6 Induced outcomes

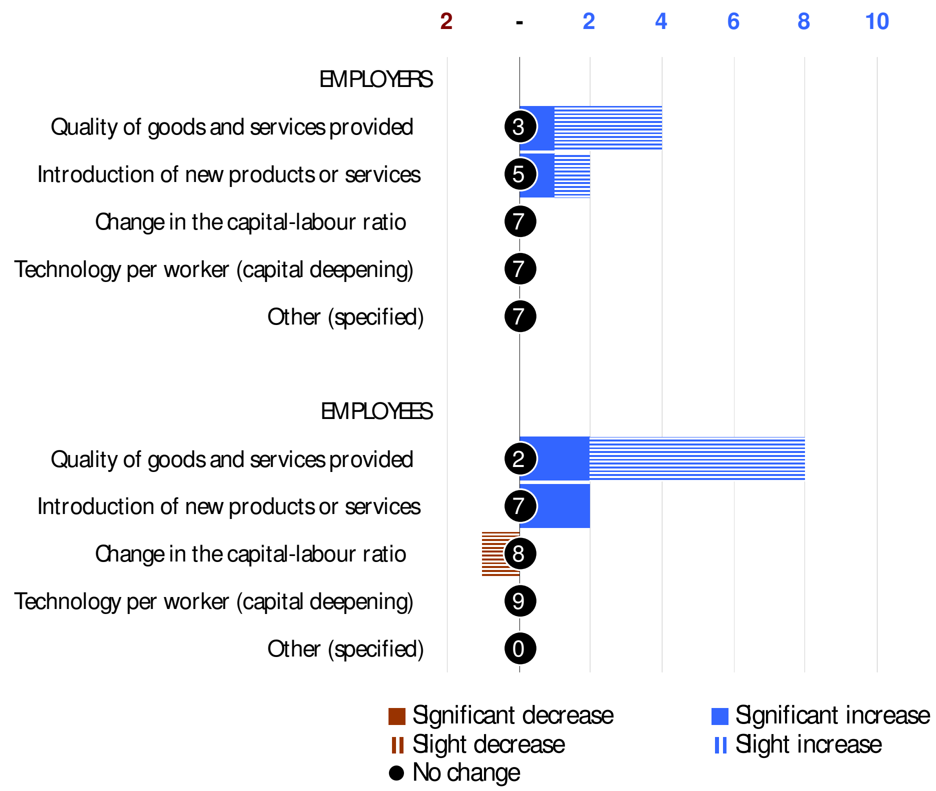
All employers with LLW affected employees reported that the Living Wage had not led to changes in the ratio of capital to labour or any increases in the use of technology per worker. This is likely to be a reflection of the service-related industries in which the contracted services operate.

Just under one third of employers reported that the Living Wage had resulted in the introduction of new products or services. This is echoed by the employees working within these organisations who reported that they now had access to a greater number of better quality products.

> *"We have been given more materials – floor strippers, cleaners and disinfectants to help us to do our jobs better. We have also had training so that we know how to use the products properly."*

Over half of employers reported that the LLW had had a positive impact on the quality of goods and services their organisations provided. Four fifths of employees reported that the LLW had increased the quality of goods and services they provided.

Figure 16: Views of respondents: Outcomes induced by LLW implementation



Source: London Economics consultation with LLW stakeholders

5.6.1 Quantitative findings

Capital stock and investment

It is important to note that due to its long-term planning horizon, in cases of more recent LLW implementations, the impact of LLW on capital investment may not yet be apparent.

- One employer that implemented the LLW in 2004 has since seen a year-on-year increase in capital stock (10.3%, 2.3%, 0.2%), following waves of capital investment. Combined with a parallel growth in employment, this investment has resulted in an initial increase in capital per worker of 2.4% (capital deepening) followed by a dilution resulting from increased employment.

- Another employer also experienced an increase in capital intensity, with the value of capital / fixed assets per employee increasing by 30.5% following a large investment programme that coincided with the LLW adoption.

Quality of service

- One Contractor noted a fall in customer complaints of 16.7% in the year following LLW implementation.

6 Conclusions on evidence of potential LLW benefits

This report has presented the findings of London Economics' investigation of the quantitative and qualitative evidence of the impacts of the LLW on public and private sector organisations in London. In this section, we summarise our findings of evidence of LLW benefits and consider these in relation to the findings of costs, barriers and impacts on business performance to draw conclusions on the evidence of potential benefits for any organisation considering implementing the LLW.

6.1 Data and evidence gaps and areas for further research

The primary constraint in this analysis has been data limitations. Firstly, the quality and coverage of the data responses have been less comprehensive than expected, for reasons outlined in the report. These data gaps have limited the evidence that we have been able to collect, for example, in the area of productivity.

Secondly, we found that the utility of existing secondary data sources for the Living Wage research is limited, as none allow the identification and isolation of those employers/employees that pay/receive the LLW. Therefore, it has not been possible to conduct an exact comparative analysis to determine the marginal impact of the LLW for an organisation. This is a significant shortcoming of the existing datasets available and represents a definite information gap that could be addressed in the future to allow further analysis.

Some suggestions that we would have for future research are:

- Quantitative investigation of the potential Exchequer cost savings as a result of removing the current incentive for very low paid workers in London to claim income support from state-funded benefits as an alternative to employment.

- Investigation of the value of wider costs to society in London of paying any cost/price increases passed through as a result of LLW implementation and whether this is offset by the societal benefits related to a reduction of poverty and increased worker welfare in London.

- Investigation of whether there is any impact on age profile of employees – especially around adult employees being undercut by younger employees entering the market.
- An expansion of the analysis to look at the wider national impact could be useful. (for instance, there are campaigns for the introduction of Living Wage policies in Leeds, Oxford, Wales etc)
- Finally, we suggest a repeat of this study after another year or two of LLW implementation, when the impacts of the policy have had more time to manifest themselves. Such research should involve all LLW employers in order to achieve as large a sample as possible, with the possibility of ongoing primary data collection to support further analysis. The ongoing collection of detailed quantitative information on an on-going basis would also allow for the direct estimation of the benefits and cost associated with the implementation of the policy

6.2 Summary of evidence of LLW benefits

Recruitment and retention of staff

Labour turnover is high (generally between 30% and 50%) amongst the organisations examined, so cost savings associated with recruitment and retention are a source of substantial benefits for LLW employers, as reported by six out of seven employer respondents.

- **Significantly lower rates of staff turnover**

  The rate of employee turnover tends to drop significantly following LLW implementation (from 61.9% to 24.4% per annum in the case of one respondent). Staff turnover on Living Wage contracts can be significantly lower (1% to 2% per annum) compared to non-LLW contracts at the same firm.
- **Substantial cost savings on recruitment and induction training**

  Recruitment costs tend to decrease following LLW implementation. The evidence has illustrated cases of estimated cost savings of £500 per person in advertising and recruitment costs. In addition, one organisation experienced a fall in total advertising expenditure 42.0%.
- **Employees more likely to stay with organisation**

  80% of employees interviewed reported that they were less likely to leave their company as a result of receiving the LLW.
- **Increased tenure of workers and continuity of workforce**

  In one case, the average length of tenure of employees increased from 2 to 3 years following LLW introduction.

Absenteeism and sick leave

- **Lower rates of absenteeism and sick leave**

  Evidence of a fall in absenteeism and sickness following LLW implementation is supported by qualitative responses (approximately 5% fall) and analysis of the data responses (between 4.5% and 28.4%). Employees, however, noted no impact, often citing that they simply were rarely absent or had taken time off sick in the first instance.

Productivity

- **Evidence of enhanced quality of work**

  More than 80% of employers believed that the LLW had enhanced the quality of the work of their staff. Employees (almost 75%) also reported increases in work quality as a result of receiving the LLW.

- **Mixed evidence of increased output per worker**

  Employers generally reported that the LLW had a positive impact on productivity within their organisation. A positive impact of LLW implementation was reported by several organisations, including an increase of 5.3% in sales/turnover per employee, and an increase of 3.1% in the value of the service contract per worker at another.

  Other cases showed no change in productivity (one case) or even a fall (two cases), though this may be due to other factors not relating to the LLW. In one case, turnover per employee fell in the first year following LLW implementation (-8.1%) but increased in subsequent years by 4.6% and 1.2%. The majority of employees felt that their output per hour had not changed with the introduction of the Living Wage.

- **Weak support for intensified work effort**

  Five of eleven workers surveyed indicated that the LLW has led them to intensify their work effort. The remaining six suggested that they already worked at maximum intensity.

- **Widespread efficient work reorganisation**

  Considerable evidence was found of organisations seeking to recoup higher wage costs by reorganising work processes and practices to remove inefficiencies. This yields a productivity gain by enabling more work to be completed by the same workers.

Worker morale and motivation

- **Significantly boosted worker morale and motivation**

  Almost all employees reported experiencing a significant benefit in relation to worker morale and motivation from the LLW. For the vast majority, the LLW had a significant positive effect on:
    - Being more motivated to work
    - Feeling more pride and higher morale about their work

  - More positive atmosphere, conducive to productive work
  - Having an enhanced work ethic/commitment to work
  - Generally being more happy with the job

Reputational benefits

- **Significant benefits for LLW organisation's reputation and public image**

  Nearly three quarters of Buyers and Contractors felt that the LLW had increased consumer awareness of their organisation's commitment to be an ethical employer.

Employee benefit

- **Significant financial and welfare benefit for employees**

  Most employees estimated the LLW added between £1,001 and £5,000 per annum to their pay, which has made them far happier in their work, improved their standard of living, have a better standard of family life, and pay for education and training.

Ability to attract high quality employees

- **Weak evidence of attracting higher quality employees**

  Due to the often low-skilled and transient nature of their service-related industries, employers did not feel that the LLW had any significant impact on their ability to attract higher quality employees.

Ease of implementation of new working practices

- **Increased management confidence to adopt new change strategies**

  Half of employers felt the implementation of the LLW had given management more confidence to adopt new strategies requiring a change in working practices.

- **Little evidence of facilitation of implementing new working practices**

  Few employers reported the adoption of any new working practices in the first instance. Moreover, the majority of employees felt that the LLW had made them more willing to implement changes in their working practices; enabled them to require fewer concessions to effect change; and made them more likely to adopt changes more quickly.

Stakeholder relations

- **Slight positive impact on stakeholder relations**

  A slight positive impact on customer satisfaction was noted. As most employers are non-unionised, there is little opportunity to develop, however, in some instances the LLW led to discussion between those organisations and Trade Unions for the first time.

Buyer/supplier relationship with Contractors

The development of a better understanding of client needs as a result of LLW negotiations was dependent on how closely each party had previously worked together.

- **Improved quality of the contracted services**
  All but one of the Buyers and Contractors reported that the LLW had improved the quality of service provided. Similarly, all but one employee felt that the level of service they provided had been improved as a result of the LLW.

Visibility of costs and resources

- **Mixed evidence on increased control and monitoring**
  43% of employer respondents felt that the LLW had had a positive impact on the visibility of costs and resources, with little or no increase in monitoring. However, employees tell a different story, with 73% reporting greater performance monitoring and/or supervision. This diverging picture is confirmed by contrasting results from the data analysis.

6.3 Consideration of costs and impacts

In the course of our research, we also investigated the implementation costs, barriers and impacts experienced by the surveyed organisations. The main barriers/difficulties in deciding to implement the LLW perceived by Buyer organisations surveyed were:

- Re-negotiation of employee/Contractor contracts
- Issues of maintaining pay equivalence
- Increased costs
- Impact on profits, prices or share price
- Ensuring Contractors pay LLW

Our research also sought to identify and quantify the costs experienced by Buyer and Contractor firms. Significant costs experienced by Buyers include:

- Increased price/costs of contracted services
- Costs from renegotiation of existing contracts

Costs experienced by Contractors are:

- Increased labour costs

- 'Ripple' wage increases to maintain wage differentials

We found evidence of little or no impact on business performance of LLW implementation. All LLW employers reported no change in sales/turnover. 50% of employers saw no change in their profits following the implementation of the LLW, with two seeing a slight decrease and one a slight increase. The majority of respondents also experienced no change in prices or output. One reason for the lack of impact on business performance is the cost-saving methods and strategies that the organisations instigated following LLW implementation, as described in the main report text.

6.4 Conclusions on potential benefits of LLW implementation

Our qualitative and quantitative research found clear evidence that employers have benefited across a wide range of areas after implementing the LLW. The findings of our research indicate that the cumulative value of these benefits is significant. At the same time, our evidence also suggests that costs of implementation can be high, driven by the increased payroll costs for Contractors and increased re-negotiated contract prices. However, we find that these costs can be mitigated through a range of cost saving strategies and induced effects.

Our findings indicate that there is some evidence of significant financial and non-financial benefits achieved by those employers that have implemented the London Living Wage. Although *some* organisations indicated that there were non-trivial, the relatively limited implementation costs and the absence of any evidence of substantial negative impacts on business performance on an on-going basis, suggests that there is a likely to be a positive net benefit of LLW implementation for a typical firm.

Furthermore, both Buyer and Contractor organisations are very supportive of the LLW initiative, owing to the range of benefits that they reap in terms of recruitment and reputation as a socially responsible organisation.

Crucially, all Buyers and Contractors reported that they would, if faced with the same choice today, implement the London Living Wage.

Annex 1 Additional information on the LLW

The estimates of the minimum hourly wage to avoid poverty in London are significantly higher than the current NMW level.

The following table shows a comparison between the level of the NMW in the UK and the proposed LLW. This shows that the proposed LLW for 2007 is 30% greater than the NMW in place. It also shows that the percentage difference between the two has been falling annually, most likely due to the high rate of growth in the NMW over the period, as the NMW was set at a conservatively low level when first introduced in 1999.

Table 2: Difference between the UK National Minimum Wage and the London Living Wage

Year	LLW	NMW	% Difference (LLW greater than NMW)
2005	6.70	5.05	+ 33%
2006	7.05	5.35	+ 32%
2007	7.20	5.52	+ 30%
2008	7.45	5.73	+ 30%

Source: NMW: Low Pay Commission; LLW: GLA Economics.

How is the LLW calculated?

The Living Wage for London is defined by the Family Budget Unit (FBU) as "a wage that achieves an adequate level of warmth and shelter, a healthy palatable diet, social integration and avoidance of chronic stress for earners and their dependents"[20], and is calculated by GLA Economics in two stages:

1. First a 'poverty threshold wage' is calculated. This is done using two methods (a detailed explanation of each follows).
   - The Basic Living Costs approach (estimate of £6.15 per hour); and
   - The Income Distribution approach (estimate of £6.35 per hour);

   Then, the average of the two estimates from the two methods is taken (£6.25 per hour).

[20] GLA Economics (2007) *A Fairer London: The Living Wage in London*, (p.7).

2. Secondly, the poverty threshold wage is converted to a Living Wage, in recognition that a Living Wage must yield a secure margin ensuring that the person involved does not fall to the level of poverty wages. Consequently, GLA Economics add an additional 15 per cent to the poverty level wage (giving £7.20 per hour as a Living Wage for London).

GLA Economics note that if means-tested benefits (including tax credits, housing benefits or council tax benefits) were to be ignored in the calculation, the LLW estimate would rise to approximately £9.15 per hour.

The two approaches to calculate the poverty threshold wage are explained in more detail below.

Basic Living Costs approach

The Basic Living Costs approach, developed by the Family Budget Unit, includes the following living costs in its calculation of what it calls a low cost but acceptable standard of living in London:

- Housing
- Council tax
- Transport
- Childcare
- All other costs (a 'regular shopping basket').

It also takes the following credits and benefits available to the workers into account, including:

- Benefits and tax credits
- Earnings and benefits
- Child tax credits
- Housing benefits
- Council tax benefits

Income Distribution approach

The second method aims to identify that hourly wage that would be required to raise all households in London to at least 60 per cent of median income. This measure is based on household disposable incomes after housing costs adjusted for household size and composition (as a proxy for material living standards). The measure of disposable income after housing costs consists of earnings, all social security benefits (including housing and council tax benefits), pensions, maintenance payments, educational grants, and cash value of payments in kind such as free school meals for all members of the household less income tax (including national insurance, pension contributions) and maintenance or support payments made to people outside the household. Rent, mortgage interest payments, water charges and structural insurance premiums, are deducted from income on this measure.

Number of workers affected by the LLW

The proportion of London employees earning less than proposed Living Wage has been estimated by the GLA using data from the Annual Population Survey (APS) for 2005.[21] The results are presented in Table 5, which shows that over 14% of full-time employees and 46% of part-time employees earn less than the LLW. The table also illustrates that over 5% of full-time London workers in London receive wages less than poverty wages (£5.35 per hour).

Table 3: Number and Proportion of Jobs held by Adults paid less than the forthcoming National Minimum Wage (UK), 1999–2006

Group	Males (%)	Females (%)	Total employees (%)
Full-time earning			
< £5.35 per hour	4.8	6.0	5.3
< £7.05 per hour	12.0	15.3	13.4
< £7.20 per hour	12.8	16.1	14.2
Part-time earning			
< £5.35 per hour	32.9	18.5	22.1
< £7.05 per hour	55.3	40.2	44.0
< £7.20 per hour	58.4	42.3	46.3

Source: GLA Economics (2007) A Fairer London: The Living Wage in London.

21 GLA Economics attach the caveat that using APS data for 2005 may lead to an overestimate of the number affected, as employees are likely to have received an increase in their pay since 2005, perhaps above the £7.20 threshold.

Annex 2 Review of literature and existing data sources

Introduction

This Annex provides a more detailed discussion of the main findings of our secondary research of economic theory, literature and existing data sources.

As a first step of the research of the potential benefits of the LLW, it is useful to review economic theory and to establish a clear picture of the existing evidence in relation to the benefits and costs of Living Wage implementation. Furthermore, it is useful to consider the available sources of secondary data as potential sources of data for supplemental analysis.

This secondary, desk-based, research will provide a key input into the identification of the appropriate metrics going forward and identification of evidence gaps. In addition, we use the information generated during this stage of research to assist in the development of semi-structured interviews for the primary research.

Economic theory of Living Wages

Standard competitive models of the labour market are unambiguous in their predictions of the outcomes that will result from the imposition of a binding (that is to say above the market clearing rate) minimum wage, such as a Living Wage. The theory predicts that firms would be expected to make a change in their behaviour, by reducing the amount of low wage labour that it employs.

The standard neo-classical model holds that an individual's wage in a competitive labour market should equal the marginal product of their labour. Therefore, if the minimum wage is set above the competitive wage of the individual, then the labour cost of the worker exceeds their marginal product and employment will tend to fall. Employers generally will substitute capital for labour. The magnitude of the reduction in employment depends on the disparity between the minimum wage and the competitive wage, and the elasticity of demand for labour.

However, there is another possible outcome that the standard economic theory does not account for: the potential for an increase in efficiency or a productivity gain in response to the introduction of a minimum wage. That is to say, that the worker increases his/her marginal product of labour to bring it back in line with the now increased minimum wage. This efficiency/productivity gain may come through on of two channels:

- **Effort intensification** - an increase in the *quantity* of labour input per hour, for example: through increase monitoring and regulation of effort by management; or workers may voluntarily increase work rate in response to higher wages, as predicted by efficiency wage theory.
- **Enhanced quality** - an increase in the *quality* of labour input per hour, for example through education, training and further skills development.

This study will consider to what extent those firms providing a LLW have realised benefits through increased efficiency levels and productivity gains.

Efficiency wages

Labour economics provides a well-developed branch of theory in relation to higher-than-market-rate wages in the form of the literature of efficiency wages. Living wages such as the LLW may be considered an efficiency wage. If however, the LLW becomes so widely adopted, then the Living Wage rate will equal the market rate, and any efficiency wage will lie above the LLW.

One of the first implementations of efficiency wages[22] was revolutionary industrialist Henry Ford, who significantly increased wage rates (doubled in most cases) through the introduction of the five dollar day in 1914, motivated by concerns such as high turnover and poor worker morale. Evidence suggests that there were substantial queues for Ford jobs, and significant increases in productivity and profits at Ford, supported by low monitoring costs and skill levels on the Ford production line.[23]

The concept of efficiency wages is based on the realisation that employee effort is not constant, that workers can choose their level of effort and they put in more effort when they are motivated to do so. In the absence of suitable motivation, workers will 'shirk' and operate at low effort levels.

22 The interpretation as efficiency wages is supported by: Raff, D. and Summers, L. (1987) "Did Henry Ford pay efficiency wages?", *Journal of Labor Economics*, Oct.

23 Raff and Summers (1987).

The central efficiency wage hypothesis holds that employees' effort level, and thus, the productivity depends positively on their wages. One way for employers to provide motivation is to pay more than other employers. Therefore, the theory of efficiency wages points to the incentive for employers to pay their employees more than the market-clearing wage in order to increase their effort, productivity and/or efficiency.

The direct implication of paying higher wages is that wages are set 'too high', that is to say, above the market rate, but the theory of efficiency wages argues that this makes sense for the employer, as paying efficiency wages has a double-reinforcing effect, explained afterwards below:

- Higher wages induce workers to put in more effort; and
- Higher wages generate involuntary unemployment and make the threat of being fired credible, with a probability of being fired as loss-making for the employee

In one common model of efficiency wages proposed by Shapiro and Stiglitz[24] is where workers either work or shirk. If employees shirk, then they have a certain probability of being caught (though the cost of assessing the level of effort is costly), with the penalty of being fired. As the wage that the employee is currently paid is set above the market rate, and thus above the rate that the employee is likely to be able to secure at another employer if fired, then the employee faces a probabilistic loss if fired, even if he/she manages to find alternate employment. Unsurprisingly, the theory also suggests that the presence of involuntary unemployment in the market further reinforces the disincentive to shirk, though this may have wider social and economic implications.

One further incentive for paying higher-than-market wages foreseen by the efficiency wage hypothesis is to minimise labour turnover, due to the high cost of replacing workers (search, recruitment, and training costs).

Therefore to summarise on efficiency wages, objective of paying a higher wage is, *inter alia*, to:

- discourage shirking by raising the cost of being fired
- encourage worker loyalty and reduce labour turnover
- raise group output norms
- improve the applicant pool and
- raise morale.

[24] Shapiro, C. and Stiglitz, J. (1984), "Equilibrium unemployment as a worker discipline device", *American Economic Review*, June.

However, as noted by Metcalfe[25], the impact on employment levels of efficiency wages can be ambiguous. Some researchers argue that efficiency wages result in a fall in employment, whilst others hold that it has a marginal, if not positive, effect. On the one hand, citing research by Brown[26] (1999 p.2110), it is suggested that "by raising the effort standard they require on the job, employment effects may be magnified rather than mitigated", the logic being that a if 10% increase in the minimum wage is matched by a 10% increase in enforced effort, then employment in efficiency units will not be changed but that either the number of workers or hours worked would be reduced by 10%. On the other hand, Brown cites an alternative model put forth by Manning[27] (1995) which portrays the reaction to an increase in the minimum wage as an outward-shifting marginal revenue product of labour curve, representing an increase in the value of the employee's work as a consequence of the extra effort, validating the payment of a higher wage as per the standard neo-classical model. Depending on the extent to which the curve is shifted, this may lead to a mitigated reduction, no change, or even an increase in the level of employment.

Expected impacts of a Living Wage

The impact if a minimum or Living Wage depends on the level at which the wage is struck. For segments of the labour market (e.g. skilled labour), the minimum wage is likely to be set below the market-clearing equilibrium level, and so there will be little or no impact (in terms of potential knock-on distortion from other segments). For workers paid wages by firms below the minimum wage/Living Wage level, then the impact will 'bite'. The theory as to the possible manifestations of this impact is discussed in this section.

A minimum wage/Living Wage[28] increases the unit cost of labour for low-paid workers. It is clear that this has the direct impact of increasing the unit costs of labour for the proportion of firms' employees that are paid less than this value.

Therefore, the imposition of a Living Wage increases production costs, which must be absorbed somewhere by the firm or consumers. Theory tells us that there are a number of firm-level responses to this, including:

- Reduce the number of employees (dismiss any workers whose marginal product is below the NMW, substituting capital for labour);

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25 Metcalf, D. (2007) "Why Has the British National Minimum Wage Had Little or No Impact on Employment?", *CEP Discussion Paper No 781.*

26 Brown, C. (1999) "Minimum wages, employment and the distribution of income", in Ashenfelter, O. and Card, D. (eds) *Handbook of Labor Economics*, vol 3, Amsterdam: North Holland, p.2110).

27 Manning, A. (1995) 'How do we know that real wages are too high?', *Quarterly Journal of Economics*, CIX, November, 1111-1125.

28 For the purposes of this discussion, the terms minimum wage and living wage are used interchangeably, though the focus is on living wage.

- Reduce the hours being worked;
- Reduce the level of profits being made;
- Pass the cost on to customers by raising prices (depending on the price elasticity of demand;
- Offset the wage increase by cutting back on non-pay elements, such as health insurance, safety or employer provided training;
- Evasion and avoidance strategies (e.g. increase the number of 16-21-year old employees, relocating out of the area covered[29]);
- Efficiency gain / productivity increases.

Whilst interested in all impacts of a Living Wage, it is the last item in this list of possible impacts of the introduction of a minimum/Living Wage that is the focus of this study.

Economic and social literature on Living Wages

In order to fully understand the structure of the LLW and assess evidence of Living Wage interventions in other regions, we review the relevant economic and social literature. As part of this process, we review both 'internal' (literature specific to the LLW from the GLA) and also 'external' documentation (published studies and academic literature in the area of Living Wages more generally).

- **Internal Documentation**

  To understand the economic benefits associated with the LLW, it is first necessary to understand the background, context and nature of the LLW, as well the strategy for encouraging the take up of its provision. In this regard, all documents published by the GLA relating to the LLW have been reviewed.

- **External Documentation**

  We are aware that there are a number of interventions of this nature, for example, the implementation of the NMW across the United Kingdom in the 1990s. In addition, there have been a number of other more localised interventions in the United States (in Massachusetts, Detroit, Los Angeles, San Francisco, Baltimore) where there is (in general) better evaluation evidence and the incorporation of appropriate counterfactuals.

29 As suggested by Brenner, M.D. (2003) "The Economic Impact of Living Wage Ordinances", Political Economy Research Institute (PERI), University of Massachusetts Amherst, Working Paper Series, Number 80.

The result is that there has been a significant volume of research generated that has attempted to assess the likely economic outcomes, at both a macroeconomic and microeconomic level, associated with the introduction of price floors. As part of this stage of the project, we considered the academic research undertaken in the area by organisations such as the Low Pay Commission (LPC), the Department for Work and Pensions and other public policy organisations (such as the Joseph Rowntree Foundation).

It is crucial to correctly understand all the initiatives containing elements similar to the LLW, however, it is also key to understand how these policies were delivered in practice and whether there was any degree of interdependence between various programmes and other related policies (whether the minimum wage was related to retaking additional education and training) or the personal characteristics of recipients (e.g. single parents, ex-offenders).

A wide-ranging review across the economic and social science literature is presented in the subsequent pages. The objective of this literature review is to build a substantial body of evidence of the existence and appropriate measurement and relative size of efficiency gains resulting from the implementation of a Living Wage in other regions worldwide. As the United States has been a forerunner in this area, there are many studies and much evidence from such initiatives in America, but whilst covering this region, we have made a deliberate attempt to seek evidence in other regions in Europe and worldwide, with a particular emphasis on the LLW in London.

We will later compare the findings of the desk based analysis to those of the employer (Buyer and Contractor) consultation exercise.

Low pay and the Living Wage in London

The GLA has conducted several studies into the pattern and causes of low-pay in London. This research has yielded much useful information to inform any discussion on low pay, minimum income and the LLW. Accordingly, this is the first set of literature to be reviewed, to set the context for the more general experience and research findings that follow.

A useful output of the methodology of this research is the distinction between a Living Wage and the national minimum wage. The distinction drawn by GLA Economics is as follows:[30]

- The national minimum wage (NMW) - The lowest wage permitted by UK law.

[30] Melville, D. and Harker, A. (2008) *Current Issues Note 22 Patterns of low pay in London*, GLA Economics.

- Living wage - A wage sufficient to meet a certain standard of living for a worker and their dependents.
- London Living Wage - Set by the Mayor of London since 2005, unlike the NMW, the London Living Wage is not a statutory wage floor.

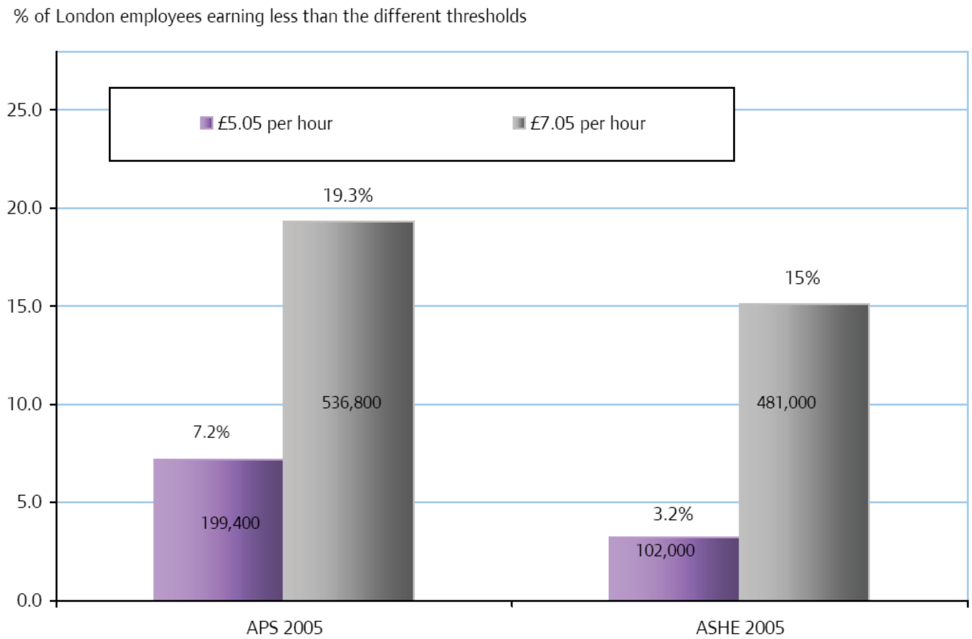
In terms of the definition of 'low pay', GLA Economics note that whilst the most common threshold used by the Office for National Statistics is the NMW, in the context of the mayor and the GLA's policy to combat poverty in London, the Living Wage threshold (as defined by the GLA) is more appropriate.

Following a review of data sources, they use the Annual Population Survey (APS) and the Annual Survey of Hours and Earnings (ASHE), noting that "the number of people defined as low paid depends on both the level at which the low pay threshold is set, and on the data sources used."[31]

GLA Economics' estimate of the proportion of low paid employees (of the total London workforce) earning less than £5.05 per hour (the NMW between October 2005 and September 2006) and less than £7.05 per hour (the LLW in 2006) is presented in the following chart. Depending on the dataset used, GLA Economics found that in 2005, between 15% and 19% of working age employees in London were low paid.

[31] Melville, D. and Harker, A. (2008), p.3, citing: Stewart, M. (2000) "Low Pay in Britain", in *The State of Working Britain*, ed. by Paul Gregg and Jonathan Wadsworth, Manchester University Press.

Figure 17: Estimated number of working age employees defined as low paid in London, 2005



Source: GLA (2008), based on APS 2005 and information from ASHE 2005 commissioned from the ONS.

The most up-to-date statistics are available from the 2008 LLW determination, wherein GLA Economics note that: [32]

- 15% of full-time employees in London receive less than the LLW of £7.45 per hour, of which, 5% receive wages that are below the LLW but above the poverty threshold wage of £6.50 per hour, whilst the remaining 10% receive wages that are below the poverty threshold wage.
- 45% of part-time workers in London receive less than the LLW, of which: 11% receive wages that are below the LLW but above the poverty threshold wage, whilst the remaining 34% receive less than the poverty threshold wage.

Therefore, they conclude, taking account of both full-time and part-time workers in London, around 1 in 7 employees receive less than the £6.50 poverty threshold wage and 1 in 5 employees receive less than the £7.45 LLW.

[32] *GLA Economics (2008) A fairer London: The 2008 Living Wage in London.*

In terms of the risk applying to low paid workers, the GLA notes the strong evidence of a '*low pay, no pay*' cycle, initially identified by Mark Stewart.[33] This cycle describes the higher probability for low paid employees to become unemployed in the future, and for workers re-entering the labour market to be in low paid jobs. Accordingly, they conclude that low paid individuals are therefore most likely to fall into poverty.

The researchers also sought to identify any patterns within the population of low paid workers. In this regard, it was found that low pay more frequently affects less well qualified, young, black and ethnic minority and disabled employees.

- The less well qualified an employee, the higher the likelihood that he/she will be low paid – Proportions of London employees paid less than the LLW: 7% with NVQ level 4 and above; 23% with NVQ level 3; and 50% with no qualifications
- 90 per cent of 16-17 year-olds were earning less than the Living Wage of £7.05 per hour in 2005
- Women are significantly more likely to be low paid than men in London - 19% of all London female employees are low paid compared to 9% of males
- A higher proportion of ethnic minority workers are low paid compared to their white counterparts - compared with 16% of white employees: 33% of mixed ethnicity individuals, 26% of Asian or Asian British, 26% of Black or Black British, and 29% of Chinese and 'other' ethnicity employees in London earn less than the Living Wage
- A higher proportion (23%) of disabled people earned less than the Living Wage than non-disabled people (19%).

In terms of the pattern of sectoral concentration, GLA Economics found that lower paid jobs in London tend to be concentrated in lower level occupations (particularly in sales and customer service and elementary occupations) and in the Hotels and Restaurants, and the Wholesale and Retail sectors, especially among employees working part-time, on which point they also note that women are more likely to work on a part-time basis than men.

In terms of geographical patterns of living, the research also found that a higher proportion of residents in Outer London are on low pay than in Inner London. In relation to region of workplace, individuals working in Outer London are much more likely to be low paid, with 50% of low paid workers working in Outer London and 50% split between Central and other Inner London.

[33] Stewart, M. (2000) "Low Pay in Britain", in *The State of Working Britain*, ed. by Paul Gregg and Jonathan Wadsworth, Manchester University Press.

Further research undertaken by GLA Economics sought to quantify the impact of each of the characteristics listed above on the probability of being low paid. The results of the research show that individual and job characteristics (e.g. age, level of qualifications achieved, and occupational level) have significant impacts on the likelihood of being low paid in London. The characteristic of working in an elementary occupation was found to be the most important factor, especially for female employees (13 times more likely than female managers or senior professionals).

Of further interest to the debate as to the appropriate level of income that would be required to support a minimum acceptable standard of living, the Joseph Rowntree Foundation has devised a minimum income standard for Britain, based on the views of members of the British public. The key thrust of this paper is the proposition of a new Minimum Income Standard (MIS) defined by what society finds acceptable for everyone in Britain. The MIS is based on a set of household budgets according to family size and characteristics, and it utilises a new equivalence scale (replacing both the McClements and OECD scale, which are found to leave families on the NMW below the poverty line, without working excess hours). For illustrative purposes, four proposed standards are presented in the report, ranging from £210.14 per week for a single working age individual to £626.43 per week for a couple with two children (including rent). It should be noted that these are again national averages, but it again highlights the debate in relation to the definition of minimum wages and incomes.

Evidence of impacts of minimum wage initiatives

The impacts of the NMW in the United Kingdom and Living Wages in the United States have been studied in detail by many researchers. In this section, we review selected papers and reports that have studied such impacts.

Impacts of the London Living Wage

Despite a significant amount of research by GLA Economics into the patterns and characteristics of low pay in London, and in relation to the calculation of an appropriate hourly age to be set as the LLW, there does not exist, to our knowledge, any study of the productivity and/or efficiency effects of the LLW. This is due primarily to the fact that the Living Wage is still a relatively new concept in London, with first examining the issue in 2004. Accordingly, the establishment of LLW impacts is the primary impetus for the current study.

Notwithstanding the above, there have been some interesting studies completed in relation to other aspects of the LLW, which we outline below.

One of the key academic researchers in relation to the LLW, Jane Wills has conducted numerous studies into low-paid employment and the Living Wage in London. Wills[34] examined the impact of the Living Wage model in the context of subcontracting, which is now commonplace across the UK in both public and private sectors, where low wage services are contracted out. Amongst the main findings were the driving influence of the upstream client of the sub-Contractor company in changing the terms and conditions of subcontracted employment, with the resultant conclusion on the importance for 'Buyer' organisations in terms of securing a Living Wage and associated conditions. The research also highlights the risk that, once better conditions have been secured, the improved pay and conditions may be eroded by cost pressures in the competitive tendering process in subcontracting.

Further research by Wills[35] into the case of contract cleaners at Canary Wharf and in the City of London points to the importance of the involvement and support of the full range of stakeholders – workers, community organisations, politicians, employers and the media – in achieving the adoption and implementation of the LLW and the improved pay and working conditions that it brings. The role of the workers themselves is also stressed in another study by Wills in East London.[36]

Of particular relevance to the current study but focussed on the employee impact, Sokol *et al*[37] at the Queen Mary University studied the impact of the improved pay and conditions of the LLW in the case of the Royal London Hospital. They found that the LLW resulted in higher worker commitment, an improved atmosphere and a 'sense of belonging', with 94.4% of workers surveyed indicating their intention to remain long-term. Contrary to standard economic model predictions, they also found little evidence of reduced hours (only 6.7% of workers), but found that 25% worked *more* hours.

A gloomier picture is painted by the results of the London Business Leaders' Panel survey by London Chamber of Commerce & Industry[38] (LCCI) in 2008, which found that, if forced to pay staff the LLW, respondents indicated that:[39]

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34 Wills, J. (2007) "Subcontracted employment and its challenge to labour", *Labor Studies Journal, Special Issue of the Labor Studies Journal focusing on community-unionism, D. Buttigieg (ed.).*

35 Wills, J. (2008) "Making Class Politics Possible: Organizing Contract Cleaners in London," *International Journal of Urban and Regional Research*, Blackwell Publishing, vol. 32(2), pages 305-323, 06.

36 Wills, J. (2004), "Organising the low paid: East London's living wage campaign as a vehicle for change", in Healy, G., Heery, E., Taylor, P., Brown, W. (Eds),*The Future of Worker Representation*, Palgrave Macmillan, Basingstoke, pp.264-82.

37 Sokol, M., Wills, J., Anderson, J., Buckley, M., Evans, Y., Frew, C. and Hamilton, P. (2006) *The impact of improved pay and conditions on low-paid urban workers: the case of the Royal London Hospital*. Queen Mary University of London, April.

38 The London Chamber of Commerce and Industry (LCCI) is a business representative organisation with 3,000 member companies which together employ 500,000 people across a wide range of sectors.

39 London Chamber of Commerce & Industry (2008) *London Living Wage would cost the capital jobs and investment - London Business Leaders' Panel survey*, Available from: http://www.londonchamber.co.uk/lcc_public/article.asp?id=957&did=47&aid=2955&st=&oaid=-1

- 42% would consider job cuts
- 49% would cut back on investment and expansion
- 26% would reduce their training budgets
- 23% would face a bill of £10,000 or more

In addition, the LCCI estimated the costs of implementing the LLW as £3,000 per full-time employee.

A previous case study of KPMG by SERTUC[40] also found that the employee turnover rate was halved, training costs reduced, staff continuity increased, and it was "a much more motivated workforce" following the implementation of the LLW. In terms of offsets, they found that LLW implementation costs were financed by service efficiencies (e.g. removal of personal under-desk bins and replacement with centralised bins on each office floor).

Impacts of the UK National Minimum Wage

Impact on employment

The Low Pay Commission found that the minimum wage had affected the distribution of hourly earnings and that annual up-ratings in the level of the NMW in recent years had increased the 'bite' of the minimum wage.[41] They found that the bite of the NMW reached more than half median earnings for the first time in 2005. This finding was supported by LPC-commissioned research that also found that that the minimum wage is becoming more pervasive and is impacting the pay structures of more companies annually. However, ultimately, they found that the minimum wage has so far not affected aggregate employment, though there was evidence to suggest that, during 2006, employment fell in the low-paying sectors as a whole and in retail and hospitality in particular.

Impact on labour productivity

In their 2007 report, the LPC also considered the impact of the NMW on labour productivity (output per worker). The results show that productivity grew steadily from Q3 2005 to Q3 2006 and attribute this growth to output growth accelerating faster than employment growth during this period.

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[40] SERTUC (2007) *London Living Wage - a working guide for trade unions*, p.9. Available from: http://www.tuc.org.uk/extras/livingwage.pdf

[41] Low Pay Commission (2007) *National Minimum Wage*, Low Pay Commission Report, CM7056, London: Stationery Office, March.

The LPC conducted a review of the evidence of the impact of the minimum wage on productivity, outlining the ways in which a firm can increase labour productivity as:

- Capital-labour replacement;
- Increase the quality of capital through technology;
- Monitoring or motivating workers to put in extra effort;
- Adjust the work organisation to improve the capital/labour mix; and
- Invest in education and training to improve the quality of labour.

The findings of their survey were that:

- One third of firms affected by the NMW had made significant efforts to tighten control over labour costs;
- One quarter had made significant changes to the organisation of work; and
- One tenth had significantly increased their use of technology.

Furthermore, the LPC conducted site visits to individual employers and they reported examples of firms taking action to improve their productivity.

The LPC's review of the evidence revealed little evidence of an impact of the minimum wage on productivity. Where a positive impact was found, it was not shown to be significant [Forth and O'Mahony (2003), Draca, Machin and Van Reenen (2005) and Machin, Manning and Rahman (2003)].[42] However, they note that a study by Galindo-Rueda and Pereira found evidence that labour productivity increased significantly faster in those firms most affected by the minimum wage.[43]

Metcalf[44] presents a comprehensive review of academic studies of the evidence of the link between minimum wages and productivity. The author notes that the impact of the NMW has been extensively analysed, finding little or no evidence of any employment effects, citing the following reasons:

- An impact on hours rather than workers;
- Employer wage setting and labour market frictions;

[42] Forth, J. and Mahony, M. (2003) "The Impact of the National Minimum Wage on Labour Productivity and Unit Labour Costs", (Research Report for the Low Pay Commission).

Draca, M., Machin, S. and Van Reenen, J. (2006) "Minimum Wages and Firm Profitability", *Centre for Economic Performance*, Discussion Paper 715, February.

Machin, S., Manning, A. and Rahman, L. (2003) "Where the Minimum Wage Bites Hard: Introduction of Minimum Wages to a Low Wage Sector", *Journal of the European Economic Association*, 1, pp. 154–180.

[43] Galindo-Rueda, F. and Pereira, S. (2004) "The Impact of the National Minimum Wage on British Firms", *Centre for Economic Performance*, London School of Economics and Yale University and University College London, September (Research Report for the Low Pay Commission).

[44] Metcalf, D. (2007) Why Has the British National Minimum Wage Had Little or No Impact on Employment? April 2007, Paper No' CEPDP0781.

- Offsets via the tax credit system;
- Incomplete compliance;
- Improvements in productivity;
- An increase in the relative price of minimum wage-produced consumer services; and
- A reduction in the relative profits of firms employing low paid workers.

The author focuses on the five most probable explanations, in his view: the productivity-prices-profits nexus, hours reductions and labour market frictions. He notes that there is (weak) evidence of intensified effort, altered work organisation and raised their investment in human capital.

Metcalf argues that the NMW might increase labour productivity in a number of different ways.

- capital deepening;
- improving the quality of their capital;
- intensification of effort;
- increased quality of the labour inputs; and
- more attention to work organisation.

Table 4 presents the review of studies investigating the impact of the national minimum wage on productivity.[45]

[45] Citations:

Arulampalan, W., Booth A. and Bryan, L. (2004) "Training and the new minimum wage", *Economic Journal*, 114, March, C87-C94.

Dickerson, A. (2006) "Long Term Implications of the NMW: A Reexamination of Employer Provided Training". Report to Low Pay Commission, March.

Draca, M., Machin, S. and Van Reenen, J. (2006) "Minimum Wages and Firm Profitability", Centre for Economic Performance, Discussion Paper 715, February.

Forth, J. and Mahony, M. (2003) "The Impact of the National Minimum Wage on Labour Productivity and Unit Labour Costs", (Research Report for the Low Pay Commission).

Galindo-Rueda, F. and Pereira, S. (2004) "The Impact of the National Minimum Wage on British Firms", Centre for Economic Performance, (Research Report for the Low Pay Commission).

Georgiadis, A. (2006) "Is the Minimum Wage efficient? Evidence of the effects of the UK National Minimum Wage in the residential care homes sector", CMPO Working Paper 06/160, Bristol University.

Machin, S., Manning, A. and Rahman, L. (2003) "Where the Minimum Wage Bites Hard: Introduction of Minimum Wages to a Low Wage Sector", *Journal of the European Economic Association*, 1, pp. 154–180.

Table 4: Review of Studies investigating the Impact of a National Minimum Wage on Productivity

Author	Definition of productivity	Result
Arulampalam et al (2004)	Change in: ▪ incidence of training ▪ intensity (days) of training	▪ Raw incidence intensity (days) treatment .10 to .17 2.3 to 6.5 control .28 to .30 5.0 to 4.9 ▪ Difference-in-difference of treatment and control – training probability increased by 8-11% points (sig) – training days increased by 10% points (sig)
Dickerson (2006)	Change in receipt of training in: ▪ last week ▪ last 4 weeks ▪ last 13 weeks	▪ 3 training definitions, 4 groups of workers ▪ 9 out of 12 coefficients positive all non-significant
Draca et al. (2006)	▪ Sales/employment	▪ During "policy on" the gain in productivity was 5.4% higher in the treatment than in the control group, but non-significant
Forth and O'Mahony (2003)	▪ Gross real value added per hour ▪ Sometimes disaggregated to – K:L ratio – TFP	▪ Positive not significant correlation between wage bill (bite) impact of NMW and growth in labour productivity ▪ Correlation stronger 1995-98 than 1998-2000 but never significant ▪ Similar findings for TFP and K:L ratio ▪ Evidence of acceleration in labour productivity growth in textiles, security and hairdressing post 1998 but not in other low paying sectors
Galindo-Ruedo and Pereira (2004)	▪ Labour Productivity - Gross Output/Employment ▪ Total Factor Productivity ▪ Gross Output/Employment	▪ Labour productivity relative increase of 11% in treatment group cf control group ▪ TFP no associations ▪ Services - increase of 6-17% at introduction of NMW ▪ Production - no association
Georgiadis (2006)	▪ Number of beds per employee/hour ▪ Number of residents per employee/hour ▪ Ratio of employees with/without nursing qualifications ▪ Worker effort ▪ Supervision intensity	▪ all associations not significant except negative association between wage gap and supervision intensity
Machin et al (2003)	▪ Residents per worker hour ▪ Change in worker effort because of NMW	▪ all associations not significant positive e.g. 10% increase in wage gap linked to 9% increase in effort but none significant

Adapted from Metcalf, D. (2007) Why Has the British National Minimum Wage Had Little or No Impact on Employment? Centre for Economic Performance, CEPDP0781.

Impacts of Living Wages internationally

It is important to note in relation to wider evidence of Living Wages that the definition and nature of the concept can differ, with important implications on the comparability across initiatives and on drawing conclusions about the lessons that we may draw from such past experience. For example, fact that an American Living Wage might be a statutory obligation in a region, the *efficiency wage* effect (of increased motivation for worker effort by paying higher than market wages) will be drowned out, as the Living Wage in this case actually equals the Living Wage; as Krugman notes "Surely the benefits of low turnover and high morale in your work force come not from paying a high wage, but from paying a high wage "compared with other companies"".[46] This is particularly the case with evidence in relation to Living Wage ordinances in the United States, where Living Wages are often statutory requirements in a region and/or limited solely to government contracts tendered by private firms.

Due to a longer history of the implementation of Living Wages, the bulk of research into the impact of a Living Wage has been based in the United States. The first successful Living Wage campaign occurred in Baltimore in 1994, after which, the Living Wage movement spread across the US to many other states. There are currently more than 100 active Living Wage ordinances in American cities and counties.

In terms of evidence of impacts, a seminal paper by Card and Krueger in the early 1990's shaped the landscape in relation to the research on minimum and Living Wages.[47] Contrary to the accepted logic at the time, consistent with the standard model of the labour market prevailing at that time, they challenged the conventional view that higher minimum wages reduce jobs for low-wage workers. Taking the case of the fast-food industry, they found that the rise in New Jersey's minimum wage in 1992 did not lead to reduced employment. Later, using evidence again from the 1992 increase in New Jersey's minimum wage, the 1988 rise in California's minimum wage, and the 1990-91 increases in the federal minimum wage, they found that increases in the minimum wage lead to increases in pay, but no loss in jobs.[48] The logic provided for this effect is that higher wages may actually help firms reduce turnover and fill vacancies, leading to greater worker productivity by improving morale and overall job satisfaction. These benefits combine to yield efficiency gains offsetting the increased labour costs.

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[46] The Living Wage, by Paul Krugman, 1998: Review of Living Wage: What It Is and Why We Need It, by Robert Pollin and Stephanie Luce. Available from: http://economistsview.typepad.com/economistsview/2006/06/paul_krugman_th_2.html

[47] Card, D. and Krueger, A. B. (1994) "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania", *American Economic Review*, September 1994, 84(4), pp. 772–93.

[48] Card, D. and Kruger, A.B. (1997) *Myth and Measurement: The New Economics of the Minimum Wage*, Princeton University Press, ISBN 0-691-04823-1.

Unsurprisingly, owing to its controversial findings, Card and Krueger's research has attracted much attention and criticism, but their findings have been accepted by many economists, including Nobel Prize winner Joseph Stiglitz.[49] One re-evaluation of the study by Neumark and Wascher[50] using payroll data found the opposite effect, but this in turn was later refuted by Card and Krueger[51] themselves.

Further research on the impact of Living Wage mandates in the United States is presented by theme in the subsequent sub-sections, which draws on a useful summary of the evidence as provided by Brenner,[52] supplemented with more recent research findings.

Cost to organisations

Evidence from empirical studies in tends to show that Living Wages tend to result in only modest cost increases for employers, though for some organisations (dependent on workforce characteristics), the cost increases can be significant. Numerous studies have been conducted ex post in the US, in numerous states with evidence suggesting that the cost increase faced by a typical organisation is likely to be modest, specifically in the range of 1% to 2%. Examples of such studies and their estimated cost increases are as follows:

- Los Angeles, CA[53] 1.5%
- Miami-Dade, FL[54] 1.8%
- San Jose, CA[55] 3.0%
- San Francisco, CA[56] 3.9%
- New Orleans, LA[57] 0.9%
- Oakland Airport[58] 1.5%

49 Stiglitz, J. (2002) "Employment, social justice and societal well-being", *International Labour Review*, 141 (1-2), p. 9 - 29.

50 Neumark, D. and Wascher, W. (1995) "The Effect of New Jersey's Minimum Wage Increase on Fast-Food Employment: A Re-Evaluation Using Payroll Records", *NBER Working Paper*, No. 5224.

51 Card, D. and Krueger, A.B. (2000) "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Reply", *American Economic Review*, December, pp. 1397-1420.

52 Brenner, M.D. (2004) "The Economic Impact of Living Wage Ordinances", Political Economy Research Institute (PERI), University of Massachusetts Amherst, Working Paper Series, Number 80.

53 Pollin, R. and Luce, S. (2000) *The Living Wage: Building a Fair Economy*. New York: The New Press.

54 Nissen, B. (1998) "The Impact of a Living Wage Ordinance on Miami-Dade County," October, Miami, FL: Florida International University Center for Labor Research and Studies.

55 Benner, C. and Rosner,R. (1998) "Living Wage: An Opportunity for San Jose," August, San Jose, CA: Working Partnerships.

56 Reich, M., Hall, P. and Hsu, F. (1999) "Living Wages and the San Francisco Economy: The Benefits and the Costs." June, Berkley, CA: University of California, Berkeley: Institute of Industrial Relations.

57 Pollin, R. Brenner, M. and Luce. S. (2002) "Intended versus Unintended Consequences: Evaluating the New Orleans Living Wage Ordinance." *Journal of Economic Issues* 36 (4): 843-875.

58 Zabin, C., Reich, M. and Hall, P. (1999) "Living Wages at the Port of Oakland," December, Berkeley, CA: University of California, Berkeley: Institute of Industrial Relations.

- Santa Monica, CA[59] 3.9%
- New York City, NY[60] 0.3%

However, there is also evidence that some firms will face higher costs, up to a 10% increase. Pollin and Luce (2000) found that in Los Angeles, CA, approximately 6.7% of covered firms would experience cost increases of 5% or more. Additionally, Pollin and Brenner (2000) found that in Santa Monica, CA, cost increases were much higher for hotels and restaurants, averaging roughly 10 percent of total sales.

Employment impacts

Consistent with Card and Krueger and evidence in relation to the UK's NMW, US evidence to date indicates that Living Wage ordinances do not adversely affect employment.

- Boston – Employment in covered firms grew by 15% following Living Wage implementation. Also, employers who raised wages to comply with the law actually increased the proportion of full-time workers after implementation. No evidence was found of firms changing hiring standards following implementation, so no worker or skills displacement was evident.[61]
- San Francisco Airport – Covered employment expanded by 15% following Living Wage implementation.[62]
- Also in San Francisco, Howes found that the number of homecare workers covered by the ordinance grew by 54% following implementation.[63]

Impacts on productivity and organisational performance

There is some evidence of a positive effect on productivity by reducing turnover and improving morale, but also some evidence that firms appear to be taking a hit in terms of lower profits:

- Boston – Turnover fell by 35 percent following implementation, and 25 percent of employers reported higher effort after raising wages. In

59 Pollin, R., and Brenner, M.D. (2000) "Economic Analysis of Santa Monica Living Wage Proposal." Amherst, MA: Political Economy Research Institute Research Report # 2.

60 Sonn, P., Bernhardt, A., and Parrott, J. J. (2002) "The New York City Living Wage Law" September, New York, NY: Brennan Center for Justice and Fiscal Policy Institute.

61 Brenner, M. and Luce, S. (2005) "Living Wage Laws in Practice: The Boston, New Haven and Hartford Experiences", Political Economy Research Institute (PERI), University of Massachusetts Amherst.

62 Reich, M., Hall, P. and Jacobs, K. (2003) "Living Wages and Economic Performance: The San Francisco Airport Model." Berkeley, CA: University of California, Berkeley: Institute of Industrial Relations.

63 Howes, C. (2002) "The Impact of a Large Wage Increase on the Workforce Stability of IHSS Home Care Workers in San Francisco County." New London, CT: Connecticut College Department of Economics.

addition, 38 percent of employers indicated that they had reduced profits as a result of the higher wages.[64]

- San Francisco – Homecare worker turnover fell by 30 percent after implementation.[65]
- San Francisco Airport – Turnover fell by up to 80 percent for selected occupations following Living Wage implementation.[66]

Conclusions and predictions from literature review

This section has presented an overview of the findings of our review of the existing literature in the area of minimum wages and Living Wages, and the findings may be summarised as follows:

- Living wage ordinances are not, generally, associated with job losses or worker displacement
- Evidence of some productivity increases (often not statistically significant), associated with higher effort, lower staff turnover, reduced absenteeism, increased stability of workforce, improved worker morale, motivation and commitment
- Increased cost pressure leads firms to seek efficiency and cost savings elsewhere, such as reorganisation of workflows and substituting FT workers for PT workers (saving NI, training, etc)
- Increased training of staff and higher service quality
- Evidence that LLW firms' profits are lowered
- Experience of 'ripple effect' wage increases to maintain pay differentials

Review of secondary data and information sources

There is a wide range of existing data sources, such as the national and local Labour Force Surveys (amongst others) that may offer unique insights into the employment outcomes of individuals surveyed, as well as their personal characteristics, occupation, industrial classification, occupational code, recent (and previous) participation in the labour market and earnings. Accordingly,

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64 Brenner, M. and Luce, S. (2005) "Living Wage Laws in Practice: The Boston, New Haven and Hartford Experiences", Political Economy Research Institute (PERI), University of Massachusetts Amherst.

65 Howes, C. (2002) "The Impact of a Large Wage Increase on the Workforce Stability of IHSS Home Care Workers in San Francisco County." New London, CT: Connecticut College Department of Economics.

66 Reich, M., Hall, P. and Jacobs, K. (2003) "Living Wages and Economic Performance: The San Francisco Airport Model." Berkeley, CA: University of California, Berkeley: Institute of Industrial Relations.

in parallel to the desk based secondary research, we also undertook an assessment of all existing secondary data that has been collected that could have been of assistance for the evaluation of LLW impacts.

The two most commonly used earnings datasets in the UK are the annual Labour Force Survey (LFS), now replaced by the Annual Population Survey (APS) and the New Earnings Survey (NES) now replaced by the Annual Survey of Hours and Earnings (ASHE). We review these two sources and a number of others in the subsequent pages.

Annual Survey of Hours and Earnings (ASHE)

The Annual Survey of Hours and Earnings (ASHE), which replaced the New Earnings Survey (NES) in 2004, provides information about the levels, distribution and make-up of earnings and hours paid for employees within industries, occupations and regions. Compared to the NES, the ASHE includes improvements to the coverage of employees, imputation for item non-response and the weighting of earnings estimates.

The ASHE survey provides data on earnings for employees by sex and full-time/part-time workers in the UK. More detailed breakdowns include: by region, occupation, industry, region by occupation and age-groups, for the following variables:

- gross weekly pay
- weekly pay excl. overtime
- basic pay incl. other pay
- overtime pay
- gross hourly pay
- hourly pay excl. overtime
- gross annual pay
- annual incentive pay
- total paid hours
- basic paid hours and
- paid overtime hours

Annual Population Survey

The Annual Population Survey (APS), collected and published by the Office for National Statistics (ONS), combines results from the Labour Force Survey (LFS) and the English, Welsh and Scottish Labour Force Survey boosts (during 2004 and 2005 the APS also comprised of an additional boost for England (APS(B)) which are funded by the Department for Work and Pensions, Department for Education and Skills, the National Assembly for Wales and the Scottish Executive[67])

The survey asks 65,000 households a year about their own circumstances and experiences regarding a range of subjects including housing, employment and education. APS datasets are produced quarterly with each dataset containing 12 months of data. The APS yields more robust local area labour market estimates than from the main LFS.

IDS Pay Reports[68]

The fortnightly IDS Pay Report is recognised as the standard source of information on what is happening to pay and conditions across the UK economy. It contains regular round-ups of pay trends in different sectors of the UK economy.

The twice-monthly publication enables everyone involved in Human Resources activities to remain well informed of the current situation in respect to pay and the general labour market:

- monitoring pay and conditions developments for more than a thousand employee groups a year, reporting on changes in named organisations
- regular overviews of the pattern of pay awards and other key changes, both sector-by-sector and across the country; and
- analysis of key official statistics on earnings, inflation and the labour market plus inflation forecasts.

67 Information from the ONS: http://www.statistics.gov.uk.

68 Incomes Data Services, Thomson Sweet & Maxwell, http://www.e-commerce-suppliers.com/dpClient/onlineorders/reportservice.jsp

IDS Pay Report 980

The survey, which relates to the 2006 calendar year, shows that staff turnover rates remain high across a number of sectors, and the number of employers finding it hard to retain staff has increased substantially (from 69 to 78 per cent). Meanwhile, although there has been a fall in the number of vacancies reported, a high proportion of employers are still experiencing recruitment difficulties. The survey results clearly reflect the robust state of the labour market.

CIPD Annual survey report 2008 - Recruitment, retention and turnover

The 2008 Recruitment, Retention and Turnover survey, published by the Chartered Institute of Personnel and Development (CIPD), contains information on current and emerging trends in people resourcing practice. This annual benchmarking survey is based on 779 respondent organisations from the UK and relates to the period 1 January to 31 December 2007.[69]

The CIPD survey includes information on the trends and changes in attraction and selection methods, diversity issues, and reports on the time and costs of recruitment and labour turnover.

Interesting findings of the 2008 survey include:

- The labour turnover rate in 2007 was 17.3%, down slightly from 2006 (18.1%);
- Labour turnover was highest in the private sector at 20.4%, with the hotel, catering and leisure industry having the highest level of labour turnover, at 41%, up 8.4% on 2006;
- Over 70% of employers believe employees' departure from the organisation has a negative effect on business performance;
- 41% of voluntary leavers quoted the level of pay as the reason for leaving;
- 80% of organisations reported having employee retention difficulties, reported across all industry sectors. Senior managers/directors were the easiest to retain (7% reporting retention difficulties), but the rate was higher across other levels of staffing, ranging from 20–36%.

[69] CIPD (2008) *Annual survey report 2008 - Recruitment, retention and turnover*, available from http://www.cipd.co.uk/NR/rdonlyres/BE3C57BF-91FF-4AD0-9656-FAC27E5398AA/0/recruitmentretentionturnover2008.pdf

- The most common strategies to address retention difficulties were increasing pay (53%), and increasing learning and development opportunities (46%).

Table 5: Average number of weeks to fill a vacancy*

Occupational group	Time (weeks)
Senior managers/directors	16.5
Managers/professionals	12.3
Administrative, secretarial and technical	6.7
Services (customer, personal, protective and sales)	7.4
Manual/craft workers	5.8

Note:
*Time from deciding there was a vacancy to the new employee's actual start date
Source: CIPD Recruitment, retention and turnover 2008

The CIPD survey also provides details on how long it takes organisations to fill job vacancies, and the estimated costs associated with recruitment and labour turnover, as presented in Table 6.

Table 6: Estimated (median) total cost of recruitment* and labour turnover** per employee		
Occupational group	**Costs of recruitment (£)**	**Costs of labour turnover (£)**
Senior managers/directors	10,000	20,000
Managers/professionals	6,000	10,000
Administrative, secretarial and technical	2,000	6,000
Services (customer, personal, protective and sales)	2,000	4,250
Manual/craft workers	553	2,750
All employees	4,667	5,800

Notes:
* Advertising costs, agency or search fees
** Vacancy cover, redundancy costs, recruitment/selection, training and induction costs
Source: CIPD Recruitment, retention and turnover 2008

Conclusions on secondary data sources

All sources are widely used and quoted for low pay analysis, however, the utility of these datasets for the current research and analysis is limited by the same limitation in all cases: namely that the datasets do not allow the identification and isolation of those employers and/or employees that pay/are paid the LLW. This issue is noted also in the literature. Brenner notes "the most fruitful avenue for evaluating the economic impact of Living Wage ordinances is at the local level, using various primary data collection methods."[70] Therefore, it is not possible to conduct a comparative analysis of these two groups, as would be required to determine the marginal impact of the LLW for an organisation.

Metrics for LLW impact research

From the desk based research, it is possible to draw up a list of the impacts and outcomes that might be expected to be seen in our primary research. Based on this collated list of impacts, a set of idealised metrics and indicators

[70] Brenner, M.D. (2004) "The Economic Impact of Living Wage Ordinances", Political Economy Research Institute (PERI), University of Massachusetts Amherst, Working Paper Series, Number 80.

to assess the impact of the various interventions on economic outcomes (short and long run) may be generated so that it is possible to consistently and objectively assess the aims, objectives and (quantitative and qualitative) outcomes of various interventions.

Based on the expected impacts of the LLW from the theory and research, it is possible to formulate the following list of ideal metrics, as listed below:

- Impact on employment
  - Number of employees, by:
    - a) Location (London or other UK)
    - b) Employment status (FT, PT)
  - Number of hours worked (Basic, Overtime) per employee
  - Level of supervision (staff and hours)
  - Level of employee turnover
  - Average tenure of employees
  - Number of man-hours lost through absenteeism
  - Number of man-hours lost through sick leave
  - Number of man-hours lost through industrial disputes
  - Training and development (expenditure and hours) per employee
- Impact on organisational performance
  - Output
  - Wage and salary costs (pay and non-pay benefits)
  - Recruitment costs
  - Financial performance (sales, profit, capital)
  - Capital investment
  - Number of customer complaints
- Cost of implementation of LLW
  - LLW implementation costs
  - Implementation costs borne by contract service Buyer
- Productivity and efficiency indicators
  - Output per employee
  - Capital per employee
  - Profit per employee
  - Gross value added per hour
  - Capital : Labour ratio
  - Total Factor Productivity
  - Incidence and intensity of training

Annex 3 Sample consultation questionnaire

Annex 4 Sample consultation data request

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