

Qualitative research on firms' adjustments to the minimum wage

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EXECUTIVE SUMMARY

INTRODUCTION

This report presents the findings of a 9-month investigation into the range of actions taken by small firms in response to the National Minimum Wage. Through qualitative case-study research, the aim was to explore not only the way firms have made adjustments to pay structures and to numbers employed, but also the way the National Minimum Wage has shaped firms' product market strategies, employment policies and practices and overall business performance. This broad perspective responds to two concerns in the literature. On the one hand, policy guidelines by the OECD and other bodies suggest that firms may respond to the need to uprate pay by improving workers' skills and shifting into new markets where quality of product or service is the basis of competition. On the other hand, however, several empirical studies suggest that firms face internal and external constraints which may impede their ability to compete in a post-NMW low wage economy. Improved empirical data that disentangles these different issues is of importance both to policy-makers and practitioners and to the wider academic community. It is hoped, therefore, that the evidence reported here will contribute to a better understanding of how the British economy can fully benefit from the NMW, promoting high skill job creation and encouraging sustainable paths of high value-added firm performance among low paying firms.

METHOD OF STUDY

The data is drawn from two stages of case-study research. A first stage involved interviews with the owner, or managing director, of 36 small firms. The firms were selected from six different low paying sectors:

- clothing and footwear manufacture (7 firms)
- hospitality (hotels and restaurants) (7 firms)
- residential care (7 firms)
- retail (7 firms)
- security (6 firms)
- cleaning (2 firms)

In addition, the firms were chosen from three geographical areas in the North West to reflect differences in labour market conditions and prosperity. A second stage involved follow-up interviews with a sample of employees at five of the case-study firms. In total, this involved interviews with 19 workers, male and female, full-time and part-time and representing a range of low paying occupations.

PRODUCT MARKET STRATEGY AND EMPLOYMENT PRACTICES IN THE CASE-STUDY FIRMS

While all 36 firms compete in the low wage part of the British economy, there is substantial diversity in product market strategy and the approach towards managing employment. Most firms operate in a strongly price-competitive environment, especially those in clothing and footwear, residential care and security. Other factors are also important in winning business. Nearly two in three firms identified personal attention to clients and nearly half valued their reputation and reliability as factors contributing to competitive advantage. A minority of firms (slightly more than one in three) competed in niche markets primarily on the basis of product quality. For some,

regular capital investment and product innovation was important, while for others the strategy appeared almost accidental.

Considering our sample of firms' approaches to managing employment, an approximate characterisation shows that only around one in five firms pursue a 'quality-enhancing' approach, compared to more than one in three with a 'cost minimising' approach. The remainder are described as adopting a 'hybrid' approach. These approaches reflect differences in: training provision (with 20 of the 36 firms providing either no training or informal on-the-job training); job promotion and pay advancement (with more than half firms operating a flat rate, or piece rate payment structure); and working time (with less than one in three firms offering flexible working time to meet workers' needs).

MAIN RESULTS

The main results of the report are structured around direct and indirect firm responses to the National Minimum Wage (NMW), as follows:

- Direct response – the impact of the NMW on pay;
- Direct response – the impact of the NMW on employment;
- Indirect response – the impact of the NMW on product market strategy; and,
- Indirect response – the impact of the NMW on employment practices.

Direct response: the impact of the NMW on pay

In 1999 and 2001, slightly more than half our sample of 36 firms were forced to increase the rates paid to their lowest earning workers. We found little evidence regarding use of the youth minimum wage. In 2001, of the 11 firms which employed workers aged 18-21 years old, just 3 firms paid the youth rate compared to 8 firms which paid these workers the adult rate. Part of the reason is a concern to provide equality of employment status to employees carrying out similar work.

Among those firms affected by the minimum wage in 1999 and 2001, slightly more than half did not maintain internal pay differentials between workers paid the NMW and more highly paid workers. Examples of differentials that were maintained include those between chefs and kitchen porters, chambermaids and housekeepers, new recruits and more experienced workers, and non-supervisory and supervisory staff. The reasons for firms not restoring differentials are twofold. First, many firms exercised their managerial prerogative in resisting demands from groups of workers to restore differentials. Secondly, a number of firms employed few workers and did not differentiate their rates of pay. At some nursing homes, there is evidence of sex discrimination in the adjusting of internal pay differentials, since pay rates between the lowest paid and other female-dominated groups were allowed to converge whereas differentials with male-dominated groups were maintained.

Among firms where lowest rates of pay were above the NMW, very few maintained the differential between internal and external rates of pay. Most did not maintain differentials either because they were unable (reflecting the difficulties of increasing

revenue to pay higher rates) or unwilling (reflecting management's desire not to give in to workers' expectations, despite improving profitability).

Direct response – the impact of the NMW on employment

We find very little evidence of an adverse impact of the NMW on employment. Around one in three of the case-study firms experienced falling employment during the period 1998-2002, but this is mainly explained by the complex relationship between product market strategy, changing pressures of competition and profitability. Some firms cut jobs as part of a move into niche markets, some closed establishments to boost profit margins and others reduced their workforce in direct response to declining product demand. Only one firm – a knitwear factory - stated that the NMW was a direct factor leading to job cuts and, ultimately, to closure of the business.

Regarding the change in hours worked, we were unable to collect precise information from all 36 firms. In several cases, especially among the nursing homes, however, hours have been cut in direct response to the NMW. This has involved full-timers being moved onto part-time contracts, as well as the reduction of part-time hours. In other cases, such as the knitwear firms, overall hours worked by homeworkers were reduced.

Finally, only one of the 36 firms had substituted youth workers for adults in order to reduce wage costs by paying at the youth minimum rate.

Indirect response – the impact of the NMW on product market strategy

The NMW potentially has two indirect effects on a firm's product market strategy. First, the NMW sets a benchmark pricing standard within a particular product market since all firms must meet a minimum level of labour costs. In principle, therefore, it seals a mutual understanding between client and provider of the need to pay a reasonable price for a given product or service. Secondly, the NMW may act as a catalyst which encourages firms to shift out of low wage, low skill product markets into niche markets where product quality is valued as a source of competition.

Our data show that evidence of the first type of positive change has been achieved in only a minority of firms. These firms were able to renegotiate prices, despite operating in a strongly price competitive mass market for their product or service, primarily because they had a strong reputation and a core of longstanding clients. However, in the majority of cases firms have not enjoyed increased power to set prices in competitive markets due to four identified constraints:

- the increased willingness of large British retail chains to shop abroad for cheaper products, including clothing and footwear products;
- the inability of individual private nursing and residential homes to alter the pricing structure set by local authorities;
- the unwillingness of many client firms to pay for a higher quality security service; and,
- the continued presence of knitwear and security firms operating in the informal economy.

These four constraints illustrate the way factors *external* to the firm impact negatively on its ability to adjust prices for a given product or service in response to the NMW.

In addition, our data support the notion that the firm's *internal* approach to managing employment may also constrain the ability of the firm to shift into markets that do not involve such strong competition on the basis of price. In particular, there is some evidence of a reinforcing cycle between a firm's cost minimizing employment approach and it being trapped in a price competitive product market.

Regarding the second type of positive change, many high paying firms argued that there was a clear relationship between high pay and their ability to offer a high quality product or service. Indeed, across the 36 firms there is a strong association between firms operating in a niche market and the payment of above-NMW wage rates. We also identified a switch in skill composition among the workforce in some firms as part of a shift to more quality-led product markets, which was prompted by the introduction of the NMW and the increased price of the given product or service. Finally, there are some exceptions to this general pattern, with several firms able to compete in quality-led product markets, despite paying NMW rates.

Indirect response – the impact of the NMW on employment practices

We assess the evidence for change across three areas of employment policy and practice and report the following findings:

- Recruitment and retention

The evidence from the 36 firms is mixed regarding whether the NMW has enabled or hindered firms' ability to recruit and retain staff. In particular, firms which are unable to uprate lowest rates of pay are facing increasing difficulties competing for labour with other low paying employers. This applies especially to those in the residential care sector and the security sector where, for different reasons, firms have found it difficult to raise prices to offset rising labour costs.

- Training and work organisation

Our data show no association between the form of training provision within the firm, on the one hand, and its product market strategy or ability to pay, on the other. In fact, among our sample of firms there is a stronger concentration of firms providing certified training among those operating in price-led markets than those operating in quality-led markets – the opposite to conventional reasoning. This means that increasing pay is not necessarily associated with investment in formal programmes of skill development, or with attention to innovative forms of work organization and multi-skilling. We present four main reasons for this finding:

- Several firms operating in quality-led markets prefer informal training provision because of poor experience with NVQ programmes;
- Some firms operating in quality-led markets prefer to poach skilled workers from competing firms and do not provide any form of in-house training;
- Many firms operating in price-led markets provide formal, certified training because they are required, or encouraged, by external regulatory bodies; and,
- In some firms, certified training is not coupled with innovative work organization which exploits the new skills. This reduces the

possibilities of securing competitive advantage in quality-led product markets.

- Working time

Despite the fact that slightly more than one in three of our 36 firms is characterized by very long working hours (more than 40 per week), we found little evidence that the NMW has acted as an incentive to reduce working hours. Managers blamed matters on a 'long hours culture' among workers. Workers told us of the need to work long hours to make up a decent weekly wage, despite the difficulties of matching long hours with a social life outside work. Reduced working hours were largely associated with firms in the security sector, where rising prices had encouraged clients firms to reduce security cover and switch to use of CCTV and mobile guards.

CONCLUSION

The report concludes by reviewing the data in light of six major policy questions concerning the impact of the NMW on small firm performance and the terms and conditions of employment facing low paid workers. Policy recommendations encompass industrial relations, local government, labour market institutions, industrial policy and include the following:

- action to improve the rights of individual workers in small firms to negotiate regular increases in pay;
- reform of the uprating mechanism of local authority fee structures for patients in nursing and residential care homes to include changes in the NMW and NHS nursing and midwifery pay rates;
- regional support for local districts of manufacturing firms;
- action to modernize small firms' approach to managing employment;
- action to restore employer confidence in the system of National Vocational Qualifications;
- transparent indexation mechanism for the regular uprating of the NMW; and,
- increase in the relative level of the NMW so that long hours are not necessary to make up a decent weekly wage.

Qualitative research on firms' adjustments to the minimum wage

Introduction

This report presents data from qualitative case-study research on the way 36 small firms in the North West of England have responded to the National Minimum Wage. Firms can do more than simply adjust numbers employed in response to the need to increase lowest rates of pay. In principle, firms might also respond with a range of inter-related actions that encompass shifts in product market strategy (diversifying into new markets or strengthening the emphasis on product quality, for example) and changes in employment policies and practices (such as improved training provision or greater opportunities for pay advancement). However, a firm does not take actions in a vacuum. A firm's chosen set of responses are constrained by a range of internal and external conditions, which affect, for example, its ability to pass on higher costs in the form of raised product prices, or its ability to participate in a well-recognised, industry-wide training system. As such, an appreciation of firms' adjustments to the National Minimum Wage in Britain must consider the different product market strategies and employment policies in the context of external pressures on product and labour markets and labour market institutions.

The report is structured as follows. The first section provides a brief review of recent debates concerning the economic impact of a minimum wage and a discussion of how these inter-relate with findings in the human resource management literature concerning the relationship between 'innovative' employment practices and a 'quality enhancing' approach to product market strategy. Section 2 introduces the research method and provides a profile of the sample of firms selected. The data are drawn from interviews with the owner or manager at 36 small firms selected from 6 low paying sectors. A second stage of research involved follow-up interviews with 19 employees at 5 selected firms. The third section describes the general business pressures facing the firms and provides a characterization of product market strategy across the 36 firms, and the fourth section provides an overview of the firms' approach to managing employment. Sections 5 and 6 identify the direct and indirect actions, respectively, taken by firms in response to the introduction, and subsequent increases, of the National Minimum Wage. Section 5 details changes in pay structure and numbers employed. Section 6 assesses the indirect consequences for product market strategy and employment policies and practices. These issues are, as we highlight in section 1, inter-related and therefore we draw out the connections between product market strategy and the firm's approach to managing employment wherever appropriate.

In general, our findings suggest that the National Minimum Wage has played a positive *enabling* role in shaping the way firms have adjusted product market strategy and HR practices. In some cases, the National Minimum Wage has in fact acted as a catalyst for positive change. However, in most cases its influence is hindered, or distorted, by an array of constraining and offsetting pressures faced by firms across the 6 different sectors. If positive transformation in business conditions and employment prospects is an objective for firms in the low wage economy and for the British government, then a raft of supplementary measures, recommendations and policy actions need to be carefully designed and implemented.

1. The National Minimum Wage and employer strategy

To date, evidence from UK-wide data suggests that the introduction of the National Minimum Wage in 1999 was not associated with either job losses or price inflation. Data from the Labour Force Survey show that employment rates for the UK (expressed as headcount and full-time equivalent) for men and women grew steadily during the period 1999-2001. Also, consumer price inflation has registered some of the lowest rates for years, with the retail price index estimated at less than two per cent during each of the years since the minimum wage was established (Riley et al. 2002).

Of course, there are difficulties in separating out the effects of a single policy on the labour and product markets, and the relatively buoyant economy has undoubtedly assisted the positive assessment. As might be expected, closer inspection of employment change by sector reveals a more varied picture. The employer survey carried out by the Low Pay Commission during autumn 2000 showed that among those firms affected by the minimum wage, the sectors most likely to report a significant reduction in staffing were hairdressing, textiles and hospitality (LPC 2001: Figure 3.18). Also, a survey carried out in Northern Ireland found that nearly three in four of the firms reporting direct job losses were in the textiles and clothing sector (Dignan 2001). Hence, there appears to be strong evidence of a sectoral effect, but as with the aggregate figures it is difficult to separate out the impact of the minimum wage from other pressures on numbers employed. Even among low paying sectors most affected by the minimum wage there is diversity in employment change, yet there is little evidence of a marked shock in 1999 when compared to the preceding pattern of change. Indeed, in textiles, for example, it is quite clear that the downward trend in numbers experienced since 1999 is a continuation of pre-1999 decline (LPC 2001).

The evidence at the aggregate level is supported by a number of recent economic studies of the impact of minimum wage policies on employment. These studies draw, on the one hand, on the results of detailed surveys of sample populations of firms and, on the other, the theoretical argument that because most firms act with some degree of monopsony power they can increase wages without having to cut jobs (Card and Krueger 1995, Machin and Manning 1994). For example, Card and Krueger's (1995) evidence from fast-food restaurants in the US suggests that some of the positive employment effects of an increase in the minimum wage are explained by low-wage firms filling their vacancies more quickly and benefiting from lower staff turnover. Crucially, the type of labour market that is in operation here is neither perfectly competitive nor purely monopsonistic, as set out in economics textbooks. Instead, the point is that employers have an important role in shaping the determination of pay in a way that varies from one organization to another:

Different firms might choose to pay different wage rates, depending on the sensitivity of their recruiting efforts to the level of wages. Some firms might choose to offer a lower wage, and to operate with higher vacancies and higher turnover. Others might choose a higher wage, and to operate with lower vacancies and lower turnover. The result of these actions is a persistent range of indeterminacy for wages (Card and Krueger 1995: 12).

Thus, recalling the classic studies by Dunlop (1957), Kerr (1954) and others, Card and Krueger find that there is considerable wage variability even for identical low skill jobs such as hamburger flippers:

We suspect that dynamic [monopsony] models, in which firms set wages to balance their hiring and quit rates, capture the essence of the low-wage market better than do static models, which assume that employers can recruit all the workers they want at the going wage. Dynamic models may also prove useful in explaining the wide variation in wages that is observed for seemingly identical low-wage workers (op. cit: 384).

The key insight underpinning the so-called 'new economics' of the minimum wage is that employer strategy matters. This claim is clearly not new to economics debates. The work of Lester (1946) and Leibenstein (1966) represent early attempts to argue that the relation between wages, productivity and employment 'is not a determinable one': Lester showed from a survey of employers that movements in wages were influenced by employer strategies such as increasing sales efforts and improving management practices; Leibenstein famously argued that there is a social aspect to productivity in the guise of 'X efficiency' factors, including employee motivation and managerial skills. In common with these studies, the recent work on the impact of the minimum wage thus represents an important shift towards an appreciation of the role of employer strategy.

Development of this thesis is greatly assisted by empirical studies carried out in the mainstream human resource management literature. Here, while there is a failure to seek answers to important economic questions regarding pay, productivity and employment, there is detailed empirical analysis of employment policies and practices. This includes themes similar to those highlighted in the work of Card and Krueger, such as a focus on why some firms choose a low wage/ high turnover policy while others prefer a high wage/ low turnover policy, drawing out the implications for employee commitment and firm performance. Choice of HRM approach reflects the outcome of a number of factors. Work by 'situational contingency' theorists suggest that differences in the product market and growth strategies shape the organisation's HRM approach. For example, an organization that adopts an innovative quality enhancement approach to product market strategy will tend to have HR policies that foster worker commitment to quality, improve investment in training and encourage worker autonomy. Organisations that adopt a cost minimization approach will tend to adopt HR practices that reduce unit labour output costs, including use of simple, routine work practices, minimal training and intensive monitoring (Kochan et al. 1984; Schuler and Jackson 1987). Whether the organization is expanding or declining also shapes the HRM approach, with more attention to recruitment and career development among expanding firms and the management of staff turnover and vacancies (to avoid compulsory redundancies) in declining firms (Kochan and Barocci 1985).

There are few studies that directly set out to test the idea that an innovative approach to product market strategy is accompanied by a high commitment HR approach (Michie and Sheehan 1999; Wilkinson 2000). However, there is a great deal of evidence that a high commitment, or innovative, approach to HRM is associated with increased productivity and profitability (Levine 1995; Ichniowski et al. 1996). For example, Huselid's (1995) US national survey shows that annual sales per employee are as much as \$100,000 higher in firms with the 'best' HR practices than they are in firms with the 'worst' (see, also, the survey by Ichniowski 1990). Similarly, a study of US steel plants finds that firms with 'innovative' HRM practices are about 7 per cent more productive than those with more traditional practices

(Ichniowski et al. 1997; see, also, the US studies by Arthur 1994 on steel, Batt 1995 on telecommunications and MacDuffie 1995 on auto-assembly plants).

A potential weakness of these studies is that by neglecting to incorporate data on product market strategy it is difficult to assess the sustainability of the new high productivity route. In particular, it is feasible that a number of innovative HRM policies may be productivity improving, but designed to meet short-term cost objectives. Obvious examples include the use of delayering in the name of fostering greater employee communication but with the side-effect of breaking vertical career ladders and thus endangering the capacity of employees to develop skills along a natural job hierarchy (Grimshaw et al. 2002), or the introduction of teamworking in the name of fostering greater worker collaboration and polyvalency but with the side-effect of intensifying the level of work effort through peer monitoring (Delbridge 1998). Thus while both practices may show up in surveys as reflecting high commitment HR practices and improved productivity, it is not clear in all cases that these add up to an approach to business strategy that is innovative and sustainable. As Sterman et al. (1997) argue, productivity improvements accompanying innovative HRM practices may involve layoffs rather than increased output so that product market innovations that depend on employee initiative may be unsuccessful.

A second, perhaps more obvious, problem with many of these studies is that it is difficult to identify the direction of causality: do innovative HRM policies inspire worker commitment and higher levels of effort, which in turn generate higher productivity, or does high productivity enhance the stability and security of the firm and increase its ability to pay for the costly investment in innovative HRM policies? This problem is minimised by those studies that adopt a longitudinal research design in order to trace the impact of a change in HRM practices on organizational performance (Ichniowski et al. 1996). Nevertheless, these typically involve a single case study so that it is difficult to control for other factors shaping performance (such as improved product market conditions, reduced competition in the industry, etc.).

The issue of how to factor in other pressures and challenges faced by the organization raises a third problem with this literature; that is, the link between HRM strategy and product market strategy may be distorted by a range of other factors internal and external to the organization. For example, employer perceptions of the motivation and capacities of particular groups of workers may limit the choice of HR approach (Beer et al. 1985, Hoque 2000), implying, presumably, that there is the possibility that a cost-reducing HR approach might be combined with a quality enhancing product market strategy where the employer attempts to exploit particular workforce groups. Relatedly, new HRM practices tend to segment workers, building in differential pay and employment conditions, which, as the OECD has recently recognized, may, at a societal level, endanger social cohesion in some countries (OECD 1997). Also, organizations may face difficulties in accessing capital or labour (either because of cost or availability), which restrict their ambitions to branch out into new product markets or to provide a higher quality of services. Changes in the structure of the industry may also hamper efforts to be innovative, especially where this involves low cost competition from firms in other parts of the world. Other 'distorting' factors include the size of the organization, the degree of worker resistance, the level of unemployment, the type of organizational form, or company structure, and the quality of business services).

Overall, while the potential for a strong association between innovative business strategy and high commitment HRM policies is welcomed, empirical assessment of this question must not neglect the range of factors that impinge, both positively and negatively, on this relationship. Awareness of these factors contributes to an understanding of a key question in this literature -- that is, why is there such a limited and slow pace of diffusion of innovative workplace practices? Impediments to diffusion might include workplace resistance (especially in brownfield sites), organizational inertia, low trust industrial relations and Anglo-American financial market pressures (Ichniowski et al. 1996; Kochan and Osterman 1995). A change in any of these features may act as an incentive for an organization to reassess its product market strategy and, in turn, its approach to HRM practices.

The introduction of the National Minimum Wage in 1999 may be considered as an example of radical change in the labour market environment for organizations operating in the UK economy and, as such, may be expected to have forced many organizations, particularly those in low wage sectors, to reassess their overall business strategy. This is the thesis considered by Brown and Crossman (2000) in their analysis of the expected impact of the NMW in the hotel sector drawing on survey results from 1998. They find strong evidence of a strategic approach to HRM (following Hoque 1999, 2000), with 55 per cent of hotels surveyed expecting to adopt a cost minimising approach (to employ more young staff, to cut training and to cut overtime premia, for example), one third with a quality maximization approach (to employ more older staff and to increase training, for example) and just 14 per cent with an 'ad hoc' approach (to increase prices and cut profits). The key contribution of this study is to show that first, there was a significant amount of strategic planning among hotel managers (of all sizes) prior to the NMW and, secondly, that a broad-ranging approach to cost minimization was preferred to direct job cuts. The problem, however, is that the method of analysis (principal component analysis) clusters HR policy responses around cost minimization and quality maximization in the absence of information on product market strategy, such as the desire to differentiate their product or to reduce costs to beat their competitors. It is no surprise, therefore, that the authors find it difficult to explain why more use of agency staff is clustered among HR policies as part of a quality maximization approach (Brown and Crossman 2000: 214). A second limitation of the study is that it does not allow for 'distorting factors'. However, arguably, because the survey was concerned to address expected changes in the future, hotel managers' responses may have implicitly incorporated appropriate controls (such as availability of external training providers, intensified competition, increased rights for part-time workers, and so on).

The Bullock et al. (2001) survey of small and medium-sized businesses in the cleaning and security sectors, conducted in 2000, does explicitly address the impact of the NMW on product market strategy. However, there is no attempt to find an association between product market strategy and a bundle of innovative or traditional HR practices, aside from distinguishing firms into those that increased and those that decreased employment and those with a high, low or zero proportion of the workforce paid the minimum wage (op. cit.: Tables 21 and 23).¹ The results show that although 71 per cent of firms reported no major impact a significant proportion of

¹ This is surprising since the analysis by Wilkinson (2000) explicitly attempts to address this question.

cleaning and security firms reported a change in their way of competing in the product market following the introduction of the minimum wage. The evidence demonstrates a shift to an emphasis on price and cost advantage, as well as a shift to an emphasis on product/service quality, speed of service and creativity. Low paying firms were more likely to change their product market strategy (whether towards a cost minimizing or quality enhancing approach) than firms with no workers on the minimum wage. There is no reported evidence of the links with HR policy, but the study does highlight the fact that business strategy in these two sectors is seriously limited by a number of factors; more than half of all firms (52%) reported lack of skilled labour as a very significant or crucial limitation, one in four firms (24%) cited lack of management skills, one in four cited increased competition (23%) and one in five (21%) the availability and cost of finance for expansion (op. cit.: Table 18, own calculations). Thus, while the minimum wage has had some impact on product market strategy (both towards cost minimizing and quality enhancing) security and cleaning firms face serious constraints on their ability to pursue these objectives. As such, if the NMW is to trigger high road competitive strategies there is a need to address these constraints in order to improve firm capabilities in the ways they manage and compete (op. cit.).

In an effort to build on these insights and in an attempt to provide a more holistic analysis of firms' approaches to product market and employment issues, the research reported here addresses three broad areas of enquiry. The first concerns the extent to which firms respond to the National Minimum Wage (NMW) by adapting prices and the overall impact on business performance. The second issue concerns the way firms respond to the NMW by changes in HR policy, including adapting numbers employed, working time and change in employment contracts. The third issue deals with efforts to improve productivity in response to the minimum wage, including efforts to move into high quality product markets, new investment in technology and innovative forms of work organization.

2. Method of research and sample profile

This project focuses on the impact of the National Minimum Wage on small firms in six low paying sectors:

- clothing and footwear manufacture
- hospitality (hotels and restaurants)
- residential care
- retail
- security
- cleaning

The project involved two stages of research: a first stage involving interviews with the managing director or owner in each firm; and a second stage involving interviews with a small sample of employees in one firm in each sector. The original intention was to visit 7 firms from each of the six sectors. Ultimately, we only achieved a sample of 36 firms, not 42. The main problem was that gaining access to small cleaning firms proved extraordinarily difficult, largely because owners spend much of their time meeting the demand for cleaning services by personally carrying out the work and, as a result, have very little time to spare. Overall, then, our first stage of

research consists of seven firms from four sectors (clothing and knitwear, retail, residential care and hospitality), six firms from the security sector and just two firms from the cleaning sector. In order to assess the potential significance of locality, the firms were selected from three different geographical districts in the North West of England, chosen to reflect differences in prosperity and levels of unemployment (see below). Firms were selected randomly using local Yellow Pages business listings for each area. For the second stage of research we conducted interviews with employees in one firm in five of the six sectors; the security sector proved impossible due to the problem of not being able to interview security guards at their place of work – since we were not able to enter buildings where they were providing security cover.

A breakdown of the sample in terms of sector and total number of employees is shown in Table 2.1. Clearly our intention is not to generate results that are nationally representative. Instead, the intention is to provide a detailed assessment of the particular dynamic relationships at the level of the firm and to identify those factors (typically not visible from a broad survey approach) that shape the range of employer actions in response to the National Minimum Wage. Appendix Tables 1 and 2 provide more details on the 36 case-study firms and the five selected for more detailed study.

Table 2.1. The 36 case study firms

	Total	Cleaning	Clothing and footwear	Hospitality	Residential care	Retail	Security
Total	36	2	7	7	7	7	6
<i>Workforce size</i>							
1-10	9	1	2	2	0	4	0
11-24	3	0	1	1	0	0	1
25-49	12	0	2	1	4	3	2
50-99	4	0	1	0	2	0	1
100+	8	1	1	3	1	0	2
<i>Sales revenue</i>							
< £0.5m	14	1	3	3	3	3	1
£0.5m-£1m	6	0	2	0	2	0	2
> £1m	16	1	2	4	2	4	3
<i>No. of establishments</i>							
1	25	2	7	5	5	3	3
2	8	0	0	2	1	3	2
3+	3	0	0	0	1	1	1
<i>Age of firm</i>							
0-5 years	7	1	0	3	1	0	2
6-9 years	1	0	0	0	0	1	0
10-19 years	14	0	3	1	6	2	2
20+ years	14	1	4	3	0	4	2

Within and between sectors, there is variation in the sample of firms by size of workforce, sales revenue, number of establishments and the age of the business. The size of the workforce ranges from just 2 (a retail firm) to 370 (a cleaning firm). Annual sales turnover also varies significantly from £50,000 at one of the cleaning firms to £5-£6 million at the largest footwear manufacturer. Of all firms, 11 had more than one establishment, and of these one residential care home owner, one retail firm and one security firm each had three establishments

The firms were selected from three different geographical districts in the North West: Manchester and Salford; Rossendale and Burnley; and Macclesfield, Cheshire. These three districts reflect a high level of variation in levels of labour market participation, as well as significant differences in average earnings. The city centers of Manchester and Salford are characterized by low levels of labour market participation and high shares of the working-age population registered as long-term benefit claimants or benefiting from income support (Table 2.2). By contrast, Macclesfield has a relatively high level of labour market participation and the Burnley/Rossendale district falls somewhere in between. Average earnings data for the broader regions of Greater Manchester, Lancashire and Cheshire suggest that it is the Burnley/Rossendale district (within Lancashire) where we find the lowest average pay, both among male and female workers, as well as the lowest level of pay at the first decile of workers (Table 2.3). Across the three districts, therefore, we expect to see differences both in the pressures arising from levels of unemployment and the available labour supply among the inactive working-age population, as well as differences in the wage structure, particularly at the bottom end.

Table 2.2. Labour market activity in three geographical districts

	<i>Economically active 1999-00</i>	<i>% long-term benefit claimants</i>	<i>% income support beneficiaries</i>
Macclesfield	81.9%	9.0%	6%
Burnley	76.6%	6.7%	13%
Rossendale	76.0%	7.4%	12%
Manchester	66.3%	22.7%	20%
Salford	70.6%	14.6%	16%
North West	76.0%	18.0%	12%
UK	78.5%	19.7%	10%

Source: Office for National Statistics

Table 2.3. Pay and employment in three geographical districts

	<i>Employment rate</i>	<i>ILO unemployment rate</i>	<i>Average gross weekly full-time earnings, April 2000 (£)</i>					
			<i>Men total</i>	<i>Men D1</i>	<i>Men D9</i>	<i>Women total</i>	<i>Women D1</i>	<i>Women D9</i>
UK	73.8%	6.0%	452	219	725	337	177	534
North West	71.1%	6.6%	429	214	672	313	173	497
Cheshire	77.1%	3.4%	454	222	708	312	170	487
Lancs	75.2%	5.5%	424	211	623	303	165	492
Greater Manchester	71.1%	6.8%	428	216	673	318	180	499

Source: Office for National Statistics

The firms selected in the hotels and restaurants sector include one hotel from the Macclesfield area and one hotel and five restaurants from Manchester/Salford (see Table 2.4). Two of the businesses have two establishments. They range in size from 8 employees to 87. Apart from the Indian restaurant where all the employees are men, there is a mix of male and female employees. However, women predominate among waiting staff, cleaners and receptionists whereas the hotel and restaurant kitchens are staffed exclusively by men. All the businesses employ a mix of full-time and part-time staff.

The residential care homes include two in Manchester/Salford, two in the Macclesfield area and three in Burnley/Rossendale. Two of the businesses have more than one establishment. They range in size from 25 to 125 employees. In all the establishments the majority of staff are female and in one of them the majority work part-time.

Three of the security firms selected are in the Manchester/Salford areas and three in Macclesfield. Three of the businesses have more than one establishment. They range in size from 13 to 170 employees. The vast majority of the security guards are male, and work full time (mostly nights and weekends). Many work very long hours, up to around 70 per week.

All of the retail establishments selected are situated in the Manchester/Salford areas, although two of them have outlets in other areas. They comprise a diverse range of retail outlets, including one with an on-site bakery and one with a mail order business. They range in size from 2 to 41 employees with a mix of full-time and part-time staff. In the menswear outlet all the shop staff are male. In the golf retail and mail order business, and the delicatessen/bakery the majority are male (including all the warehouse staff in the former, and all the bakers and delivery drivers in the latter).

The three footwear manufacturers are all situated in the Rossendale Valley. One specialises in slipper manufacture, one in women's shoes and one in dance and bridal shoes. They range in size from 24 to 250 employees, most of whom work full-time. There is a mix of male and female employees, but women predominate in the sewing and finishing areas, with other areas such as cutting and lasting staffed predominantly by men. The four clothing companies are all knitwear manufacturers located in the central area of Manchester, where there are more than 100 small knitwear manufacturers – largely Pakistani owned. Three were founded in the 1980s and one in 1974 and all four adjust numbers employed according to seasonal changes in demand for the product. Knitwear1 and Knitwear4 were both closed when we visited but expected to be operating again before the start of the summer with around ten and five employees, respectively. The majority of employees in these factories are recent immigrants – mainly from Pakistan, India and Bangladesh, but with new recruits from Afghanistan also. All workers work at least a full-time week of 40 hours, with most – especially the men – working in excess of 60 hours.

The two cleaning firms include a small business offering a domestic cleaning service in Manchester/Salford, which employs six women who work part-time hours, and a larger business – with 370 employees - which provides cleaning services to large client firms, again located in the Manchester/Salford area.

Table 2.4. Sample of firms by geographical district

	<i>Total</i>	<i>Cleaning</i>	<i>Clothing and footwear</i>	<i>Hospitality</i>	<i>Residential care</i>	<i>Retail</i>	<i>Security</i>
Manchester/Salford	24	2	4	6	2	7	3
Rossendale/Burnley	6	0	3	0	3	0	0
Macclesfield	6	0	0	1	2	0	3

3. Business pressures and product market strategy in the case-study firms

In this section we begin by providing an overview of the main business and economic pressures facing each sector and identify successful, steady and falling performance among the case study firms. This is followed by a more detailed analysis of business performance and product market strategy in the 36 case-study firms. Throughout we draw on interview data and other forms of documentation collected as part of our research.

3.1. Business pressures across the six sectors

Clothing and Footwear

The footwear industry in the UK, including the Rossendale Valley, has declined dramatically in recent years. There is now only a handful of firms in Rossendale which actually make footwear. Of the surviving businesses most have become wholesalers and distributors or cash and carry factory outlets selling direct to the public. The reason for this decline has been cheap imports from both Europe and the Far East. As the number of manufacturers has decreased the industrial infrastructure, including machinery supply and maintenance, has also shrunk, and whereas the industry originally evolved from local textile manufacturing, most raw materials now come from abroad. All three firms in our sample have survived by establishing niche markets - Footwear1 specialises in wide-fitting shoes for older women, Footwear2 in machine washable slippers particularly suitable for the elderly care home resident, and Footwear3 in dance and bridal shoes. Footwear3 sold off the slipper making part of its business two and a half years ago to concentrate on the part of the market which faces no foreign competition and in doing so managed to turn a loss making business into a profitable one.

The UK knitwear industry is concentrated in the North West with seventy five percent of firms located in three districts of central Manchester. The firms are all Pakistani, Bangladeshi and Indian owned and rely on a workforce of mainly recent immigrants prepared to work for long hours on low pay. As with the footwear industry, the firms face competition from overseas, particularly Eastern Europe. Production techniques remain largely outdated and the industry is geared to output rather than productivity.

Although there have been recent initiatives to streamline the production process, and to enable the manufacturers to deal direct with the large clothing retailers rather than through agents, all four companies in our sample are struggling on very low margins and one faces imminent closure.

Retail

The main business pressures identified by the retail sector firms were the high costs of city centre leases and competition from out of town shopping centres. The owners felt that neither the city councils nor the out of town centres were keen to attract independent retailers, relying on the multiples instead.

The successful retailers competed on quality of goods and service and by serving a 'niche' market distinct from the multiple chains. In our sample the shoe retailer (Retail1), furniture retailer (Retail 6) and leather goods shop (Retail 7) had city centre outlets. Retail 1 and Retail 7 also had outlets in nearby towns. The success of these businesses was attributed to high quality merchandise and attentive service. Retail3 (card and gift shop) also specialises in more unusual 'upmarket' merchandise. It had a city centre outlet until quite recently, but the high cost of a new lease had forced the owner to move the business to the suburbs. A further outlet has now been opened in another city where the authorities are seen as more sympathetic towards independent retailers. Retail2 (the delicatessen/bakery) also competes on the quality of its produce. Its main competitors are the large supermarkets, which can sell at lower prices, but the owner of Retail2 clearly regards the supermarket product as vastly inferior. Although the golf equipment retailer (Retail4) has recently closed one of its two shops, this has been compensated for by an expansion of its extremely successful mail order business. Retail5 is a menswear outlet that has been owned by the same family for over one hundred years. It has also recently closed one of its two shops, but this decision was made because of a lucrative offer for the premises, rather than a downturn in business.

Residential Care Homes

This sector has received much recent press coverage as home closures have forced elderly residents to move homes. The cost of maintaining large, often very old buildings has prompted some owners to sell their homes for development. In addition, regulations stipulating minimum standards of accommodation (such as private rooms, en-suite bathrooms) have involved costly renovation work. This is made more difficult by the fact that some of the homes are listed buildings, and this places restrictions on the amount and type of renovation that can be carried out. In many homes the majority of residents are funded by local authorities. Fees paid (around £350 per week) cannot be increased in practice and have not risen in line with costs. Staff recruitment problems are exacerbated by the national shortage of qualified nurses. For care assistants the homes compete with other sectors, particularly supermarkets, which pay higher rates for jobs that are seen as less demanding and stressful.

In our sample, Home1 had been affected by all the above factors, although the main problem here was under-occupancy, and lack of financial backing for the required renovations. In fact the situation was so bad that the owner had decided to sell the home and retire. At the other end of the scale Home6 is a partly purpose-built home with modern facilities situated in a very affluent area. The decision by the owner to

purchase a property in this particular area and to accept only privately-funded residents means that the home, unlike the others in the sample, does not face the problems created by the low level of local authority fees. This home has a waiting list for residents, as does Home5, another purpose-built home. However Home5 has recently de-registered as a nursing home, and now only accepts residents who have been assessed as not needing nursing care. This decision was prompted mainly by a shortage of suitable qualified nursing staff. All the other homes were managing to stay in business as nursing homes but most had some difficulties. Problems of staff shortages had been partly solved by recruitment of overseas nurses, and providing working arrangements that are more 'family friendly' (including negotiation of flexible part-time hours) than those offered by the NHS.

Hospitality

The recent proliferation of new restaurants, especially in city centres, is one of the biggest pressures faced by the owners of small, independent restaurants. As in the retail sector, the multiples, or chain restaurants have more 'buying power' to obtain suitable premises. Another problem identified by some of the owners in our sample was the failure of the local authority to provide a suitable infrastructure, including parking facilities. Similarly, the hotel sector has faced stiff competition from the newly built low price 'chain' hotels such as Travel Inns.

Restaurants1, 2 and 3 and 5 in our sample competed with the 'chain' restaurants on the superior quality of their food and service. None of them claimed to be cheap, rather they placed themselves in the mid-price range, but all said they offered good value for money. One important aspect of quality was that they all produced dishes from fresh produce rather than using partly prepared, bought in ingredients. Restaurants2 and 3 have recently opened new premises and Restaurant1 is about to do so. Restaurant4 is in a rather different position in that it competes with the large number of other Indian restaurants in the area. The manager complained that the local authority has granted too many planning applications in recent years so that the area has now reached 'saturation point' with an increasing number of restaurants serving the same customer base. Many of these restaurants are offering meals at extremely cheap prices so that Restaurant4, although long established, and with a good reputation for quality, reported falling profits in recent years. Hotel1 in our sample is a historic building with a new extension situated in a prosperous Cheshire village. A particularly profitable part of the business is the function side, especially wedding receptions. However, a decline in restaurant bookings during the week has prompted the owners to start offering low priced lunches for pensioners. On the other hand, Hotel2 is a sixties-built hotel in Manchester/Salford. It struggles to compete with the low price chain hotels which, being more recently built, offer superior room facilities. Even though Hotel2 offers the facilities of a 'full service' hotel, business is declining and a large proportion of its guests are construction site workers. The manager is so pessimistic about the hotel's prospects that he has recommended to the owners that they sell the site for housing development.

Security

The security industry is characterised by low pay and a (predominantly male) workforce prepared to work very long hours to bring their pay to an acceptable level. One of the problems the industry faces is the refusal of some client companies to recognise the importance of a high quality security service, preferring instead to give

the contract to the lowest bidder. This is exacerbated by the fact that many security firms operate illegally paying 'cash in hand' at rates below the minimum wage to security guards who continue to claim benefits. This goes undetected because most security work is night work, although forthcoming legislation requiring the compulsory registration of security guards should alleviate this problem. The industry is associated with a high level of staff turnover and some managers reported a problem finding reliable 'good quality' staff who were prepared to undertake what is a very responsible and potentially dangerous job for such a low wage.

All the firms in our sample are reputable businesses operating within the law. Difficulty competing on price means that they have to offer a superior service. Many said that they offered a more personal service than the big, national security companies as the manager was readily available to sort out any problems. Although most companies offered a range of security services there was some specialisation (e.g. hospital security, dog handling). Security6 has moved into the wider area of building management, supplying building services officers who also undertake front-of-house duties in multi-tenancy office blocks.

Cleaning

Long hours of work, particularly in professional and managerial occupations and the rise in 'dual earner' households has seen a rise in the demand for domestic cleaning services. Although much of this work is carried out by self-employed individuals, a number of small businesses employ cleaners to do a range of domestic work which may even include such tasks as ironing, changing beds and defrosting freezers. The promise of a reliable service, with 'properly vetted and insured staff' means that, in practice, the business owners themselves often have to step in to provide the service.

Cleaning1 is one such small business. It was started just over a year ago with the owner herself doing all the cleaning, has now expanded to employ six cleaners and has 40 houses on the books. The owner admits her prices are higher than other similar firms but claims to provide a superior service, personally checking the houses herself. She has plans to expand into a wider geographical location and include other services such as dog-walking, decorating and gardening.

In contrast Cleaning2 is a larger, older established business with contracts for cleaning offices, small factories and educational premises. It does not undertake any domestic work at all. Its prices have to be competitive, especially to gain a contract initially, but it also competes on its good reputation for quality of service and reliability. The company does have some difficulty finding cleaners especially in the more affluent areas where there are fewer people prepared to do the work and where domestic cleaning work is plentiful, better paid and seen by many as a more pleasant alternative.

3.2. Characterising product market strategy

Table 3.1. Main characteristics of product market strategy

	<i>Total</i>	<i>Business performance (profitability over last five years):</i>		
		<i>Increased</i>	<i>Stable</i>	<i>Decreased</i>
Price	26	7	7	12
Personal attention to client needs	22	9	8	5
Mass market	22	6	5	11
Product quality	19	9	9	1
Niche market	15	7	7	1
Established reputation/reliability	14	5	7	2
Product design	9	4	4	1
Diversification	4	2	1	1
New capital investment	3	0	3	0
<i>Total firms (N)</i>	36	12	12	12

Notes: Each firm adopts a combination of product market strategies, so that the numbers in each column do not add to the number given in the bottom 'total' row.

Source: see Appendix Table 3 for more details.

By way of summary, Table 3.1 lists the main characteristics of the product market strategy adopted across the 36 case study firms and also disaggregates the results by nature of business performance over the last five years. The majority of firms operate in a strongly price-competitive environment, and this is particularly true in the sectors of footwear/clothing, residential care and security where nineteen of the twenty firms covered in these sectors described their product market as highly price competitive (see Appendix Table 3). The following quotes are illustrative:

The selling prices of knitwear have dropped over the last ten years. In fact, we could have got more for a garment about ten or fifteen years ago than we are getting for it now (Knitwear2).

[The Local Authority] says we don't have to accept them [patients] at the rates that they are offering, but if we don't accept them how do we run on 10 per cent occupancy? (Home4).

[Client firms] don't care you've been going for 20 years. They don't care that the people [the security guards] you're putting on there – that we've checked them out. What they care about is – are you 10 pence more expensive than this other guy I've phoned? (Security2).

I always say I will match anybody's prices if I can – if it's a legitimate company (Security5).

As might be expected, the need to compete on price tends to be associated with the delivery of a product or service characterized by mass market consumption, meaning that the firm is unable, or unwilling, to provide a specialised product or service. All four knitwear firms provided relatively standardized garments to a customer base of largescale wholesalers and, in some cases, high street retail chains. The two retail firms which identified strong price pressures sold products for a general market (Retail3 and Retail5). Of the residential homes, the six which faced strong pressures on the price of patient care all catered predominantly for local authority patients; the one exception (Home6) provided a more tailored service for private patients and enjoyed greater flexibility in its pricing strategy. Four hotels and restaurants kept a close eye on pricing, and two provided a relatively standardized service: Hotel2 faced strong price competition from the new larger chains; and the Indian restaurant (Restaurant4) faced 'cut-throat' competition in a saturated market for a relatively standardized product. All six security firms provide a standardized service in a price

competitive environment. Finally, one of the two cleaning firms sells a standardized package of cleaning to large client organizations that bid for services primarily on the basis of price.

While price is the clear front-runner in characterizing product market strategy among the case-study firms, other factors are also considered important in winning business and improving competitive advantage. 22 of our firms argued that personal attention to client needs was essential to the way they conducted business. In many cases, this strategy was highlighted as a way that small firms can compete against larger firms since their clients, or customers, are more likely to be able to negotiate business directly with one of the senior partners, or managing director. What seems clear from Table 3.1 is that among firms where this was practiced, the majority had experienced increasing or stable profit margins during the last five years.

[Sales staff] have got to be polite, they have got to be courteous (Retail4).

Our main effort is that all the customers leave happy and look forward to coming back again and [that] we over-exceeded their expectations (Restaurant2).

Knowledgeable clients are saying – if I've got a bigger company, I can't get the MD on the phone and say I'm not getting the service I want (Security1).

[Client firms] get the feeling that, certainly with national security suppliers, you're just another contract. . . . I think the smaller companies are quicker to respond than the bigger boys (Security6).

So how do we convince working professional people to pay the most expensive prices for cleaning? By giving them the very best service. I make each and every single client feel special. . . . I never let them down, even if it means I have got to clean those houses myself (Cleaning1).

The remaining characteristics of product market strategy identified in Table 3.1 – product quality, niche market, and so on – are all strongly related with stable or improving business performance. These characteristics may be described as contributing to a 'quality-led' product market approach. A focus on product quality and product design, operating in a niche market, sustaining a good reputation based on reliable service, or diversification and new capital investment, all reflect a determination by the firm to compete on more than just price and to contribute something new or distinctive to the market for goods and services. In many cases, of course, the desire to deliver high quality, or to establish a good reputation, is buffeted by strong market pressures on price, and, in some cases, price is still the over-riding factor shaping market share. The following three examples are taken from firms where a 'quality-led' approach was claimed to be important, but profitability had nevertheless declined:

I always pride myself on quality. But you can't sell in the market with just quality. You have to compete [on price] also. So competition was forced upon you (Knitwear4).

[The hotel] tries to compete based upon service, based upon reputation and, as I say, it's full service so you don't have to go across the car park to go and get your breakfast. . . . But of course it adds to the cost of the operation (Hotel2).

But in the main, a 'quality-led' approach to product market strategy seems to be positively related with stable or improving performance. While some of the elements of this approach, such as a focus on product quality, or attention to reputation, are difficult to substantiate (from the researchers' point of view), the degree to which the firm operates within a niche market is more transparent. The 15 firms identified covered a range of niche markets, including the manufacture of ladies' wide-fitting shoes, washable slippers, dance and bridal shoes, the making and selling of high quality baked bread, the retailing of very expensive formal shoes, golfing equipment,

interior design/ furniture and leather bags, private residential care for the elderly, corporate hospitality, high quality and innovative restaurants and building services management. Across the different firms, some were established in a niche market from the outset, while others moved into niche markets to avoid increasing cost pressures in markets for more standardized products; in some cases this involved diversification so that the firm operated in both mass markets and niche markets simultaneously. Moreover, the financing of capital investment and product design were a mainstay of the niche market strategy at many firms, while at others the ability to operate in a niche market appeared almost accidental. Some of the following quotes reflect this diversity of approach:

Q. Did you have to invest in new technology to design the washable slippers?

No, I gave the wife a pair to stick in the washing machine. We've been doing the same thing for so long, they're obviously right because we hardly get any returns either (Footwear2).

Funnily enough I get a lot of my ideas from the multiples [supermarkets]. They come up with something, they abuse or anglicise something from abroad, they send all the researchers out, and I think, I can do that better, we can respond fast (Retail2).

Ten years ago we moved completely out of children's footwear and concentrated purely on ladies' slippers. . . . Two and a half years ago we decided to pull out of slippers completely and we now concentrate purely on dance shoes, bridal shoes and wide-fit footwear (Footwear3).

I had quite an ambition . . . and I couldn't see this industry working on a chain basis where you had a lot of shops. . . . but I thought it would be a good idea for mail order. So we tried a couple of pilot schemes, a couple of small leaflets and we got a good response and from there we thought let's just roll it out, make it bigger and bigger. [The competition] are all about five years behind (Retail4).

Yes, we are a security company . . .but [the guards] do a range of other roles within a building. . . We have sort of stepped in between property management and security. We've merged bits of the two, really, to give them added value (Security6).

4. Employment practices and pay structures in the case-study firms

The study of whether the NMW has impacted upon the way firms manage employment typically seeks to explore the way firms act to minimize the impact of the NMW by adopting new, or revising old, employment policies and practices. By contrast, in our analysis of the case-study data we wish to emphasise the path-dependency and contingency of each firm's approach to managing employment. In other words, a given response to the NMW needs to be understood in the context of the longstanding employment approach of the firm, as well as other conditions such as business performance, product market strategy and whether or not it is a low paying or high paying firm. In this section, we provide a brief overview of the key features of employment policy and practice in the 36 firms, drawing together the data in tabular form. This provides background information for analysis of the indirect impact of the NMW on employment policies and practices examined below in section 6.2.

We focus our attention on three areas of employment policy and practice: training provision; opportunities for pay advancement and/or job promotion; and working time arrangements (Table 4.1). Regarding training provision, our sample of 36 firms is fairly evenly split between those providing informal on-the-job training and those providing formal training leading to some form of certification (typically NVQ qualifications). The former group of 15 firms includes 5 retail businesses, four clothing and footwear firms and the two cleaning firms investigated. The latter group

includes 4 hotels and restaurants and 5 of the 7 nursing and residential homes. All 7 nursing and residential homes must provide mandatory training on moving and handling, fire safety and health and safety, and 5 also facilitate NVQ training for care assistants with the associated cost usually shared between employer and employee. Curiously, the security firms display an equal tendency towards both strategies with 3 providing informal on-the-job training and 3 providing certificated training; essentially, some rely on poaching qualified staff while others invest in the training accredited by the Security Industry Training Organisation. The problems of cost and risk of poaching were described by the general manager at Security3:

For you to train somebody up, you're going to have to pay for a day – to two days – to sit in here at say £4.50 at a time. So you're paying about £100 per person for training, plus your time and effort. So it could well be £200 to £300 to train one person up. Then when you've trained them up they could just go down the road to another company and say look now I've got my SITO training (Security3).

Table 4.1. Employment policies and practices in the 36 case-study firms

	<i>Total</i>
Training:	
- informal on-the-job	15
- formal on-the-job	3
- formal leading to certification	13
- none	5
Job/ pay advancement:	
- flat rate or piece rate	18
- incremental pay scale	18
- job promotion	14
- no job promotion	22
Working time:	
- long hours (>40pw)	14
- Sat+Sun working	23
- PT hours to meet staff needs	11

Notes: Total sample, N = 36. Figures for job/ pay advancement and working time do not add to 36 since each firm may have one or more of the alternative policies listed under each heading.

Source: see Appendix Table 4 for more details.

The second employment policy described in Table 4.1 concerns opportunities for pay progression – with experience or skill - or promotion to a higher paid job. Firms are characterized according to whether they have flat rate (or piece rate) or an incremental pay-scale, on the one hand, and, on the other, whether they have opportunities for job promotion or do not have such opportunities. Of the 18 firms with a flat rate or piece rate system, 12 firms, from a mix of sectors, operate a flat rate payment system and 6, from clothing and footwear, operate a system of piece rates. Examples of flat pay rates include the following:

Retail7	All sales assistants	£4.75 per hour
Home3	All domestics and care assistants	£4.10 per hour
Home4	All domestics and care assistants	£4.10 per hour
Home6	All care assistants	£4.80
Home7	All domestics and care assistants	£4.10 per hour
Restaurant2	All waiters and kitchen assistants	£4.10 per hour
Restaurant3	All waiters and kitchen assistants	£4.10 per hour
Restaurant5	All waiters	£4.67 per hour

Security5	All security guards	£4.10 per hour
Cleaning2	All cleaners	£4.10 per hour

In these firms, the principle of the flat rate payment system means that the rate of pay is matched to a job, or set of jobs. Differences in age, experience, skill or qualification among workers are not recognized or rewarded. In some firms, workers earn additions to pay in the form of tips (restaurants and hotels) and weekend premia (some of the nursing homes and Cleaning2).

18 of the 36 firms have opportunities for pay progression within a given job title, but typically the range of pay is relatively narrow. Higher rates are associated with age, or experience on the job, with evidence of skill acquisition, or on successful completion of a probationary period. The following examples are illustrative:

Retail1	Sales assistants	£4.10, up to £5.38 per hour with experience
Retail2	Sales assistants	£5.20, up to £5.50 per hour with experience
Retail3	Sales assistants	£4.20, up to £4.35 with age
Home2	Care assistants	£4.50, up to £5.00, £5.50 with NVQ 2, 3.
Home5	Care assistants	£4.10, up to £5.50 with NVQ qualifications
Restaurant4	Waiters, kitchen assistants	£4.10, up to £5.00 with experience
Security2	Security guards	£4.10, up to £4.25 after 2-3 months
Security3	Security guards	£4.10, up to £5.00 depending on the site
Security4	Security guards	£4.50, up to £5.50 with probation and age
Cleaning1	Cleaners	£4.50, up to £5.00 after 4 weeks.

Around two in three firms provide no, or very limited, opportunities for promotion from one job to another within the firm. Of course, job structures that provide for internal, vertical job progression are usually found in large organizations (associated with the notion of 'internal labour markets') not in small firms. Nevertheless, the near absence of opportunities for advancement through job moves, or pay progression, in so many firms is striking; for the main occupational group in 13 of the 36 case-study firms – that is, more than one in three - we found evidence of neither pay progression or job promotion prospects. Workers in jobs with this degree of limited job promotion or pay advancement could be described as being in 'dead end jobs'. In some firms, job promotion is not possible because of the very flat structure among employees and because all the management and supervisory posts are held by family members of the owner, or partners, of the firm. For example, at each of the four knitwear firms the owners, or partner managers, assume management and supervisory responsibilities and all employees carry out the basic function required by each job task. Also, two retail firms (Retail5 and Retail7) are managed solely by members of the owner's family, with employees covering the sales assistants posts. In others, the lack of opportunities for job advancement reflects a strikingly flat, low paid job structure with no attempt by the owner of the firm to carve out some form of job or pay differentiation among employees. For example, at one of the security firms (Security5), all 30 employees working as security guards are paid the NMW, regardless of age, experience and skill, and there is no differentiation in job title, which reflects the standardization of service provided by this particular firm. This may mean, of course, that the firm loses skilled employees who quit to seek promotion elsewhere:

It's like a tight-knit family here. Everyone's settled in their own jobs. If you wanted a bakery manager's job you'd have to go somewhere else for one. . . You don't want to stay doing the same job all the time (Senior Baker A, Retail2).

I think I'd have to move elsewhere [for promotion]. You can't really go very far in a nursing home, can you? There's no promotion (Care Assistant, Home1)

The third policy reported in Table 4.1 concerns working time arrangements. Long and unsocial hours working is characteristic of a substantial portion of our case-study firms, but is concentrated in certain sectors of activity. All six security firms rely on very long hours of work among their security guards – anywhere between 45 and 70 hours per week – with concentrated activities over the weekend – from Friday evening through to Monday morning. Five of the seven hotels and restaurants are characterized by long working hours, and six require weekend shifts. Three of the four knitwear firms are characterised by very long working hours among the male full-time workers (60-70 hours per week) for all seven days of the week during busy periods of the season. Finally, the seven nursing and residential homes require weekend working, but as part of a regular shift system organized around anything from a 32 to a 42 hour week for full-time employees (Home7 and Home1, respectively).

Slightly less than one in three of the case-study firms expressed a positive attitude towards arranging hours for part-time employees to fit in with their other non-work commitments. Eight of the 11 firms are retail firms or nursing and residential homes. In each case, the main rationale was either to ease recruitment and retention difficulties or to offer a non-pay inducement where cost pressures make higher rates of pay difficult. The following quote is illustrative:

We are much more flexible [than the NHS] when it comes to rotas. . . We try and offer whatever we can. We're a great believer – if we can give people what they want, they will work with us with a bit of loyalty (Home4).

In an attempt to establish an aggregate indicator for each firm's approach to managing employment, Table 4.2 describes the number of firms in each sector with a quality enhancing, hybrid and cost minimising approach. 28 of the 36 case-study firms have either a hybrid or cost minimizing approach and just 8 fit our definition of a quality enhancing approach. Firms with a cost minimizing approach are clustered in the clothing and footwear and hospitality sectors, whereas firms with a quality enhancing approach are found mainly among the nursing and residential homes and security firms. For now, we defer any elaboration of the potential inappropriateness of this stylized characterization of firms' approaches to managing employment to section 6 below.

Table 4.2. Quality enhancing and cost minimizing approaches to managing employment

	<i>Quality enhancing</i>	<i>Hybrid</i>	<i>Cost minimizing</i>
Clothing & footwear	0	2	5
Hotels & restaurants	1	2	4
Nursing & residential homes	3	4	0
Retail	1	4	2
Security	3	1	2
Cleaning	0	2	0
Total	8	15	13

Note: A firm has a 'quality enhancing' employment approach if it has 3 or more of the following practices: formal on-the-job training; formal certified training; incremental pay-scale; job promotion; part-time working hours to meet staff needs. A firm has a 'cost minimizing' approach if it has 3 or more of the following: informal on-the-job training; no training; flat rate pay (or piece rate); no job promotion; long working hours.

5. Direct responses to the National Minimum Wage

Firm responses to the NMW can be divided into two categories: direct and indirect. In this section we consider direct responses, which include adjustment of pay structures and change in the number, or composition, of workers employed. In section 6 we explore evidence of indirect responses, with a focus on changes in product market strategy and the firm's approach to human resource management. As we show below, while many of our case-study firms were forced to adjust their pay structures following the introduction of the NMW and then to alter pay rates in line with subsequent increases, few firms adjusted employment levels. As such, there appears to have been a net gain for low paid workers, with higher rates of pay offsetting the few instances of job losses. Arguably, however, the more substantive transformation has occurred through indirect responses to the NMW. As we show in section 6, the data suggest that the NMW has generally acted as an instrument *enabling* positive change in the way the firm has adapted its product market strategy and its approach to managing employment. However, because the NMW is not the only pressure on firms, the final outcome is not necessarily positive, since the NMW competes with an array of other internal and external factors. Indeed, because of the complexity of the firm's business environment, it is very difficult to state with certainty that such and such a strategy or practice is directly or indirectly attributable to the NMW. Therefore, throughout the following analysis we recognize that firm strategies and practices are typically implemented in response to a range of often conflicting pressures and changing conditions, both internal and external to the firm (see Beynon et al. 2002 for a fuller treatment of this issue). Nevertheless, the data support the argument that the NMW, since its introduction, has acted as a pressure towards positive change – both towards enabling or supporting a high quality product market strategy and encouraging more innovative employment practices. However, in a context of increasing competition, constraints on labour and capital markets, or conflicts between NMW policy and government policy in other areas, we all too often find that the potential for positive change is not realised.

5.1. The impact of the NMW on pay

As a consequence of the introduction and uprating of the NMW, a firm may adapt its pay structure and payment practices in one or more of the following ways:

- increase the lowest rates in line with the NMW;
- restore internal pay differentials between employees paid at the NMW and those above;
- restore external pay differential between lowest rates and the NMW;
- introduce new payment practices; and,
- introduce pay differentials between youth (18-21), trainees and adult workers.

When the NMW was introduced in 1999 at the hourly rate of £3.60 for adult workers, 17 of our 36 case study firms were forced to increase the rates paid to the lowest earning members of their workforce. The increase in the NMW two years later, from £3.70 to £4.10 affected slightly more firms (21 of the total). Very few firms were affected by the youth rate (£3 in 1999 and £3.50 in 2001), either because they do not employ anyone below the age of 22 years, or, more commonly, because they pay

workers aged 18-21 years old the adult rate for the NMW (see below). Many firms employ workers who fall outside the NMW legislation because they are less than 18 years old. For these workers, hourly pay rates range from around £3.20 to £3.85.

Table 5.1. The impact of the NMW on pay structures

	Number of firms making a direct response to the:	
	1999 introduction of NMW	2001 increase in the NMW
Increased lowest rates -- for adult workers	17	21
-- for youth workers	4	3
Unaffected by adult rate	19	15
Restored internal pay differentials	8	9
Restored external pay differentials	4	4
Introduced different rates for youth, trainees and adult workers	4	3

Note: Total sample of firms is 36. Firms were allowed more than one response so that the values in each column do not add to 36.

Source: Forms completed by sample firms plus management interviews on describing the impact of the NMW on pay (questions 5.1, 5.2 and 5.3).

Across the six sectors, the direct impact of the NMW on the lowest rates of pay has been most evident in footwear/knitwear, nursing and residential care and security. In the sectors of retail, hospitality and cleaning the experience has been more mixed. This is confirmed by the details shown in Table 5.2. Overall, the table shows that in nearly half of the firms we visited most workers (more than 50%) are paid the NMW. Low pay is most evident in the nursing and residential homes and the clothing and footwear firms, where only one of each sample of seven paid all its workers above the minimum wage. By contrast, around half or more of the firms visited in the sectors of retail, hospitality and cleaning pay all their adult workers above the NMW.

Table 5.2. The share of adult workers paid the NMW in each firm

Sector	Share of adult workers paid at the NMW:			Total Sample
	None	Less than 50%	More than 50%	
Cleaning	1	0	1	2
Clothing & footwear	1	2	4	7
Hotels & restaurants	4	0	3	7
Nursing & residential homes	1	1	5	7
Retail	6	1	0	7
Security	3	1	2	6
Total	16	5	15	36

Source: Forms completed by sample firms plus management interviews on describing the impact of the NMW on pay (questions 5.1 and 5.2).

Our interviews with employees revealed a great deal of satisfaction with the introduction of the National Minimum Wage, with many arguing that it had made a strong and direct impact on their wage and living standards. Others, however, signaled that the level of the NMW was too low. The following selected quotes are illustrative:

For places such as Nursing Homes, I think [the NMW] is good because they are very low paid aren't they? So if there wasn't a minimum wage I'm sure I'd be on a lot less than £4.10 (Care Assistant, Home1).

[The NMW] has been helpful, yes. Because there were a lot of people on £3 an hour. They could employ you and pay what they wanted, couldn't they? (Waitress and bar worker, Hotel2).

Of course [the NMW] has been a good thing. Else we'd be in the Dark Ages wouldn't we? We'd never get anything! (Chambermaid, Hotel2).

I can't understand how anyone can live on this type of [minimum] wage. . . . Okay, this government has tried to bring in a fair working wage, but it's still not enough. The responsibility these girls [care assistants] have got out there – it's frightening. And whatever you pay people is what you'll get out of it, isn't it? If you pay £4 an hour, you'll only get £4 an hour's worth of work. . . It isn't a very good wage, not for anybody (Cleaner, Home1).

[The NMW] has been a positive change, but it's not enough in general for the low paid workers. . . . A fair minimum would be about £5 an hour. When you think that your tax is going up and your poll tax and your rent, and then they give you a minimum wage, most firms are going to pay the minimum aren't they, £4.10 (Supervisor, Cleaning2).

Disaggregation of firm response by business performance shows that in both 1999 and 2001 firms experiencing declining profitability were more likely to have to adjust lowest rates in line with the NMW. In contrast, while firms with increasing performance make up one third of the sample, they represent less than one quarter of firms that increased lowest rates in both years (Table 5.3). This evidence suggests there is an association between payment of NMW rates and declining business performance; in 2001, this group of firms includes one footwear firm, four knitwear firms, three nursing homes, one hotel, one restaurant and one security firm.

Table 5.3. Number of firms directly increasing lowest rates in response to the adult NMW, by business performance

	<i>Business performance (profitability over last five years):</i>			Total
	<i>Increased</i>	<i>Stable</i>	<i>Decreased</i>	
Increased lowest rates in:				
- 1999	4	4	9	17
- 2001	5	5	11	21
All firms	12	12	12	36

Among footwear and knitwear firms, the impact of the NMW is complicated by the widespread practice of paying workers on a piece rate. Estimation of the impact of the NMW relies on accurate information of the weekly wage (which can vary significantly from one week to the next) and hours worked in the reference week. Only one firm (Footwear1) provided us with accurate data on pay and hours worked for all its workers. For the others we have had to rely on oral evidence regarding the average weekly wage and average hours worked. Despite a certain expected degree of inaccuracy, however, it is still possible to construct a rough portrait of hourly rates for the different groups of workers in these firms. For example, we know that in Knitwear3 the cutters, knitters and pressers earn between £250 and £300 per week and, as these are all men, we know they tend to work between 60 and 70 hours per

week. Their hourly rates thus lie within a range of £3.57 to £5.00. These are the high paid workers. Men working in ancillary jobs (packing, quality checking) work similarly long hours but earn just £150-180 per week, giving a rough hourly wage of between £2 and £3. Most women work as sewers, again earn between £150 and £180 per week but work fewer hours – typically around 40 each week. For women, therefore, hourly pay works out at somewhere between £3.75 and £4.50. At Knitwear4, use of homeworkers to carry out the sewing makes it impossible to estimate hours worked as the owner has no need to collect information. Only one of the four knitwear firms, Knitwear2, pays an hourly rate (the NMW) to all its workers and has recently decided to close the business rather than be forced to uprate pay once again in October 2002. Among the knitwear firms, therefore, there does appear to be evidence of illegal payment of hourly rates below the NMW. Other confidential sources with extensive knowledge of the local industry informed us that the going rate of pay for most workers is currently around £2 to £3 per hour. Since the introduction of the NMW, the practice for many of these firms is to sign a contract with workers which specifies a 40-hour week and a fixed weekly wage that meets the NMW legislation, but to design a system of piece rates which means that workers are forced to work longer hours if they wish to earn the expected weekly wage; this practice obviously leads to hourly rates that often fall below the NMW. The following quotes illustrate the grey area within which some of these firms fix pay:

[Older men and women who work on a part-time basis] are not bothered about minimum rates. All they want is a few bob extra – you know beer money, fag money – and they are quite happy to do that. It's not worth paying four pound odd if he's just standing there trimming. Find a way of doing that without paying £4, because you just couldn't [pay that] (Knitwear1).

The contract actually says you are paid on a rate per production. . . . Nice as it would be to have a utopia – we all earn a thousand pounds a minute – you can't have that. The weekly or hourly rate for many companies is just ridiculous (Knitwear3).

We found little evidence regarding use of the youth minimum rate among the 36 case-study firms – just four firms in 1999, and then three in 2001, paid workers aged 18-21 years the youth rate. By contrast, eight firms paid all workers aged 18-21 the adult NMW. Part of the reason may be differences in cost pressures; three of the four firms which have used the youth NMW are nursing homes with declining profit margins. However, one of the four is a rapidly expanding retail business (Retail4) and, moreover, another nursing home experiencing declining profit margins pays workers aged 18-21 years the adult NMW rate (Home1). One reason that appears to explain some of the difference in approach is a concern for providing equality of employment status among employees carrying out similar work, as the following quotes demonstrate:

We don't drop their [18-21 year olds] rate, because my opinion is if you're doing the job the same as the 45 year old, you're getting paid the same as the 45 year old. If you're not doing the job you get sacked – basically we don't drop your wage, we drop you (Security6).

We decided they [18-21 year olds] are doing the same job and once they are trained they are as good as the others [and] apparently it was complicated to have various rates (Cleaning2).

In response to the introduction of the NMW in 1999, of the 17 firms which had to increase rates of pay for the lowest paid adult workers, 8 firms informed us that they restored internal differentials between workers paid at the NMW and more highly paid workers. In 2001, 9 of the 21 firms affected restored internal pay differentials (Table 5.1). Examples of groups of workers whose pay differential has been maintained include care assistants and cooks, chefs and kitchen porters, chamber

maids and housekeepers, new recruits and experienced workers and non-supervisory staff and supervisory staff. The following comments are illustrative of the kind of changes that have taken place:

[An employee will say to me -] 'On a week I've been averaging £300 and my mate on the other side has been averaging £250. He's now going to £270, mine should go to £330.' You get deputations of people coming in here saying that it's about time we discussed this (Knitwear3).

It wasn't the fact that you've had to pay £4.10 . . . it was the fact that you then had to retain the differential between the person who was earning the minimum and his or her manager or supervisor (Hotel2).

When the minimum wage went over £4 an hour, we did bump certainly the next two or three pay levels up a little bit (Restaurant2).

The [more experienced] lads are on £4.25, so they will want to keep the differential between them and the people who are starting (Security2).

We didn't let [the NMW] erode differentials. It has not eroded them because the supervisors have responsibilities and they do not get a lot more for that responsibility so we kept the differential there (Cleaning2).

But in both 1999 and 2001, slightly more than half the firms affected by the NMW did not maintain differentials. Such evidence is consistent with national pay data which demonstrate a year-on-year compression of the wage distribution with a spike around the NMW hourly rate (LPC 2001: Figure 3.6). These firms break down into two groups. A first group is characterized by active resistance on the part of employers to demands from various groups of workers to restore differentials. The usual justification given for the resistance is a general concern to avoid any knock-on impact on labour costs and profit margins. At Footwear1, one group of workers unsuccessfully argued with management that their weekly earnings from piece rates had converged with workers on day rates (paid at the NMW) and an increase in piece rates was therefore needed. At Restaurant3, the manager had a close eye on the salary-turnover cost ratio and argued that people on above-NMW rates would find it 'tougher' to receive pay rises if the NMW rise cut into the 30% optimum ratio. Some of the quotes further illustrate the position of these owner/ managers:

The real world is you get what you negotiate in life don't you and unless people come knocking your door down you're not going to do it (Restaurant3).

[Differentials] have not been religiously preserved – there is only a certain amount of money to go round (Restaurant4).

Every now and again, we say we need a wage rise, but nobody listens so you don't get it. It's like when young girls come in and they are on the same wages as we are and we take a lot more responsibility really (Waitress and bar worker, Hotel2).

This finding reflects the limited capacity for workers to voice their demands in many of the small firms we visited. This is a well-known characteristic of small firms (Marlow 2002). What our evidence demonstrates is the limited influence of the NMW in strengthening the bargaining power of workers in pressing for better pay. It has also been shown that pay structures and pay systems in small firms are strongly delineated by gender (Craig et al. 1984). Importantly, this previous research rejects the argument (still heard today) that women's low pay is associated with confinement of many women to low skill jobs. Instead, the study shows that the problem is more accurately defined as non-recognition of skills and job demands, with difference in employment status between male and female workers in a firm more strongly associated with differential pay and job grade, rather than differences in the nature and content of the jobs or the educational level of the worker (op. cit.: 97). Evidence from our research suggests that some firms have responded to the NMW by

maintaining the pay differential between some groups of workers but allowing it to narrow for others in a way that seems to reflect the greater ability of male-dominated work groups to maintain differentials over female-dominated work groups. For example, at some of the nursing homes we visited, the pay differential between women working as domestics (cleaners and laundry) and as care assistants had disappeared altogether, while the differential with men working as cooks, gardeners or caretakers had been maintained. For example, at Home1, women working as care assistants earned £3.90 in 2000, slightly above the minimum wage rate of £3.70 paid to domestics (cleaners and laundry staff). After the rise to £4.10 in October 2001, both female groups of workers were paid the minimum wage. By contrast, the differential with the cook and the gardener was maintained, with these male workers earning £5 and £8 per hour, respectively in 2001. At Home1, the laundry worker told us she felt uncomfortable about the loss of the differential with care assistants:

[The minimum wage] is not enough though is it, especially for the carers, for the job that they do. . . . The girls here, they get the same as me but they do a damn sight harder work. I mean my job compared to their job is a doddle and they are on the same pay as me. They should be on more. . . . For me to stay on £4.10 and the girls on, say, a fiver an hour. To me that would be quite fair (Laundry Assistant, Home1).

A second group of firms, which have not maintained internal differentials in response to the NMW, appears to have faced little pressure since they employ small numbers of workers and pay everyone a flat hourly rate, at the level of the NMW, irrespective of age, experience or skill. For example, at Knitwear2 the owner employs 15 part-timers to cover the various jobs of knitting, cutting, sewing and packing and pays each person the minimum hourly rate. Similarly, at Security5 the workforce consists of 30 men working as guards and each is paid at the minimum hourly rate of £4.10 (see section 4 above).

Among those firms where the lowest rates of pay fell comfortably above the NMW (19 out of 36 in 1999 and 15 in 2001), four firms claimed that the NMW had a knock-on impact on their pay structure since it was necessary for them to maintain the differential between internal and external rates of pay (Table 5.1). For example, at Home2 the starting rate for a care assistant was increased to £4.50 in 2001 in order to compete with the above-minimum rates paid at the local supermarkets. At Security6, although pay rates of security guards had to be raised in line with the NMW when it was introduced, the director then made the decision that it was beneficial to pay rates significantly above the minimum to attract good quality recruits. There is also a separate case (Retail3) where the firm owner wished to pay higher than external rates but opted to introduce new bonus payments, rather than increase hourly rates, with annual non-consolidated payments paid as reward for increased turnover.

Other firms did not maintain differentials with external rates, either because they were unable or unwilling. For example, at several of the nursing homes, security firms and one of the hotels we were told that while they wished they could pay care assistants, security guards, or waiters, higher rates they could not because of stringent cost pressures. In particular, at one of the security firms in Macclesfield – the relatively prosperous area – we were told that rates of pay for the security officers (from £4.50 to £5.50 per hour) compared unfavourably with local rates paid to cleaners. In contrast, at some of the shops, we encountered what appears to be

an unwillingness to be perceived as giving in to workers' raised expectations in a context of stable or improving profitability.

[Care assistants] must like the job because they are on such poor pay [£4.10-4.60] . . . they should be on £6 per hour . . . if we had the residents we could pay the staff better (Home1).

[Carers in local authorities are paid more] doing exactly the same thing as somebody working in this environment who is being paid, as you can see, bloody peanuts [£4.10] . . . it is very, very unfair (Home3).

This hotel really needs to set its pay about the same levels as the supermarkets . . . but it cannot recoup those extra costs through increased selling prices (Hotel2).

My lads are out there risking their life . . . We had a lad on Saturday night attacked with a Stanley knife and slashed across the stomach. And he's on £4.75 an hour. I wouldn't get out of bed for £4.75 an hour if I thought I was going to be attacked with a Stanley knife. I wouldn't do it. I would go on the dole, definitely (Security4).

We had a little meeting, funnily enough, and it lasted about five seconds, because one guy was saying – 'Well, if this is the minimum, we should be on . . . ' and I said 'so from now on you want £3.60 an hour?' And we never seemed to get any further than that (Retail2).

[Employees] are always wanting more than a small firm like us can afford to give them and their expectations are very, very high in terms of pay, perks, holidays (Retail7).

Among some of the workers, we encountered frustration regarding their inability to restore their pay to an appropriate external level, as well as a rather misplaced sense of solidarity with owners of firms which were experiencing declining performance:

There's always jobs advertised in the paper for senior care assistants, and they usually start at £6, £6.50. But we do understand [the owner's] predicament. That's why we don't pursue the pay rise, because obviously we understand how she's fixed, being a small business . . . If [the NMW] hadn't come into force then the girls [care assistants] would probably still be on £3.60. But I still think it could be a bit more because of the cost of living today (Senior Care Assistant, Home1 on £5 per hour since April 2002).

5.2. The impact of the NMW on employment

According to a pessimistic view of the response of firms to the National Minimum Wage, we might consider the following three options regarding staffing policy:

- decrease the number of workers employed;
- decrease the number of hours per worker (either by cutting overtime hours or reducing hours of part-timers); and,
- substitute youth for adult workers.

While other studies attempt to test the employment effects of the minimum wage through complex microeconomic models, simulation exercises or detailed quantitative survey research (Card and Krueger 1995, Stewart 2001), the small scale of our research project does not allow us to make strong assertions. Instead, our aim is to illuminate the diversity of responses among the 36 firms surveyed, with decisions concerning employment made in a context of changing business performance and competitive conditions.

Table 5.4 sets out the number of firms, which experienced increasing, stable or decreasing numbers of workers employed during the period 1998 to 2002, and also disaggregates the results by change in business performance over the same period. Overall, 13 firms reported a decrease in numbers employed, 9 reported no change and 14 reported an increase. As might be expected, there is a strong association with business performance: 7 of the 8 firms with a large increase in numbers employed also registered increased profitability; and 8 of the 13 firms with a small or

large decrease in the number of workers registered falling profitability. There is also something of a sectoral effect: 5 of the 8 firms with a large increase in their workforce are from just two sectors (2 retail shops and 3 security firms); and 9 of the 13 firms with a decline in numbers employed are also from just two sectors (5 from the footwear and knitwear sector and 4 from the nursing and residential homes) (see Appendix Table 1 for more details). In some cases, the association between business decline, or business expansion, and the change in numbers employed is very strong, as the following selection of quotes testify:

I didn't want any of [my sons] working in this trade because you can't see a future in it. It's actually plummeted like a stone over a particular period (Footwear2) [from 30 to 25 workers, 1999 to 2002].

I laid off most of my staff last year. . . It was a very bad season and I couldn't foresee really how to keep them for the next season (Knitwear2) [from 30 to 15 workers, 1998 to 2002].

We have had quite a growth really. All being well we are opening another showroom in the next street (Retail6) [from 7 to 10 staff, 1998 to 2002].

We are a growing company and we've gone from one to two branches – we will have three or four shortly (Restaurant3) [from 10 to 87 staff, 1998 to 2002].

We haven't seen a year yet, touch wood, where we haven't grown. . . This year has been the biggest growth we've ever seen. We've practically doubled the company in a little over eight months . . . The bigger we are the more lads we need because that's our product (Security6) [from 22 to 65 staff, 1998 to 2002].

Table 5.4. Change in numbers employed in the case-study firms, 1998-2002

Change in numbers employed:	Total	<i>Business performance (profitability over last five years):</i>		
		<i>Increased</i>	<i>Stable</i>	<i>Decreased</i>
Large increase	8	7	1	0
Small increase	6	2	3	1
Stable	9	0	6	3
Small decrease	7	1	2	4
Large decrease	6	2	0	4
<i>Total</i>	36	12	12	12

Source: Forms completed by sample firms plus management interviews on describing the change in numbers employed (question 3.1).

In four cases, the relationship between employment change and business performance is the opposite to the norm. Three firms report increasing profitability, but decreasing numbers employed. There may be a potential case here for evidence of the adverse employment impact of the NMW. What we find, however, is a more complicated association with product market strategy. At Footwear3, the successive development of a niche product market strategy selling dance and bridal shoes since the early 1990s has been associated with rising profit margins, more stable business conditions and a halving of the workforce; workers who worked on the more standardized products (slippers) were transferred to a factory under the ownership of a different firm which bought the accompanying machinery. The other two examples are both retail businesses that closed shops in order to boost profit margins. Retail1, the shoe retailer, closed one of its four shops leading to the loss of five staff, and Retail5, the menswear shop, closed one of its two shops in 2001, cutting its workforce from 7 to 5. Only one firm, Home4, reports declining profitability alongside a small increase in employment. However, as we report below, the small increase in

numbers employed (from 80 to 90 between 1998 and 2002) disguises a reduction in contracted hours among many of the staff.

In fact, there is only one example from our 36 case-study firms where the minimum wage was explicitly mentioned as a *direct* factor leading to job losses. The owner/manager of Knitwear2 identified the NMW as one of the main factors that was forcing him to consider closing the factory, after a long period of declining business sales. The standard hourly rate in 1998 prior to the NMW was around £3 per hour and faced with the choice of paying the NMW or laying off workers, he laid off staff in 2001. Several firms argued that the NMW *indirectly* constrained their ability to conduct business effectively, or that it reduced profit margins, but this is an issue we consider in more detail in section 6.1 below.

Concerning the impact of the NMW on hours worked, we were unable to collect precise information on how firms changed contracted hours for all workers employed. We do know, however, that in a number of cases average hours worked were adjusted in direct response to the NMW, and, in some cases, hours were reduced while the numbers employed increased. At Knitwear4, five male full-time workers have been employed in the factory over the last five years and the owner has made use of six out of a potential pool of ten homeworkers. But as fewer orders came in, each homemaker was given less sewing work to complete, reducing the overall hours worked. At Home1 and Home4, contracted hours of staff have been reduced as numbers of patients have fallen. At Home1, six of the twelve full-timers were moved onto part-time contracts and hours worked by part-timers were cut. At Home4, average hours worked have fallen despite the fact that the total number of staff increased from 80 in 1998 to 90 in 2002.

Finally, according to our interview data, only one of the 36 firms (Home4) had substituted youth for adults in order to reduce wage costs by paying at the youth minimum rate. In part, the lack of evidence for this employment practice reflects the resistance to paying workers different rates for similar work (see section 5.1), as well as the widespread practice of using flat rate payment structures (section 4).

6. Indirect responses: the National Minimum Wage as enabler of positive change?

In this section we assess the evidence for the indirect impact of the NMW on the product market strategy and approach to managing employment associated with each of the 36 firms surveyed. In section 3.2 and section 4 we introduced the broad characteristics of product market strategy and employment practices, respectively, with the aim of giving a general impression of the diversity of policy and practice in these two areas of business strategy. Here, we focus our attention on the way these approaches have adapted since 1999 with the introduction, and subsequent increases, in the NMW. In particular, we address the question – Has the NMW encouraged, or enabled, positive transformation within a firm towards a quality, niche-orientated product market strategy and/ or a quality enhancing approach to managing employment? Importantly, we argue that the potential for transformation in one area of business strategy is strongly interconnected with the other. Hence, throughout our analysis we draw out the inter-relatedness between product market

strategy and employment practices in order to understand the factors and conditions that enable or hinder a positive transformation by a firm in response to the NMW.

6.1. The impact of the NMW on product market strategy

In this section, we assess two questions regarding the potential transformation in product market strategy. First, has the NMW enabled firms to establish a more stable and secure product market for their product or service by providing a universal floor to labour costs and, in turn, pricing structure? Second, has the NMW encouraged firms to switch out of product markets characterized by standardized goods and services into quality, niche markets supported by a quality enhancing HR approach?

The power to set prices in competitive product markets

As we saw in section 3.2, more than two in three of our case-study firms (26 out of 36) described the product market they faced as strongly price competitive. These firms face strong competition from a mix of other small firms and large national chains (as well as, in some sectors, firms operating illegally) and typically provide a relatively standardized product. The result is that client firms and individual customers enjoy the stronger hand in negotiating prices for the particular product or service and firms are forced to adapt their cost base (associated with labour, capital, property and supply chain costs) in line with an unstable and uncertain source of revenue. The introduction and uprating of the NMW offers the potential for positive change. In principle, the NMW sets a benchmark standard within a particular product market since all firms must build a universal minimum labour cost into their pricing structure and are no longer faced with the threat of being undercut by low cost domestic competition. In other words, the NMW offers the potential for firms to establish more stable product markets and helps seal a mutual understanding between client and provider of the need to pay a reasonable price for a product or service to meet the cost of minimum labour standards, which, in turn, improves the capacity for employer and employee to forge a more stable employment relationship.

In this section, we review the evidence for such positive transformation in product markets drawing on those firms operating in strongly price competitive product markets. We find some positive examples of change. However, the bulk of our evidence highlights two important constraints to the hypothetical scenario outlined. First, firms may not be able to pass on the full increase in labour costs, in the form of prices, to the clients or customers. Secondly, competition with 'cowboy' firms operating in the informal economy impedes change.

19 of the 26 firms, which identified their product market as strongly price competitive are from three sectors – clothing/ footwear, nursing and residential homes and security. In the security sector we identified several firms where the NMW had stabilised product market prices and had enabled managers to build steady wage cost increases into their pricing strategy. For example, at Security2 wage rates for security guards prior to 1999 were £3.00-£3.50; as such, the need to comply with the NMW meant a significant increase in fees to client firms. The owner took the decision to write to the client firms explaining the need to increase prices as a result of the NMW, despite the risk of losing business:

We pointed out that anybody charging less than this could not legitimately be doing it . . . and we actually broke down the costs for them . . . the pay rates and employer's National Insurance and things just really to prove that we were not intending on making vast profits out of them (Security2).

Loss of business was limited by the fact that Security2 also competes on the basis of its reputation in the local area and it has serviced many of its clients for a long period of time. Nevertheless, bidding for work from new clients may prove more difficult. At Security5 and Security6, the NMW was important in establishing what was a legitimate price, and wage, for security services:

There are still some [client firms] that will go for the down and out cheap prices, but I always say to them – ‘Be it on your own head, don’t come back to us screaming because you’ve paid somebody £4 an hour to watch your premises when the minimum wage is £4.10’. . . We have been able to pass increases in wage costs on to the customers for now. . . We levied a 9 percent rise although we had an 11 per cent rise in the minimum wage (Security5).

The minimum wage was quite good in our opinion. We were never a low payer anyway, but we couldn’t pay the rates we wanted to prior to the minimum wage because you still had jokers out there that were paying pennies . . . So the minimum wage levelled all that off I think . . . I think there is an acceptance out there [among client firms] about the minimum wage and I think there is an acceptance from the companies that at the end of the day you’ve got to pay it (Security6).

The few examples of a stabilization of product market prices through the NMW are considerably outweighed by evidence of constraints. Four examples are identified here:

- the increased willingness of large British retail chains to shop abroad for cheaper products, including clothing and footwear products;
- the inability of individual private nursing and residential homes to alter the pricing structure set by local authorities;
- the unwillingness of many client firms to pay for a higher quality security service; and,
- the continued presence of knitwear and security firms operating in the informal economy.

Among the clothing and footwear firms the problem is that prices in the product market are set through international, not domestic, competition. These firms find it impossible to press for a rise in product prices from high street chains and wholesalers in the UK because retailers are increasingly able and willing to look abroad for cheaper products. Marks and Spencer’s is the well-known example of this business practice, but our interviews suggest that this is now common practice among most retail chains and many owners of the clothing and footwear firms are aware that abolition of the international Multi-Fibre Agreement in 2005 will exacerbate the problem. At each of our case-study firms, with the exception of Footwear3, we encountered a sense of resignation to the new global pressures, coupled with a frustration that more could not be done to turn around the domestic industry:

We have a lot of people who go out to the Far East, Brazil and all over the place and they come back and they say – ‘look at this court shoe here, £2 odd’ – and it costs us £5 or £6, and they [foreign-made shoes] are leather or suede (Footwear1).

I was quoted one of our slippers – somebody bought the equivalent from Spain for £2 a pair less. Ours are about £5, theirs are £3 (Footwear2).

My grievance is that [the government] is saying you have got to pay so much to the employees but they don’t take it the next step and tell our customers that they have to buy a certain proportion of your retail stock from the UK. If America can protect their steel industry by banning or putting tariffs in or whatever, there is no reason why they can’t do that (Knitwear2).

The buyers have been given a brief to go looking around the world because the shops are under more competition to get prices down . . . If we make a garment here for £4.50 that

same garment would come here delivered at £2. It's a massive difference. The government knows what's going on, they're not stupid. They're not interested in manufacturing. We've lost the car industry, we've lost the shipping industry. They're not interested in this industry. . . . It's not progress as far as I am concerned (Knitwear3).

The shift of manufacturing to overseas has also meant the near collapse of the domestic industry to supply the materials, such as the rubber, the fabric and so on, making it increasingly difficult for these firms to find cost savings from the purchase of materials and, at the limit, forcing firms to close.

There's only one company makes the rubber for the soles and they went out of business four weeks ago. Luckily they have got going again, so that was a bit touch and go (Footwear2).

Among the nursing and residential homes we visited, the problem is that prices in the product market for non-private fee-paying patients are set by local government. Four out of seven homes are faced with the prospect of closure because of their inability to pass on the increased wage costs associated with the NMW to the local authorities in return for higher fees. Here, we find an apparent case of a lack of connectedness between one area of government policy and another – between the NMW and funding for elderly care. As reported widely in the media during the spring of 2002, there is a crisis among nursing homes since local authorities, who pay for around 70 per cent of care home residents, have been forced to contain pressure on social services spending by paying care homes annual increases lower than inflation, despite forthcoming legislation that requires all homes to carry out extensive refurbishments (*The Guardian*, 19.03.02). The standard weekly fees received by one of the homes we visited (Home1) have changed marginally from £330 (April 2000-April 2001), £338 (April-September 2001) and £345 (October 2001-April 2002). This represents an increase of less than five per cent over the period April 2000-April 2002 and compares to an increase of more than 14 per cent in the adult rate National Minimum Wage during this same period. The fees paid by the local authorities are adjusted according to a composite index that reflects inflation and average earnings growth. The problem, however, is that earnings growth among low paid workers has increased by more than the average for the economy following the introduction and increases in the NMW.

The stories we heard from owners were desperate ones. All homes, with the exception of Home6 where patients are all private, complained that the inability to pass on the additional costs by charging local authorities higher fees is 'the major problem', as the owner of Home3 put it, facing their business. This has led to reduced profit margins. More significantly for workers and patients in this sector, the shrinking margin between costs and income mean that some Home owners can not pay staff (especially care assistants) the higher wages they believe they deserve, others can not carry out the refurbishments required to maintain the standards of the property, some Homes find it difficult (or impossible) to comply with new care standards and others are considering cutting back on quality of care. The following quotes are relatively long, reflecting in part the strength of feeling on this issue:

They [the staff] get paid what I can afford to pay them. I would love to pay them an extra £2 an hour. Either I fill these homes with private patients and get a realistic rate . . . or Social Services put the rates up to what they should be. The minimum rate for a nursing home now should be in excess of £400. . . . This business is not now functional unless it is 100 per cent occupied. That indicates to me that everything we have done to achieve economies of scale – three homes with the same management team – and it still just breaks even at Social Service rates. . . . And if we have got to invest in the business as the government wants us to – put

single rooms with en suites in all the homes – where the hell is the money coming from? (Home2).

The expectations of [the new Care Standards] are so ridiculous that you can only achieve them if you are running a five-star hotel with appropriate fees to match . . . I would not advise anybody to come into the healthcare sector. If you can sell, then go. In our society there is no concept of what care is actually about. It is purely commercialised (Home3).

Currently [the local authority] is trying to get us to accept – and I say trying because we are refusing - £230 a week. That fee was set in April I believe and it has not changed since. . . . We can't turn it away because they are our only customers and of course now they are telling us . . . the wages we'll pay the staff for doing it (Home4).

The jaded opinion is that everybody is in it for the money, but there really isn't any money. . . . We are ticking over but there is nothing we can alter unless we say [to the patients] you don't have puddings any more, you don't eat cakes, we buy our foods from Aldi, or staff don't wear aprons and gloves . . . or if we don't have fresh flowers (Home5).

The problem, in the eyes of these Home owners, is that there is insufficient opportunity to adapt costing or pricing structures because each area is subject to tight regulations. These regulations cover the scale and composition of staffing, as well as the duties of nurses, care assistants, catering and cleaning staff.

Where's the business at this point? A business which has its wage cost at between 50% and 60% of its income is told by the government . . . how many staff it's got to employ, down to not just how many nurses and care assistants, but how many cooks, how many cleaners . . . [And now] they specify your wage bill (Home2).

Faced with the squeeze on prices, four of the seven Homes face imminent closure. At Home1, in the month following our interview, the owner sold the property and has retired. In her last years running the business she had cut costs in as many areas as possible, including reducing the weekly purchases of meat for the residents and canceling external entertainment (such as the once regular annual trip to Blackpool). Quotes from our interviews with three other Home owners illustrate the decision to close:

We've tried to cut back on everything we can which is why we are at the stage . . . of having to close down. . . . People [in the sector] are saying I've had enough, I'm getting out (Home4).

[The NMW is] just another nail in the coffin really in the care sector (Home5).

Most entrepreneurs are getting out, it is not worth the agro. I will be out as soon as I can (Home6).

The third example of constraints to the power of firms to pass on the cost increases associated with the NMW comes from the security sector. Here, we have a domestic market for the service provided (unlike the clothing and footwear sector) and a large number of firms on the demand side of the product market (unlike the nursing and residential home sector). Nevertheless, five of the six security firms we visited complained that client firms followed a cost minimizing strategy and were not interested in paying a higher price for a better quality service (the exception is Security6, see below). Security services are seen by client firms as a peripheral area of business. For some security firms (as with the nursing homes), this made it difficult to build on the NMW by financing programmes of skill development

Security is always in the secondary domain of the business [of the client firm]. They are not adding anything to production, so they will always switch to cheap. It's a stupid investment decision, but that's what they do (Security1).

I would like for all our guys to have a decent living wage. I would like to have enough spare money in the system to be able to say – 'People, I would like you to take this SITO, or whatever' – and I would like to think that it mattered enough to the clients when I do a quotation and I say all our guards are vetted, our insurance is in order, all our people are SITO Class 1, Class 2, whatever (Security2).

From the very worst . . . guard in the world – if he's getting £4.10 and a guard that is trained up to NVQ standards is getting £4.10, what would you do? You'd take the NVQ guy, but the NVQ guy will go to somebody who's paying £5.50 and you're just all left with the same £4.10 guy who doesn't really want to work (Security3).

An additional problem associated with this sector is that the uncertainty of each year's uprating of the NMW is difficult to manage when many contracts with client firms are signed for a period lasting more than 12 months. Such evidence supports the view that there ought to be a more transparent and stable uprating mechanism for the NMW, as found in other European countries. The following quote illustrates this problem:

Where a lot of the security industry fell down was when the minimum pay went up to £3.70 and then £4.10. People were half way in between three and five year contracts and it went up 40p an hour when you are only charging £5 an hour for a site . . . you might only be making 30p,40p an hour. . . So everybody was trying . . . to say - 'Look, we want more money because of this' – and they were all turning round saying – 'Tough, it's not our fault the government fetched it in' (Security3).

The fourth, and final, example of constraints to firms' pricing strategy concerns the continued presence of firms operating in the informal economy. This applies to the security sector and the knitwear sector. At all six security firms, we were told that the NMW had not yet driven out 'cowboy' firms, which offer cut-price security by operating illegally:

The way to maximize your profit is to do what they do. Firstly, you have a static job [one guard on site] that nobody ever visits; then you don't put a static on it. You've got a job that requires three people, you only put two of them on. . . . These people [the other firms], they haven't got a history with anybody, they just cash, cash, cash, and then when a big bill comes in or the VAT man comes knocking . . . they just say they are not here any more (Security2).

How can you pay a guy £4.10 if you're only charging the customer £4.00? . . . I put a price in – it was £5.99, and we were paying the guy £4.50. They said 'no sorry – we're only being invoiced £4.00 an hour' (Security3).

[The client] was paying the company £5.25 an hour! There is no way he is going to be paying his guard the minimum wage and making a profit. So we just said – 'No chance'. You are up against things like that all the time, because of the villains basically (Security4).

Similarly among the knitwear firms we visited, each was concerned about the need to compete with firms operating illegally – both in the UK and abroad. What was not clear, however, was the extent to which our four case-study firms also operated in the grey areas of pay and employment practices. The following quotes illustrate this ambiguity, as well as the pressure on some owners to consider closure as an alternative to slipping into the informal economy:

What happens, is that – not us – but at the cheaper end of the market, they [other employers] . . . take advantage of these people [the first generation immigrant workers]. And they don't know about the legislation, they don't know about the minimum wage . . . and they [the firms] do that to achieve their lower prices. . . I'm not blaming them. Everyone else is doing it (Knitwear1).

I had a factory inspection from Littlewoods last year and the chap said that some of the things he has seen in factories abroad are absolutely crazy – within a fence all locked up, for eight hours, they're not even allowed to go to the toilet (Knitwear2).

I believe very strongly in doing things correctly. Probably that's why I have no alternative but to go out of business. If I was a devious person I would have found ways to continue still. But I just couldn't. . . I have a very good name in my community . . . [which] is worth more than anything else (Knitwear4)..

Overall, the four factors considered emphasise the way factors *external* to the firm impact negatively on its ability to readjust prices for a given product or service in

response to the NMW. An important *internal* factor that also shapes the firm’s ability and willingness to act is its approach to managing employment. We do not assume a linear causal relationship here, but suggest that there is a potential for a vicious cycle between a low road product market approach and a cost minimizing employment approach, a cycle that may also be reinforced by the kind of external factors analysed above. Table 6.1 examines the relationship between product market strategy and HR approach, drawing on stylized definitions introduced in sections 3.2 and 4 above. Three product market strategies are identified – price-led, price and quality-led and quality-led – and in each case the table associates the firm’s product market strategy with employment approach – cost minimizing, hybrid or quality enhancing. Because of the small sample size, the results only serve to reveal very general patterns.

Table 6.1. Product market strategy and employment practices in the case-study firms

<i>Product market strategy→ Employment practices→</i>	<i>Price-led</i>			<i>Price and quality-led</i>			<i>Quality-led</i>		
	<i>CM</i>	<i>H</i>	<i>QE</i>	<i>CM</i>	<i>H</i>	<i>QE</i>	<i>CM</i>	<i>H</i>	<i>QE</i>
Clothing & footwear	4	0	0	1	2	0	0	0	0
Retail	1	0	0	0	1	0	1	3	1
Nursing & residential homes	0	3	2	0	0	1	0	1	0
Hotels & restaurants	2	0	0	1	0	1	1	2	0
Security	2	1	2	0	0	1	0	0	0
Cleaning	0	0	0	0	1	0	0	1	0
Total	9	4	4	2	4	3	2	7	1

Note: CM = cost minimizing approach to managing employment; H = hybrid approach; and QE = quality enhancing approach. See note to Table 4.2 for definitions.

The main finding of interest from Table 6.1 is that the bulk of firms characterized as having a cost minimizing approach to managing employment (9 out of 13) are also characterized as facing a strongly price competitive product market. Also, among all 17 firms with a price competitive product market, more than half have a cost minimizing employment approach, compared to just one in five among firms which compete mainly on the basis of quality of product or service.

Considering the 9 firms that appear trapped in a reinforcing cycle of a cost minimizing employment approach and a price competitive product market, we find 1 footwear firm, 3 knitwear firms, 1 retail firm, 1 hotel, 1 restaurant and 2 security firms. The footwear firm (Footwear2) pays piece rates, offers no form of training – preferring to recruit from the pool of experienced workers made redundant from neighbouring footwear factories – and organizes work around a narrow division of labour with minimal opportunities for job change, whether to a job position at the same or higher status. As the owner admits, there is little future investment planned, with any competitive advantage gained through intensification of work:

We’ve not been looking very far ahead for the last ten years really, because the trade – it slowly went down and down and down. . . . We’re one of the few employers that employs Asians in the footwear trade I believe. . . . Our Asian vulcanisers are almost doing twice as much as one of our competitors up the road . . . ours work say 12 pairs, they might do 8 pairs (Footwear2).

The 3 knitwear firms appear to survive by tapping into a reserve army of recruits from refugees and recent immigrants to Britain, desperate for any form of paid work. Operating at the boundary of the formal and informal economies, these firms are able to survive with what would otherwise be impossible profit margins. None of these firms had invested in new machinery for more than 15 years and all relied on long working hours as the major employment practice underpinning production. The main exception among price-led firms is the nursing and residential homes sector. Here, we find 5 firms with a hybrid or quality enhancing approach to managing employment. There are two reasons for this. The first is that nursing homes must meet regulations that require staff to undertake training. The second is that most homes offer a great deal of flexibility in working time arrangements in a bid to recruit and retain nurses and care assistants, given the inability to offer higher rates of pay. Nevertheless, there are signs of a cost minimizing approach, especially since the heightened cost pressures imposed by the NMW and the inability of Homes to increase patients' fees. In particular, recruitment of overseas qualified nurses paid at lower rates and more part-timers on reduced hours (below the National Insurance threshold) are two strategies used (and not picked up in our stylized characterization of employment approach). Other Homes rely on the commitment of staff, despite poor terms and conditions of employment and the uncertain business environment. The following two quotes are illustrative:

Of course now we are in the fortunate position if they [qualified nurses] want to move on I just shake their hands and say well good luck, we've got plenty of [overseas] nurses – which is a nice situation to be in (Home4).

The only reason that I have got the staff I've got is because they are dedicated to that type of work and it is very difficult to find people who are (Home2).

The incentive to focus on product quality

As noted in section 3.2, a number of our case-study firms have developed an apparently successful product market strategy underpinned by a focus on a niche market and product/ service quality. By setting a floor to the overall wage structure, the NMW enables firms to identify more accurately their relative position within the low wage economy. It is not easy to separate out the distinctive impact of the NMW on product market strategy, but in several of the firms we visited it does appear that the NMW has provided either a supporting, or an enabling, set of labour market conditions that have propelled firms forward.

Before examining if there is evidence of any general patterns across firms, we first consider some of the case-study examples of successful development of quality-niche product market strategy and the interlinkages with pay. Several firms argued that their ability to offer a high quality service or product to customers was very much a result of the fact that their workers earned above the NMW hourly rate. The comparison between our two cleaning firms highlights the importance associated with workers' perceptions of their relative wage and quality of service, with one firm pursuing a quality-led approach and the other operating in a highly price competitive product market:

If I want to get respect from those girls, I have to show them respect, and paying them a minimum wage and asking them to go around the world and back – because their job isn't easy and I have got standards. Minimum wage, minimum effort; above-average wage, above-average effort. That's the way I see it (Cleaning 1).

Whereas three years ago, £3.50 was a smashing wage, because £4.20 is now the minimum anyone can get £4.20 so if you are a very good cleaner you are looking for £4.75 to £5.00. So although we thought [the NMW] would be very good for the industry . . . it has had a strange

effect on the cleaning staff. . . . The fact we are not paying more than £4.10 is now perceived to be very poor. . . . People's perception is that the minimum wage is minimum – that is, the lowest form of pay is the minimum wage. It is a bad name for it. If it said it is an excellent wage, or a fair wage . . . you could do an interesting paper on the psychology of that (Cleaning2).

At some of the security firms, the higher rates passed on to client firms following the introduction (and successive uprating) of the NMW encouraged many clients to switch from a policy of using 'static' guards (round-the-clock physical presence on site) as the main source of security to use of mobile security services or installation of more high-tech surveillance technologies. As such, the NMW could be said to have indirectly encouraged a switch towards use of higher skilled and more capital intensive security services. Mobile security guards are usually classed as supervisors and are more highly paid than 'static' guards. As such, in this case the NMW has encouraged a positive switch towards greater use of more highly paid workers who carry responsibility for a wider range of job duties, leading to a positive bias in the skill-mix in these small firms. Profit margins earned from the 'mobile' contracts are higher, so while reduced hours for 'static' jobs decreased overall revenue, profits have remained steady during the period of the NMW.

We did put price increases in and we tended to concentrate more on trying to build up the mobile side and try and build up the key holder side . . . It does give us a much better profit margin (Security2).

At this particular firm, a shift in composition of workers from 'static' to 'mobile' guards represents a significant shift in pay structure with the former paid hourly rates of £4.10-4.25 and the latter paid £4.75. Nevertheless, progress appears to have been slow and the owner argued that while he would like to develop a quality HR approach, this is impeded by the competitive conditions of the market for security services, coupled with the low level of the NMW:

My feeling is that for a static job, I should be able to charge somewhere between £7 and £8. [The clients] are paying a site labourer £8 and the people that come and clean £8, but for some reason they completely undervalue the people that . . . look after their office on their own for a complete weekend. . . . And ideally what I'd like is some extra money in the system so that we could pay for training . . . and we could afford like over and above a fiver a week to put in everybody's pension fund – great (Security2).

Only one of the six security firms we visited could be said to be operating in a niche market. In this case (Security6), the decision to diversify was strongly influenced by a determination to reposition itself above other firms paying NMW rates, in part to attract higher quality staff, but also to offer a more rewarding work experience at higher rates of pay. Security guards were retrained as 'building services officers' and now offer a range of additional services, including being able to maintain and repair plumbing and heating, as well as supervising cleaning staff:

As a result of the minimum wage, a lot of clients are now interested in having the right person on site and they've realized that the biggest element in getting that is the pay. So we've seen them [pay rates] creep up and, as I said, our lower line is rapidly approaching £5 an hour. . . . You've got the ones [other security firms] that are banging everybody out at the minimum wage and then you've the ones that are at the higher levels. It's whether the bottom end are ever going to step up, I don't know. I don't know why they haven't done it already. If we've managed to get away with it surely everybody else can . . . I say to all our lads, if you want more pay do a good job, because I will go to our clients and say – 'Look this is what he's done for you in the past twelve months, he's surely worth 20p an hour more. . . . And nine times out of ten they will turn round and say yes he is (Security6).

Four of the seven retail firms we visited combine a quality-led niche product market strategy with above-NMW rates of pay and, again, our interview data suggest a strong association between the willingness of the employer to pay high rates and a commitment (among staff) to quality of service. At Retail2 – a successful small bakery business that produces and sells its own high quality bread – the owner has always paid staff well above the NMW to attract the quality of skills needed. And at Retail4, the owner had recently diversified into selling golfing products by mail order and maintained a firm commitment to his employees’ potential for quality work and the need to match this with above-NMW rates of pay.

You’ve just got to be innovative really. And if you’ve got the skills you’ve cracked it . . . Everyone seems to pay around the minimum really. I like to be above (Retail2).

I think everybody’s good quality given the chance to be appreciated. . . . There’s not many bad people out there I don’t think as long as you look after them and treat them as a human being (Retail4).

To some extent the introduction of the NMW has not directly influenced the perceptions of owners in these two retail firms. What is important for our purposes is that the evidence is supportive of a general pattern - reported in Table 6.2 - that a product market strategy founded on product quality and a niche market tends to be associated with paying above-NMW rates of pay. 7 of the 9 firms competing in niche markets on the basis of product quality paid all their workers above the NMW. By contrast, 10 of the 16 firms competing in mass markets on the basis of price paid more than half their workers at the rate of the NMW.

Table 6.2. Product market strategy and level of pay

<i>Characteristics of product market strategy</i>	<i>% share of employees paid at the NMW</i>		
	<i>None</i>	<i><50%</i>	<i>>50%</i>
Price-led and mass market ¹	4	2	10
Product quality and niche market ²	7	1	1

Notes: 1: Firms are included here if they include the characteristics of ‘price’ *and* ‘mass market’ and do not include either ‘product quality’ or ‘niche market’; 2: Firms are included here is they include the characteristics of ‘product quality’ *and* ‘niche market’ and do not include either ‘price’ or ‘mass market’. Note that this method of characterizing firms means that not all 36 firms are included.

As Table 6.2 reveals, not all firms with a quality-led product market strategy pay above-NMW rates. The two exceptions are Retail1 and Restaurant2. Retail1 pays its sales assistants hourly rates of between £4.10 to £5.38 (which compares to £5.20-£5.50 at Retail2 and £5.00-£10.00 at Retail4), despite the fact that it sells very expensive imported shoes and relies strongly on high quality service from its sales staff. Similarly, Restaurant2 pays its waiters and kitchen assistants £4.10 (plus tips), yet is positioned at the high price end of a niche market in quality food. The following quotes from Retail1 demonstrate the emphasis on quality service, on the one hand, and the unwillingness to pay, on the other,

It is not like a normal shoe shop. . . . I mean our average men’s shoe is £150-£200. . . . We are certainly not a shop where you just go up to the till and say I will have these. We spend time with people. . . We do not sell on the price, we sell on the customer service and that is what brings people back. . . .

We are not looking for a rocket scientist. We are looking for people to be pleasant and I think people have either got that manner or they haven't. . . I don't think it makes much difference what they are paid (Retail1).

6.2. The impact of the NMW on employment practices

In this section we examine the impact of the NMW on each firm's approach to managing employment. In particular, we examine three areas of employment policies and practices: recruitment and retention; training and work organization; and working time. Each of these areas are central to debates concerning the impact of the NMW on work, organizational performance and society. The optimistic scenario suggests that in the post-NMW low wage labour market firms face less difficulties in recruiting and retaining staff since more firms pay a standard rate for a job, reducing competition for staff. Firms invest more in programmes of skill development and innovative forms of work organization to match the higher rates of pay with increased human capital and productivity. Finally, workers paid at higher rates have an incentive to reduce weekly hours of work, leading to a lower incidence of long working hours in low paid sectors. These scenarios ignore a range of countervailing pressures and incentives that lead to alternative outcomes. For example, recruitment and retention may be made more difficult for many firms that traditionally paid above other low paying employers but now find themselves only able to pay the same minimum rate. Also, while a higher hourly rate acts as an incentive to reduce working time (to earn the same weekly wage), it also increases the opportunity cost of each hour not spent in paid work so that some workers may in fact wish to work longer hours.

We explore the evidence surrounding these issues in the following discussion. Throughout our analysis of the interview data we seek to identify the role of the NMW as a pressure for change in employment practices and, where appropriate, we examine firm differences in product market strategy as an additional conditioning factor.

Recruitment and retention

The evidence from the 36 case-study firms is mixed regarding whether the NMW has acted as a stabilising or destabilizing force on firms' ability to recruit and retain staff. The differential impact is, in part, contingent on the product market strategy of the firm with those operating in a price-led, mass market more likely to experience the adverse impact of the NMW on recruitment and retention.

Most of the nursing and residential homes we visited – which could be said to operate in a price-led, mass market for patients – are experiencing grave difficulties recruiting and retaining care assistants as a result of the introduction of the NMW. Given the inability to pay higher rates of pay (see above), Homes now compete with all the major low paying local firms and, in some cases, even find that they can no longer compete on price.

There's a new retail park going to be built in [the local area] . . . How the hell are we going to keep our employees when they do that? I haven't the faintest idea, because they will pay them a damn site more. . . . Every one of them could work quite happily in a retail outlet (Home 2).

The introduction of the minimum wage has brought many problems which is why people who would work in a Care Home will now start looking for jobs in supermarkets, shops and places like that. In the past, supermarkets . . . were paying a lower wage than Care Homes. It's not easy work in a Care Home and so they think why work really hard for £4.10 an hour when I

can get it for sitting behind a till. . . . It's easier jobs for the same rate when they never used to be (Home4).

I only see it getting worse. I see Tesco and Aldi advertising at £7 per hour, there is just no way. I lost four staff this month for the new Sainsbury's [which is paying] £9 to £10 double time on Sunday (Home6)

A similar situation is evident at most of the security firms we visited, where owners complained that the strong competition on prices for security services made it impossible to increase rates of pay, despite the fact that in their local area domestic cleaners were known to earn more. The NMW had also created problems at Cleaning2 where, as we described in section 6.1, the manager argued that it was difficult to attract staff at the NMW rate, but the firm competed on the basis of price and therefore was forced to keep wage costs down. Here, instead of adapting its product market strategy, Cleaning2 emphasised the 'softer' elements of its HR approach as a means of recruiting and retaining staff, despite much dissatisfaction among the workforce regarding the minimum rate of pay.

Q. Are there any other ways you can sell the job as a good package?

Well, financially no. But from a caring point of view – a pastoral sense if you like – we think we do a good job in that respect. Our area managers will be counselor to a lot of the cleaners - available to advise them on everything to being beaten up at home to what to do because they have got terrible bills. So we do a lot of that (Cleaning2).

Providing advice on how to cope with household bills seems a less logical solution than paying higher rates of pay (which may be the cause of such problems), given the problem of recruiting staff.

More positive evidence is detectable among the restaurants visited. Two restaurants paid their waiters and kitchen staff the NMW (Restaurant2 and Restaurant3), but experienced no problems recruiting and retaining staff because of an expectation among job applicants that the good reputation of the restaurant would be positively associated with earnings from tips. As such, the NMW appears to have set a floor to the pay structure in some parts of the restaurant sector, with increments in pay matched with a particular firm's reputation in providing good food and attracting high paying customers.

Upskilling and innovative forms of work organization?

One of the more surprising findings from our study of 36 small low paying firms is that there appears to be very little association between the form of training provision within the firm and its product market strategy and ability to pay. Table 6.3 sets out the number of firms according to four basic categories of training provision and disaggregates the results first by product market strategy and second by the proportion of the workforce paid at the NMW. If we focus on the final column – those firms providing formal training leading to certification (typically NVQ) – we find that 8 of the 13 firms operate in price-led, mass markets and 6 of the 13 pay more than half the employees the NMW. By contrast, only 2 such firms operate in quality-led, niche markets and 4 pay all their workers above the NMW. Looking at the data from a number of different angles does not change this essential story – that is, there is no evidence from our 36 case-study firms of a positive association between training provision and either a quality-led product market strategy, or the ability to pay above NMW rates.

Table 6.3. Training provision, product market strategy and pay

	<i>Form of training provision:</i>			
	<i>None</i>	<i>Informal on-the-job</i>	<i>Formal on-the-job</i>	<i>Formal with certification</i>
<i>Product market strategy:</i>				
- price-led and mass market ¹	0	7	1	8
- hybrid ²	4	3	1	3
- product quality and niche market ³	1	5	1	2
<i>% of employees earning NMW</i>				
- none	4	7	1	4
- >50%	1	2	0	3
- >50%	0	6	2	6
Total	5	15	3	13

Notes: 1: Firms are included here if they include the characteristics of 'price' *and* 'mass market' and do not include either 'product quality' or 'niche market'; 2. Firms included here have some combination of price-led, or mass market *and* product quality or niche market; 3. Firms are included here if they include the characteristics of 'product quality' *and* 'niche market' and do not include either 'price' or 'mass market'.

From the case-study data we suggest there are four main reasons why it is difficult to put together an easy stylized picture regarding training, product market strategy and pay relative to the NMW. First, several successful firms operating in quality-led, niche markets refuse to provide employees with certified training because of disillusionment and bad past experience with the system of National Vocational Qualifications; instead these firms prefer to rely on an informal practice of on-the-job training where new recruits follow the custom of learning from a more experienced colleague:

The two [college students on work experience] at the moment are the worst we've ever had. They are being pushed through. I don't know whether the standards are lower or what but they should be taken off it, because they are not good enough (Retail2). I don't [provide NVQ training] any more. . . . Because I have never seen such crap in all my life. NVQs are just a joke. For example, I trained five NVQ level 3 that had been with me for three years and they have all left for better money in the health service. It was probably the five worst ones I had [who] managed to get NVQ level 3 and it didn't make them any better (Home6).

If you work for us, you get a great [informal on-the-job] training – a great grounding. . . . And it does pay, because we are using fresh products, whereas they [large chains] buy in. They [NVQ trainees in chains] become 'line chefs' if you like. It comes in a box, they open the box, they take it out, they read the instructions – they do whatever they have to do. Very simple. And that is the way the industry is going. There are still a few of us left, but we're the last of that dynasty that do things the proper way (Restaurant1).

Mirroring these opinions among owner managers, one of the senior bakers at Retail2 argued that contemporary training programmes do not enskill workers in the art of baking bread:

What the formal training did was give me a greater technical knowledge of what was happening, so if there's a problem I'm able to work out what it is. . . . The greatest disaster in this country, in my opinion, was the abolition of the apprenticeship system, because you get the practical application and the theoretical knowledge (Senior Baker B, Retail2).

Second, a number of firms which compete on the basis of high quality products or services prefer to 'buy' skilled workers rather than to 'make' them. In other words, several successful firms poach workers who have received training in other firms – a problem that is a well-known characteristic of the so-called low-skill equilibrium that prevails in the UK employment system. Again, this means that firms operating in niche markets are likely to rely on informal on-the-job training.

We have no formal training. If I advertise for anybody I ask for somebody experienced. . . It is getting more and more difficult because there's hardly any people to pinch the employees off (Footwear2).

I can't remember the last time we brought someone completely green in. Not in my time here anyway (Retail5).

If you invest a lot of time, money and effort in an officer, you might just end up doing it for somebody else (Security1).

A third reason why the data does not tell the expected story of high paying niche based firms providing formal, certified training is that several firms operate in price competitive markets but provide certified training because they are required to, or encouraged, by external regulatory bodies. This applies to the nursing and residential home sector and, to a lesser extent, to the security sector. Among the 7 nursing homes visited, five provide NVQ training to staff and two have devised a formal programme of on-the-job training without general certification. Here, the pressures on costs and the external structuring of the market for patients removes the linkage between employment practices, on the one hand, and, on the other, the firm's ability to pay, or product market strategy. Moreover, the one Home that relied solely on private, fee-paying patients had recently discontinued its NVQ training programme because of disappointment in the results (Home6, see quote above). Among the security firms, the encouragement to provide industry-wide certification (SITO) is part of an effort to upgrade the value of security services. Two of the three firms we visited provided such training, despite operating in price-competitive markets (Security1 and Security3) – the third firm, Security6, does in fact demonstrate that formal training can underpin a successful transition to a niche, quality-led market; the innovative development of training was a driver for its successful diversification into high quality building services management. At Security1, skill development was believed to underpin the reputation of the firm in a strongly price competitive market. And at Security3, the provision of certified training was part of a medium-term plan to shift into a new market or higher quality security services, despite fears of staff being poached and the risk of failing to secure new contracts at higher rates. The following quote from the General Manager at Security3 articulates this attempt at transition:

We're thinking if we develop our side as training, the training gets better, the staff get better, we're going to get better. . . . There's profit there. . . . You've got two choices. We're here trying the second choice of training standards and getting standards up and hoping that will expand us. But we could lose out, because we are not going for the little – all the building sites – we're not going for the nasty sites as we call them where all they want is a body on site (Security3).

Fourthly, in several firms we found that although formal and certified training is offered to workers, there is little management effort to develop innovative forms of work organization which exploit the upgraded skills. Arguably, the absence of new forms of work organization limits the extent to which these firms can make the successful transition into niche markets with a focus on product and service quality. The most extreme example is the clothing and footwear sector where patterns of

work organization are extraordinarily dated. Production is characterized by a strongly Taylorist system of work organization with employees and homeworkers working day after day on the same highly simplified job task. The large footwear factory, Footwear1, is an NVQ training centre and management is committed to training every new recruit to NVQ levels 1 and 2. However, there was no evidence of a similar commitment to developing new forms of production organization (involving, for example, job rotation, teamworking and employee involvement in innovation), nor to provide the 250 employees with rewarding and satisfying work. For example, workers in the 'bottom stock area' spend their days manually applying solvents to the soles of shoes; in the 'closing' area around 50 women carry out repetitive tasks on basic sewing machines; and in 'lasting' male workers work on individual tasks finishing shoes, standing all day on a small step at the edge of a slowly rotating machine. For all these workers, there is no variation of job tasks. When questioned, managers argued that workers preferred to specialize in one task since they could maximize their earnings from the piece rate system and that this system of costing was optimum for the firm. This coincidence of wants appears unlikely. It is more likely that since management believes the narrow division of labour is associated with higher levels of productivity, employees have in fact limited opportunity to voice their preferences over the form of work organization. Importantly, this firm's resistance to multi-skilling has led managers to challenge the industry standards for National Vocational Qualifications, which were initially designed to promote acquisition of broad skills across a range of job tasks. As a leading firm in the industry and an NVQ training centre, Footwear1 has recently been able to change these standards so that only one narrow skill is now required for NVQ Level 2.

Other firms in this sector appear locked into a low road, low quality approach, with no investment in training and no apparent concern to move out of the price competitive market. At Footwear2, there was evidence of a failure to invest in machinery that provided for basic safety. The owner had resorted to employing Asian workers to carry out the job of 'vulcanising' (the process of moulding the uppers of the slipper to the sole), since, in the owners words, '[they] are prepared to do the lousy jobs aren't they, rather than a lot of white people'. The job is highly dangerous as it is fast paced and involves near physical contact with metal parts maintained at high temperatures. The labour process was described to us as follows:

It takes ten minutes for each mould to produce a pair of slippers. So one man runs about twelve moulds. So depending how quick he is going around, he starts at one end and by the time he has got round to the start again ten minutes should have elapsed, which is the cooking time. If you cook them too long they burn (Footwear2).

The incentive to reduce working time?

14 of the 36 case-study firms have long hours of working for most workers. These include 3 knitwear firms, 2 hotels, 3 restaurants and all 6 security firms visited. A simple comparison of those firms with long hours and those with standard hours of 40 or less per week shows that the former group are more likely to compete in mass markets on the basis of price (Table 6.4). Nine out of 14 firms that require long weekly working hours compete in mass markets on the basis of price, compared to seven of the 22 firms with standard weekly working hours.

Table 6.4. Working hours and product market strategy

	Long hours (>40 per week)	Standard hours
<i>Product market strategy:</i>		
- price-led and mass market ¹	9	7
- hybrid ²	3	8
- product quality and niche market ³	2	7
Total	14	22

Notes: 1: Firms are included here if they include the characteristics of 'price' *and* 'mass market' and do not include either 'product quality' or 'niche market'; 2. Firms included here have some combination of price-led, or mass market *and* product quality or niche market; 3. Firms are included here if they include the characteristics of 'product quality' *and* 'niche market' and do not include either 'price' or 'mass market'.

We encountered the longest working hours at the knitwear firms and the security firms. In both cases, many of the owners and managers we interviewed made the somewhat extraordinary argument that the problem was the fault of workers demanding longer hours – that there was a 'culture' of working long hours, among older workers (in the security firms) and among the Pakistani immigrants (at the knitwear firms):

The way the culture is set up, the men would like to work 7 days, they'd like to do the 12 hours. . . . They are always asking for more work (Knitwear1).

Oh [the workers] work longer hours than we do. They could work 60-70 hours per week. They do a different culture thing to us altogether. But this is not forced by management. They've nothing else to do. When I finish work, I like to go home, relax . . . I might go for a bite to eat. These don't do that. . . They've nothing else to do but work. It's a different culture (Knitwear3).

A lot of our guards just didn't take any time off. I think probably the nature of the guards has probably improved slightly and they are more the caliber that they would be taking more holidays . . . The older lads, - 'Oh bloody hell' – they'll say to me sometimes – 'can you find me anything for Friday or Saturday? . . . bloody mother-in-law's coming up . . . I can just say to the wife can't do it love, got to work' (Security2).

A lot of them [security guards] are sad, lonely people. It's because they haven't got a life. . . They work up a lot of hours, but they're happy to do it. We won't force anybody into it. A lot of people ask us if they can do more hours and we don't like doing it because we think they're just going to kill themselves in the long run. If you're doing seven nights a week at 12 hours or 14 hour shifts you cannot be *compos mentis* (Security3).

However, the argument that workers suffer from an ingrained 'culture' of long working hours does not fit with our evidence from talking with employees, as the following quote demonstrates:

You have no social life, for a start. By 7 o'clock, 8 o'clock at night you are looking for your bed. You get a day off, Sunday, but after a Saturday in here all you are fit for on a Saturday night is a couple of pints and that's it (Driver, Retail2).

Moreover, there is clearly an issue related to the unwillingness, or inability, of managers – in the absence of a strong incentive – to reorganise the system of working time. In one of the security firms, the manager admitted that splitting long night shifts between guards might lead to unnecessary costs:

If the company shuts at 5.30pm, they will want a guard on duty from 6 o'clock until 6 in the morning. If you had to split that into an 8 hour shift and a 4 hour shift, staff levels would double (Security4).

This particular manager argued that employing more people on shorter shift patterns would be more costly because it involves additional recruitment costs and additional complications organizing multi-worker schedules for cover on each site. Of course, this ignores the fact that increasing the size of the workforce reduces the difficulties of covering for absences (sickness or holidays) since not only are there more workers available to provide cover, but also the number of hours to cover is less.

We found evidence of reduced working time as an indirect result of the NMW among firms in just one sector – security. At Security2, in response to the higher prices charged for hourly security cover, many client firms reduced the amount of cover required. Consequently, many night shifts had been reduced from the traditional 16-hour shift (5pm-9am) to 12 hours (typically 7pm-7am). While we do not have data to show whether the total number of shifts among security guards changed or remained constant, the reduction in long shifts marks a positive development indirectly associated with the NMW. At Security6, the uprating of pay following the introduction of the NMW meant that some guards preferred to work fewer hours, while others saw the chance to earn an even higher weekly wage. The following quotes illustrate these findings:

People used to work tremendous hours. If I was going to average it I would say they probably averaged like 70, 80 hours a week and some people would work more. . . . But the hours have definitely come down over the past five years. . . . If you tell [a client firm] their hourly rate is going up by £1 or £1.50, then that's £180 a week . . . so they said – 'Instead of coming on at 5pm come on at 7pm . . . and instead of staying on until 8 or 9 o'clock, . . . why don't you stay on until 7?' (Security2).

We have got lads now who work less hours than they did before simply because we are paying far more than they need and we have got some lads who basically have seen the opportunity to get even more money (Security6).

Nevertheless, there is evidence (from managers and workers) that workers are opting for more hours at reduced rates of pay in an effort to maximize weekly, not hourly, earnings – especially in a context where old premium payments for unsocial hours have been abolished:

Group4 and Securicor, and people like that, they will do a certain amount of SITO training and what they then don't necessarily provide is - even if their wages are 50p or £1 more than we are paying – if they then say to somebody – 'Look, we will only allow you to do 30 hours a week, or 35 hours a week' - or whatever, they say I'd rather work another ten hours a week. . . . And so we get them trickling to us (Security2).

I do about 52, 54 hours a week. . . . It's the only way of making a decent wage. The only way I can come with anything worth taking home is by putting the hours in. . . . It does cause a bit of friction at home . . . There are plenty of jobs to be done at home . . . You're working unsocial hours and if I work Sundays you don't get any premium rate (Conference and Banqueting Supervisor, Hotel2).

In most firms, however, the NMW appears to have done little to alter working time arrangements. Moreover, where information was forthcoming, we found that firms reliant on long working hours asked their employees to sign away their rights as covered by the Working Time Directive and that overtime hours were paid at standard rates of pay. Our investigation into the reasons for long working hours reveals that they are largely related to the unwillingness among managers to reorganize working time around a standard working week that fits with the demands on production and service delivery. A secondary reason is that some workers are still keen to work long hours in order to build up their level of weekly earnings – sometimes taking on another part-time job to supplement full-time earnings. This

reflects both the low level of the NMW and the absence of payment structures within the firm that provide for steady pay advancement over a worker's life.

Of course, of course you have to [work elsewhere]. Most people now have two jobs, you do need it. It's Asda that's keeping me going at the moment (PackerB, Knitwear3).

[The Working Time Directive] is marvelous. I'm all for it. I wish everybody could work 48 hours a week. It doesn't work that way. . . Theoretically if you are sitting in Westminster it's easy. If you are sat in Manchester trying to keep people employed – and it's a low pay industry, a lot of small companies are paying the minimum wage – so those guys want at least sixty hours to be able to live (Security1).

What we do, we get them to sign a disclaimer saying that they'll work anything over 48 hours a week (Security3).

Conclusion

This report presents qualitative case-study evidence of the way 36 small firms have responded to the introduction of, and subsequent increases in, the National Minimum Wage. Many of the firms surveyed have welcomed the NMW, and see the benefits this potentially brings in terms of their ability to bargain with client firms over prices, their capacity to link higher pay with investment in training and better ways of working, and the opportunity to develop a 'high road' approach to the provision of the particular service or product. However, the evidence demonstrates that much of the potential of the NMW to inspire positive transformation in strategies towards product markets and employment policies has not been realized because of a range of conflicting and constraining factors, both internal and external to the firm.

Our research provides qualitative evidence concerning the major policy questions on the impact of the NMW at the level of the firm. *First, what is the effect of the NMW on pay structures in small firms?* We found that around half our sample were forced to increase the lowest rates paid (in 1999 and 2001) and slightly less than half of these firms restored internal differentials with workers on higher rates. Importantly, therefore, our data reveal that the spike in the wage distribution around the NMW reflects both the uprating of pay from levels previously below the NMW and a narrowing of pay differentials among low paid workers in some firms. Moreover, in some nursing homes there is evidence of a strong gender effect, with a narrowing of differentials among female-dominated occupational groups yet a restoration of differentials with the higher paid male-dominated occupations. The difficulty for policy-makers is that the limited evidence of restoration of internal pay differentials represents a positive result for those concerned with the inflationary impact of the NMW, yet a negative result for those concerned with improving the terms and conditions of all low paid workers – not simply those paid at (or below) the NMW. Moreover, our research demonstrates that in many small firms workers find it very difficult to press for regular increases in pay, so that it looks very likely that differentials among low paid workers in small firms are set to narrow over the medium-to-long term. Such an outcome is not desirable as it removes opportunities for pay progression, coupled with job advancement, within the firm. Policy therefore needs to consider how to address this issue, either by improving the rights of individual workers in small firms to negotiate regular increases in pay, or to work with unions towards the goal of strengthening unionization among these workers.

Secondly, what is the impact of the NMW on jobs? Here, our data show that only one of the 36 firms stated that the NMW was a major, direct factor in the decision to cut the numbers employed. Overall, 13 firms reduced their workforce between 1998 and

2002, but the main explanatory factors involved changes in product market strategy, declining product demand and declining profitability – all of which predate the introduction of the NMW. Other firms, such as those in the nursing and residential care sector, would have reduced jobs but were forced to meet government regulations on staffing-patient ratios; instead we found evidence of reductions in working time among full-timers and part-timers.

Thirdly, does the NMW increase the ability of small firms operating in competitive markets to agree reasonable prices with their clients? Only a minority of firms have experienced a stabilization of product prices thanks to the NMW. Some security firms, for example, are now able to build regular wage increases into their contracts for services with client firms; although the lack of a transparent uprating mechanism for the NMW makes the writing of contracts of more than 12 months very difficult. Our data show that the majority of firms face serious constraints. The knitwear and footwear manufacturers find it impossible to bargain with the large British retail chains because retailers increasingly look abroad for cheaper product prices. Nursing and residential homes are unable to negotiate higher prices with their clients (mainly the local authority) because they are locked into a fee structure set independently of NMW increases. Some security firms have found it difficult to pass on higher costs because of the apparent unwillingness of many of their client firms to upgrade their valuation of security services. Finally, firms operating illegally in the knitwear sector and security sector make it difficult for other firms in these sectors to agree reasonable prices from clients. There is clearly scope for practical policy measures and industry initiatives here. The nursing and residential care sector is the most obvious and immediate case that demands policy action. It is quite clear that the fee structure, which is regulated independently by local authorities, and the level of costs borne by individual homes, which is increasingly determined by the NMW, need to be brought into line. This involves new guidelines on the factors used to determine fee increases, with disproportionate weighting given to changes in the NMW, alongside other factors such as the annual pay rise for NHS nursing and midwifery staff and the retail price index. Policy initiatives may also be developed to support local districts of knitwear firms. For example, regional bodies might provide firms with marketing advice, or government might encourage the large retailers to support local industry by buying British products. Finally, the adoption of an indexation mechanism for regular uprating of the NMW would facilitate the pricing of services agreed in the form of multi-year contracts.

Fourthly, can the NMW encourage small firms to switch into niche-based, quality product markets? Our research shows quite clearly that firms operating in niche-based product markets are more likely to pay workers above-NMW rates than firms operating in mass markets. Interviews with owners of firms demonstrate that this is not a coincidence; we identified a positive commitment to paying relative high rates of pay as a means of encouraging workers to deliver a high quality service or to manufacture a high quality product. In the security sector, some clients have responded to the knock-on effect of the NMW on prices by opting for a higher quality (and higher paid) form of security services. In one security firm, in a positive effort to move out of the low wage labour market following the 2001 increase in the NMW, the owner now provides building management services, in addition to the traditional security services, and has achieved this by retraining the existing workforce and paying them higher rates. But the number of examples where the NMW has acted as

a positive catalyst for change is limited. The reason for this is that for many firms a low road product market approach (that is, a mass market characterized by strong price competition) seems to be locked in by a cost minimizing approach to managing employment (that is, informal or no training, no pay progression and long working hours). For example, knitwear firms rely on desperate immigrant workers to work long hours as a strategy to meet uncertain customer demands, rather than invest in new machinery or programmes of skill development. Also, two of the three footwear manufacturers organize workers into very narrow, detailed job tasks to fit with their piece-rate payment systems, but this conflicts with practices of upskilling and employee involvement which, arguably, are required for a high road product market strategy. As such, there is some evidence of inertia among the owners and managing directors of small firms. Policy initiatives need to focus on encouraging small firms to modernize employment practices - in line with new pay structures underpinned by the NMW - as a foundation stone for an alternative quality-based product market approach that can improve profit margins and performance of the firm.

Fifthly, does the NMW encourage small firms to provide more training? We expected to find that firms paying higher rates to their workers would be more likely to support this with a package of continuous skill development than firms paying lower wages. However, our data show no such association. On the one hand, several firms operating in quality-led product markets had poor experience with NVQ programmes or prefer to poach workers and therefore do not offer in-house training. On the other hand, many firms operating in price-led markets are either required to provide formal training by regulatory bodies, or do not exploit their formal training programmes by adopting innovative systems of work organization. These findings confirm the longstanding problems with institutionalizing a system of vocational training in the UK that is both reputable among employers and discourages poaching. Moreover, where formal training programmes are adopted these need to be accompanied by innovative forms of organizing work (job rotation, increased worker discretion) in a way that supports a switch into quality-based product markets.

Sixthly, what is the impact of the NMW on working hours? The data provide limited support to the argument that the NMW acts as an incentive for workers to reduce working hours. Some security firms reduced working hours both because client firms requested reduced hours cover following the price increases and because some employees expressed a preference to work fewer hours. But most firms operating on the basis of long working hours continue to do so. Firm owners blame the lack of change on a culture of long working hours among their workers – although we found no evidence of this from interviews with employees. Instead, employers appear to lack the will to implement new shift systems, and employees argue that long hours are the only means of taking home a decent weekly wage. As a result, employees are happy to sign opt-outs from the Working Time Directive since this enables them to build up their weekly earnings. Here, policy action needs to be two-pronged. On the one hand, employers need encouragement to adapt their business practices around more reasonable working hours. On the other hand, the relative level of the NMW needs to be improved so that a standard 40-hour week provides for a decent

wage.² The lack of evidence of job cuts in response to the NMW suggests that higher levels of the NMW can be sustained in the labour market.

Overall, the qualitative research data reported here shows that while most small firms have adjusted pay structures in direct response to the NMW and few have cut numbers employed, there are limited signs of substantive transformations associated with indirect adjustments in product market strategy or employment policy. The evidence suggests that this is largely because of the way other factors have impeded the potential for positive change. It is these factors that ought to be the focus for future initiatives and policy action in the effort to lift up the low wage economy in Britain – in the name of providing decent work for the many low paid workers surveyed here and supporting improved business conditions for small firms.

² During 2001, the adult rate of £3.70 was 38.7% of the median hourly pay of all male full-timers and, with the increase in October to £4.10, the ratio increased to 42.8%. However, against 2002 median earnings this ratio will be reduced for the period January to September (*New Earnings Survey* data are not yet available).

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APPENDIX

Appendix Table 1. Characteristics of 36 case-study firms

Clothing and Footwear

	Region	Found ed	Own ers hip	Establish -ments	Annual Sales Turnover	Change in profitability (1988-2002)	No. of Employees	Change in numbers employed (1998 – 2002)	Share of employees paid at NMW	Main Activities
Footwear1	Burnley/ Rossendale	1896	Ltd. Co. (part of Group)	1	£5m - £6m	Stable	250	None	Less than 50%	Shoe manufacture
Footwear2	Burnley/ Rossendale	1952	Ltd. Co.	1	£1m.	Decrease	25	Small decrease	None	Slipper manufacture
Footwear3	Burnley/ Rossendale	1932	Ltd. Co.	1	£650,000	Increase	24	Large decrease	Less than 50%	Manufacture of dance and bridal shoes
Knitwear1	Manchester/ Salford	1989	Ltd Co.	1	£125,000	Decrease	10*	Large decrease	More than 50%	Knitwear manufacture
Knitwear2	Manchester/ Salford	1988	Ltd. Co.	1	£300,000	Decrease	15*	Large decrease	More than 50%	Knitwear manufacture
Knitwear3	Manchester/ Salford	1983	Ltd. Co.	1	£1.5m	Decrease	65*	Large decrease	More than 50%	Knitwear manufacture
Knitwear4	Manchester/ Salford	1974	Ltd. Co	1	£175,000	Decrease	5 (+ 6 home workers*)	None	More than 50%	Knitwear Manufacture

*For the knitwear firms the number of employees listed refers to the peak level during the current year (May 01 - Feb 02)

Retail

	Region	Founded	Ownership	Establish -ments	Annual Sales Turnover	Change in profitability (1988-2002)	No. of Employees	Change in numbers employed (1998 – 2002)	Share of employees paid at NMW	Main Activities
Retail1	Manchester/ Salford	1993	Ltd. Co.	3	£1.3m	Increase	30	Small decrease	Less than 50%	Shoe Retail
Retail2	Manchester/ Salford	1985	Ltd. Co.	1	£1.4m	Increase	41	Small increase	None	Delicatessen and Bakery
Retail3	Manchester/ Salford	1986	Ltd. Co.	2	£300,000.	Stable	8	Small decrease	None	Cards and Gifts
Retail4	Manchester/ Salford	1980	Partnership	2	£5m	Increase	27	Large increase	None	Golf clothing and equipment (incl. Mail order)
Retail5	Manchester/ Salford	1895	Ltd. Co.	1	£200,000	Increase	5	Large decrease	None	Menswear
Retail6	Manchester/ Salford	1979	Ltd. Co.	1	£2m	Increase	10	Large increase	None	Retail furniture and interior design
Retail7	Manchester/ Salford Burnley/ Rossendale	1948	Partnership	2	£400,000	Stable	2	None	None	Leather goods, gifts, luggage

Nursing and Residential Homes

	Region	Founded	Ownership	Establishments	Annual Sales Turnover	Change in profitability (1988-2002)	No. of Employees	Change in numbers employed (1998 – 2002)	Share of employees paid at NMW	Main Activities
Home1	Manchester/Salford	1983	Sole proprietor	1	£350,000	Decrease	25	Small decrease	More than 50% (Check)	Registered nursing home
Home2	Macclesfield/Cheshire	1992	Partnership	1	£936,000	Decrease	50	Small decrease	More than 50%	Registered nursing home
Home3	Burnley/Rossendale	1987 (Nursing Home) 1995 (Medical Centre)	Partnership	2	£600,000	Decrease	42	Large decrease	More than 50%	Registered Nursing Home and Medical Centre
Home4	Burnley/Rossendale	1990	Partnership	3	£1.2m	Decrease	90?	Small increase	More than 50%	Registered nursing home
Home5	Burnley/Rossendale	1985	Ltd. Co.	1	£360,000	Stable	26	Small decrease	Less than 50%	Residential home
Home6	Macclesfield/Cheshire	1997	Ltd. Co.	1	£2 - 4m	Stable	125	Large increase	None	Registered nursing home
Home7	Manchester/Salford	1988	Ltd. Co.	1	£478,000	Stable	25	None	More than 50%	Registered Nursing/residential home

Hotels and Restaurants

	Region	Found- ed	Owner- ship	Establish- -ments	Annual Sales Turnover	Change in profitability (1988-2002)	No. of Employees	Change in numbers employed (1998 – 2002)	Share of employees paid at NMW	Main Activities
Hotel1	Macclesfield / Cheshire	1952	Ltd. Co.	1	£1.4m	Stable	36	Small increase	None	Hotel, restaurant and conference centre
Hotel2	Manchester/ Salford	2000	Ltd. Co	1	£1 - 2m	Decrease	64	None	More than 50%	Hotel
Restaurant1	Manchester/ Salford	1982	Ltd. Co.	1	£310,000 - £340,000	Stable	8	None	None	Restaurant
Restaurant2	Manchester/ Salford	1987	Sole Propriet or	2	£1.25m	Stable	70	Small increase	More than 50%	Restaurant and Wine Bar
Restaurant3	Manchester/ Salford	1997	Ltd. Co.	2	£1.5 - £1.7m	Increase	87	Large increase	More than 50%	Pubs/ restaurants
Restaurant4	Manchester/ Salford	1970	Sole propriet or	1	£300,000	Decrease	10	Small decrease	None	Indian Restaurant
Restaurant5	Manchester/ Salford	1997	Partners hip	1	£200,000	Stable	12	None	None	Restaurant

Security

	Region	Founded	Owner-ship	Establish-ments	Sales Turnover	Change in profitability (1988-2002)	Employees	Change in numbers employed (1998 – 2002)	Share of employees paid at NMW	Main Activities
Security1	Manchester/ Salford	1987	Ltd. Co.	2	£2m	Stable	150	None	None	Security Services/ Manned guarding
Security2	Macclesfield / Cheshire	1973	Ltd. Co.	1	£700,000	Increase	36	Small increase		Security Services/ manned guarding
Security3	Manchester/ Salford	1997	Ltd. Co	2	£2.5m	Increase	171	Large increase		Security Services/ manned guarding
Security4	Macclesfield / Cheshire	1998	Sole proprietor	1	£180,000	Increase	13	Large increase	None	Security Services/ manned guarding, dog handling
Security5	Manchester/ Salford	1992	Ltd. Co.	3	£500,000	Decrease	30	None	All	Security Services/ manned guarding
Security6	Macclesfield / Cheshire	1992	Ltd. Co.	2	£1.9m	Increase	65	Large increase	None	Security services, building services, manned guarding, risk management consultancy

Cleaning

	Region	Founded	Owner-ship	Establish-ments	Sales Turnover	Change in profitability (1988-2002)	Employees	Change in numbers employed (1998 – 2002)	Share of employees paid at NMW	Main Activities
Cleaning1	Manchester/Salford	2001	Sole Proprietor	1	£50,000	Increase	6	Large increase	None	Domestic cleaning
Cleaning2	Manchester/Salford	1951	Ltd. Co.	1	£1.7m	Stable	370	Small increase	More than 50%	Office Cleaning

Notes: Change in numbers employed referred to as a large increase (>25%), small increase (0<25%), small decrease (-25%>0) and large decrease (<-25%).

Appendix Table 2. Details of employees interviewed in five firms

<i>Knitwear3</i>	<i>Retail2</i>	<i>Home1</i>	<i>Hotel2</i>	<i>Cleaning2</i>
Cutter A (male full-time)	Driver/ order picker (male full-time)	Senior Care Assistant (female full-time)	Breakfast/lunch Supervisor (female full-time)	Office Cleaner A (female part-time)
Cutter B (male full-time)	Baker (male full-time)	Care Assistant (female full-time)	Conference/banqueting Supervisor (male full-time)	Office cleaner B (female part-time)
Packer/ presser A (male full-time)	Senior Baker (male full-time)	Cleaner/ odd jobs (male part-time)	Waitress and bar worker (female full-time)	Supervisor (female full-time)
Packer/ presser B (male full-time)		Laundry Assistant (female full-time)	Chambermaid (female part-time)	
			Receptionist/payroll/sales/relief Duty Manager (male full-time)	

Appendix Table 3. Characteristics of product market strategy

	<i>Total</i>	<i>Footwear/ clothing</i>	<i>Retail</i>	<i>Residential Care</i>	<i>Hospitality</i>	<i>Security</i>	<i>Cleaning</i>
Price	26	7	2	6	4	6	1
Mass market	22	4	2	6	2	6	2
Product quality	19	3	6	2	5	1	2
Established reputation/ reliability	14	2	2	2	4	3	1
Niche market	15	3	5	1	5	1	0
Product design	9	3	5	0	1	0	0
New capital investment	3	1	0	1	1	0	0
Personal attention to client needs	22	1	4	7	3	5	2
Diversification	4	1	1	0	1	1	0

Notes: Total sample, N = 36.

Source: Management interviews on describing the way the firm competes (question 1.4).

Appendix Table 4. Characteristics of HR approach

	<i>Total</i>	<i>Footwear/ clothing</i>	<i>Retail</i>	<i>Residential Care</i>	<i>Hospitality</i>	<i>Security</i>	<i>Cleaning</i>
Training:							
- informal on-the-job	15	4	5	0	1	3	2
- formal on-the-job	3	0	0	2	1	0	0
- formal leading to certification	13	1	0	5	4	3	0
- none	5	2	2	0	1	0	0
Job/ pay advancement:							
- flat rate or piece rate	19	7	2	2	6	1	1
- incremental pay scale	17	0	5	5	1	5	1
- job promotion	14	2	3	2	3	3	1
- no job promotion	22	5	4	5	4	3	1
Working time:							
- long hours (>40pw)	14	3	0	0	5	6	0
- Sat+Sun working	23	3	1	7	6	6	0
- PT hours to meet staff needs	11	0	4	4	1	1	1

Notes: Total sample, N = 36.

Source: Management interviews on describing the way HR policies (questions 3.5, 3.8, 4.4, 4.6).

