

Quarterly Economic Survey – Q3 2017

There are five key components that are essential for productivity growth; Innovation, Investment, Enterprise, Competition and *Skills*¹. According to official figures, in July 2017 UK productivity, defined simply as the amount a UK worker can produce in a specific timeframe, dropped back to pre-crisis levels. This weak and fluctuating growth has been referred to as the “productivity puzzle”.

Coventry & Warwickshire’s productivity has, however, outgrown all but 2 LEP areas across the UK, over the same horizon. Nevertheless, in the first quarter of 2017, 1 in 3 businesses locally believed that a skills shortage was their biggest barrier to growth. A scarcity of workers with the right skills has the potential to reduce workplace efficiency and growth potential, thus negatively impacting productivity.

The aim of asking skills-specific questions 16-20 in the latest Quarterly Economic Survey (QES), is to help inform government about the current skills shortage and whether alternative opportunities are being considered. Targeted policy measures can then minimise the impacts of a shortfall of workers with the appropriate skills. This proactive approach should improve the resilience of Coventry & Warwickshire’s economy and reinforce it as a good place to do business. Responses to survey are, therefore, invaluable and we appreciate your participation.

Are those who are looking to recruit in the next 3 months suffering from a skills shortage?

Despite a fall in overall confidence in the last quarter, recruitment expectations remain strong - more than half of business looked to recruit in the last three months, and 1 in 3 expect their workforce to increase in Q3.

Small, medium and large businesses (SML)² make up 54% of the survey responses. While they only make up half of the sample size, they employ approximately 98% of employees in the survey. When analysing the responses on skills shortages, SML businesses will, therefore, have a better representation of skills in the labour market than micro-sized businesses. As a result, analysis of the two groups has been separated.

Over the last 3 months, more than 3 in 4 SML businesses have looked to recruit. **Of those who are looking to recruit, 70% believe that recruitment difficulties are attributable to a skills shortage.** This is lower than research done by the Open University. Over a similar sample size, they found that 90% faced difficulties recruiting workers with the right skills.

¹ Office of National Statistics *Productivity Handbook*.

² There are four sizes businesses are categorised by – micro, small, medium and large. Each category is defined by the number employed in a business: 0-9 for micro, 10-49 for small, 50-249 for medium and 250+ for large.

Across both sectors, **44% of all recruiting businesses considered a lack of workers the biggest reason for a skills shortage.** This reinforces recent labour market data covered in the WCC Quarterly Labour Market bulletin. The unemployment rate fell last quarter from 3.4% to 2.9% - the first fall in 2 years in Warwickshire, widening the gap with the West Midlands (5.4%) and England (4.5%). The long term unemployment rate is now at 0.1%, suggesting that all of those people in the county who wish to find work, are able to find it within 12 months. This data suggests that there are indeed few job seekers in the labour market.

Irrespective of business recruitment decisions, are skills shortages still prevalent in Coventry & Warwickshire?

It is important to determine whether skills shortages remain an issue for businesses regardless of their recruitment choices. Each quarter, job vacancies per 1,000 people in Warwickshire, for example, are almost double the number seen across England. On average, as many as 1 in 4 postings are not filled. However, a lower-than-average unemployment rate in the county could mean that this could be higher. If more vacancies are not filled locally because of low unemployment, businesses may be discouraged from hiring. These are the types of businesses we may encounter in this section.

Results from the survey show that **62% of businesses currently believe their firm is suffering from a skills shortage.** This shortfall of skills within businesses could be an underutilisation of skills or gaps within their existing workforce and do not have to be related to recruitment difficulties.

Most businesses who are faced with a skills shortage, regardless of their recruitment choices, **believe a lack of workers is the reason.** Broken down by employment size, the graph below is relatively intuitive. Micro businesses, which are the majority of businesses in Coventry & Warwickshire, suffer most from competition and the funds to pay for workers. SML businesses which are, by definition, heavily dependent on the number of workers, suffer from a lack of workers.

Subdued pay growth despite low unemployment has been a conundrum for many economists over the last year. With prices beginning to rise across the UK, we should expect wages to increase as businesses compensate their workers for a higher cost of living. Question 18 in the QES asks *if and why businesses are looking to implement a pay rise in the next 12 months.* This should enable us to gauge if pay is expected to increase and whether it is affected by a skills shortage.

The survey shows that **80% of all businesses facing a skills shortage, in both the manufacturing and service sectors, are implementing a pay rise in the next 12 months.**

This proportion increases to 87% if we focus on SML businesses, who employ more than 3 in 4 of Coventry and Warwickshire's workforce.

There seems to be a clear correlation between a pay rise and a skills shortage. Only 35% of businesses who believe they are not facing a skills shortage are looking to implement a pay rise in the next 12 months. **This means that workers in the retail, public and creative sectors are least likely to see a pay rise over the next 12 months**

Almost 1 in 2 (45%) businesses in the sample are implementing a pay rise to retain current employees. These types of businesses were also more likely to quote a 'lack of workers' as the reason for a skills shortage. On the other hand, only 1 in 5 businesses are increasing pay due to a higher cost of living. It is, therefore, not unreasonable to conclude that **pay increases in Coventry and Warwickshire over the next 12 months will most likely be borne out of a skills shortage, rather than inflation.** This is an important finding coming out of the survey.

Across the full sample, **79% of SML businesses are looking to implementing a pay rise in the next 12 months**, regardless of whether they are recruiting or face a skills shortage. Manufacturing and service sector businesses are equally as likely to increase pay, however, you are most likely to experience a pay rise in the construction, consumer services and transport & distribution sectors.

On average, **57% of businesses in the sample are looking to increase non-wage related pay over the next 12 months.** Large businesses are most likely to increase non-wage related pay in the next 12 months, whereas micro businesses are least likely. Micro businesses are most inclined to increase annual leave entitlement. Micro and small businesses make up almost half of businesses offering flexible working hours. Medium-sized businesses are most comfortable with increasing training/development opportunities, whereas large businesses are looking to offer more employee benefit schemes incentives.

Combined, 7 in 10 businesses will implement either a pay or non-wage related pay increase over the next 12 months. This figure increases to 85% of businesses if we exclude micro-sized businesses, and could cover up to 78% of Coventry and Warwickshire's workforce.

Are businesses considering labour force alternatives?

There are a number of solutions that can minimise the impacts of a skills shortage on businesses. The last question is aimed at identifying whether and what type of labour force alternatives businesses are exploiting. They can look for close substitutes; *Apprentices and graduates* are often skilled but relatively inexpensive employees, *workers currently outside of the workforce* can also be invaluable and *overseas workers* offer relief for those who are

eligible and can afford it. In the short- to medium-term, businesses can also look to retrain existing worker to fill recruitment gaps, or they can improve links with schools to minimise longer term problems.

A third of businesses have considered both apprenticeships and graduates, and retraining existing employees. These options are particularly popular for large- and medium-sized firms, with 86% of large firms using apprenticeships and graduates, and 68% of medium-sized firms retraining existing employees. Overseas labour is the least popular selection, although 1 in 5 large businesses still find this an important option. Recruitment outside of the workforce, which includes those with physical and learning disabilities, is more popular in the manufacturing service – 46% compared to 23% of services sector businesses.

More than 1 in 2 micro-sized businesses are not considering labour force alternatives. These businesses account for 75% of total businesses in Coventry and Warwickshire and gives a clear direction for the types of businesses that need skills support. Although a number of micro-sized businesses may feel as if they do not need to consider alternatives if they are not facing a skills shortage, there is still a much larger-than-average proportion who are not considering alternatives despite facing a skills shortage. That would suggest that the reason for not looking towards alternative labour force options is capacity.

Undoubtedly, skills are an issue for businesses in Coventry and Warwickshire. SML businesses, which employ the majority of workers locally, are most likely to be facing a skills shortage. We have shown from the sample that pay increases are correlated to skills shortages and that this is the main reason for potential pay and non-wage related pay increases in the next 12 months. Alongside an increasing cost of living, up to 78% of Coventry and Warwickshire's workforce could be set for an increase to their pay package in the next year.