The true cost of labour shortages

The 2022 CBI/Pertemps Employment Trends Survey results

Sponsored by

Pertemps Network
the face of recruitment

Contents

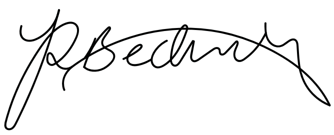
Foreword CBI

Stagflation in 2022 continues a bruising period for businesses since the Covid-19 pandemic. Despite demand for goods and services returning after economic shutdowns, one of the tightest labour markets on record alongside supply chain blockages has resulted in shortages holding back growth. Combined with 40-year high inflation squeezing household spend and pushing up business costs, firms are more pessimistic about growing their workforce and the competitiveness of the UK labour market.

This years' results show the impact of labour and skills shortages on growth, affecting business' ability to meet output demands, deliver products and services or make capital investments. Growth underpins living standards, pays for public services and enables investment: it matters to us all. Yet the extent to which firms have been in crisis-response to labour shortages has made it harder for them to invest in crucial productivity-boosting measures like automation or skills. This has long-term implications for the UK's growth plans. The reality of an aging workforce, high economic inactivity, and new immigration rules post-Brexit, means that growing the size of the labour market on its own is not a viable strategy to achieve sustainable economic growth.

As we look forward, economic stability continues to be the prerequisite for growth. Improving the competitiveness of the UK labour market requires joint business and government action. This survey shows that businesses want to work in partnership to ease the impact of shortages and boost productivity in the long-term – for example, by introducing incentives to unlock business investment in automation and creating an economically responsive skills system by turning the Apprenticeship Levy into a flexible Skills Challenge Fund.

This should be paired with action to increase labour supply, including through pragmatic immigration reforms that reflect the range of skills needed across UK supply chains. The government's forthcoming review of inactivity is a welcome step and must be followed by reforms that remove barriers to work, like unaffordable childcare. Together, these measures will ease costly labour and skills shortages holding back UK business and unlock the labour market's potential for growth.



Jennifer Beckwith

Deputy Director, Employment

Foreword Pertemps

With talk of a looming recession, predominantly caused by inflation, high interest rates and taxes, it's the first time ever that the number of vacant positions remains at an all-time high.

What's perhaps most troubling is that 70% of employers think access to labour is a threat to competitiveness and still will be in five years' time.

The issues we are seeing in terms of labour shortages are not new and are not going to go away in the short term. These are being exacerbated by the current economic climate. Concern about labour costs (59%) has risen on last year and the cost of living (69%) has become a significantly larger threat.

It's imperative that within the eco-system, recruitment agencies, the education sector, employers and Government are all working together to ensure we have the right skills in place now and for the future. 55% of firms have already reported that they are investing in training to upskill current employees.

There is a wealth of untapped talent out there who, with the right incentives and the right training, can be a valuable resource to overcome the concerns expressed by respondents in this year's survey.

For companies to survive, they need robust attraction and retention policies, with investment in training and development and a focus on diversity, equality and inclusion, as well as the environmental performance of the organisation. Many firms are looking to improve their employee value proposition (45%) and are investing in base pay (56%).

There is no single thing that can be done to solve the labour issues – it involves collaboration between supply chains, businesses and recruiters to come up with longer-term, sustainable, recruitment strategies.

But there is excitement ahead. With growing concern over climate crisis, we are witnessing a surge in "green" jobs, with the Government setting a target of creating two million roles in this arena by 2030. We have also seen the creation of alternative routes into employment for young people, the Government's Kickstart scheme and the Apprenticeship Levy, which are all helping people into employment.

With continued collaboration, we can move forward effectively, help the economy recover, and offer a sustainable future for a diverse range of talent.

Carmen Watson

Chairperson, Pertemps Network Group

Survey results at a glance

The employment trends survey 2022

- The survey was conducted between 16th August and 1st September 2022.
- 325 business, of all sizes and sectors across the UK, responded in total.
- SMEs are defined as companies with fewer than 250 employees.

Labour market tightness continues as vacancies remain high and inactivity rates continue to rise

- While increasing over the last year, there are signs that employment growth may be slowing, with the employment rate falling in the last quarter. Unemployment is close to record low levels and projected to stay low in the near-term.
- The number of vacancies fell in the three months to September after reaching record highs this year and are still 450,000 above pre-pandemic levels. 2022 is the first year since records began that there are more vacancies than unemployed people, resulting in a tight labour market and chronic labour shortages.
- Nearly half of manufacturers (49%) cite shortage of labour as a factor likely to limit output, and 46% of service sector businesses believe shortages will limit their capital expenditure in the next 12 months.
- The economic inactivity rate has reached heights not seen since 2015, with long-term sickness the leading reason for economic inactivity, with data also showing a rise in students staying in education for longer.
- Private sector pay growth is the strongest on record outside of the Covid-19 pandemic (+6.2%), and nearly three times greater than the public sector (+2.2%), but has been wiped out by inflation resulting in the second-worst real-terms pay growth since records began (-2.9%).

Employers are softening expectations for growing their workforce

- Fewer than half of businesses (43%) expect to grow their workforce in the next 12 months, down from 57% last year.
- Meanwhile, 15% of businesses anticipate that their workforce will be smaller next year – giving a balance of +28%, compared to +50% last year[1].
- The softening of expectations is clearest in the permanent recruitment market. 85% of businesses are planning to recruit permanent roles in the next 12 months, with a third (33%) expecting higher levels of recruitment, and almost two-fifths (39%) expecting the same level of recruitment, compared to 46% and 33% respectively in 2021.
- 13% are expecting lower levels of recruitment, and a further 13% are expecting no recruitment at all, compared to 9% and 11% respectively in 2021.
- In the temporary recruitment market, 13% of businesses expect higher levels of recruitment and 15% expect lower levels, compared to 16% and 12% respectively in 2021. For entry level jobs, 21% expect higher levels of recruitment and 13% expect lower levels, compared to 28% and 9% respectively in 2021.

Access to people and skills are the biggest threats to UK labour market competitiveness

- 72% of businesses say that the UK labour market has become a less attractive place to invest and do business in the last five years – the least attractive it has been since the question was first asked in 2008.*
- Almost three-fifths (58%) of businesses believe that the UK labour market will become a less attractive place overall to invest and do business in the next five years, with less than one in five (18%) expecting it to become more attractive overall.*
- The main current threats to the UK's labour market competitiveness are seen as access to labour (75%), access to skills (72%), and the cost of living (69%).*
- These threats are expected to persist in the years ahead, with access to skills (73%), access to labour (70%), and labour costs (57%) seen as the top three threats to competitiveness over the next five years.*

Businesses are doing all they can to support employees through the cost-of-living crisis

- Fewer than one in ten businesses (7%) expect to increase pay above inflation and almost three in ten (29%) plan to increase pay in line with inflation, the lowest since 2012.*
- Just over a third (34%) of businesses expect to increase pay below inflation, a significant jump from 3% in 2021 and 5% in 2020. Only 3% of businesses are planning to freeze pay, continuing a downward trend from 2021 (8%) and 2020 (33%).*
- Almost nine in ten (87%) businesses have taken action to support employees during the cost-of-living crisis, with just under half (46%) bringing forward or having additional pay reviews, while over a third (37%) are offering wellbeing provision and giving staff one-off bonus payments (36%).**
- Of those impacted by the National Living Wage (NLW) increase, almost three-fifths (57%) of businesses are offsetting costs by reducing the rate of pay growth for the rest of the workforce. Just under half (48%) are offsetting the costs by raising prices, and almost three in ten are absorbing the whole cost (28%) or part of the cost (27%) through reduced profit.**
- Nearly two in five businesses affected by the policy (38%) believed the Low Pay Commission (LPC) should have increased the NLW between 4-9%, a view shared by both large and small firms. Over half (53%) think the government should focus on productivity growth to increase wages across the board while relying on the current relative target for the NLW (two-thirds of median earnings) to ensure that it rises too.***

Businesses are deeply concerned about the impact of labour shortages on growth

- 75% of businesses say they have been impacted by labour shortages in the last 12 months.* Of those affected, almost half (46%) have been unable to meet output demands, more than a third (36%) have had to make changes to or reduce the products or services they offer, and a quarter (26%) have reduced planned capital investment in other parts of the business.**
- Firms have taken a number of steps to ease the impact of shortages, including investing in base pay (56%), investing in training to upskill current employees (55%), and improving their employee value proposition (45%).
- To ease the impact of labour shortages, just under half (46%) of businesses said the government should introduce incentives for technology and automation investment to boost productivity and more than two in five (44%) want the government to grant temporary emergency visas for roles in obvious shortage until a new Shortage Occupation List (SOL) is finalised. Two in five firms (40%) want the government to reform the apprenticeship levy so employers can spend levy funds on a variety of training to help fill shortage roles.*

Investment in the workforce is front and centre as businesses aim to attract and retain talent

- Looking to the year ahead, businesses expect their top workforce priorities to be retaining talent (55%), maintaining or achieving high levels of employee engagement (43%) and improving leadership and management skills (39%).*
- Effective line management (44%) and pay (43%) are seen as the top drivers of employee engagement.*
- Three-quarters (75%) of businesses say pay has become more important as a driver of employee engagement in the past year, while six in ten (59%) say flexible working practices and just over half (54%) say effective line management has become more important.*
- To improve their employee value proposition (EVP), more than three-fifths (62%) have invested in basic pay, just over half (51%) have adopted more flexible working patterns, and 51% have focused on developing and communicating a strong purpose and company values.

Businesses continue trying to find the right balance to maximise the benefits of hybrid working

- More than two in five businesses (43%) where most of their staff can are working in a hybrid way.
- Of those, 37% say it has had a positive impact on productivity and performance, compared to 29% who say it has had a negative impact. Just under half of businesses (47%) say it has had a positive impact on employee engagement, compared to over a third (37%) who said it has had a negative impact. Over a third (34%) say it has had a positive impact on company culture, compared to two in five (40%) who say it has had a negative impact.
- This gives a positive balance of +8% for productivity and performance, +10% (employee engagement), +12% (diversity and inclusion), and a negative balance of -6% for company culture and -20% for training and development opportunities[2].
- Only three in ten (29%) are confident they have found the right balance of hybrid working, while a quarter (26%) say they would like employees to come into the office more often.**

Businesses are putting health and wellbeing at the forefront of their D&I agenda

- D&I is a priority for nearly nine in ten (87%) businesses. Two thirds (64%) are prioritising supporting health and wellbeing, 38% improving inclusivity and building a culture of belonging, and 37% supporting a multi-generational workforce.*
- Businesses expect health and wellbeing (54%), supporting a multi-generational workforce (40%) and improving inclusivity (36%) to be their D&I priorities in two years' time.*
- Two-thirds of businesses (66%) have taken steps to reduce gender pay gaps. A third (33%) have introduced or extended flexible working opportunities, 30% have increased monitoring and data collection to better identify and measure areas for improvement, and 30% have reviewed recruitment practices to widen the pool of applications and reduce bias in selection processes.*
- Three-fifths of businesses (62%) have taken steps to reduce ethnicity pay gaps. A third (33%) have reviewed recruitment practices, just under a third (30%) have increased monitoring and data collection, while a quarter (25%) have introduced or extended flexible working opportunities.*

*** 'not applicable' responses excluded from the data analysis

** 'don't know' and 'not applicable' responses excluded from the data analysis

* 'don't know' responses excluded from the data analysis

The Employment Outlook

Labour market tightness continues as vacancies remain high and inactivity rates continue to rise

The UK economy is grappling with multiple headwinds culminating in weak economic growth. The cost of living has been increasing in the UK since the beginning of 2021, with inflation reaching a 41-year high (11.1%) in October this year. The price of goods, energy and fuel have increased the most, due to high demand from consumers, the war in Ukraine, and problems with supply chains - driving up the cost of doing business for firms across the economy. This comes as low unemployment and record high vacancies mean the labour market is tight, driven by the growth in the number of economically inactive people since the start of the pandemic, lower net migration from the EU, and higher than expected demand post-pandemic. The labour market is expected to remain tight in the near to medium term but loosen over time as unemployment increases. How quickly this happens is uncertain and depends on the extent, and impact of, the cost-of-living crisis on demand, and whether economic inactivity levels remain high.

Key findings

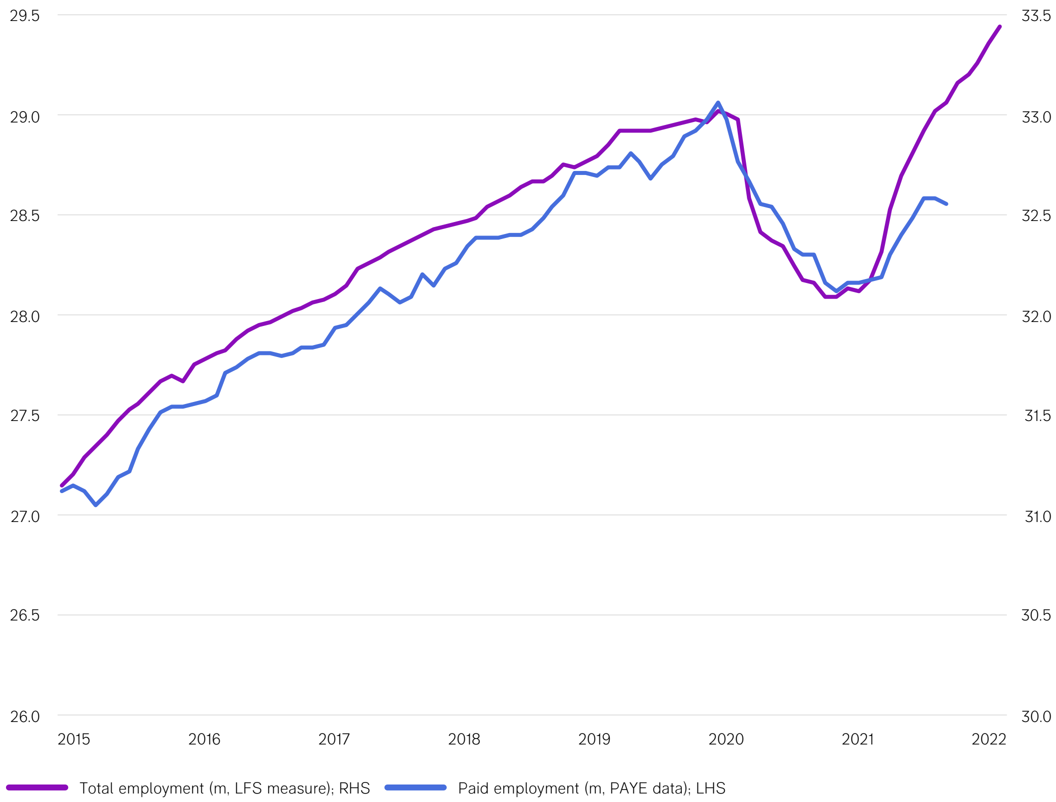
- While increasing over the last year, there are signs that employment growth may be slowing, with the employment rate falling in the last quarter. Unemployment is close to record low levels and projected to stay low in the near-term.
- The number of vacancies fell in the last quarter, after reaching record highs this year - and are still 450,000 above pre-pandemic levels. 2022 is the first year since records began that there are more vacancies than unemployed people, resulting in a tight labour market and chronic labour shortages.
- Nearly half of manufacturers (49%) cite shortage of labour as a factor likely to limit output, and 46% of service sector businesses believe shortages will limit their capital expenditure in the next 12 months.
- The economic inactivity rate has reached heights not seen since 2015, with long-term sickness the leading reason for economic inactivity, with data also showing a rise in students staying in education for longer.

- Private sector pay growth is the strongest on record outside of the Covid-19 pandemic (+6.2%), and nearly three times greater than the public sector (+2.2%), but has been wiped out by inflation resulting in the second-worst real-terms pay growth since records began (-2.9%).

Employment growth shows signs of slowing, as the employment rate falls

Employment decreased by 109,000 in the three months to August 2022 compared with the previous quarter, but increased by 265,000 on the same period a year ago. Despite this increase overall, the employment rate has decreased by 0.3% percentage points to 75.5% **(Exhibit 1.1).** Employment levels had been rising steadily this year, following a fall during the Covid-19 pandemic, but are now showing signs of slowing. Compared to pre-pandemic, employment in June-August this year is 230,000 below levels in January-March 2020.

Exhibit 1.1 Employment rate (% 2015 to 2022)



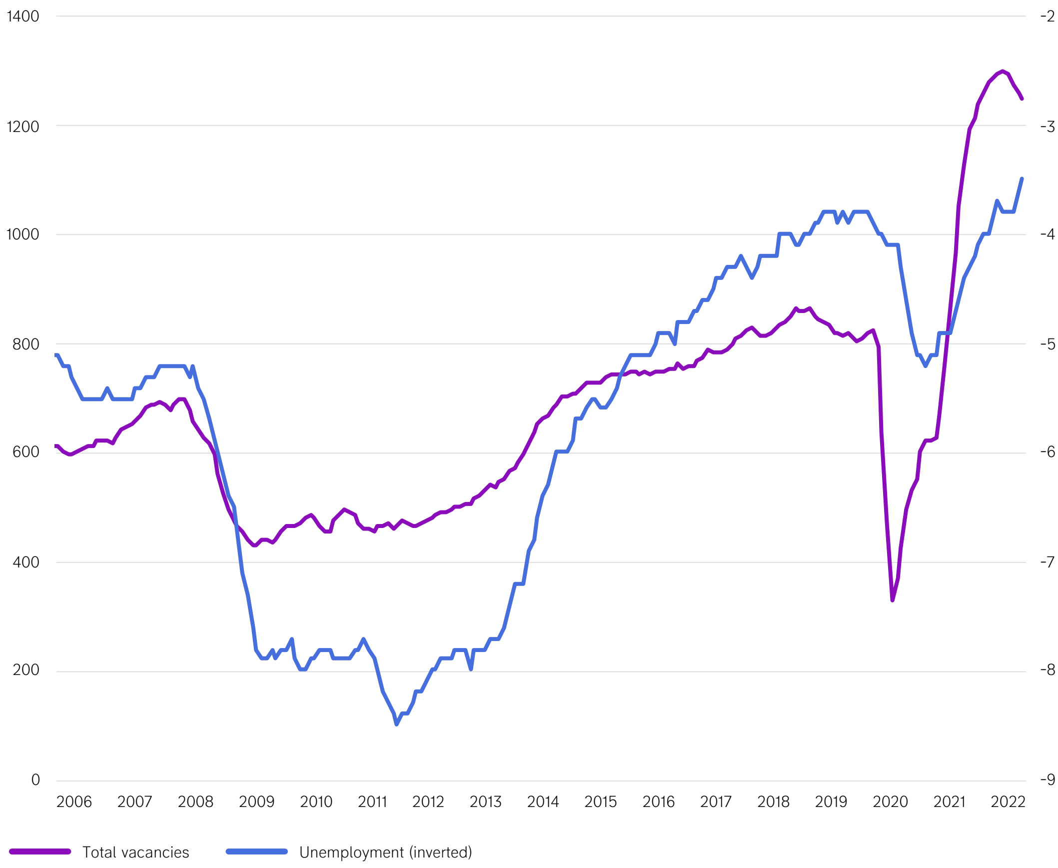
Labour shortages bite as unemployment reaches record lows and vacancies peaked in the Spring...

In the three months to August 2022, unemployment decreased by 97,000 to 1.18 million. The unemployment rate stood at 3.5%, a decrease of 0.3% points on the previous quarter, the lowest rate since 1974 **(Exhibit 1.2).** This comes as vacancies remain high. While vacancies fell to 1.25 million, they are still 450,000 higher than the pre-pandemic quarter of January-March 2020 after reaching their highest level since records began in March-May. Throughout 2022, the number of job vacancies has continued to outpace the number of unemployed people - leading to labour shortages across the economy. While vacancies in all sectors are above their pre-pandemic levels, vacancies are higher in some sectors than others. Vacancies in manufacturing, retail and accommodation and food services – while still high – are showing signs of softening, but the health and social care, education and public administration sectors are showing record high vacancies.

The pressure of labour shortages is reflected in the most recent CBI sector surveys. In services, 46% of businesses believe labour shortages are a factor likely to limit their capital expenditure over the next 12 months[3]. For manufacturers, nearly half (49%) cited a shortage of skilled labour as a factor likely to constrain output in the next 12 months - the highest since 1973[4]. Similarly, in consumer services, labour shortages have risen to a record high (+46%, compared to +9% in the previous quarter) as a concern weighing on firms' investment plans for the next 12 months. Concerns about labour shortages as a factor to limit investment plans have also reached a record high (+35%) in business and professional services[5].

The labour market is expected to remain tight in the near-term, with the Bank of England projecting that unemployment will steadily increase to between 4.3% - 4.9% by Q4 2023, and then to 5.1% - 6.4% by Q4 2025[6]. However, unemployment may increase more quickly if inflation proves more persistent than expected, interest rates rise more aggressively, and consumer spending suffers a deeper downturn due to cost of living pressures. These factors would be likely to impact the level of demand for goods and services, potentially having a knock on effect on the demand for labour in the medium-term. The trajectory for unemployment also depends on whether economic inactivity levels remain high.

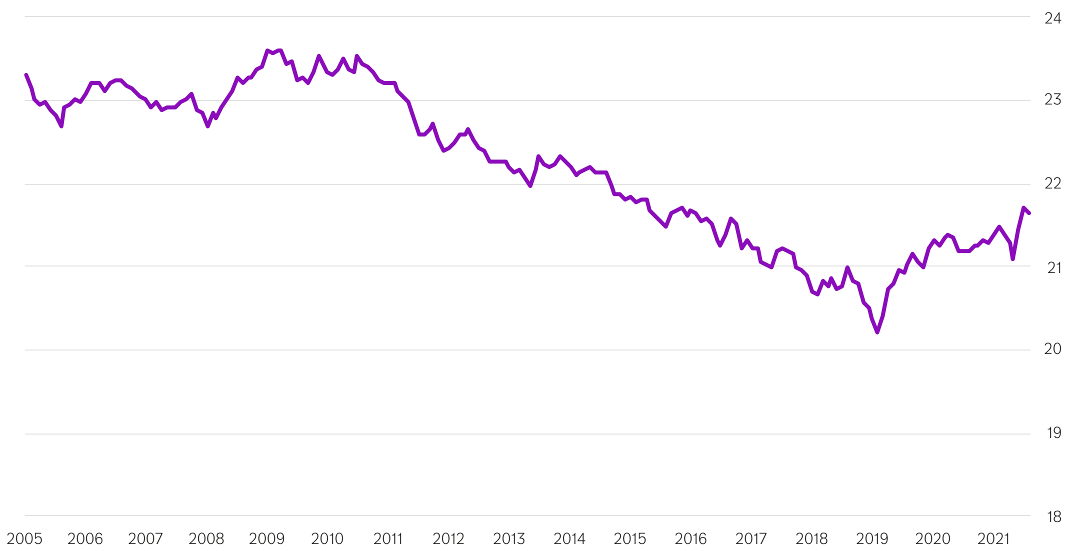
Exhibit 1.2 Vacancies vs unemployment rate (% 2006 to 2022)



...and the economic inactivity rate rises to a seven-year high

Simultaneously, the economic inactivity rate (those not in work or actively looking for work) has risen by 0.6% percentage points to 21.7%, the second largest quarterly increase since records began in 1971, and the highest economic activity rate since August 2015 **(Exhibit 1.3).** The number of economically inactive people rose during the pandemic and failed to fall back to pre-pandemic levels. Long-term sickness (28%) and being a student (27%) are the main drivers, with the number of economically inactive people with a long-term illness at its highest recorded level since records began in 1993. The largest increase has been among those age 50-64. When considering the reason why, the ONS found that more than half of people aged 50+ (51%) who have left work since the pandemic and not returned had a physical or mental health condition or illness[7].

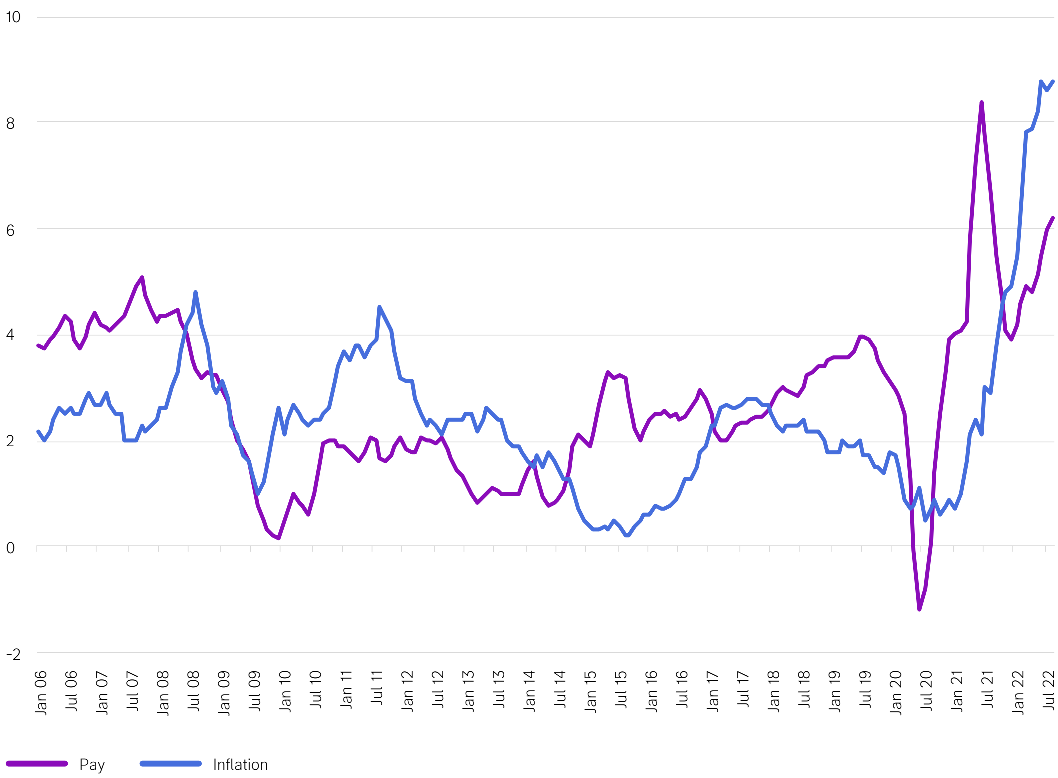
Exhibit 1.3 Economic inactivity rate (% 2006 to Oct 2022)



Wage growth is strong in the private sector but continues to fall behind inflation

A tight labour market seeking to keep pace with high inflation has resulted in strengthening pay growth, with private sector pay up by 6.2% compared to the same period in 2021 - the strongest pay growth seen outside of the Covid-19 pandemic period. However, the high inflationary environment means this wage growth is not reflected in an increase in consumer purchasing power, with real-terms regular pay excluding bonuses at -2.9% in the three months to August 2022, the second lowest on record **(Exhibit 1.4).** The real value of wages is expected to continue falling throughout 2023 as nominal wages fail to keep up with inflation.

Exhibit 1.4 Pay growth vs CPI inflation (% 2006 - 2022)



Employers are softening expectations for growing their workforce

Inflation raising the cost of doing business mixed with slowing post-lockdown demand means that hiring intentions are softening. Now, with the UK expected to face its longest recession since records began, businesses of all sizes are feeling less confident about growing the size of their workforce. Where businesses are looking to hire, high vacancies and labour shortages remain a persistent problem. Given that demand for labour has not matched supply since the economy reopened in mid-2021, many employers are struggling to fill long-standing vacancies.

Key findings

- Fewer than half of businesses (43%) expect to grow their workforce in the next 12 months, down from 57% last year.
- Meanwhile, 15% of businesses anticipate that their workforce will be smaller next year – giving a balance of +28%, compared to +50% last year[8].
- The softening of expectations is clearest in the permanent recruitment market. 85% of businesses are planning to recruit permanent roles in the next 12 months, with a third (33%) expecting higher levels of recruitment, and almost two-fifths (39%) expecting the same level of recruitment, compared to 46% and 33% respectively in 2021.
- 13% are expecting lower levels of recruitment, and a further 13% are expecting no recruitment at all, compared to 9% and 11% respectively in 2021.
- In the temporary recruitment market, 13% of businesses expect higher levels of recruitment and 15% expect lower levels, compared to 16% and 12% respectively in 2021. For entry level jobs, 21% expect higher levels of recruitment and 13% expect lower levels, compared to 28% and 9% respectively in 2021.

UK jobs outlook softens with just over a quarter of firms expecting to grow their workforce...

Fewer than half of businesses (43%) expect to create additional jobs over the next 12 months **(Exhibit 2.1)**. This compares to 57% in 2021, showing that expectations for hiring have begun to soften. In addition, just over one in seven firms (15%) expect their workforce to be smaller, while two in five (40%) expect the size of their business to remain the same. This represents a balance of +27%, and is significantly weaker than 2021 (+50%) **(Exhibit 2.2).**

However, while high inflation and economic uncertainty means expectations are lower than previous years, firms are still predicting to hire despite a prolonged economic downturn. Their confidence is linked to the severity of labour shortages across the economy. Having affected firms since the post-pandemic reopening of the economy, many businesses are still looking to hire to fill long-standing vacancies in attempt to meet current demand.

Exhibit 2.1 Expected size of workforce in 12 months' time (% of respondents)

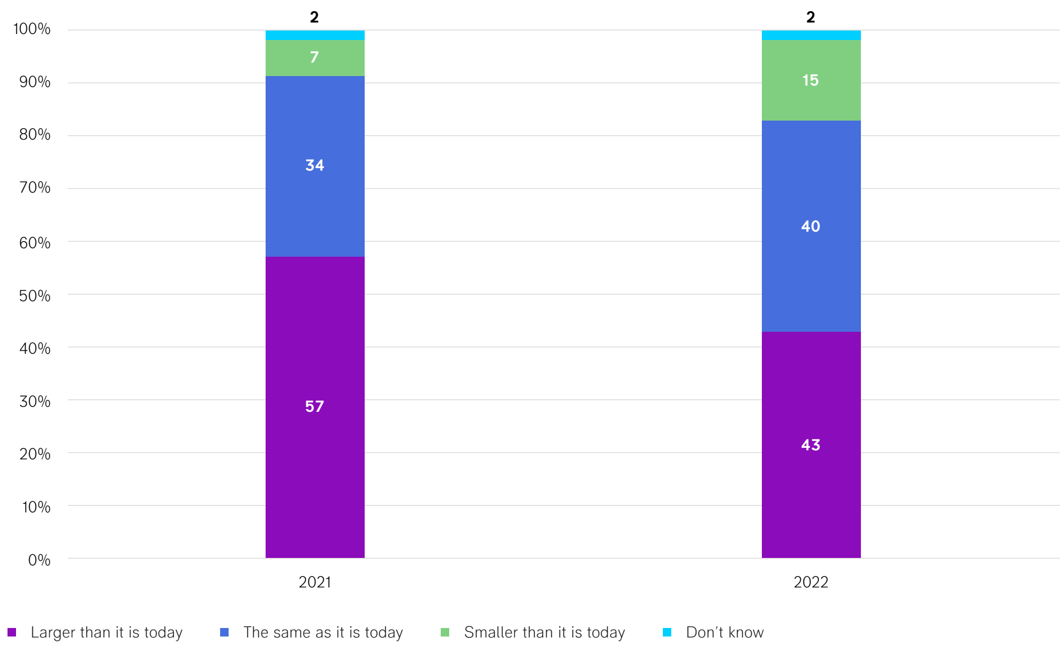
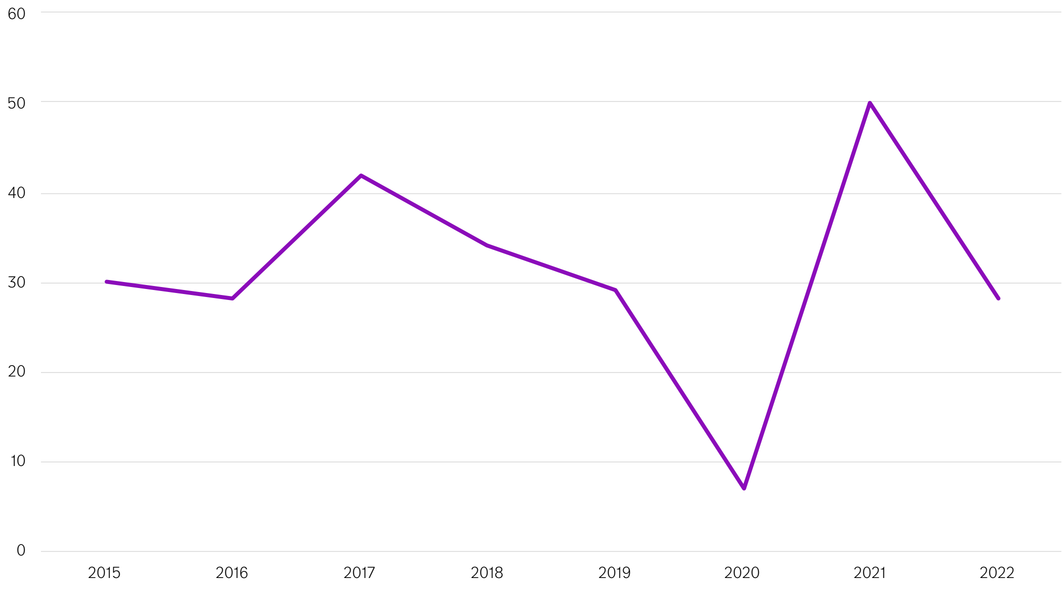


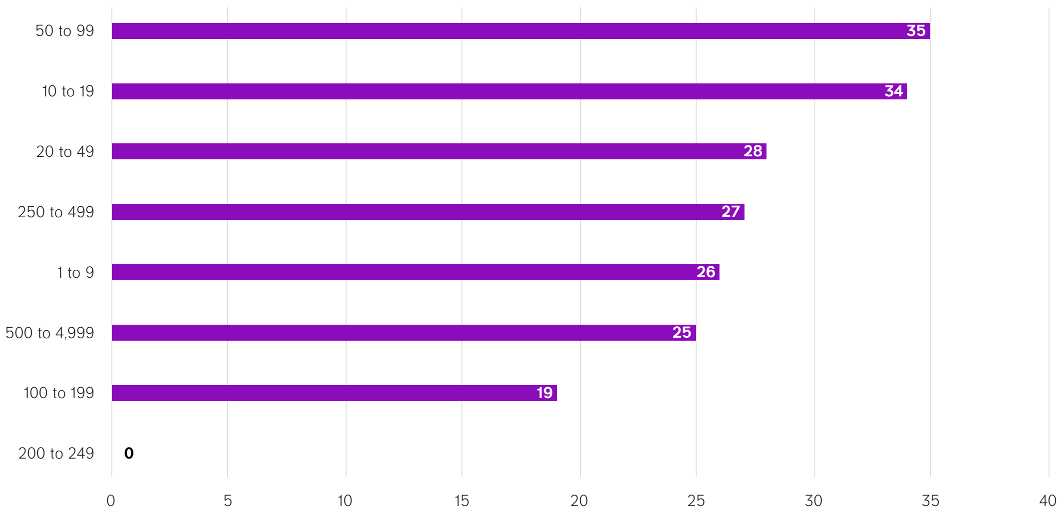
Exhibit 2.2 Positive balance of firms expecting workforce growth 2015-2022 (% of respondents)[9]



Large and small firms share similar expectations for workforce growth over the next 12 months

Softening expectations for workforce growth in the next 12 months is shared among large and small firms. Among SME's, a balance of +28% expect to take on more employees in the coming 12 months – the same as for large firms, showing the UK's economic challenges are affecting businesses of all sizes **(Exhibit 2.3).**

Exhibit 2.3 Positive balance of workforce growth 2015-2022 (% of respondents, by size)[10]



Permanent job expectations fall compared to last year as labour shortages and rising inflation hits firms...

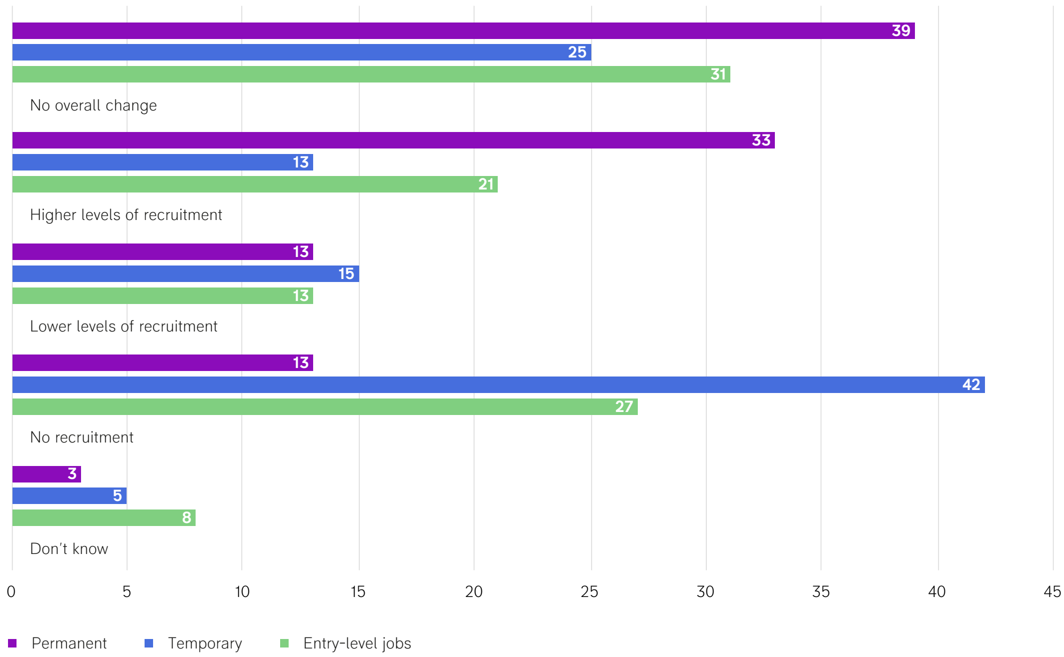
We asked firms to indicate their hiring expectations for permanent, temporary, and entry-level positions for the year ahead. While permanent hiring is holding up overall, there are softening expectations from firms to grow these roles which are typically their primary workforce. More than four in five firms (84%) expect to recruit permanent roles in the next 12 months, compared to 87% in 2021 **(Exhibit 2.4)**. While comparable, hiring rates are slowing. A third of businesses (33%) expect higher levels of recruitment, compared to 46% last year, and nearly two in five (39%) expect the same level, compared to 33% last year. One in eight (13%) expect the rate of recruitment to be lower, compared to 9% in 2021.

...and businesses are showing signs of caution about creating more entry level roles too

When asked about their approach to recruitment for entry level jobs, one in five businesses (21%) expect higher levels of recruitment and one in eight (13%) expect recruitment to be lower **(Exhibit 2.4).** This compares to 28% and 9% in 2021 respectively, reflecting the wider trend of business' softening hiring expectations. As entry level roles typically require businesses to invest more time in training and development, softening expectations are also likely to reflect that firms are finding it difficult to free up staff to provide training where others aren't available to back fill roles in a labour shortages environment.

On the demand side, it may also reflect the rise in economic inactivity, which has been driven in part by rising student numbers. Nevertheless, with a potential economic downturn looming, businesses and government need to be alert to the employment prospects of those new to the labour market to ensure they're not disproportionately affected by long-term scarring.

Exhibit 2.4 Plans for recruitment over the next 12 months (% of respondents)



"72% of firms believe the UK labour market has become less attractive as a place to invest and do business"

Access to people and skills are the biggest threats to UK labour market competitiveness

While the UK has built a strong reputation for creating jobs, most firms believe the UK labour market has become less attractive as a place to invest and do business, continuing a trend of pessimism. Firms have long cited access to people and skills as the top threats to UK labour market competitiveness, but following 18 months of chronic labour shortages, for the first time, access to labour tops access to skills. This has long-term implications for the UK's growth plan. Increasing the size of the labour market has been a source of economic growth in the past, but with labour shortages rampant across the economy, relying on increasing the size of the labour market alone is no longer a viable strategy to achieve growth.

This presents an opportunity for business and government to work together to support business investment in productivity boosting measures that will help firms pave the path towards sustainable long-term growth. The cost of living and labour costs are also weighing heavily on business confidence this year due to the impact of high energy prices and inflation driving up costs for both businesses and households. And with competition for talent as fierce as it has been for decades, businesses have been investing in pay packages in a bid to attract and retain talent.

Key findings

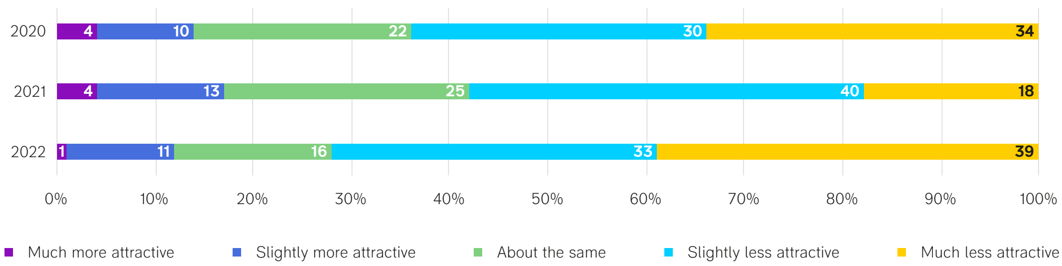
- 72% of businesses say that the UK labour market has become a less attractive place to invest and do business in the last five years – the least attractive it has been since the question was first asked in 2008.*
- Almost three-fifths (58%) of businesses believe that the UK labour market will become a less attractive place overall to invest and do business in the next five years, with less than one in five (18%) expecting it to become more attractive overall.*
- The main current threats to the UK's labour market competitiveness are seen as access to labour (75%), access to skills (72%), and the cost of living (69%).*
- These threats are expected to persist in the years ahead, with access to skills (73%), access to labour (70%), and labour costs (57%) seen as the top three threats to competitiveness over the next five years.*

* 'don't know' responses excluded from the data analysis

More than seven in ten businesses believe the UK labour market has become a less attractive place to invest and do business...

Following a continued downward trend, this year's survey reveals that more than seven in ten businesses (72%) believe the UK has become a less attractive place to invest and do business in the past 5 years **(Exhibit 3.1)**. This compares to 58% last year and is the highest proportion since we first asked this question in 2008. Nearly four in ten businesses (39%) believe the UK has become much less attractive, compared to just over one in six (18%) last year. Just under one in eight (12%) believe the UK has become more attractive overall in the last 5 years, compared to 17% in 2021. This suggests increasing pessimism among business leaders compared to previous years and continued concern about the attractiveness of the UK labour market as a place to invest and do business. This increase is likely due to the impact of on-going labour shortages affecting businesses of all sizes and sectors since the economy reopened post-covid, and a level of uncertainty about the economic landscape.

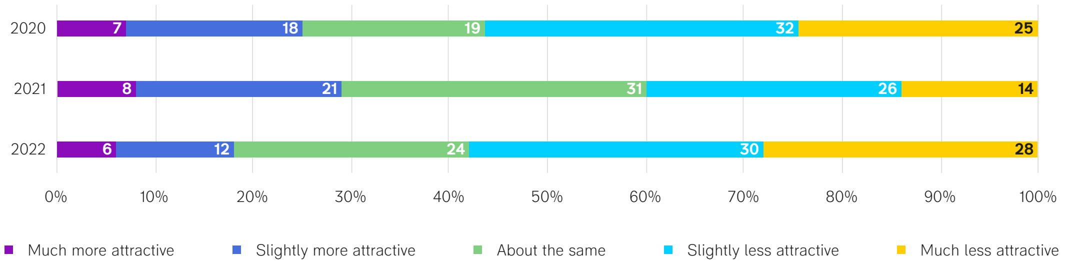
Exhibit 3.1 The UK as a place to invest/do business over the past five years (% of respondents)[11]



...and firms remain uncertain about the UK's labour market attractiveness in the future

Pessimism about the attractiveness of the UK labour market is expected to continue as firms expect it will remain an unattractive place to invest and do business over the next five years. Just over one in six businesses firms (18%) think the UK labour market will become more attractive, compared to almost three in five (58%) that expect it will continue to become less attractive over the next five years **(Exhibit 3.2).** This compares to 29% and 40% in 2021 respectively. As the UK aims for sustained economic growth, these figures highlight the entrenched structural issues facing the UK labour market. Without any quick fixes, joint business and government action is needed across a range of areas to rebuild and restore confidence. This includes action to address labour and skills shortages and tackle high inflation which is driving up concern about labour costs and the cost of living.

Exhibit 3.2 The UK as a place to invest/do business in 5 years' time (% of respondents)[12]

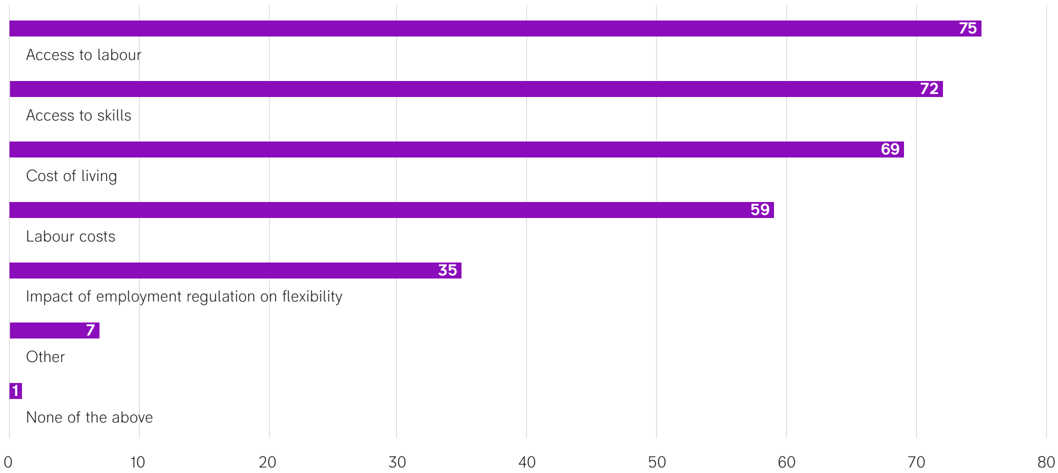


Access to people and skills continues to be the top concerns for UK firms...

Access to labour has overtaken access to skills as the number one threat to UK labour market competitiveness, after eight consecutive years of it being the primary business concern. Three quarters of firms (75%) now cite access to labour as a threat to competitiveness **(Exhibit 3.3).** This is broadly consistent with results from last year (76%) and represents a significant increase from 2020 (36%). It also accords with businesses' experiences across the economy who have been facing persistent labour shortages over the last 18 months. To tackle this issue, the government has an important role to play to increase the supply of labour, including helping people overcome barriers to work and taking a pragmatic approach to immigration with targeted reforms.

Access to skills remains a key concern for businesses across the economy with seven in ten firms (72%) reporting that access to skills currently threatens the UK's labour market competitiveness. This has decreased since last year (77%) but is at the same level as 2019 before the pandemic hit (72%). Access to skills and skills investment is a fundamental enabler of economic growth, with skills improvements typically accounting for around 20% of the UK's productivity growth before the financial crisis[13]. In addition, CBI research found that closing future skills gaps could provide a £150bn uplift in GVA by 2030 and contributes to improving people's living standards[14]. Creating a system that delivers the skills markets need for now and in the future requires agility and responsiveness to ensure firms invest and upskill employees to support macro-economic shifts. To ensure that people can be upskilled and reskilled, private investment needs to be unlocked by turning the levy into a flexible Skills Challenge Fund, providing full flexibility on the skills training this can be spent on.

Exhibit 3.3 Current threats to UK labour market competitiveness (% of respondents)[15]



High inflation is driving concern about labour costs and the cost of living

Prices are rising across the world, with annual consumer price inflation reaching close to a 41 year high at 11.1% in the UK in October this year. There are many contributing drivers – including increases in the costs of consumer goods, and rising wholesale energy prices following the Russian invasion of Ukraine. This has caused both businesses and households to feel the tightest real terms squeeze since 1982. More than two-thirds (69%) of businesses say that the cost of living threatens labour market competitiveness, compared to 40% in 2021 and 34% in 2020 **(Exhibit 3.4).** This response reflects business' views when inflation was at 9.4%, and the government had not yet announced their energy support intervention. Since then, adjustments to the Energy Price Guarantee and continued upwards pressure on food and raw material prices are likely to mean inflation remains higher for longer.

Another significant change driven by high inflation is the number of businesses highlighting labour costs as a threat to UK labour market competitiveness this year. Three in five (59%) businesses say that labour costs are a competitiveness threat, compared to 47% in 2021, and the highest proportion since we first asked the question in 2016 **(Exhibit 3.5)**. While the upward cost of employment has long been a business concern, firms increasing pay for roles facing shortages in a bid to attract and retain talent has significantly driven up cost impacts. This also comes at a time when firms are doing all they can to support staff financially with the cost of living.

Exhibit 3.4 Rise of the cost of living as a threat to UK competitiveness (% of respondents, compared from 2018-2022)

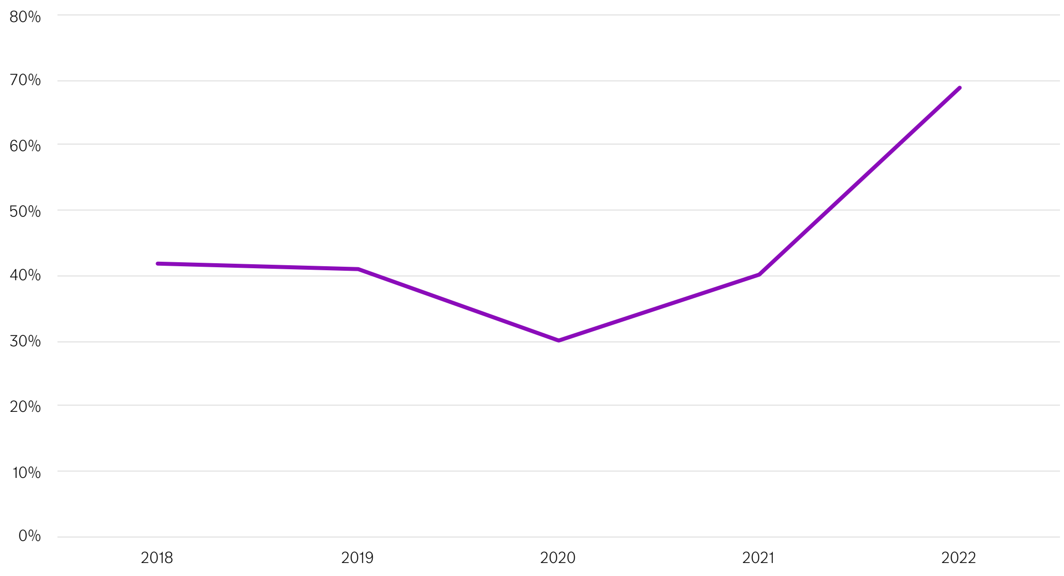
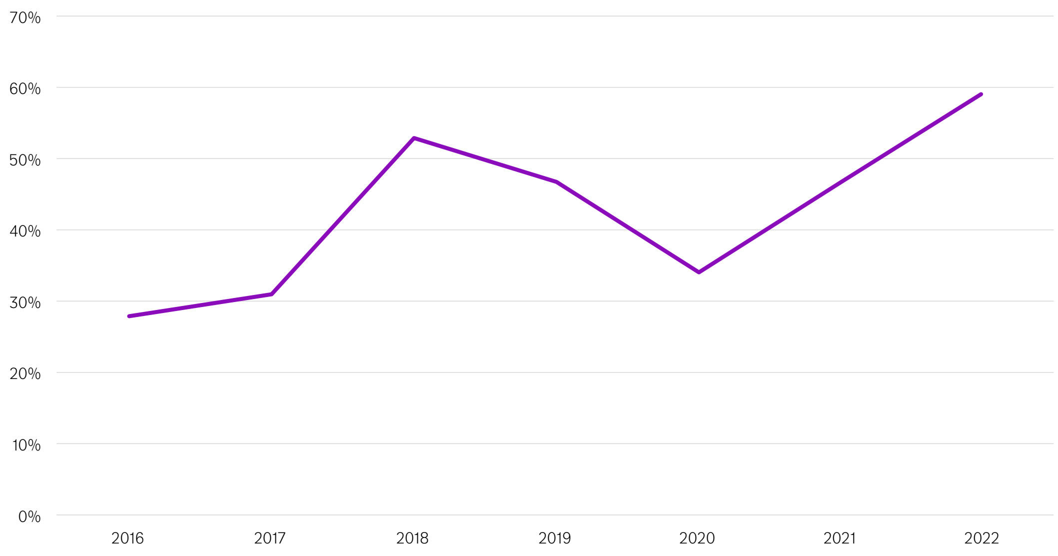


Exhibit 3.5 Rise of labour costs as a threat to UK competitiveness (% of respondents)

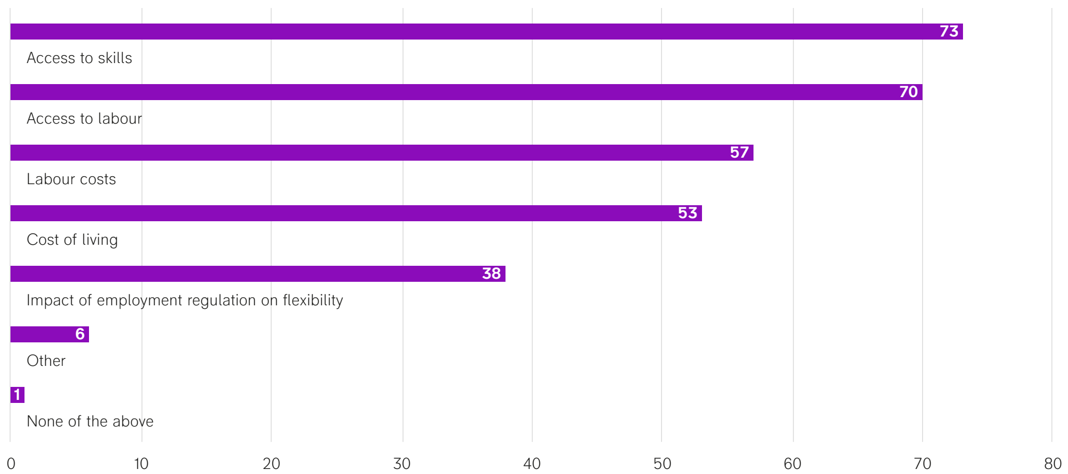


...with joint business-government action required to ensure shortages don't continue to hold back growth as expected

The same set of concerns are at the forefront of business' minds when asked to consider threats to labour market competitiveness in the next five years. Access to skills (73%), access to labour (70%), labour costs (57%), and the cost of living (53%) all remain more frequently reported threats than in 2021, then at 69%, 58%, 44%, and 43% respectively **(Exhibit 3.6)**. This highlights the extent to which businesses see difficulties accessing labour and skills as a structural and entrenched challenge in the UK labour market. To go for growth and build a higher-wage economy, we need to build a skills system that is responsive to the needs of the economy, and ease shortages to create the conditions for higher business investment. That means helping more workers overcome barriers into the workplace.

The cost-of-living crisis is weighing heavily on businesses long-term planning. With no certainty of when rising inflation will end, and the prospect of energy bills rising sharply again in April 2023, the government needs to set out the details of any future targeted support sooner rather than later, in addition to how the country establishes its longer-term energy security.

Exhibit 3.6 Future threats to UK labour market competitiveness (% of respondents)[16]



Businesses are doing all they can to support employees through the cost-of-living crisis

Growing inflation is putting pressure on both households and businesses, with concerns about the cost of living reaching its highest level since we started asking the question in 2018. This presents difficulties for both households and businesses and has contributed to greater industrial action this year. While employers have been doing what they can to support employees through the cost-of-living crisis, spikes in inflation and energy costs are also affecting the cost of doing business. The government has since announced the Energy Price Guarantee, providing support for energy costs to both consumers and businesses until April 2023. Firms have been cautious about their role in contributing to inflation, with the reality of inflation-matching pay rises meaning firms would need to raise prices. This comes as businesses are facing fierce competition for talent, putting pressure on firms to raise wages for in-demand roles in attempt to attract and retain people. Together this has impacted pay settlements, making pay rises in line with inflation unaffordable for many, with short-term measures, like one-off bonus payments and earlier pay reviews more attractive and affordable. In the longer-term, it points to the need for measures that support productivity growth to sustainably increase wages by growing the economy.

Key findings

- Fewer than one in ten businesses (7%) expect to increase pay above inflation and almost three in ten (29%) plan to increase pay in line with inflation, the lowest since 2012.*
- Just over a third (34%) of businesses expect to increase pay below inflation, a significant jump from 3% in 2021 and 5% in 2020. Only 3% of businesses are planning to freeze pay, continuing a downward trend from 2021 (8%) and 2020 (33%).*

* 'don't know' responses excluded from the data analysis

- Almost nine in ten (87%) businesses have taken action to support employees during the cost-of-living crisis, with just under half (46%) bringing forward or having additional pay reviews, while over a third (37%) are offering wellbeing provision and giving staff one-off bonus payments (36%).**
- Of those impacted by the National Living Wage (NLW) increase, almost three-fifths (57%) of businesses are offsetting costs by reducing the rate of pay growth for the rest of the workforce. Just under half (48%) are offsetting the costs by raising prices, and almost three in ten are absorbing the whole cost (28%) or part of the cost (27%) through reduced profit.**
- Nearly two in five businesses affected by the policy (38%) believed the Low Pay Commission (LPC) should have increased the NLW between 4-9%, a view shared by both large and small firms. Over half (53%) think the government should focus on productivity growth to increase wages across the board while relying on the current relative target for the NLW (two-thirds of median earnings) to ensure that it rises too.***

Expectations for pay growth weaken as high inflation drive business' affordability concerns

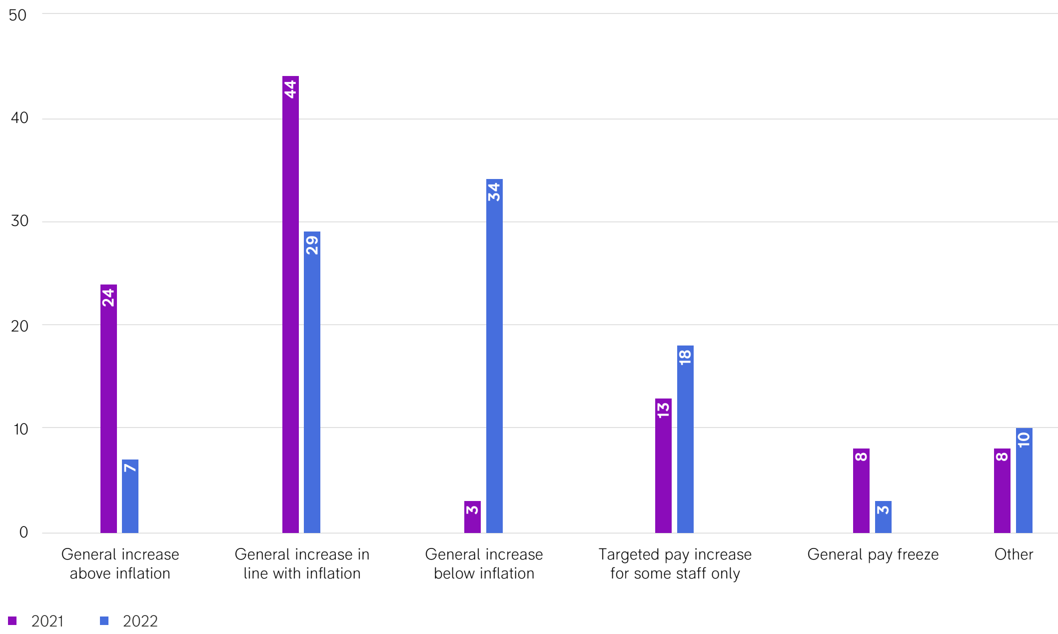
This year, nearly one in three businesses (29%) plan to increase pay in line with inflation at their next pay review, down from 44% in 2021 **(Exhibit 4.1).** Less than one in ten (7%) expect to increase pay above inflation, a marked change from 24% last year. Significantly, more than a third of businesses say they are planning to increase pay below inflation (34%), a vast increase compared to 2021 (3%). These results reflect the impact of high and rising inflation (at 9.4% when the question was asked) on affordability concerns and align with real-terms pay falling by 2.4% over the year[17]. Firms have been facing difficult decisions when considering pay increases, with many seeing no good option. While businesses want to do all they can to support employees, spikes in inflation are also affecting the cost of doing business as goods, energy and services costs increase. For most firms, the reality of matching the current inflation spike would require passing extra costs onto consumers, adding to upwards inflationary pressure. To achieve sustainable wage growth, business and government need to focus on measures that help to boost productivity which leads to higher living standards through sustainable wage growth.

*** 'not applicable' responses excluded from the data analysis

** 'don't know' and 'not applicable' responses excluded from the data analysis

* 'don't know' responses excluded from the data analysis

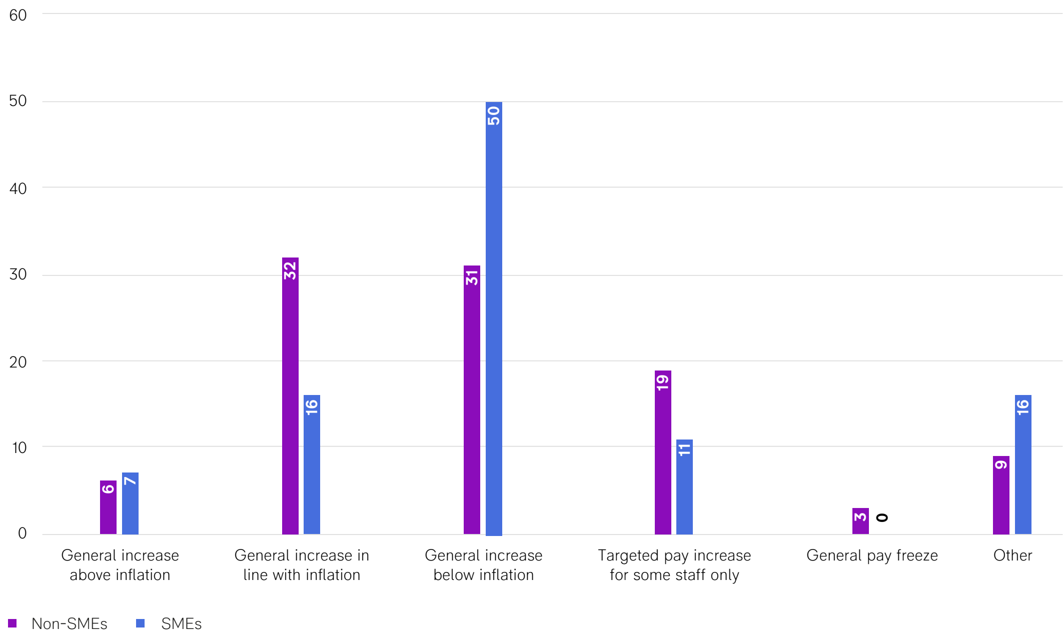
Exhibit 4.1 Firms' approach to their next pay review (% of respondents)[18]



...with smaller firms more ambitious about increasing pay in line with inflation

When looking at company size, more than three in ten (32%) small and medium sized firms plan to increase pay in line with inflation, compared to 16% of larger firms **(Exhibit 4.2).** Larger firms are also more likely to increase pay below inflation (50%) compared to SMEs (31%). This is a marked change compared to previous years, with SMEs usually opting to take a slightly more cautious approach to pay increases compared to larger companies. This could reflect SMEs putting a primary focus on pay increases to help attract and retain staff in a tight labour market, compared to larger businesses who may focus on investing in a variety of non-wage benefits, such as flexible and hybrid working arrangements, improved health benefits and enhanced family leave.

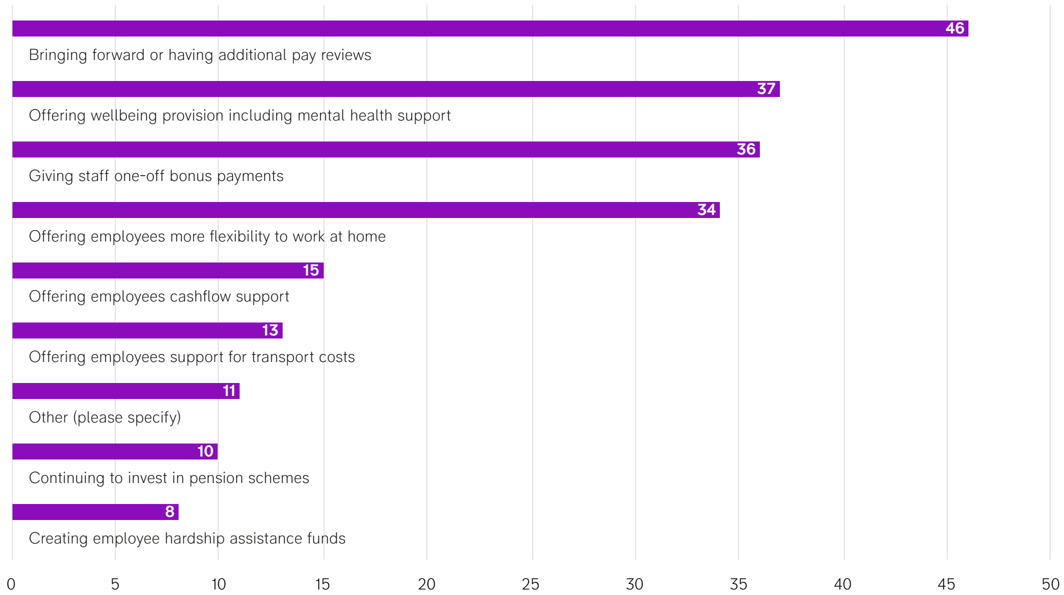
Exhibit 4.2 Firms' approach to their next pay review (% of respondents, by size)[19]



Just under half of businesses are bringing forward or having additional pay reviews in response to the cost-of-living crisis

With cost-of-living concerns higher than ever, almost nine in ten (87%) businesses have taken action to support their staff. Many have made direct financial interventions, with almost half of those who have acted (46%) bringing forward or having additional pay reviews and just over a third (36%) giving staff one-off bonuses **(Exhibit 4.3).** With pay increases in line with inflation unaffordable for most firms, short-term measures like these are more attainable measures to support staff. Businesses are also looking at flexibility and wellbeing provision to support staff too – with over a third (37%) offering wellbeing provision including mental health support and advice for employees facing financial hardship, and a third (34%) offering employees more flexibility to work at home to reduce transport costs.

Exhibit 4.3 Actions businesses are taking to support employees with the cost of living (% of respondents)[20]

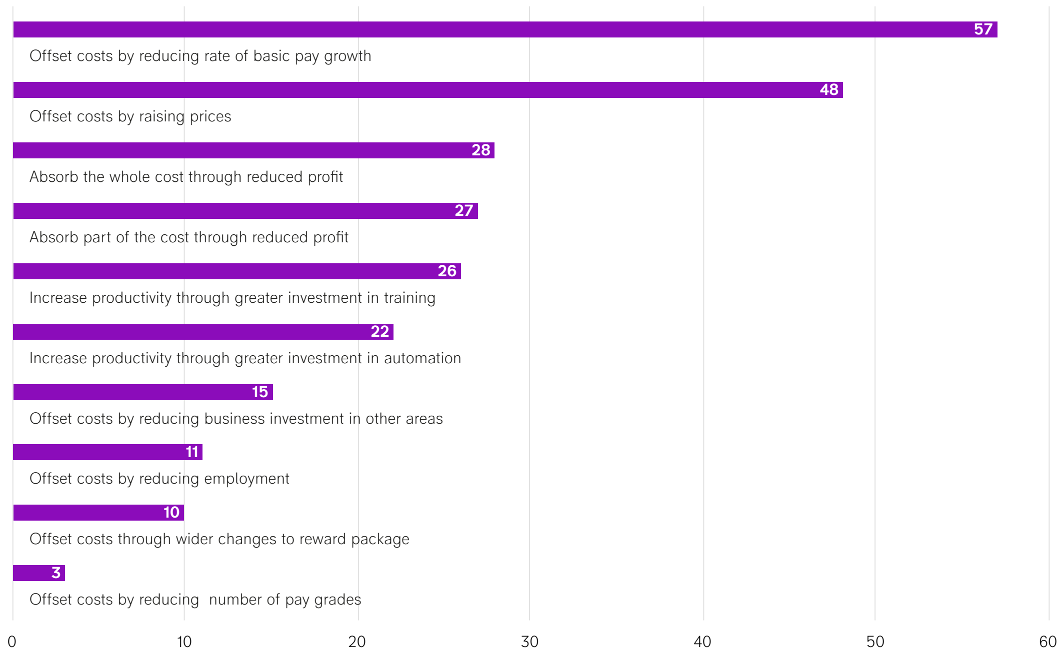


Businesses are offsetting the rise in the National Living Wage by raising prices…

In April 2022 the National Living Wage (NLW) increased by 6.6% to £9.50. The rate is set to reach two-third of median earnings by 2024 – currently projected at £10.95. To accommodate these increases, businesses that pay NLW rates have responded in a variety of different ways. The most common, taken by nearly three in five businesses (57%), being to offset costs by reducing the rate of pay growth for the rest of the workforce, impacting pay differentials **(Exhibit 4.4).** A further half (48%) of businesses are offsetting costs by raising prices, while nearly three in ten are absorbing the whole (28%) or part of the cost (27%) through reduced profit. Taken together, this shows that most firms are shouldering NLW costs themselves by seeking to pay for increases through other means.

When the minimum wage was introduced, the intention was for expected productivity growth to pay for the increases. The Low Pay Commission (LPC) has since acknowledged that despite being a key aim of the policy, productivity improvements have been harder to realise than many expected[21]. This is borne out in business' responses, with only 22% of firms investing in automation or training (26%) to increase productivity in response to rises. This compares to 34% and 32% in 2019 respectively. The upfront costs of these approaches are likely to act as a significant barrier, as well as because these measures tend to have a longer-term pay-off, so require other mitigating actions to relieve cost pressures in the short-term. Introducing incentives to help firms invest in technology and reforming the skills system to make it more flexible are essential steps the government can take to facilitate and encourage greater levels of automation and training investment in the long-term.

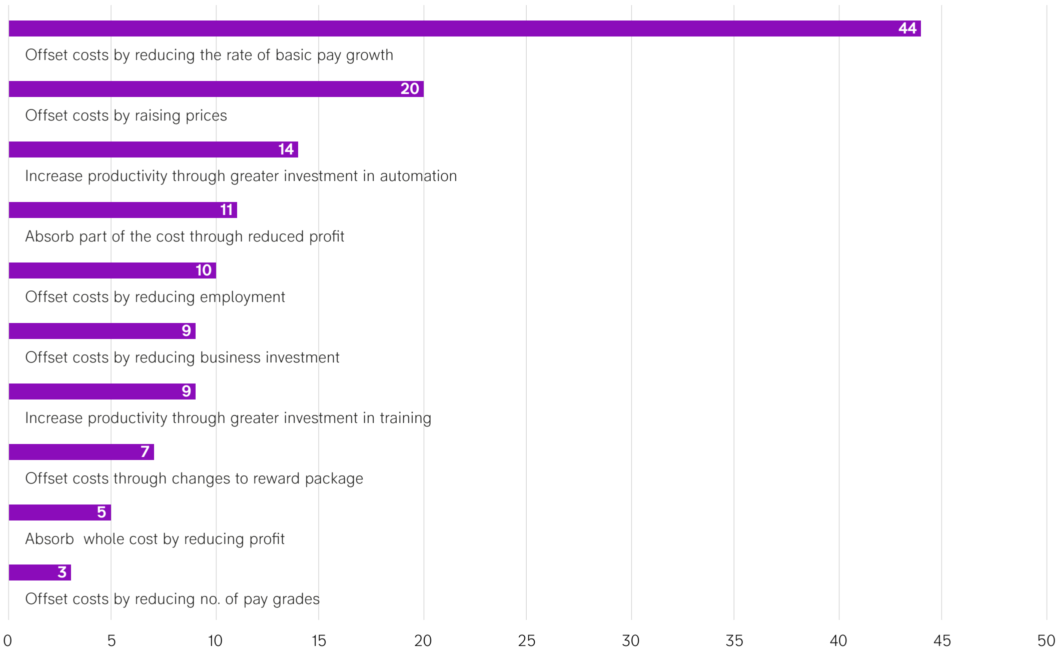
Exhibit 4.4 Actions businesses are taking in response to the rise in the NLW now (% of respondents)[22]



...and will continue to do so in the next two years

When asked what measures businesses would take in response to the NLW rising over the next two years, continuing to offset costs by reducing the rate of basic pay growth for the rest of the workforce (44%) was the most common response, followed by offsetting by raising prices (20%) **(Exhibit 4.5).** Disappointingly, only 14% of firms are planning to invest in automation, or training (9%) to increase productivity. With business' affordability challenges unlikely to abate anytime soon, continuing a cycle whereby rises in the NLW rely on businesses offsetting the costs through raised prices or reduced profits instead of productivity growth is not a sustainable way to improving living standards and grow the economy. Instead, the government should look at incentives to help businesses invest in long-term productivity boosting measures such as tech-adoption, with SMEs alone having the potential to add £45bn to the UK GVA by 2030 by embracing automation[23].

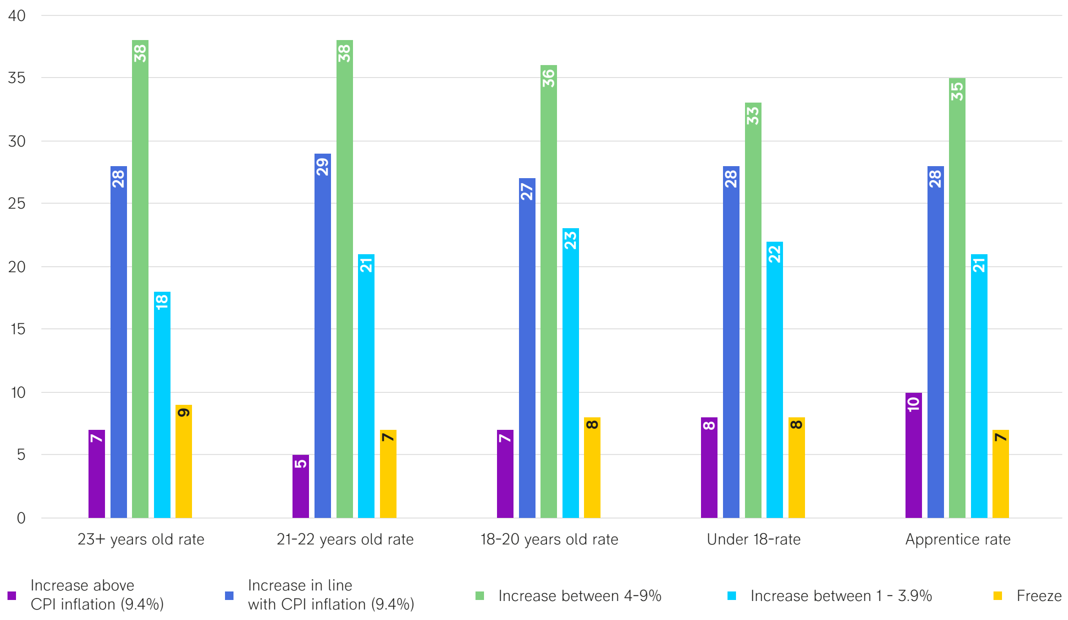
Exhibit 4.5 Actions businesses are taking in response to the rise in NLW in 2 years (% of respondents)[24]



Firms believed the National Living Wage should increase cautiously ...

When asked about the LPC's approach to different minimum wage rates, nearly two in five (38%) NLW payers believed the rate should have increased between 4-9% **(Exhibit 4.6).** Fewer than three in ten businesses (28%) believed it should increase in line with CPI inflation, and just over one in six (18%) believed it should increase between 1-3.9%. Broken down by size, both large (45%) and small (37%) firms favoured a more cautious approach, believing the NLW should increase between 4-9%. This reflects the rising cost of doing business since last year, with wages playing a big part in this increase. Businesses are trying to raise pay as much as possible to support staff, but across the board pay settlements have remained below inflation. Increasing the NLW in line with inflation would be unaffordable for many businesses, especially SMEs who tend to use minimum wage rates more than larger firms. Without productivity growth, a balance must be struck to protect the real wages of the lowest paid, without threatening the viability of firms.

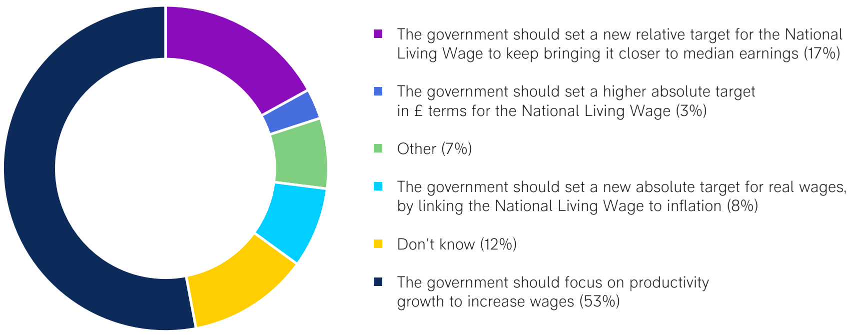
Exhibit 4.6 Business' views on the LPC's approach to the national minimum/living wage (% of respondents)[25]



...and think the government should focus on measures to support productivity growth to increase wages across the board

We asked firms what the government should do next on the NLW after the LPC's' remit to increase it to two-thirds of median earnings is expected to be met in 2024. Most employers (53%) believe the government should focus on productivity growth to increase wages across the board while relying on this current relative target to ensure the NLW rises too **(Exhibit 4.7).** This compares to one in six (17%) who believe the government should set a new relative target for the NLW to keep bringing it close to median earnings, and fewer than one in ten (8%) believing the government should set a new absolute target for real wages by linking it to inflation. Minimum wage policy alone is not enough to create a high-wage, high-skill economy. By 2024 the UK will have technically ended low pay, but many workers – especially given price-rises – will continue to see their finances under pressure. The only sustainable path to higher wages for those earning the minimum wage, and right across the economy, is higher productivity. A plan for unlocking business investment will have the greatest impact on living standards.

Exhibit 4.7 What businesses think the govt should do next for the NLW/LPC remit (% of respondents)[26]



"75% of businesses have been impacted by labour shortages in the last 12 months"

Businesses are deeply concerned about the impact of labour shortages on growth

Despite strong demand for goods and services, labour and skills shortages continue to hold back growth. A combination of rising economic inactivity and lower migration means the UK workforce is smaller, especially compared to its pre-pandemic trend[27]. This has triggered competition for talent from a severe imbalance of supply and demand. Ongoing labour shortages are having wide-ranging economic impacts – with businesses reporting that they are unable to fulfil output demands or make investments in the business as a result. If left unaddressed, labour and skills shortages could see the UK economy lose around £30bn-39bn annually[28]. Labour shortages also make it harder for firms to invest in productivity boosting measures, as time and money is having to be spent on their short-term crisis response, rather than investment in productivity boosting measures like automation and skills, which underpin a high skill, high wage economy. While businesses are pulling every lever they can to ease the impact, this is an opportunity for the government to work with business on measures to boost productivity – such as introducing incentives to unlock businesses investment in skills and automation, and action to increase labour supply by implementing proportionate immigration reforms and tackling labour inactivity, primarily by reforming unaffordable childcare.

Key findings

- 75% of businesses say they have been impacted by labour shortages in the last 12 months[29]. Of those affected, almost half (46%) have been unable to meet output demands, more than a third (36%) have had to make changes to or reduce the products or services they offer, and a quarter (26%) have reduced planned capital investment in other parts of the business.**
- Firms have taken a number of steps to ease the impact of shortages, including investing in base pay (56%), investing in training to upskill current employees (55%), and improving their employee value proposition (45%).

- To ease the impact of labour shortages, just under half (46%) of businesses said the government should introduce incentives for technology and automation investment to boost productivity and more than two in five (44%) want the government to grant temporary emergency visas for roles in obvious shortage until a new Shortage Occupation List (SOL) is finalised. Two in five firms (40%) want the government to reform the apprenticeship levy so employers can spend levy funds on a variety of training to help fill shortage roles.*

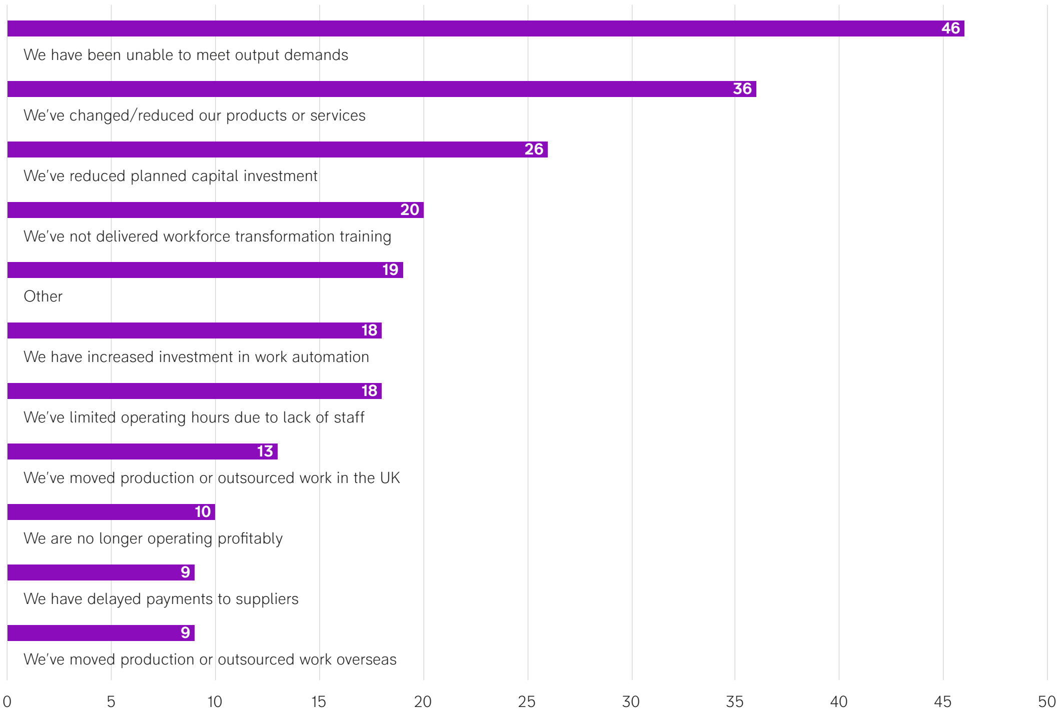
Nearly half of businesses facing labour shortages have been unable to meet output demands...

Labour shortages are affecting the vast majority of businesses, with three-quarters (75%) saying they have been impacted in the last 12 months. Of those, almost half (46%) say they have been unable to meet output demands as a direct result **(Exhibit 5.1).** More than a third (36%) say that labour shortages have resulted in a change or reduction in the products and services they offer to customers, while a quarter (26%) are reducing planned capital investment elsewhere in the business due to limited people available to fulfil demands. This shows that labour shortages are having a material impact on firms' ability to operate at full capacity, let alone grow. This accords with anecdotal evidence from CBI members facing chronic shortages for the last 18 months – from airports struggling to find baggage handlers, to local bakeries forced to reduce their operating hours. Severe shortages are also hindering higher workforce and wider business investment. Firms are having to spend their budgets on pay to help attract and retain talent in a tight labour market, limiting the available capital to spend on productivity boosting measures such as automation, that are necessary for growth and addressing labour shortages in the long term. Businesses have also said that one of the main causes of their skills shortages is their inability to find available candidates in the labour market to join their training programmes.

** 'don't know' and 'not applicable' responses excluded from the data analysis

* 'don't know' responses excluded from the data analysis

Exhibit 5.1 The impact that labour shortages are having on businesses (% of respondents)[30]

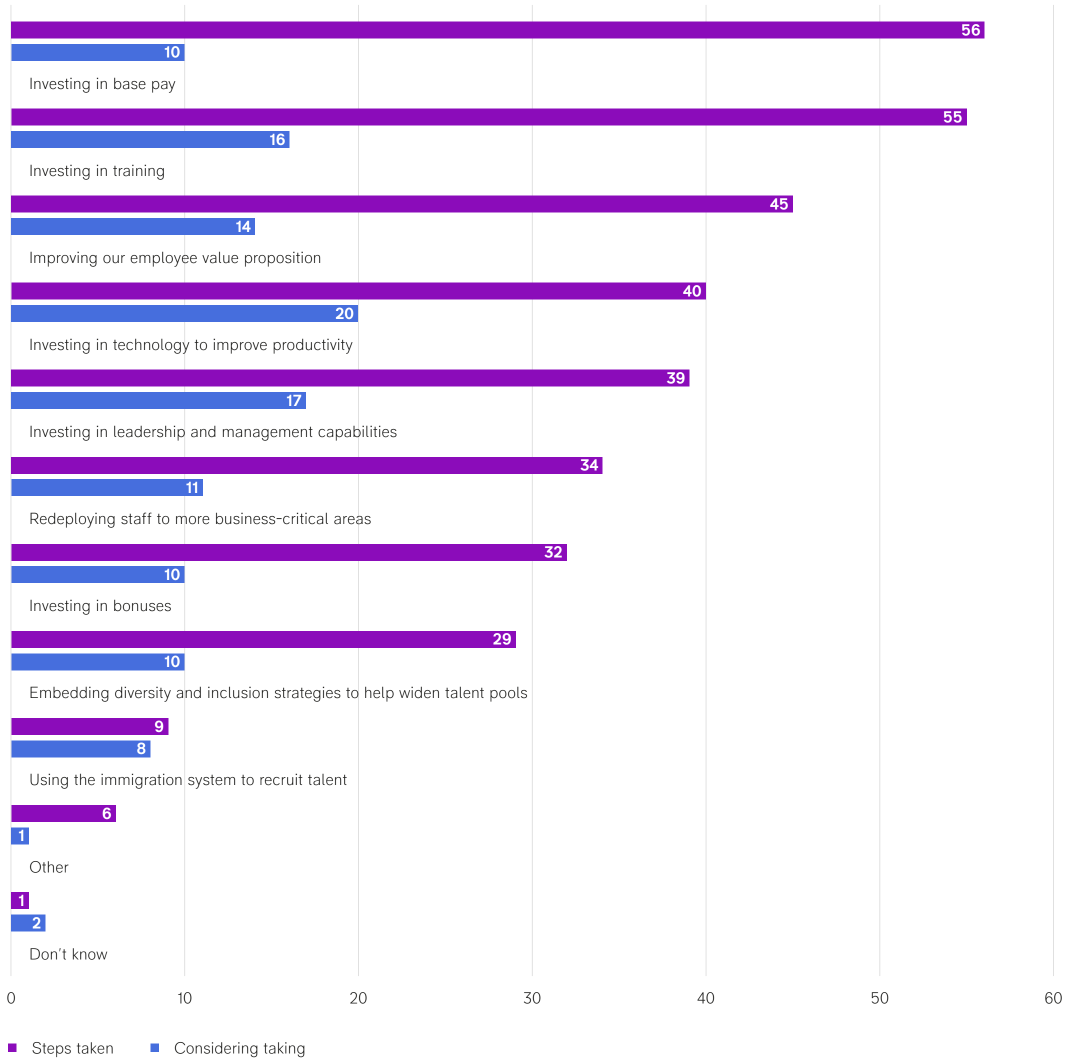


...yet more than half have already invested in base pay and training to help attract and retain talent

Adapting to the reality of on-going labour shortages, businesses have been doing all they can to maximise attractiveness, with more than half (56%) investing in base pay and 45% improving their employee value proposition to compete for talent **(Exhibit 5.2).** Businesses have also been investing in measures to address the structural impact of shortages. More than half of businesses (55%) have invested in training to upskill current employees, and two in five (40%) have invested in technology and automation to improve productivity and reduce reliance on labour.

In the longer term, businesses plan to continue taking similar steps to ease shortages. One in five (20%) are considering investing in technology or automation to improve productivity, one in six (17%) are considering investing in leadership and management capabilities, and a similar proportion (16%) considering investing in training to upskill current employees. This shows that firms are expecting to continue strategies requiring workforce or business investment, with the relative importance of automation adoption increasing as firms expect shortages to persist.

Exhibit 5.2 The steps businesses have taken or are considering taking to ease the impact of labour shortages (% of respondents)



Businesses believe the government should introduce incentives to help them invest in technology and automation to boost productivity

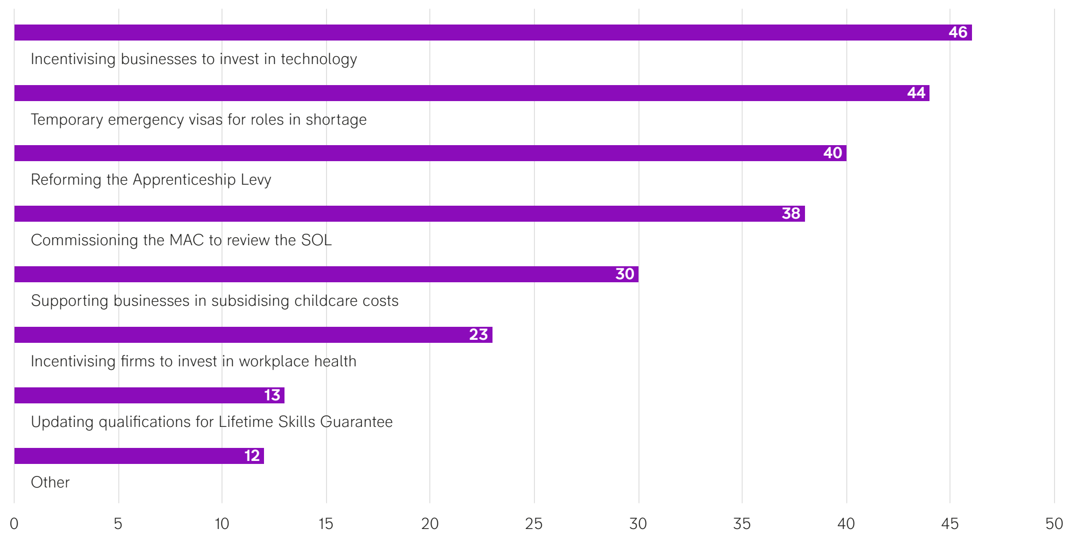
Achieving growth and building a higher-wage economy depends on easing shortages to create the conditions for higher investment. Alongside businesses doing all they can to attract and retain talent, government has an important role in addressing the underlying structural issues contributing to shortages. Businesses believe this requires a range of measures across technology, skills and immigration. Just under half of businesses (46%) believe the government should prioritise introducing incentives to help businesses invest in technology and automation to boost productivity **(Exhibit 5.3).** Innovation and technology adoption are powerful engines for business and productivity growth – with a potential 1.4% productivity uplift possible across sectors through the automation of tasks[31]. This reduces the need for labour in a tight labour market, and has been linked with increased job satisfaction[32], helping firms attract and retain talent, as employers can offer more varied and less repetitive or labour-intensive tasks.

A further two in five firms (40%) believe the government should prioritise reforming the apprenticeship levy to give employers flexibility to spend levy funds on a variety of training to help fill shortage roles. Overly prescriptive Apprenticeship Levy regulation is distorting firms' investment decisions and resulting in inefficient or unused funding. Its reform into a flexible Skills Challenge Fund would better unlock trapped private investment in upskilling and reskilling that helps to avoid shortages growing and meets longer-term skills needs. This would provide full flexibility on skills spend, and support modular training beyond apprenticeships, with any regulated or accredited modular course eligible. Reskilling initiatives are also vital to optimise productivity gains in technology and automation investment. Getting maximum value from new and evolving technology requires skills that are topped-up over a career and learnt via accessible modules, not just full qualifications.

More than two in five (44%) businesses experiencing labour shortages this year would like to see the government grant temporary emergency visas for roles in obvious shortage until a review of the Shortage Occupation List (SOL) is finalised. A further 40% would like the government to commission the independent Migration Advisory Committee (MAC) to immediately review the SOL. Substantive changes to the list of eligible shortage roles have not been made outside of health and social care since before the COVID-19 pandemic and introduction of the points-based system. The government had asked the MAC to provide its recommendations, although the review remains paused. Updating eligible roles on the SOL must be urgently delivered and the MAC should be asked to assess the merit of adding roles at lower skills levels that meet the salary threshold due to severe shortages – as they did with adult social care. Targeted immigration reform that responds to economic need, and flexing the skill threshold where domestic people are not available, would help to ease the most severe shortages to create the space for long-term investments to pay off.

On top of supply side reforms – rising levels of economic inactivity show that 1.7million people would like to work if the barriers to work were removed[33]. With the right interventions, the government could help some of these people into work. This includes action to lower the cost of childcare, while maintaining quality, to ensure working parents are supported to return or remain in the workforce. The UK has the third highest childcare costs and the second lowest in the OECD[34]. It is estimated that 1.7 million women are prevented from taking on more hours of paid work due to the availability and affordability of childcare - resulting in up to £28.2bn lost economic output last year[35]. A review of the whole childcare system should explore support for parents through the existing tax-free childcare offer and provision for 1- and 2-year-olds, alongside the cost of provision for suppliers.

Exhibit 5.3 Measures businesses think the government should prioritise to help ease the impact of shortages (% of respondents)[36]



Investment in the workforce is front and centre as businesses aim to attract and retain talent

With firms struggling to recruit and retain talent, businesses have been investing in a variety of wage and non-wage benefits to ensure they are an employer of choice in a competitive labour market. Improving their employee value proposition (EVP) has been front and centre of firms' employee engagement strategies, as well as ensuring employees have a competitive pay package, with bonus payments a key attraction and retention tool in the past year. Businesses have also been ensuring their employee offer reflects what's become more important to employees over the past year. With inflation and the cost-of-living rising, pay has become a more important driver of engagement alongside hybrid and flexible working practices following changes in post-pandemic working practices to help employees balance home and work life.

Key findings

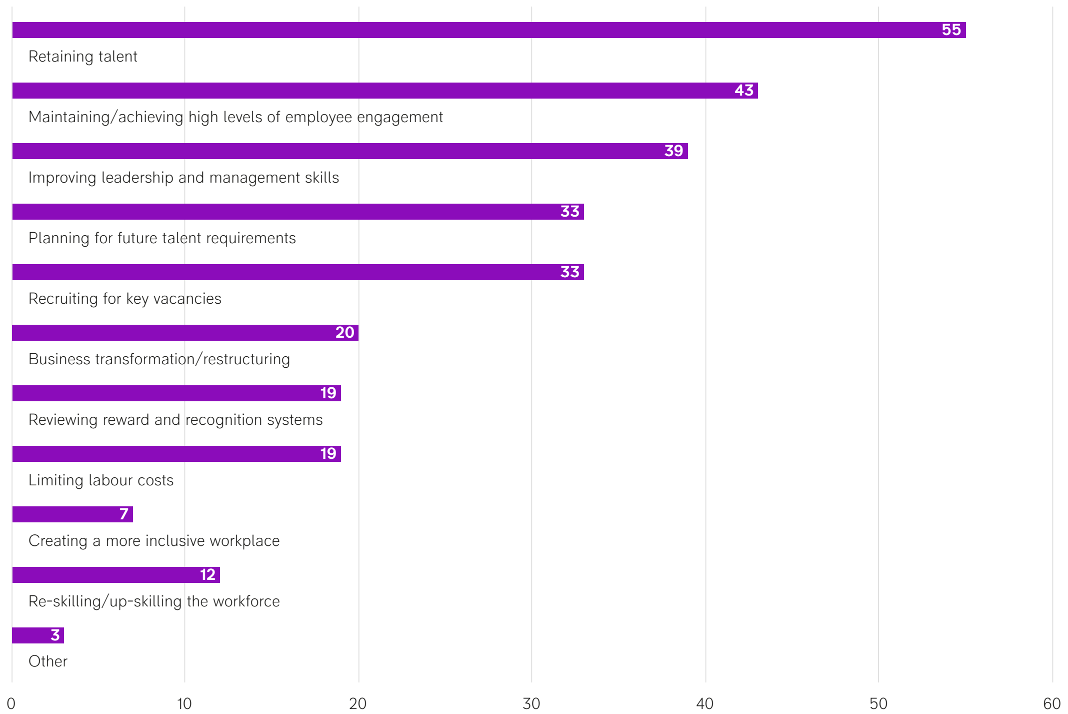
- Looking to the year ahead, businesses expect their top workforce priorities to be retaining talent (55%), maintaining or achieving high levels of employee engagement (43%) and improving leadership and management skills (39%).*
- Effective line management (44%) and pay (43%) are seen as the top drivers of employee engagement.*
- Three-quarters (75%) of businesses say pay has become more important as a driver of employee engagement in the past year, while six in ten (59%) say flexible working practices and just over half (54%) say effective line management has become more important.*
- To improve their EVP, more than six in ten (62%) have invested in basic pay, just over half (51%) have adopted more flexible working patterns, and 51% have focused on developing and communicating a strong purpose and company values.

* 'don't know' responses excluded from the data analysis

Retaining talent is firms' top workforce priority for the next 12 months...

We asked businesses to indicate their top three workforce priorities for the year ahead. As with last year, retaining talent is firms' number one priority with more than half (55%) saying that it will be a key focus for the next 12 months, an increase from 48% in 2021 **(Exhibit 6.1).** Consistent with previous years, achieving or maintaining high levels of employee engagement is also a top priority (43%), as well as improving leadership and management skills (39%). As labour shortages and fierce competition for talent continues across the economy with no clear end in sight, firms are preparing for another year focused on engaging and retaining their people.

Exhibit 6.1 Workforce priorities in the coming year (% of respondents)[37]

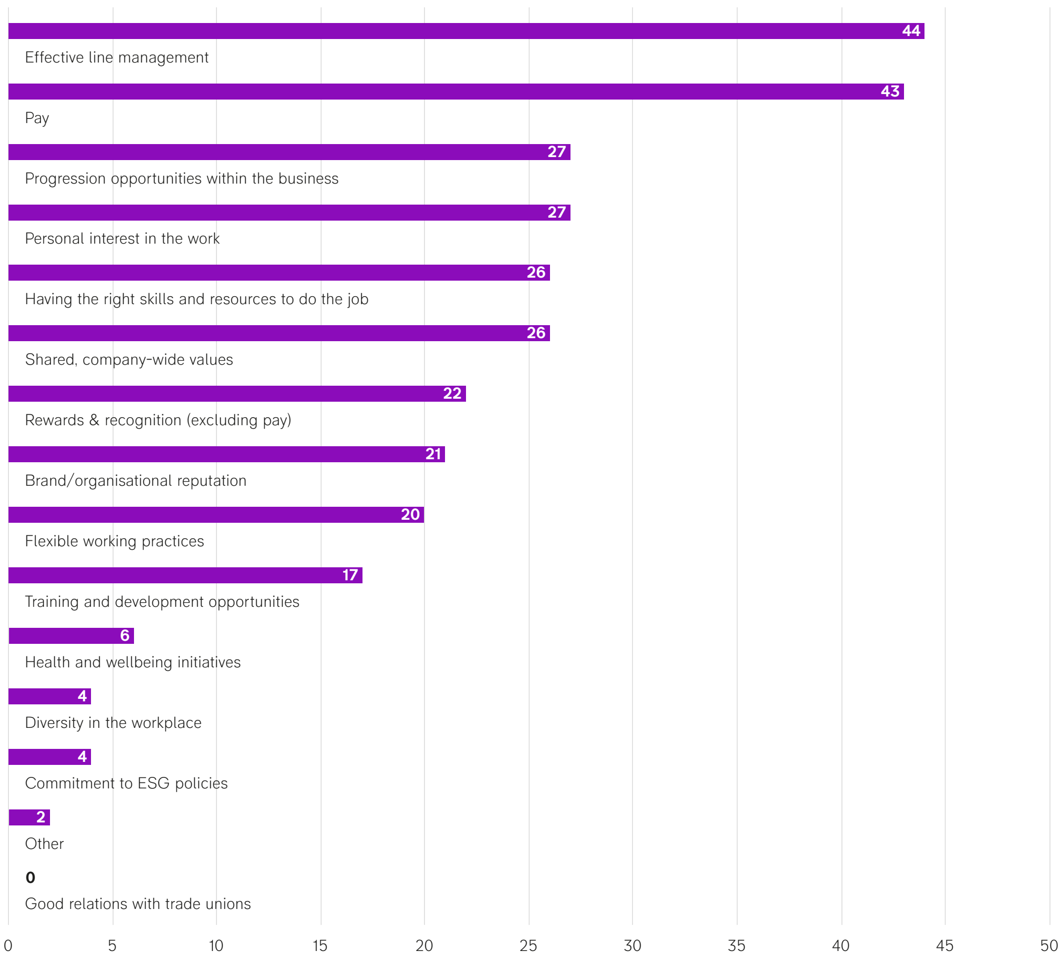


Effective line management continues to be a key driver of employee engagement

We asked businesses to identify the three drivers of employee engagement in their organisation. Nearly half (44%) identified effective line management as the top driver for the sixth year in a row **(Exhibit 6.2).** Businesses understand that improving management skills benefits company performance – with firms in the highest quartile for engaging employees seeing 41% less absenteeism and 22% higher profits than those in the lowest quartile[38]. Managers tend to have the greatest impact on an employee's experience at work, with good management practices playing a crucial role in engagement and retention of staff. Progression opportunities within the business (27%) and personal interest in the work (27%) were identified as the joint third top driver of employee engagement. In the battle to attract and retain talent, identifying and understanding the factors driving employee engagement will help firms succeed.

New this year is the number of firms identifying pay as a key driver (43%) compared to less than one in three last year (29%) - likely a direct response to 40-year high inflation levels pushing up the cost of living.

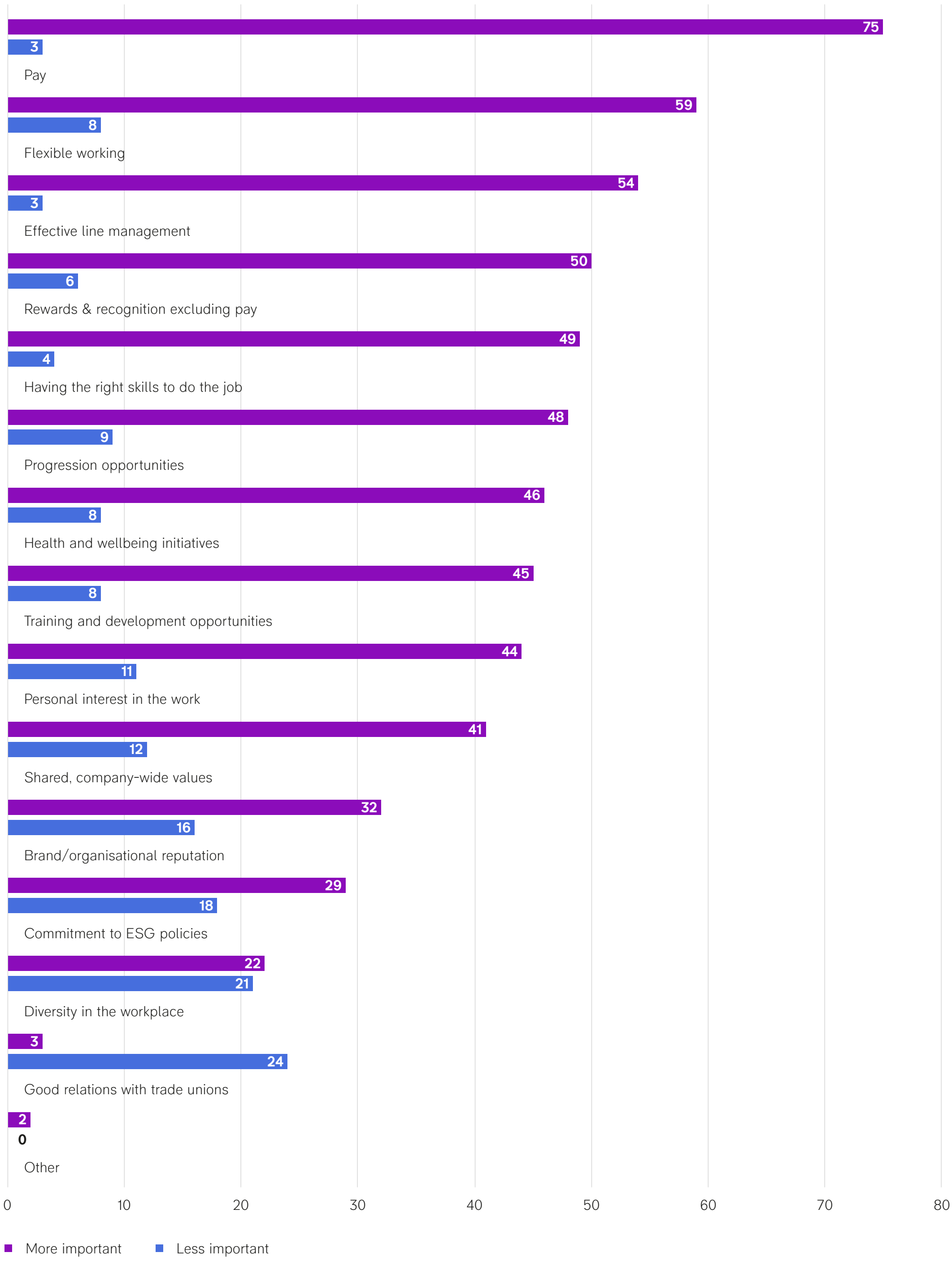
Exhibit 6.2 Key drivers of employee engagement (% of respondents)[39]



Three-quarters of businesses say pay has become a more important driver of employee engagement…

When asked what has become a more important driver of employee engagement in the past 12 months, firms identified a range of measures – pointing to the extent to which businesses have been trying to engage and retain their staff through labour shortages. The number one business response was pay (75%) **(Exhibit 6.3).** With high energy costs and current inflation levels reaching 11.1% (9.4% at the time of asking) it is perhaps not surprising that pay has become a more important means of engagement in the last year. People have been looking to businesses and the government to support them with the increased cost of living, with a rise in industrial action evident across the economy. While businesses have been doing all they can to support employees through the crisis, spikes in inflation and energy costs are also affecting the cost of doing business, making inflation-matching pay rises unaffordable for some. Nearly three in five firms (59%) say that flexible working practices have become more important in the past year as individuals seek greater flexibility at work post-pandemic, while just over half (54%) identify effective line management as more important in the past year too.

Exhibit 6.3 Drivers of employee engagement that have become more or less important in the past year (% of respondents)[40]

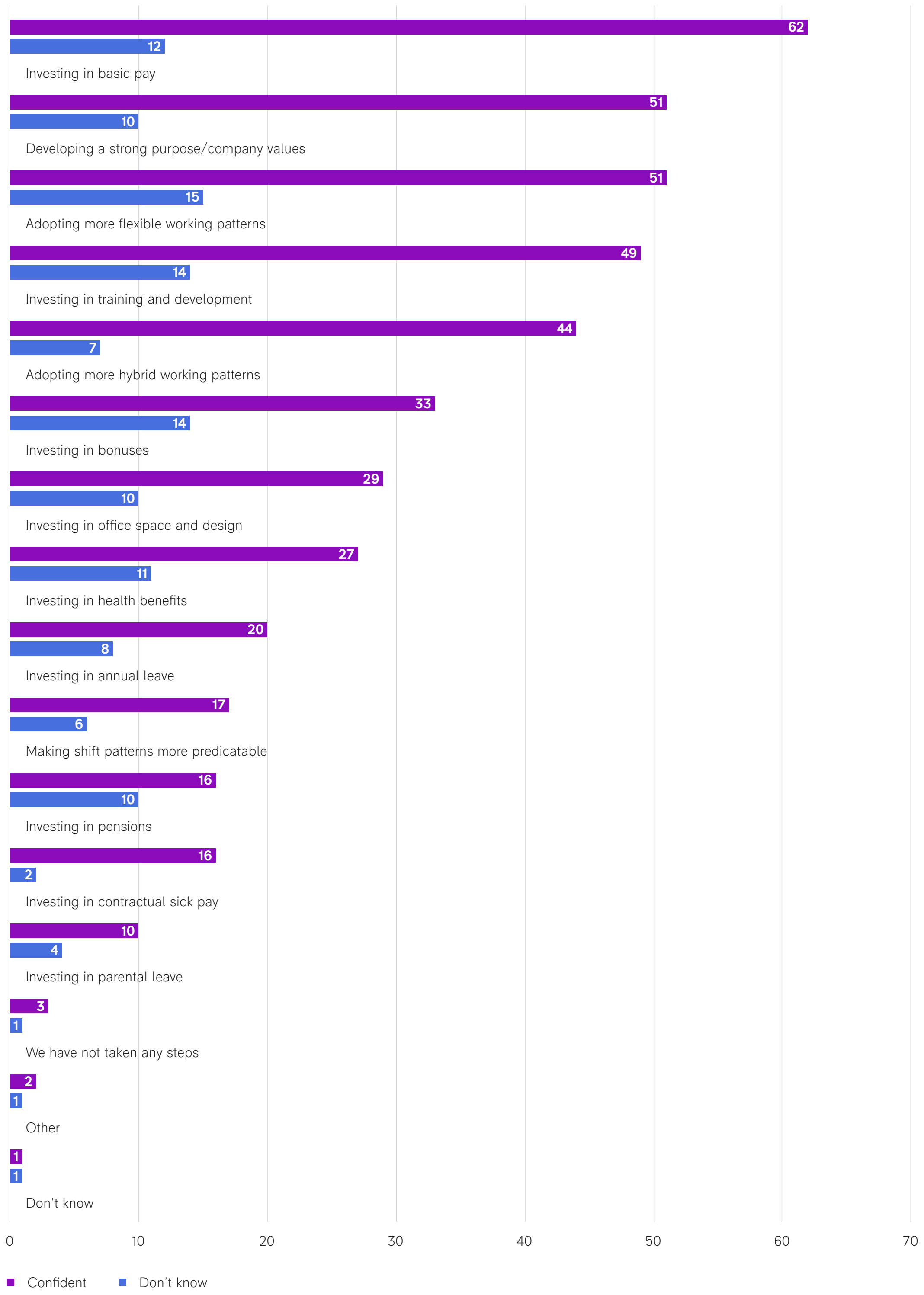


...which is why businesses have prioritised investing in pay to improve their Employee Value Proposition

With shortages biting across the economy, this year we asked businesses what direct steps they have taken or are considering taking to help attract and retain talent. Consistent with pay being the top driver of employee engagement, three in five firms (62%) have invested in base pay to improve their Employee Value Proposition (EVP), with a further 12% considering taking this step **(Exhibit 6.4).**

Half of businesses (51%) say they have prioritised adopting more flexible working patterns to improve their EVP and a further 44% have adopted hybrid working patterns. This reflects wider data showing employees' changing expectations about the way they work post-pandemic, with prospective candidates increasingly prioritising a flexible working pattern when looking for a new job. A recent ONS survey found that the proportion of workers hybrid working has risen to 24%, with the most common hybrid working pattern involving mostly working from home, and sometimes from their usual place of work (42%)[41]. This aligns with results from this survey too - with 43% of respondents where most of their staff can, working in a hybrid way **(Exhibit 7.1)**. Half of firms have also prioritised developing and communicating a strong purpose and company values (51%) and investing in training and development opportunities (49%). Development opportunities are increasingly core to people's expectations at work, with employees actively seeking out opportunities to progress and improve their skills. Doing so requires a flexible skills and training system that allows firms to invest in relevant and accessible modules and short courses that help employees easily top up their skills. Instead of relying on rigid 12-month long programmes, this would boost skills investment, with employers providing more development opportunities to staff to suit changing business needs.

Exhibit 6.4 Steps businesses are taking to improve their EVP (% of respondents)



"75% of businesses believe pay has become more important as a driver of employee engagement in the past year"

Businesses continue trying to find the right balance to maximise the benefits of hybrid working

The pandemic necessitated an overnight revolution in working practices, and since then businesses have been experimenting with new hybrid working patterns. As the impact of hybrid working on different areas of operations becomes clearer, companies are continuing to evaluate their approach as to which days staff are in the office or at home and the extent to which this is required, or not, in different parts of the business. Firms recognise the benefits of hybrid working to attract, engage and retain staff, but also know their approach underpins and needs to optimise operations for business performance. For those that work in a hybrid way, a similar proportion feel they have found the right balance to achieve this as those that want employees to come into the office more often. Looking at the impact of hybrid policies, the picture is mixed. Overall, more companies say the impact on productivity and employee engagement has been positive, but firms are concerned about the negative impact of hybrid working on training and development and company culture. With shortages leaving firms competing for talent, and in an effort to support employees to save money through the cost-of-living crisis, businesses are embracing hybrid and flexible working as a tool to attract and retain talent and support staff.

Key findings

- More than four in ten businesses (43%) where most of their staff can are working in a hybrid way.
- Of those, 37% say it has had a positive impact on productivity and performance, compared to 29% who say it has had a negative impact. Just under half of businesses (47%) say it has had a positive impact on employee engagement, compared to over a third (37%) who said it has had a negative impact. Over a third (34%) say it has had a positive impact on company culture, compared to two in five (40%) who say it has had a negative impact.

- This gives a positive balance of +8% for productivity and performance, +10% (employee engagement), +12% (diversity and inclusion), and a negative balance of -6% for company culture and -20% for training and development opportunities[42].
- Only three in ten (29%) are confident they have found the right balance of hybrid working, while a quarter (26%) say they would like employees to come into the office more often.**

Firms are still experimenting with new working patterns...

With the shock of the pandemic in the rear-view mirror, this year has marked the longest stretch of time that firms been able to operate without Covid-19 restrictions. This has given businesses the opportunity to experiment with different working patterns and evaluate their effectiveness. To understand more about businesses' new working patterns and their confidence in them, this year we asked about the working arrangements they've adopted for most of their employees since Covid-19 restrictions were lifted. More than two in five (43%) said most of their staff work in a hybrid way, one in five (21%) are working full time in the office, and 3% are working full time remotely **(Exhibit 7.1).** Over a quarter of firms (28%) are not able to work in a hybrid way as their business operations require employees onsite. This reflects wider data suggesting that those who can work in a hybrid way, are doing so.

Over the last year, businesses' hybrid working experiments have predominantly focused on striking the right balance of days in the office versus at home, recognising the benefits the office can bring for culture and training, while also wanting arrangements that are attractive to staff and support their working and home lives. Excluding those whose operations mean employees are required onsite, less than a third (29%) say they are operating a hybrid working pattern and confident they have the right balance, while just over a quarter (26%) would like to see their employees come into the office more often **(Exhibit 7.2).** This shows that a similar proportion of firms feel confident they have the right balance of days in the office and at home as those that want employees to come into the office more often. Employers that aren't confident with their approach and would like employees to come into the office more are often hesitant to do so knowing that flexibility is an increasingly core expectation for employees and that losing staff to competitors has even greater impact in a tight labour market.

** 'don't know' and 'not applicable' responses excluded from the data analysis

The cost-of-living crisis is likely to be one of the reasons why hybrid working is important to staff. In an environment where commuting to work means higher transport costs and working from home could lead to increased energy bills, employees are having to weigh up how best to save money. Firms are playing a role to help employees – with many businesses offering more flexibility in working arrangements (34%) as a means to support employees with the cost of living by mitigating commuting costs **(Exhibit 4.3).**

Exhibit 7.1 Working patterns for majority of staff since covid-19 restrictions were lifted (% of respondents)

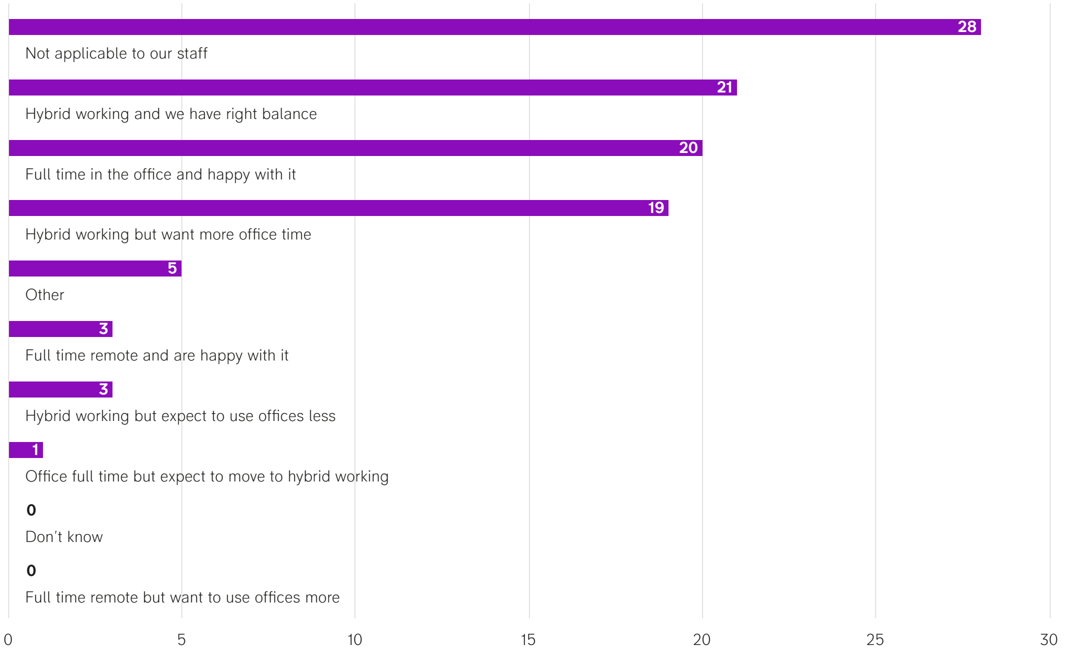
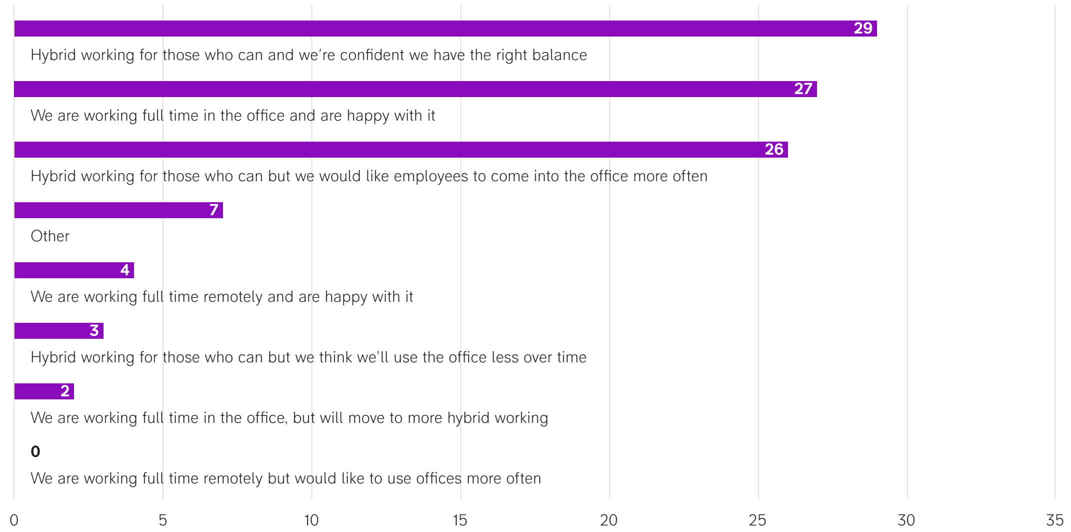


Exhibit 7.2 Working patterns for majority of staff since Covid-19 restrictions were lifted (% of respondents, excluding those who it's not applicable to)[43]



...as hybrid working is seen as having a mixed impact

Confidence in a hybrid working strategy is usually the result of a sustained period of experimentation. From considerations about what technology will help boost collaboration and communication, to establishing what skills employees and managers need to communicate and operate effectively. Over the last two years, businesses have been planning, experimenting, evaluating – making every effort to maximise their approach to hybrid for business performance. To understand how this has affected firms so far, we asked businesses about the ways hybrid working is affecting their business operations.

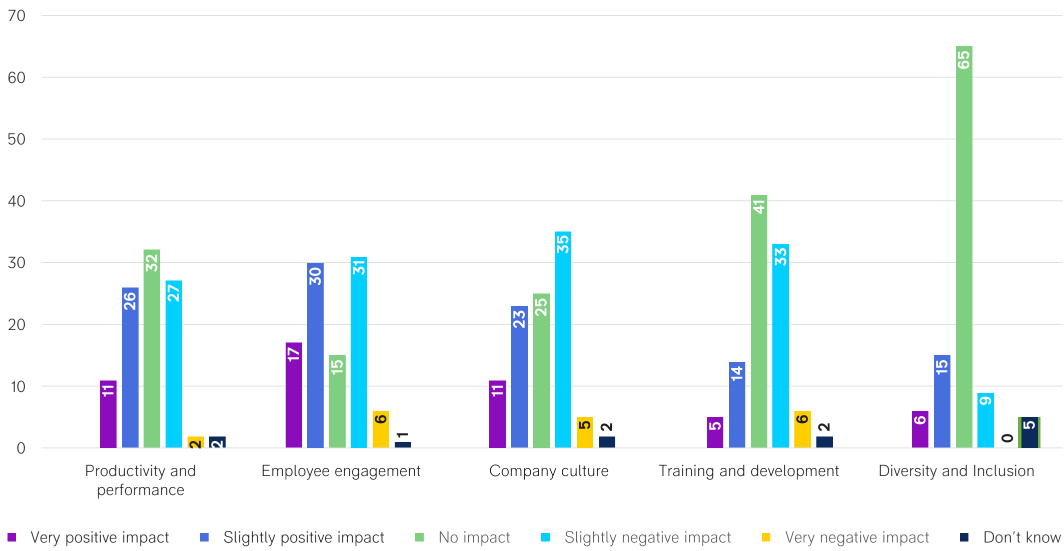
The results are mixed. Looking at the balance of firms' responses overall, +8% believe hybrid working has had a positive impact on productivity and performance compared to a negative impact **(Exhibit 7.3).** This compares to +10% for employee engagement, and +12% for diversity and inclusion. When looking at the breakdown for the impact on productivity and performance, nearly two in five firms (37%) believe it has had a positive impact compared to just under three in ten (29%) that believe it's had a negative impact **(Exhibit 7.4).** Just under a third of businesses (32%) believe it has had no impact. Business' view of the impact of hybrid working on employee engagement is similarly mixed, with just under half (47%) saying it has had a positive impact compared to nearly two in five (37%) that believe it's had a negative impact. For diversity and inclusion, a fifth (21%) believe it has had a positive impact, compared to a tenth (9%) who believe it's had a negative impact. Significantly, two-thirds (65%) believe it has had no impact. While there are more companies who say that the impact on productivity, diversity, and engagement is positive, or has stayed the same, than those who say the impact is negative, this highlights the disparity in firm's experience with hybrid working so far.

More companies believe hybrid working has had a negative impact on training and development and company culture than those that think its impact has been positive. The balance of firms that believe hybrid working has had a positive compared to a negative impact is -6% for company culture, and -20% for training and development opportunities. When looking at the breakdown, fewer than one in five (19%) believe that it's had a positive impact on training and development compared to nearly two in five (39%) that believe it's been negatively impacted. Two-fifths of firms (41%) believe hybrid working has had no impact. This is the most consistent impact cited by firms, in a wider set of responses that indicate a mixed picture.

Similarly, for company culture, two in five (40%) believe it's had a negative impact, compared to a third (34%) who believe it's had a positive impact. A quarter of firms (25%) believe it's had no impact. This accords with anecdotal evidence from CBI members who say that training and development for junior members of staff has been particularly challenging in a hybrid environment. The lack of senior leadership visibility, communication issues and information-sharing around shared objectives has been much harder to replicate in a hybrid environment. Firms have also told us that company culture is harder to build in a hybrid environment, with colleagues having fewer chances to build relationships and develop a sense of loyalty to the organisation – especially important in a tight labour market. Nevertheless, firms want to get hybrid working right, and know they will need to continue to evolve, experiment and evaluate their approach to strike the right balance between flexibility that helps to improve their EVP, while also ensuring that performance and business outcomes are met.

Exhibit 7.3 Positive balance of how firms perceive the impact of hybrid working (% of respondents, excludes no impact)[44]

Exhibit 7.4 Ways in which new working patterns are affecting business operations (% of respondents)



Businesses are putting health and wellbeing at the forefront of their D&I agenda

The pandemic put a renewed focus on the importance of physical and mental health. Since then, the number of people who are economically inactive due to long-term sickness has reached a record high. This combination has put health and wellbeing at the forefront of firms' D&I priorities, with focus also on supporting a multi-generational workforce to retain older workers' skills and experience and reintegrate those who've left the labour market back into work. While the business case for D&I continues to strengthen, company practices remain at very different stages, with many firms still needing to act to improve gender and ethnic equality, as well as social mobility and the experience of disabled employees. It is important that businesses do not lose the progress and momentum they have built by continuing to develop diverse workforces and inclusive workplaces despite economic uncertainty and pressure on company finances. As well as being the right thing to do, broadening talent pipelines by ensuring fair and equal opportunity is a long-term solution for firms to address their labour and skills shortages.

Key findings

- D&I is a priority for nearly nine in ten (87%) businesses. Two thirds (64%) are prioritising supporting health and wellbeing, 38% improving inclusivity and building a culture of belonging, and 37% supporting a multi-generational workforce.*
- Businesses expect health and wellbeing (54%), supporting a multi-generational workforce (40%) and improving inclusivity (36%) to be their D&I priorities in two years' time.*

* 'don't know' responses excluded from the data analysis

- Two-thirds of business (66%) have taken steps to reduce gender pay gaps. A third (33%) have introduced or extended flexible working opportunities, 30% have increased monitoring and data collection to better identify and measure areas for improvement, and 30% have reviewed recruitment practices to widen the pool of applications and reduce bias in selection processes.*
- Three-fifths of businesses (62%) have taken steps to reduce ethnicity pay gaps. A third (33%) have reviewed recruitment practices, just under a third (30%) have increased monitoring and data collection, while a quarter (25%) have introduced or extended flexible working opportunities.*

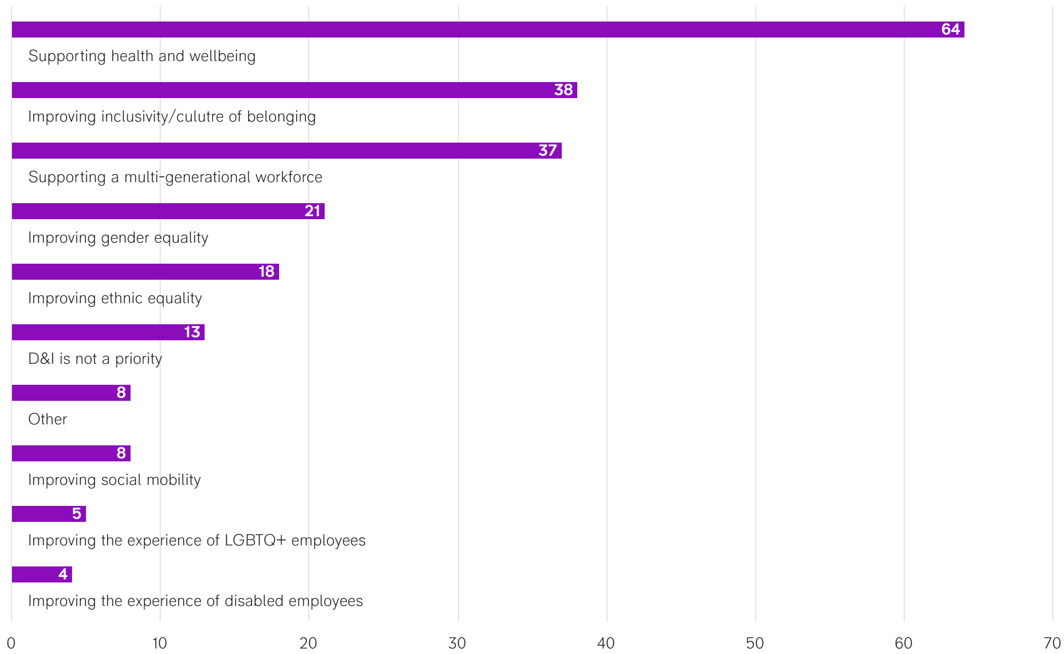
Supporting health and wellbeing is the top priority for firms of all sizes...

Firms have continued to face multiple headwinds this year – from record-breaking inflation and soaring energy prices, to supply chain disruptions and labour shortages. At a time of volatility and uncertainty, D&I could have been deprioritised, but this year's survey reveals that firms remain focused on diversity and inclusion, with nearly nine in ten (87%) businesses saying it is a priority. This is consistent across size too, with 85% of SMEs citing it as a priority.

Supporting health and wellbeing is the top focus, cited by nearly two-thirds (64%) of firms **(Exhibit 8.1).** The pandemic brought health and wellbeing to the fore. Since then, increases in the number of workers reporting a mental illness has likely ensured it remains a priority. For example, in 2022 there have been three times more disabled workers reporting a mental health illness (up to 1.1million people) than there were in 2013, equivalent to 3% of the overall working-age population[45]. Businesses are also aware of the benefits of investing in employee health and wellbeing, including reduced sickness absences[46] and increased likelihood of employees returning to work after periods of sickness[47]. Improved employee health also correlates strongly with higher job satisfaction, which in turn drives business performance[48].

Also among firms' top D&I priorities are improving inclusivity and creating a culture of belonging (38%) and supporting a multi-generational workforce (37%). Around one in five reported improving gender equality (21%) and ethnic equality (18%) as current priorities. This reflects that while firms continue to focus on increasing the representation of women and ethnic minorities, the scope of their D&I strategies are broadening.

Exhibit 8.1 Firms D&I priorities now (% of respondents)[49]

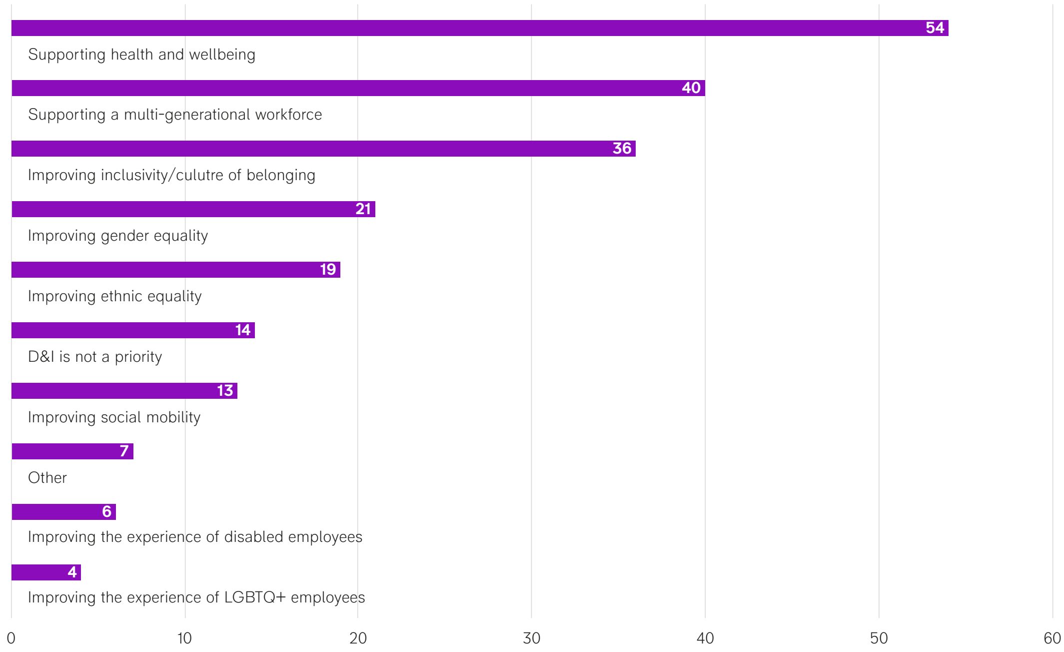


...and remains a high priority in the medium-term

Looking at the next two years, businesses top D&I priorities are the same as their current ones, with slightly greater prioritisation given to supporting a multi-generational workforce. Just over half of firms (54%) expect health and wellbeing to remain their number one priority **(Exhibit 8.2).** Two in five (40%) expect to focus on supporting a multi-generational workforce, and over a third (36%) will be prioritising improving inclusivity and building a culture of belonging.

This reflects that the UK population is ageing and by the mid-2030s half the adult population will be over 50[50]. Economic inactivity rates are already rising, notably driven by those aged 50 to 64 leaving the workforce. Workforce exit rates continuing among this group will exacerbate the impact of UK labour shortages. To meet future skills needs, it will not be enough to primarily recruit younger workers for early-careers and not shape talent strategies to attract older workers. Firms need to embed policies into their workforce strategy to retain and develop older, more experienced workers, and find ways to transfer industry-specific knowledge and networks from these individuals before they retire. The ability of employers to enable older workers to thrive in work for longer and knowledge share with other generations will have an impact on firms' productivity and performance.

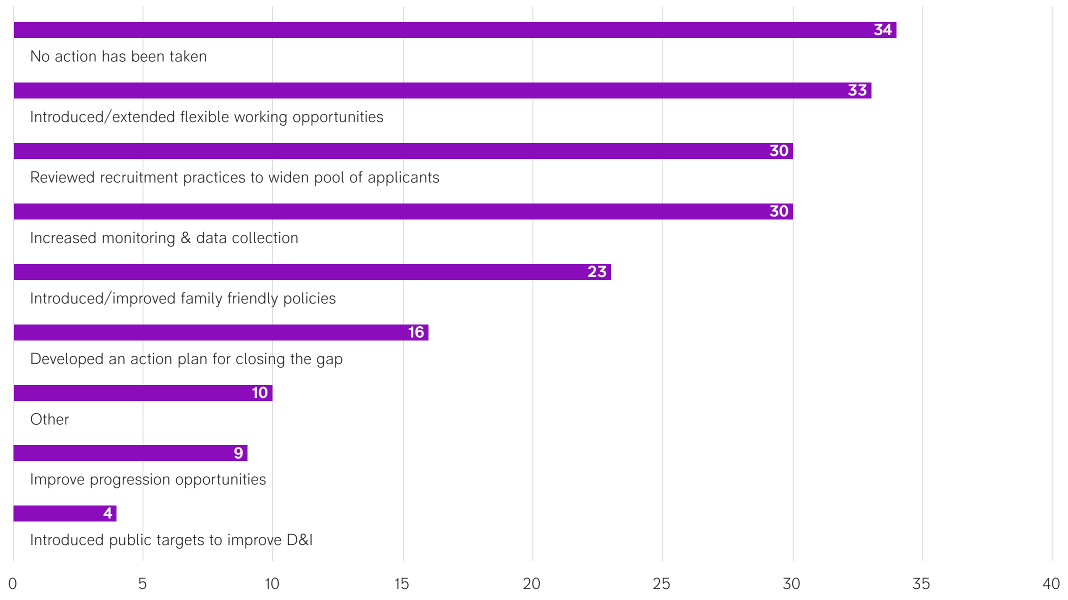
Exhibit 8.2 Firms D&I priorities in two years' time (% of respondents)[51]



Businesses are focusing on flexible working to help reduce gender pay gaps...

Gender pay gap reporting regulation came into force 5 years ago. Since then, the UK's pay gap has narrowed overall, although it saw a slight increase in 2020 due to the pandemic. Women were more vulnerable to Covid-19 related economic effects because of existing gender inequalities, particularly because the virus significantly increased the burden of unpaid care, which is disproportionately carried by women[52]. Nevertheless, businesses are taking action to continue reducing pay gaps, with a third (33%) reporting that they have introduced or extended flexible working opportunities for staff to ensure working hours don't act as a barrier to female participation in the workforce **(Exhibit 8.3).** Businesses are also looking at their internal processes to help reduce gaps, with three in ten (30%) increasing monitoring and data collection to better identify and measure areas for improvement and the same proportion (30%) reviewing recruitment practices to widen the pool of applicants or reduce bias in selection processes. Discouragingly, over a third of businesses (34%) have not taken any action to reduce gender pay gaps, and data from 2021 shows that the UK's gender pay gap rose from 14.9% to 15.4%[53]. This shows that while progress has been made there is still a long way to go.

Exhibit 8.3 Steps businesses are taking to improve reduce gender pay gaps (% of respondents)[54]

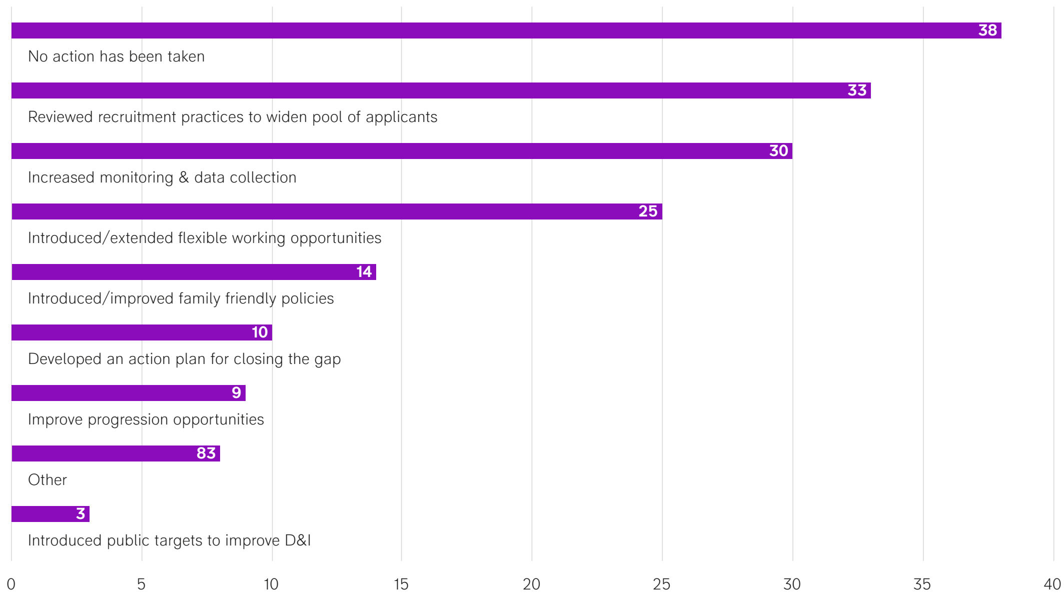


...and are reviewing recruitment practices to reduce ethnicity pay gaps

To reduce ethnicity pay gaps, employers are taking similar steps to those adopted to reduce gender pay gaps. A third (33%) report reviewing recruitment practices to widen the pool of applicants or reduce bias in selection processes **(Exhibit 8.4)**, and three in ten (30%) say they have increased monitoring and data collection to better identify and measure areas for improvement. A further quarter (25%) have introduced or extended flexible working opportunities.

Attracting and supporting ethnic minority employees is an integral part of creating an inclusive workplace. According to Business in the Community, the proportion of black people in leadership positions barely changed between 2015 and 2019, and results from this survey shows that almost two-fifths (38%) have not taken any action to improve ethnicity pay gaps. That's why, businesses support a new mandatory reporting requirement on ethnicity. Reporting can provide a real foundation to better understand and address the obstacles to improving workplace diversity and encourages companies to put greater focus on ethnicity at work. To do so, the government should replicate key aspects of gender pay reporting to make reporting on ethnicity as simple as possible.

Exhibit 8.4 Steps businesses are taking to improve reduce ethnicity pay gaps (% of respondents)[55]



Overview

This year's survey was carried out in the period 16th August to 1 September 2022. There were 325 business respondents in total.

Sectoral analysis

Respondents were drawn from all parts of the private sector **(Exhibit 9.1).** Manufacturing companies made up the largest single grouping (38%), followed by other service activities (13%), and wholesale and retail trade, repair of motor vehicles and motorcycles (10%).

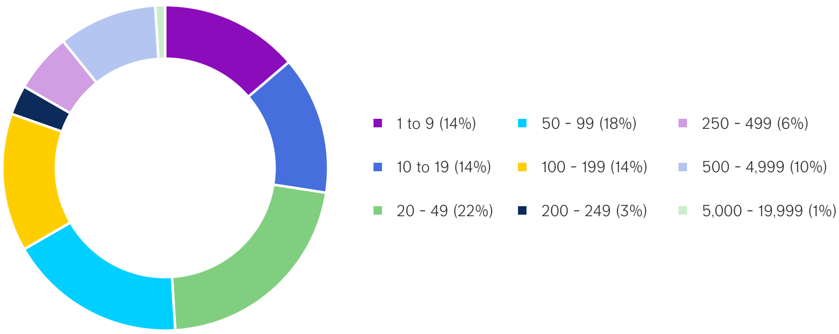
Exhibit 9.1 Respondents by economic sector (%)

Sector	%
Accommodation and food service activity	3
Administrative and support service activities	2
Agriculture, forestry and fishing	2
Arts, entertainment and recreation	2
Construction	5
Education	2
Electricity, gas, steam and air conditioning supply	2
Financial and insurance activities	5
Human health and social work activities	0
Information and communication	3
Manufacturing	38
Mining and quarrying	0
Professional, scientific and technical activities	10
Real estate activities	1
Transportation and storage	3
Water supply, sewage, waste management and remediation activities	0
Wholesale and retail trade, repair of motor vehicles and motorcycles	10
Other service activities	13

Respondents by company size

This year's survey had 83% responses from SMEs (less than 250 employees) and 17% from large firms (250 or more employees) **(Exhibit 9.2).**

Exhibit 9.2 Respondents by company size (%)



Respondents by region

Many respondents had employees based in several regions of the UK **(Exhibit 9.3).** Just over one in six (16%) had employees based in London, with the same number (16%) based in the South East. Just under one in six (14%) of respondents had employees based in the South West and the West Midlands, while one in eight (12%) of respondent companies had employees based in the East Midlands and Yorkshire and Humberside, respectively.

Exhibit 9.3 Map graph


Sorry
WE'RE

References

1. A balance is the difference between the percentage of firms reporting an increase and those reporting a decrease
2. A balance is the difference between the percentage of firms reporting an increase and those reporting a decrease
3. Service Sector Surveys, CBI, August 2022
4. Industrial Trends Survey, CBI/Accenture, October 2022
5. Service Sector Surveys, CBI, August 2022
6. Monetary Policy Report – November 2022, Bank of England, 2022
7. Reasons for workers aged over 50 years leaving employment since the start of the coronavirus pandemic: wave 2, ONS, September 2022
8. A balance is the difference between the percentage of firms reporting an increase and those reporting a decrease
9. A balance is the difference between the percentage of firms reporting an increase and those reporting a decrease
10. A balance is the difference between the percentage of firms reporting an increase and those reporting a decrease
11. These figures exclude 'don't know' responses from the data analysis
12. These figures exclude 'don't know' responses from the data analysis
13. UK skills and productivity in an international context, Department for Business, Innovation and Skills, 2015
14. Seize the Moment, CBI, 2021
15. These figures exclude 'don't know' responses from the data analysis
16. These figures exclude 'don't know' responses from the data analysis
17. Labour Market Overview, Office for National Statistics, October 2022
18. These figures exclude 'don't know' responses from the data analysis
19. These figures exclude 'don't know' responses from the data analysis
20. These figures exclude 'don't know' and 'doesn't affect my business' from the data analysis
21. The National Live Wage Review (2015-2020), Low Pay Commission, 2022
22. These figures exclude 'don't know' and 'doesn't affect my business' from the data analysis
23. Seize the moment, CBI, 2021
24. These figures exclude 'don't know' and 'doesn't affect my business' from the data analysis
25. These figures exclude 'don't know' and 'doesn't affect my business' from the data analysis
26. These figures exclude 'doesn't affect my business' from the data analysis
27. Where are Britain's missing million workers? BBC, January 2022

28. Overcoming shortages: How to create a sustainable labour market, research from CBI Economics and Recruitment & Employment Confederation, 2022
29. These figures exclude 'don't know' responses from the data analysis
30. These figures exclude 'don't know' and 'doesn't affect my business' from the data analysis
31. A Future that works: Automation, Employment, And Productivity, McKinsey Global Institute, 2017
32. Engaging workers as consumers, Deloitte, 2019
33. Labour Market Overview, Office for National Statistics, October 2022
34. Is Childcare Affordable? OECD, June 2020
35. Spring Budget 2022: Childcare & Gender, Women's Budget Group, March 2022
36. These figures exclude 'don't know' responses from the data analysis
37. These figures exclude 'don't know' responses from the data analysis
38. The Relationship Between Engagement at Work and Organisational outcomes, Gallup, 2016
39. These figures exclude 'don't know' responses from the data analysis
40. These figures exclude 'don't know' responses from the data analysis
41. Is hybrid working here to stay?, ONS, 2022
42. A balance is the difference between the percentage of firms reporting an increase and those reporting a decrease
43. These figures exclude 'don't know' and 'doesn't affect my business' from the data analysis
44. A balance is the difference between the percentage of firms reporting an increase and those reporting a decrease
45. Labour Market Outlook Q3 2022, Resolution Foundation, 2022
46. Health and well-being at work, CIPD, 2020
47. Predicting return to work after long-term sickness absence with subjective health complaints: a prospective cohort study, BMC Public Health, 2020
48. Analysis based on J. De Neve, C. Krekel, and G. Ward, Employee Wellbeing, Productivity and Firm Performance (2019); Work and well-being: A global perspective (2018); Global Happiness Council, Global Happiness Policy Report (2018); and Alex Edmans, Does the stock market fully value intangibles? Employee satisfaction and equity prices. (2011)
49. These figures exclude 'don't know' responses from the data analysis
50. Future of an Ageing Population, Government Office for Science, 2016
51. These figures exclude 'don't know' responses from the data analysis
52. Coronavirus: Impact on the Labour Market, House of Commons Library, 2022
53. Gender pay gap in the UK: 2021, Office for National Statistics, 2021
54. These figures exclude 'don't know' responses from the data analysis
55. These figures exclude 'don't know' responses from the data analysis

About the CBI

Founded by Royal Charter in 1965, the CBI is a non-profit business organisation that speaks on behalf of 190,000 UK businesses of all sizes and from across all sectors, employing nearly 7 million people between them. That's about one third of the private workforce. This number is made up of both direct members and our trade association members. We do this because we are a confederation and both classes of membership are equally important to us.

The CBI's mission is to promote the conditions in which businesses of all sizes and sectors in the UK can compete and prosper for the benefit of all. With offices around the UK (including in Scotland, Wales and Northern Ireland) and representation in Brussels, Washington, Beijing and Delhi, the CBI communicates the British business voice around the world.

Our mandate comes from our members who have a direct say in what we do and how we do it

The CBI receives its formal mandate from 9 Regional Councils, 3 National Councils from Scotland, Wales and Northern Ireland plus 16 sector based Standing Committees. These bodies are made up of members in that region, nation or sector who serve a term of office. The chair of each Standing Committee and Regional and National Council sit on the CBI's Chairs' Committee which is ultimately responsible for setting and steering CBI policy positions.

Each quarter this formal engagement process across the CBI Council reaches over 1,000 senior business leaders across 700 of our members who have a direct say in what the CBI do and how they do it, from refreshing their workplan to discussing the key business issues of the day and re-calibrating its influence. Over 80% of the businesses represented on the CBI Council are outside of the FTSE350 as the CBI represents a wide range of sizes and sectors from the UK business community. This formal governance process is supported by a wide range of working groups, roundtables, member meeting and events that makes the CBI unparalleled at listening to and representing British business.

CBI Council in numbers

1000+

Committee and Council representatives

28+

Regional and National Council and sector based Standing Committees

50%

Representatives of the CBI Council at C-Suite level

80%

Of the CBI Council from non-FTSE 350 businesses

To share your views on this topic or ask us a question, contact:

Yusuf Ali-Hassan
Policy Advisor, Immigration, CBI
yusuf.ali-hassan@cbi.org.uk

Product code: 12786

cbi.org.uk