Tackling the Low Skills Equilibrium: A Review of Issues and Some New Evidence

Edited by Rob Wilson and Terence Hogarth

with contributions by
Derek Bosworth, Andy Dickerson, Anne Green, Chris Jacobs, Ewart Keep, Ken Mayhew, and Sarah Watson

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Contact details: Rob Wilson
Institute for Employment Research
University of Warwick
COVENTRY, CV4 7AL
R.A.Wilson@warwick.ac.uk
Tel: 02476-523530

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SUMMARY

S.1 Aims and Objectives

A low skills equilibrium (LSEq) is a situation where an economy becomes trapped in a vicious circle of low value added, low skills and low wages. A combination of relatively low wages but high employment seems to have become increasingly common in some parts of the UK economy. While there has been considerable success in terms of tackling unemployment and creating many new jobs, in a number of regions and sectors there is an increasing reliance on low skilled and low paid jobs. However, it is far from clear that this position is sustainable in the longer term. This was an important part of the motivation to undertake the present DTI funded study.

This problem is seen by many as part of a general systems failure, involving the UK's vocational education and training (VET) system and related institutional and regulatory frameworks. However, that the UK as a whole is in some kind of LSEq state is not the central contention motivating the present research. The UK may well lie closer to the low skills equilibrium end of the spectrum than the high skills end, but many organisations are following product and skill strategies that cannot be so readily characterised as low skill trajectories. This suggests the need for a micro level approach, based on case studies of individual organizations.

The aims and objectives of the project were:

- to assess what evidence there is of a low skills equilibrium in particular parts of the UK economy;
- to explore whether or not this phenomenon has regional or sectoral specific aspects;
- to advise about whether the causes (and potential solutions) are amenable to policy intervention, especially at a regional level.

Since the term was first coined in the late 1980s, the concept of a low skills equilibrium has been the object of debate and refinement. Although much of the early discussion was in terms of the situation at a macro, whole economy level, it is arguably best understood at the level of the individual organisation. An organisation makes strategic decisions about the specification of its product. There is a spectrum available, from low to high specification. A product becomes higher specification the more characteristics it possesses, the more ready its producer is to customise it for different consumers at any given point in time, and the more its characteristics change over time. The choice of specification dictates the production process and, other things being equal, the lower the specification, the lower the skill intensity of the production process – the lower the demand for skill. Producers of low specification products will compete largely on price and therefore on unit labour costs. By contrast, producers of high specification products will be less dependent on price competition.

In any country, organisations will be found at different points along the specification spectrum. But the LSEq concept is about the aggregate of these individual positions;

it is also a relative one, which has usually been used to compare different countries. It has been contended that a larger proportion of UK economic activity is low specification than in traditional comparator countries. If such a contention is true, then a significant proportion of the country's workforce will be involved in relatively low wage, low value added production. A country that finds itself in this position might be described as being on a low skills trajectory. Historically the term equilibrium has been used to emphasise two important things. First, the individual organisation may be perfectly successful when operating at the low end of the product spectrum, but if too many organisations operate there, the aggregate consequences may be undesirable for society as a whole. Second, even if such an organisation wished to move higher up the product chain, a battery of historically inherited constraints and incentives, some specific to the organisational and some societal, may prevent this.

Though normally deployed at the national level, the concept of low skill equilibrium or trajectory can also be used to study regions within a country. This was the objective of this research project. Specifically it involves case studies of organisations in food processing and in the business hotel sector in the East and West Midlands. Given the focus upon individual cases, it is important to recognise that the project is not designed to make judgements about whether or not these two regions as a whole are trapped in low skill trajectories. Rather it studies the complex interactions between product specification and skills at the organisational level. The results provide important lessons for policy makers who may wish to devise measures to encourage higher specification, higher value added production within a country or region.

S.2 The Approach

The focus of the study is on the *individual organisation and its product strategy.* While general sectoral and spatial factors may play an important role, the experience, behaviour and performance of individual organisations need to be examined in depth if useful lessons are to be learned.

The core of the approach is, therefore, a set of company level case studies, involving comparison, across two selected industries and two regions. These focus upon the effect of product strategy and skill policy on organisational performance. Comparisons are made between companies operating in the same segment of their product market but generating different levels of value-added. The main aim here is to look at their product strategies and their deployment of skills, including how the latter are influenced by and interact with the education and training system. The case studies also address, as far as possible, the extent to which employers use the external education and training system to support their product market strategies.

The first stage of the project involved discussion and negotiation with various local partners as well as with the sponsors of the research (the Department of Trade and Industry (DTI)). The aims of this inclusive approach were threefold:

- to engage in a debate about the issues;
- to clarify the environment within which organisations were operating; and finally,
- to help in the selection of cases.

This was quite a complex process. It involved a series of primarily informal meetings. The initial focus was on identifying particular cases (sectors and particular companies) for more detailed study.

The final choice of regions and sectors focussed upon the East and West Midlands, with interviews concentrated amongst organisations in the food processing and business hotels sectors. These choices provided a range of both manufacturing and service activities, which are significant employers in the two regions and where the problems of low wages and low skills are particularly acute.

Food processing

Food processing is a mature manufacturing sector that has seen an expansion in the sale of higher value-added products because of increasing consumer demand for ready prepared food. Employment in this higher value-added segment of the sector is primarily semi-skilled. However, it also involves a substantial number of technicians and associate professionals concerned with food technology, health and hygiene, and new product development activities, as well as a cadre of maintenance engineers responsible for installing and maintaining production lines. There is also a premium products market, for example, the production of premium quality meat and cheese products. Here quality production standards also have to be maintained but this relies upon more labour intensive processes, with the emphasis on the skills and knowledge of a few key personnel.

At the other end of the market there is the low value-added sector, engaged in either highly automated or labour intensive production of standard quality foods, sold at a low margin. Arguably, the buying power of a relatively small number of food retailers compounds the problem of being stuck in a low-value added market, given the alleged capacity of these retailers to push down prices.

Whilst there is potential for extending the premium products market, there is concern that the food and drink industry is not achieving its true potential. From a skills perspective, research has pointed to an unsophisticated demand for skills from employers and a poor supply of skills from colleges mutually reinforcing one another.

Business Hotels and Hospitality

Tourism is a growth industry throughout Britain. In the East and West Midlands there is a mix of high and low value-added activities. Tourism covers a very wide range of activities. For this project it was necessary to select a sub-section of the sector, which could be defined with reference either to types of consumer (for example, business tourism, short break holidays, consumer tourism) or to types of activity (for example, hotels or restaurants). This project chose to concentrate on business hotels.

At one extreme, business tourism is a potentially high value-added market with large international chains of hotels offering luxurious comfort and 24-hour service to residents and to delegates at conferences and other events. This requires not only high staffing rates but also specific skills related, for instance, to kitchen activities and the management of events. But there is a range of possible market offerings. For example, budget hotels provide a basic service where the guest may not even meet a member of staff. Provision of a room key and refreshments may be an automated process. Other types of budget hotels might run along more conventional lines. If the service is successfully but minimally produced then, potentially, a high financial margin accrues to the hotel. Management skills are likely to be important in this context.

The Case Studies

Detailed case studies were conducted on ten organisations in the food and drink sector and ten in the business hotel sector across the East and West Midlands.

The choice of cases was guided by a need to identify low and high value added performers within an industry and to study a range of performers located at different points on the product market spectrum. The "cases" did not comprise just a single interview but often a number of interviews with different individuals, aimed at getting an overview of the way product strategy interacts with skills. The cases have attempted to obtain different perspectives. In some instances, it was possible to interview respondents responsible for product markets and human resources. In other cases, managers responsible for product market development (works manager, business development managers *etc.*), were the principal management respondent. In larger organisations the human resource manager was the principal management respondent.

The following issues were explored:

- the internal policies of organisations, including an analysis of the changing product markets they face, product market strategies, the role of skills in the design of product market strategies and the role of skills in meeting product market goals;
- the external environment of the organisation, such as assistance provided by national/local institutions in designing product market strategies and the nature of the assistance provided.

The studies aimed to identify how individual companies might become trapped in a low skills equilibrium by addressing concerns such as whether the product market strategy of an organisation is successful in addressing external competitive pressures; how well the product strategy performs in terms of securing either existing markets or capturing new markets; and the extent to which this is related to either a lack of capital and / or lack of skilled labour.

S.3 Key Findings

In general terms, the case studies confirm that in both of the sectors studied there was evidence that some of the organisations concerned were firmly embedded in a low skill equilibrium or on a low skill trajectory. This was the result of the internal market and other environmental constraints that they faced in their day-to-day operations. Despite the efforts of some organisations to extract themselves from this situation, the most common reaction of respondents was acceptance of their position and of the fact that there was little that they could do to change it.

Findings for the Business Hotel Sector

Three categories of hotels (classified according to the level of service they offer) were studied:

- *quality hotels* - top class business hotels, 4/5* establishments providing a wide range of services to business and business travellers;
- *standard quality hotels* - typically 3* establishments, offering a more limited range of services;
- *budget hotels* - providing a basic level of service at a relatively low cost.

In all cases, the researchers carefully distinguished between the specification of the product (the particular level of quality and breadth of service that a hotel provided) and the efficiency with which that service was produced.

None of the hotels in the case studies reported that they were seeking to move out of the market segment in which they were currently situated. In general, the parent company (national or international) dictated the market position of the hotel, so that local management had little influence over that positioning.

One hotel, however, had recently made the transition upmarket, and had encountered considerable on-going problems in doing so. It had shifted from a hotel concentrating on the food and beverage business to one providing facilities for conferences and meetings and leisure hotel facilities over the weekends. In the view of management, this transition required major skill upgrades. Perceived difficulties in recruiting the appropriate level of skill and skill deficiencies amongst staff hampered an effective move upmarket.

Another quality hotel pointed out that it had experienced significant turnover of managers. The hotel was looking to recruit people with entrepreneurial flair who were also comfortable with financial accounting and with running a relatively large concern. People with these skills were difficult to recruit because pay rates were poor in comparison to the retail sector from where such employees were ideally sought.

Although not looking to shift their market positions, most hotels were attempting to improve the way in which they delivered their services. In many instances this related to streamlining of administrative processes where activities once undertaken at the hotel level were transferred to head office. In many respects the changes the hotels had introduced were concerned with cost control, and labour was the single largest element of their cost base.

Two out of three quality hotels identified management skills as difficult to recruit. Housekeeping, kitchen and reception were areas seen as problematic for the standard and budget hotels. None of the quality hotels, however, reported problems with hiring either general kitchen or housekeeping staff. In many instances shortages of housekeeping staff were related to low wages.

In general, skills were not seen as a constraint on the market position. However the majority of the hotels reported that they acted as a constraint on improving delivery of the existing service. If hotels were to move upmarket, this usually required substantial capital investment, related to improving the quality of bedrooms and of conference and leisure facilities. Whilst it was recognised that moving upmarket would require the acquisition of new skills amongst the workforce, this was not seen as the key issue. In most cases, the main problem was that either capital or land was not available to make the shift. Moreover, there was a view that the high end of the market was well catered for in each of the case study areas.

At the top end of the market, delivery of the service was labour intensive. Whilst this is dependent upon a large number of relatively low skilled staff, often paid at around the level of the minimum wage, it also involved a large cadre of more highly skilled staff especially in the kitchen and amongst management.
At the other end of the scale are the budget hotels that typically employ relatively few staff. These include managers, receptionists, and housekeepers providing a limited range of services. There has been a growth in this type of hotel and occupancy rates of such hotels represented in this study were generally high. Profit margins are maintained by minimising staff costs. These hotels reported that they possessed the staff and skills consistent with their product position.

Where skills posed a constraint it was in relation to:

- managing a process of change within the current product market position; and,
- tying up management time where recruitment was a problem.

As for the middle group of hotels, there was some evidence that their product market position was being squeezed by those above and below them in the product spectrum. To some extent their difficulties were exacerbated by skill shortages, insofar as they were hindered in their attempts to manage a process of change to secure their current product market position.

Findings for the Food Processing Industry

The case studies cover organisations ranging from large-scale (sometimes multinational) producers of household name products through to medium and small niche producers, often engaged in the preparation of low volume, premium products. The former tend to be characterised by automated production processes requiring relatively little labour input, and the latter by production of labour intensive, often hand-made, goods - automation is often not cost-effective given the small production volumes.

Companies were classified according to whether they were:

- *mass producers* of standard goods;
- *niche producers ;*
- *producer of budget goods.*

Most food processing companies reported facing downward pressure on prices from the major supermarkets. Most large organisations reported that they were developing production processes that would provide efficiency savings. For both mass producers and budget producers this could be achieved by increased automation. However for niche producers producing hand made products, automation offered limited scope as a route for cost saving. As in the case of hotel industry, there was little evidence that organisations were looking to move upmarket.

Neither production nor management skills were reported as barriers to improving production efficiency. Skills supply might have been less than ideal, and this may have had an impact by creating a dependency upon agency workers who were not only more expensive on a *per* hour basis, but were also associated with knock on costs because they were less familiar with production processes. But overall, development of the product base was not thought to be constrained by a lack of skills.

The main recruitment problem related to production workers. Given the dependence upon low skilled, low waged labour, perhaps unsurprisingly the main problem that employers mentioned in relation to their current workforce was high labour turnover and absenteeism. This was less of a skill problem and more of a wage problem. Organisations in many instances reported that wage levels were at or near to the minimum wage. Only the large mass producers reported that they paid relatively well for semi-skilled labour in their local labour market.

This is a labour intensive industry. As compared to other food processing establishments, those engaged in mass production are more automated with, as a consequence, relatively less reliant on semi-skilled production workers and more on maintenance engineers. Amongst the niche producers the demand is very much for semi-skilled staff paid at relatively low wages. That said, there is evidence that where organisations recognise the value that investment in semi-skilled personnel can bring to the production process, then it is likely that this will reduce labour turnover and improve the efficiency of these workers.

As with the business hotel sector, there was little evidence that the case study food processing organisations were looking to break into higher value-added market segments. Rather they were concerned to increase the efficiency with which they produced the existing range of goods and services. Admittedly there was also improvement to the range of goods and services provided, but these were improvements very much within their existing market segment.

Employers in areas of generally high labour demand struggle to find staff because people choose more highly remunerated and/or more satisfying work in other industries.

A key dimension of a low-skill equilibrium is that the education and training system fails to provide a skills supply that might foster the development of higher value production. It is apparent that at a regional level there were policies in place, such as the Passport to Skills in the food processing industry in the East Midlands, as well as national programmes such as Modern Apprenticeships which are reported to be of assistance to employers with both recruitment and retention of staff. It is lack of demand rather than supply that is the key issue emerging from the case studies.

S.4 Conclusions and Policy Implications

The policy implications of this study are rather stark. The aim was to suggest methods by which policy makers might encourage moves to higher value-added production. However, the case study results suggest that organisations following low skill trajectories are acting rationally and that, in the short term at least, businesses are not failing as a consequence. Finding levers to change this situation is therefore very difficult. Exhortation by government for employers to raise skill levels is unlikely to be effective. Simply improving the supply of intermediate and higher level skills to such sectors is unlikely to change this position to any significant extent.

1. No quick fixes

The evidence that emerges from examining these two sectors suggests that quick and easy solutions to moving the UK closer towards being a knowledge driven, high wage, high skill, high productivity economy may not be available. Generally the organisations studied are content with their product market positions and are not contemplating anything like step change in investment, skills, or product market strategies. Moreover, for many of these organisations, their current strategies are, at least for the time being, delivering the desired results, in terms of profitability and business success. They are not failing businesses.

Their owners and managers can therefore argue that they are acting rationally in the face of the product markets that they deal in and the incentive structures that these create. Many cater to relatively low value added market niches because the patterns of demand that sustain such markets are there to be met.

2. Balancing policy options – high skill trajectory vs. employment

There seem to be few policy levers that can be used to shift the position of the companies interviewed towards a more high skill trajectory. These businesses find themselves in their present positions as a consequence of a plethora of economic, social, and institutional factors, which conspire to encourage operations that place a relatively low emphasis on higher-level skills. Although there may be some scope for micro-level interventions, much more radical changes, such as raising the level of the minimum wage, may be needed if employers are to be shocked into following product and skill strategies that place a greater emphasis on higher level skills. Such a policy would force employers to move away from strategies which rely upon the use of low skilled labour, paid at the current minimum wage level, and encourage strategies that place greater emphasis on raising productivity and skill levels.

Of course, in the short term, such a policy change might risk the loss of existing low skill jobs with no compensating increases elsewhere. However, if announced well in advance, giving employers time to adjust and prepare, and if accompanied by a raft of other measures designed to change many of the constraints and incentives currently faced by organisations in these industries, it would probably prove a much more effective lever than exhortation.

The problem for policy makers is that, while the individual organisations may be acting and investing rationally and thereby optimising their own situation, the outcome for society, particularly in terms of the emphasis that this implies on generating relatively lowly-skilled and low paying jobs, may be sub-optimal. The research indicates that, currently at least, there is a thriving marketplace for goods and services sold on the basis of low cost and supported by low wages. This results in a substantial number of relatively lowly skilled jobs that offer only fairly limited opportunities for upgrading skills, growth and progression.

The tension between private and more general social objectives is especially acute in cases where a significant proportion of the workers in these organisations are being supported by the state *via* in-work benefits. Such employers are having their product market strategies (and the low wages that support these) subsidised by the taxpayer. Such strategies are supported by the minimum wage being set at a relatively modest level.

3. Particular problems at a regional level

Policy makers at the regional or local level face particular problems for three reasons:

- first, many of the establishments in their areas are part of larger national organisations and strategic decisions are often taken at the national level;
- second, there are well documented and significant differences in the business environment across the English regions; and,
- third, many of the policy levers available are ones where only national level action could be taken. There is not enough flexibility or regional funding leverage to effect change.

This implies a rather limited role for regional /local specific policies. There are some things that can be done at a more micro level, including making sure that any interventions that are made take full account of the specific local circumstance in which the organisations in these sectors are operating within their borders. However, simply increasing the supply of intermediate and higher level skills at a regional level is unlikely to have any significant impact, unless it is accompanied by other policies aimed a changing business behaviour. This might include links to DTI *Industry Forums* and *Innovation Strategies*.

4. Possible policy levers

Many of the elements to support a high skills eco-system, such as state support for R&D, and knowledge transfer arrangements, are either in place or are being set up in various parts of the UK. A key problem is that they are less obviously relevant to the types of sector and organisation that are the focus of attention of this study, tending to be more focussed on high tech. sectors. More effort therefore needs to be made to expand the coverage of such initiatives to include the kinds of sectors covered here. This should include greater emphasis on encouraging enterprise and innovation in these sectors. It is also important to ensure that the DTI *Innovation Review* is not too narrowly focussed on sectors which may offer less hope of generating large numbers of jobs.

One potential lever is the use of public purchasing policy. The state (in terms of the NHS, central and local government and their many agencies) is a major purchaser of labour – the more so with the contracting out of many aspects of public services. Using as a criteria in awarding contracts issues such as quality of work and aspects of job design and work organisation that allowed frontline staff to deploy (and be rewarded for) higher levels of skill, would be a significant step forwards and one that would have an impact on a substantial swathe of low skilled, low paid employment.

4. Supply is not the problem

A key message is that the limits of what can be achieved by skills supply interventions are being reached. Policy actors with greater leverage over the demand for and usage of skills, such as the Sector Skills Development Agency (SSDA), Regional Development Agencies (RDAs), and DTI itself, need to become more heavily and visibly involved in policy formation. In particular, this requires the development of a more integrated approach, with VET fully integrated within a wider business development agenda. The study suggests that this is beginning to happen. This is very much what RDAs are being asked to address in *Regional Economic Strategies*, *Frameworks for Regional Employment and Skills* and in future *Regional Skills Partnerships*. The research emphasises the importance of involving sectoral bodies in this process. Work organisation may be a much more effective demand lever than skills supply.

Skills were not, in most cases, the major constraint on the business studied here, and they are also not liable to be a major driver of change, since many of the work processes and systems of job design found in the organisations studied would offer limited room for substantially higher levels of skill to be productively deployed in production or front line work.

Without significant changes to product market strategies, service standards, work organisation and job design, improving the skills of those who undertake these jobs may achieve only limited results and may lead to over-qualification and to skills that are under-utilised or not used at all.

5. An Important role for DTI

DTI is well-positioned to work with other partners, such as the SSDA and Sector Skills Councils (SSCs), the Small Business Service, and RDAs. This partnership needs to evolve less narrowly-focussed solutions to the skills problem. As the central government department with prime responsibility for competitiveness and innovation, as well as employment relations (including work organisation and job design), the DTI is well placed to develop and take forward the kind of policies that the PIU project suggested might be needed to begin to stimulate long-term demand for skills within employment and to ensure that those skills are then used to maximum productive effect.

6. Targeted support

The gap between the policies and practices in leading edge companies and the rest continues to widen. Different sectors and sub-sectors of the economy address profoundly different markets, which carry with them divergent demands for skill. There is therefore a need for more precise targeting of government support for businesses. It is apparent from the case studies that different organisations have very different needs and demands, in part determined by their underlying product market strategy, but also by what stage or phase of business development they are currently in. Closely targeted support that goes beyond skill supply, and which can embrace wider business development objectives, would be more effective than uniform policy interventions across and within different sectors.

7. The need for a long-term view

The overall message from the case studies is that the kind of step change in economic performance and competitive orientation being demanded by the Treasury and others will be a long process, with some sectors and organisations much more able to make rapid progress than others towards a high wage, high skill, high productivity future. This raises big issues for policy makers, at national government level, but also within SSCs and RDAs. If time, energy and resources are finite, where should they be directed – towards those organisations and sectors that are already on the “high” rather than the “low road”, or towards those who are making the least progress and whose workers are hence in danger of getting left behind in low wage, low skill employment?

The former orientation might produce quick wins but may miss the areas where the need for intervention is greatest. The latter, as the case studies discussed above show, might require protracted support and generate much slower and more limited gains. However, unless some of the issues and barriers that face these less well placed sectors, not least the structure of demand and the incentives it generates, are tackled, it may lead to increasing labour market and income polarisation. While low skilled and low wage jobs may be preferable to no jobs at all, the strategies being adopted by many organisations may be unsustainable in the longer term. For many sectors and regions, as in the past, product and skill strategies based solely on cost cutting and competing on price are likely to prove a dead end.

1 INTRODUCTION

1.1 Background

A low skill equilibrium can be characterised as a combination of low wages but high employment. While the UK has been successful in recent years in tackling unemployment and creating large numbers of new jobs, many of these are low skilled and poorly paid. In a number of regions and sectors within the UK there is an increasing reliance on such low skilled jobs. However, as the discussion in Chapter 2 highlights, it is far from clear that this position is sustainable in the longer term. This was an important part of the motivation to undertake the present DTI funded study.

Any assessment of the existence of a low skills equilibrium needs to be made with some care. The problem is seen by many as part of a long-standing and systemic failure of the UK's vocational education and training system. Although some may contend that the UK as a whole is in some kind of LSEq state, this is not the central contention motivating the present research. To address this possibility would require an international comparative study.[1] Moreover, while some parts of the UK economy might be characterised in this fashion, many others operate in a much more successful manner than such a blanket description might imply.

Compared with some of its main competitors, the UK may well lie closer to the low skills equilibrium end of the spectrum than the high skills end. However many organisations are following strategies that cannot be so readily characterised as low skill. There is a danger of oversimplification based on a focus on comparisons at an aggregate national level. There are clearly problems in characterising a complete economy (such as the UK) as being in a LSEq, given the vast diversity and heterogeneity across regions and sectors. This suggests the need for a more micro level approach, based on case studies of individual organisations.

1.2 Aims and Objectives

The general aim of the study was to provide the Regional Development Agencies (RDAs) and others with advice on how to structure their policy interventions and to provide them with some practical ongoing lessons and models for how to approach these issues and what levers they might pull to make a difference.

[1] Research along these lines has been conducted by NIESR. See the review in Keep *et al.* (2002).

The project addresses three general issues:

- first, it attempts to clarify the meaning of the term "*low skills equilibrium*". This is refined and extended in Chapter 2 by the introduction of the more micro-level and dynamic concept of a "*low-skill trajectory*" for an individual company or organisation;
- second, it explores the conditions which can result in such phenomena, including the link to choices about product strategy within individual organisations;
- third, it questions whether choices about skills, that are both rational and optimal from the perspective of the individual organisation, may prove sub-optimal, for the economy as a whole, in the long-term.

The project seeks to provide some answers to the following specific questions.

- Is there evidence of a low skills equilibrium (high employment, low wages) in particular parts of the UK economy?;
- Does this phenomenon have regional specific aspects?;
- Is it a sectoral phenomenon?;
- Are its causes (and potential solutions) amenable to policy intervention at regional, sectoral or national level?

The first of these questions implies that this project is not concerned solely with another overview of macro evidence. There have already been a number of relevant reviews and the prime intention is not to cover this ground again here although Chapter 2 (and the more detailed review upon which it is based) provides an up to date summary. Rather, the prime focus of the present project is on trying to identify some specific micro level examples of this phenomenon and to assess what might be done to address the problem. This recognises the possibility that high and low skills outcomes can often coexist within the same economy, region or sector.

1.3 Approach

Most previous studies have taken a macro view of such matters. The main objectives of the present project were to identify some specific examples of low skills equilibrium and to provide an analysis of causes and consequences. The emphasis in the present study is therefore on looking ***within*** sectors, and ***within*** regions, to see whether some organisations have tendency to exhibit LSEq characteristics compared to others and, by comparing and contrasting their respective experiences, to draw some general lessons.

The desire to focus on a more micro level suggests the need for a ***case study approach***. This does, of course, have its limitations, especially in terms of generalising the findings to a broader UK level. Nevertheless, there are a number of advantages, as set out in detail in Chapters 2 and 3. This is one of the first attempts to address these questions using this type of method. It offers a number of lessons, both in terms of research methodology and new findings, that take the debate on these issues forward to a new level.[1] The results from these case studies make a significant addition to the evidence base on which policy development can draw.

With support from the DTI and two RDAs, two regions and two sectors were selected, upon which the detailed case studies were to be based. The regions chosen were the East Midlands and the West Midlands. Details of the two sectors chosen, (food processing and hotels), are also given in Chapter 3.

Telephone interviews were carried out, both prior to carrying out formal face to face interviews with companies and to extend the coverage to some additional cases not formally interviewed. Such telephone interviews were used to ask questions about the respondents' views about low skills equilibrium as well as obtaining examples of particular organisations, sources of their problems and the types of actions they are taking. This helped in finalising the questions asked of the companies themselves in the face to face interviews.

The telephone interviews were used to obtain a view about an organisation's product market strategy and the extent to which skills acted as a constraint on improving product market position. The Employer Perspectives Survey and Employers Skill Survey 1999 questionnaires were used to construct a semi-structured interview schedule for the telephone interviews. Both these surveys probed employers in some detail about their product market position, and the latter asked explicitly whether a shortage of skills had stopped organisations moving upmarket.

A range of potential candidates was identified and interview dates arranged. The initial round of interviews was completed in the early summer of 2003, with the full analysis, including follow-ups, being completed in September 2003.

1.4 Results, Conclusions and Policy Implications

Chapter 4 sets out the results from the detailed case studies and draws out the key findings. Similarities and differences, both between sectors and across the two regions, are highlighted. Chapter 5 concludes with a summary of main findings and draws out the key policy implications.

2 LSEq: A REVIEW OF CONCEPTS AND ISSUES

2.1 Introduction: The Concept of a Low Skill Equilibrium

A detailed review of concepts and issues was undertaken as a preliminary stage of the present project (see Bosworth *et al,* 2003). This chapter provides a summary of that review, drawing out a number of key concepts which are important in guiding the choice of cases and also the design of the survey instruments used in the case study interviews. The chapter is structured as follows:

- Section 2.2 begins with a review of the general concept of a low skill equilibrium, its key characteristics and main causes;
- Section 2.3 emphasise that the concept is both a relative and a dynamic one;
- Section 2.4 attempts to refine the concept in the context of the current analysis, emphasising the need to focus on product and skill trajectories for individual organisations as well as sectors and regions; finally,
- Section 2.5 draws out some preliminary conclusions based on the review of previous research about the more general implications for policy and research.

2.2 Low Skill Equilibrium, Vicious Circles and "Systems Failure"

It is apparent that the LSEq concept has been widely used, often rather loosely. The phrase low skill equilibrium (LSEq) was first coined by Finegold and Soskice (1988). They argued that Britain as a whole was trapped in a low skill equilibrium: "…*in which the majority of enterprises staffed by poorly trained managers and workers produce low quality goods and services*" (*op cit* p.22).

Figure 2.1 Low Skill Equilibrium and Alternative Scenarios

employer demand for higher level skills		
high	**SKILLS SHORTAGE IMBALANCE -** mismatch caused by companies demanding higher qualifications than are available in the local workforce	**HIGH SKILL EQUILIBRIUM –** economy with a strong demand for high level skills, which has a positive effect throughout the supply chain on enhancing the aspirations and actions of individuals with respect to participation in education and training
low	**LOW SKILL EQUILIBRIUM –** employers face few skill shortages in a predominantly low skilled workforce, where there is little incentive to participate in education and training and raise qualification levels and aspirations	**SKILLS SURPLUS IMBALANCE –** mismatch caused by a workforce which cannot find local employment to match their skills and aspirations
	low **skills surplus**	*high*

Source: Adapted from Green *et al*. (2003).
Notes: The term training is used here and elsewhere to encompass both formal and informal learning.

Figure 2.1 provides a brief summary of what constitutes a LSEq and various alternative scenarios. This places a strong emphasis on the balance of demand and supply for skills. A common misinterpretation is that an economy is in a low skill equilibrium if average wages are low while employment levels are high.

However, to characterise every situation of low wages and high employment as a low skill equilibrium begs a number of questions. Such a situation can arise for a number of different reasons, not all of which are readily distinguished.[1]

Finegold and Soskice (1988) used the term low skill equilibrium to denote a self-reinforcing network of societal and state institutions which interact to stifle the demand for improvements in skill levels. Essentially, they saw the UK's problem as one of "systems failure", where UK individuals and employers react rationally to the incentives they face and end up in a low rather than a high skills equilibrium. It is about a broad set of structural, environmental and incentive system interactions, and hence a complex policy problem, which cannot be solved by relatively straightforward policy interventions.

The LSEq term has tended to be used to describe a macroeconomic situation across the whole economy, as opposed to the position faced by individual companies or organisations operating as part of particular sectors, in specific geographical locations. The approach adopted in this study to identify and analyse this type of phenomenon is based around a number of detailed, in depth case studies. It is essentially a micro rather than macro level analysis.

This leads to the need for a change of emphasis. The use of the term *equilibrium*, can be somewhat misleading in this context, since this focuses attention on a rather *static* position. The key issue for individual organisations is essentially a dynamic one, about the paths or *trajectories* they are following. In the context of examining evidence on individual organisations, it is therefore helpful to think of a "low-skill path" or "trajectory". Such a trajectory might persist for a considerable period, and could lead to an increasing probability of organisational failure.

The emphasis should be on *dynamic processes* ("skills and product trajectories"), rather than static equilibria. Skills "levels" need to be seen as a spectrum rather than in simple black and white terms. Comparisons need to be made of the *relative*

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[1] Of course, some regions/sectors have higher wages than others, and some higher employment rates. Similarly, within regions/sectors, some organisations will have higher wages and some higher employment than others. These patterns are consistent with a number of equally plausible hypotheses, of which the Low Skill Equilibrium explanation is just one. The alternatives include the idea of efficiency wages and/or rent sharing arguments.

Efficiency wage models provide a number of rationalisations for why some organisations pay higher wages in order to elicit greater worker effort and hence higher productivity. Motivations are varied but include: the organisation's wish to prevent shirking (Shapiro and Stiglitz, 1984) (since the cost of job loss is higher); to minimise labour turnover costs (Stiglitz, 1985); to diminish adverse selection (Weiss, 1980) in that offering higher wages will encourage 'better' workers to apply for jobs; and to improve worker morale (Akerlof, 1984). Finally, union threat models emphasise the threat of collective action as a reason for some organisations paying higher than competitive wages.

In contrast, rent-sharing arguments reverse the causality of this argument, and instead suggest that more productive and hence profitable organisations are able to pay higher wages, and will do so if the bargaining power of the employees is sufficient to allocate a greater share of the rents to wages.
Both sets of arguments generate a range of plausible - and perhaps inter-related - reasons as to why some organisations may pay higher wages than others, unconnected with their skills and product strategies.

or *comparative* positions of different organisations, sectors, regions or economies rather than their absolute positions.

The original hypothesis has been refined and developed in recent years. The emphasis is now on product (or service) specification rather than product (or service) quality. Product specification refers to the position in the market at which a product or service is pitched (*e.g.* premium food products). Product specification may relate to technical characteristics, and how these may change over time, as well as the ease with which it can be customized. Product quality refers to the capacity to produce any product or service to a specified quality standard.

Low specification products can be produced by many others. The main emphasis in competition in such markets is on price and on unit labour costs. They are also characterised by: long production runs; standardisation; economies of scale; and by designing the skill out of jobs in order to keep down unit labour costs. High specification products, by contrast, can be characterised as from non-rigid production processes or short production runs, where there is little opportunity to design skill out of jobs and where a flexible and capable workforce is required to respond to changing skill needs linked to product development.

Even in the case of high specification products, skills often appear to be a third order issue. First come general strategic decisions about product strategy, second are decisions about the production process itself and, only third in line, decisions about the *derived* demand for skills. However, this perception needs to be qualified by recognition of the fact that the first and second order decisions may themselves be constrained by skills.

Imagine a particular organisation which, for whatever historical reasons, has been producing and continues to produce a low specification product. Then, if that organisation has been efficient, the institutions, incentives and habits of the organisation will be geared to this type of production. The low specification organisation will be producing much the same thing for a prolonged period of time. Other organisations can produce exactly the same product and competition will be on price and therefore on unit labour costs. The emphasis will be on long production runs and on standardisation, in order to obtain the benefits of economies of scale. Since the nature of the production process changes only slowly, management will have the opportunity to design skill out of many of the necessary jobs. Indeed this is probably essential since this means that low skill labour, which commands only a low wage, can be hired, thus keeping down unit labour costs.

The high specification producer, by contrast, will not be able to adopt stable production processes or long production runs. For this reason there is little opportunity time to design skill out of jobs. On the contrary, a workforce is required which is capable at all levels of adapting to the production of changing products, a workforce for which it is impossible to construct a programmed series of simple tasks and one which is able to “teach the job”.
In any country or region, within any narrowly defined product range, there may be a number of companies, some of which are towards the low end of their product specification spectrum, some in the middle and some at the high end. The

contention is that the UK has a significantly higher proportion of low specification companies than do traditional comparator countries. Hence the skills problem in Britain is not so much lack of supply but one of limited demand for skills. On this interpretation, improving the supply of skills might be a necessary condition for solving the skills problem, but it would not be a sufficient one.

The causal interaction between relatively low product/service specification/quality and workforce skills can be regarded as a vicious circle. Products are poor because the workforce skills to produce better ones are often lacking, and skills are poor because existing product market strategies do not demand high levels of skill and because work has been organised, and jobs are designed to require low levels of skill and discretion. Low wages can also result in a further reinforcing factor, limiting consumer demand for more highly specified products and services.

A major part of the problem is that the decisions of one organisation may impinge on the decisions of others. Even if organisations want to change their strategies, path dependency and other barriers may make change difficult and risky. Moreover, the more organisations that follow the low specification route, the greater the number of constraints to any other route that they build not just for themselves, but also for other organisations. For example, retailers operating in an area where low specification employers dominate would face relatively poor customers, with obvious implications for the style of their own operations.

Individual organisations may be behaving perfectly rationally in following such strategy. They may also be profitable. But in aggregate such decisions may result in non-optimal situation for society more generally. This equilibrium is hard to shift, because it reflects a whole range of underlying factors to do with:

- the structure of domestic product markets;
- short-termist financial pressures;
- a strong tradition of voluntarism and reliance on the good will of enlightened employers;
- a highly de-regulated labour market;
- the prevalence of models of competitive advantage based on economies of scale, central control, cost containment, standardisation;
- weak employer groupings and social partnership arrangements;
- the structure of ownership, especially the importance of multi-nationals (MNCs);
- institutional factors, especially the lack of a proper structure.

It is important to emphasise that, in such a low skills equilibrium, individual organisations may be behaving perfectly rationally. They may also be profitable. However, the aggregate of the decisions of individual organisations may amount to something which is not optimal for society as a whole. In an open economy low specification organisations will survive only if they maintain unit labour costs which are at least as low as those of their foreign competitors. Increasingly these competitors may not be countries like France and Germany, but countries like India or South Korea. Thus, at best, a low skills equilibrium will produce unfortunate distributional outcomes. At worst, it may be that the low specification route proves unsustainable for individual organisations, as they find it impossible to continue to drive down costs. It may then be that some such organisations relocate to lower cost countries and continue to thrive as low specification producers. It is effectively a dead end as far as domestic employment prospects are concerned. In contrast the high specification alternative is more open ended, offering the possibility at least of longer term employment prospects in higher quality jobs.

A low skill equilibrium is more than a simple “market failure”. It is a fundamental and broadly based “systems” failure. Taking action to change any one element of the system may, at best, only lead to marginal improvements. Given the economic ”theory of the second best”, there is also a real concern that, if there is a general systems failure, it might be a mistake to try to do anything (since intervention though well intended might make things worse). While most would probably agree that this was a risk, it is also a counsel of despair and overly pessimistic. A more positive conclusion is that there is no simple solution, but a need for wide ranging policy initiatives that involve more than just the labour market.

2.3 Low Skills Equilibrium as a Relative and Dynamic Concept

That a low skills equilibrium is best regarded as a “relative” concept was recognised by Finegold and Soskice (1988), who emphasised the importance of making international comparisons. They also emphasised that the use of the term equilibrium was not meant to imply that all British organisations produce low quality products or services, or that all individuals are poorly educated and trained, since a number of companies (often, but not always, foreign owned MNCs) have succeeded in recruiting the educational elite and offer good training.

Britain does seem to be closer to the low skills equilibrium end of the spectrum when compared to many other developed nation states. At a national level, a low skills equilibrium means that workforce, product and service specification (and perhaps quality) are generally lower, and that in consequence the aggregate levels of skill needed by the workforce are lower relative to what is needed in other countries.

Just as countries may differ, so may regions within any country. The regional dimension has assumed greater importance in UK policy making since 1997, with devolution, the introduction of the Regional Development Agencies, the emphasis on cluster policies (which may be different in different regions), the production of Frameworks for Regional Employment and Skills Strategies (FRESAs), *etc.* While the Regional Economic Strategies are quite similar for different regions, there is increasing recognition that different regions and sub-regions play different roles in the regional/national/international socio-economic system and of the need for policy and institutional support frameworks to be developed accordingly.

More recently, the emphasis has shifted towards high skill eco-systems and “learning regions”. Finegold (1999) emphasises that high skill regions or sectors can exist within otherwise relatively low skill economies. He also recognises that the high skill/low skill equilibrium (HSEq/LSEq) dichotomy also tends to over-emphasise the value of German and Japanese approaches to skill creation and related economic decision making, while underestimating the potential of more market based systems to compete in high skill markets by innovation and enterprise. In many respects the HSEq/LSEq concept is also a rather static one. The focus on eco-systems, as opposed to equilibria, places greater emphasis on evolution and dynamics.

Studies such as those by Morgan (1997) and Maskel and Malmberg (1999) highlight the importance of a supportive environment, including a good basic infrastructure (especially transport and communications), a general climate attractive to knowledge based workers (both physical and in terms of support services), and a regulatory regime that supports risk taking (including making the creation and closing of business easy). Such studies also emphasise the high degree of interdependence between the various actors in terms of a common focus and a high degree of co-operation among the actors that facilitates the learning process (networking horizontally and vertically between organisations and also amongst the individuals involved).

2.4 Refining the Concept: Low Skills Trajectories

As noted above, in some respects, the use of the term "equilibrium" is unhelpful, tending to imply a rather static situation. The vast majority of the literature on the operation of UK labour markets suggests that they are better characterised by disequilibrium and, at best, by slow and highly imperfect adjustment towards equilibrium. It is therefore helpful to think of the process as being both relative (in the sense of countries, regions or individual organisations being at some point along the low-to-high skill spectrum) and dynamic (in the sense of them moving towards one end of the spectrum or the other). For current purposes, especially when focussing upon the situation in individual organisations, which may be following very different paths, the concept of *product and skill trajectories* is therefore more appropriate than that of a *low skill equilibrium*.

Whilst use of the term trajectory has many advantages, it should be stressed that movements along a trajectory can be slow. Changing just one incentive or constraint in a low skill/low specification economy may have little impact, given the battery of forces that have made that economy low specification The importance of viewing the problem as one of a general systems failure rather than just a simple case of "market failure" remains. The implication is that there are no simple solutions. There is instead a need for wide ranging policy initiatives that involve more than just the labour market.

The focus on product and skill trajectories emphasises the importance of considering skill requirements in the context of the general goals and strategies adopted by organisations. The position of the organisation within the product innovation cycle and the crucial role of managerial skills are especially important.

Goals and strategies can be proactive (*i.e.* the case of an organisation that is always striving to improve product specification as well as to reduce costs or improve quality) or they can be reactive (*i.e.* cases where, faced by increased competition from foreign, low cost producers, the organisation is forced to take action to increase efficiency and reduce it's cost base).

Both have implications for the "skills trajectory" being followed. Organisations faced by increasing competition from low cost foreign producers may try to further reduce the need for skills and, thereby, reduce their production costs. They are on a low skill trajectory. Where they cannot do this, production may be shifted abroad (*i.e.* in the case of a UK multinational company) or all UK interest in the production of this good may cease altogether (as has been in the case in a number of sectors over the last few decades). In contrast, an organisation that is engaged more proactively in developing new and better products and services is likely to be on a high skills trajectory, since such strategies require such inputs to be successful. One clear piece of evidence is that companies that set clearly articulated goals, on balance, out-perform those that do not set goals. The choice of goals depend on the background of the manager (differing between owner *versus* professional managers, and those with different education, training and discipline backgrounds).

The goals of the company, management skills and skill demands are intimately bound together. The goals and product strategy of the company, product quality, human resource management (HRM), work organisation, work design, *etc.* are all inter-related (Bosworth *et al.* 2002; Keep *et al.* 2003). The links between skills and all these are factors are not only complex but also dynamic in nature. The decision making processes and, thereby, the management skills of the organisation play a central role, with particular emphasis on entrepreneurship and leadership.[1]

The extent to which very high specification products require a very highly skilled workforce is likely to differ across sectors. In some products and services the high level skills may be embodied in a small elite cadre of individuals (*i.e.* the top managers, the research and development department, *etc.*), without the need for high levels of skill elsewhere in the company.

This situation is dynamic. Products are themselves part of a well researched dynamic process – the product life cycle. This begins with research and development and development of new products and services, followed by the product launch. The success of each of these stages is related to the skills of the organisation (especially management skills). Over the product cycle, individual and company learning processes change the skills required in the production process. In the main, maturing and mature products are associated with lower skills trajectories.

A *successful* economy will have a mix of sectors, combining both new, maturing and mature products and services (up to the point at which the production process moves abroad to achieve lower costs). By implication, it will also have a mix of low and high skills trajectories. As a consequence, not every organisation can or should have a high skills trajectory, what is important for a successful economy is to have the right balance. Ideally, the various skills trajectories should balance with the innovative activity of the economy such that the levels of technology in use produce a demand for skills that matches that available in the economy.

2.5 Implications for Research and Policy

The review in Bosworth *et al.* (2003) highlights that the term low skill equilibrium has been used in many different ways. The simple dichotomous concept of high *versus* low skills equilibrium is in many ways an over-simplification. The real world is much more complex. In particular, the skills "level" should be seen as a spectrum and comparisons should be made of the *relative* or *comparative* positions

[1] By management skills, something much broader than the more mechanistic management tasks is implied, including leadership and entrepreneurship.

of different organisations, sectors, regions or economies – not their absolute positions. In addition, and especially when focusing on individual cases, the emphasis should be on a *dynamic process* – a "skills or product trajectory".

Any economic unit (whether an organisation, sector, region or economy) will typically display a diversity of skills trajectories (and relative positions). Particular individuals within a organisation may be on a high skills trajectory, while others may be on a low skills trajectory. What matters for the unit concerned is the mix of these trajectories. This is a complex issue, because it is not necessary, or indeed desirable, for everyone to be on a high skills trajectory. The question is one of *balance* in, for example, what proportion of organisations in an economy (whether at regional or national level) should be following a high skills trajectory and what proportion a low skills trajectory.

Skills trajectories are linked to the goals and product market strategies of organisations and, thereby, to innovation within the economy. New product launches (and to a lesser extent product modifications) are not only risky, but are generally associated with heavy investments in R&D, marketing, *etc.* that need to be recouped during the life cycle of the product. While the period leading to launch may require a high skills trajectory – the subsequent period of exploitation, during the maturation phase, is more likely to be one of a low skills trajectory. Thus, for an economy more generally, the question of whether the balance of skills trajectories is appropriate is closely tied to the question of whether there are sufficient high-level investments and product innovation.

This raises further complications. The first of these concerns the incentives on offer to organisations to act in various ways and whether the actors concerned (particularly managers) are making correct choices. The review in Bosworth *et al.* (2003) suggests that a low skills equilibrium tends to emerge because the incentive structure is such that the low skills choice is a rational one from a private perspective. This does not mean that it is optimal from a broader perspective. The present study demonstrates why it may be difficult to isolate latent skills shortages if it is rational for the majority of organisations to adopt a low skills trajectory. A second related worry is that the choices made by managers (which may well seem rational to the managers themselves) depend heavily on the characteristics and skills of managers. Here is a key focus for concern, because the evidence points to significant deficiencies in the skills of managers (and the management skills of workers). For example, compared with other countries, UK managers are severely lacking in formal qualifications (Bosworth, 2000).

This study does not attempt to judge whether managers made good or bad decisions. The information to make such a judgement is seldom available to researchers and frequently only available to insolvency experts in the cases where decision making has been catastrophic. But, through comparison of the product market decisions made by management in comparable organisations, and identifying the basis of that decision making, insights are obtained from the case studies.

A final complication that the review emphasises is that the emergence of a low skills "equilibrium" is a "systems failure". While observed outcomes may be the result of rational individual decisions, the system conspires to produce incentives for individuals to act in a way which does not result in a socially optimal outcome. This indicates that it is important to consider the general environment within which organisations are operating as well as the policies and strategies they are following when attempting to understand observed behaviour.[1] A key problem with systems failures is that taking action to change any one element of the system may, at best, only lead to marginal improvements and could, because of the nature of dynamical systems, lead to perverse or even chaotic results. On the other hand, attempting to transplant the whole of a system that appears to work better (e.g. trying to impose the "German" system, or elements of it, in the UK) is also fraught with difficulties. It is essential to try to identify all of the elements of the system and the relationships between them, before advocating change.

[1] The environment takes three forms. The first of these is the ***product market environment*** (*e.g.* the downward pressures on prices that food manufacturers face from their major customers). Second, there is the ***labour market environment*** (*e.g.* labour/skill shortages, outputs from the education and training system). These are both explored in the case studies and the extent to which they shape organisations' product market strategies. The final element is the ***socio-economic environment*** in which the organisation operates. This includes the education and training system as well as various support systems provided by regional and sectional organisations. These were also explored in the case studies.

3. METHODOLOGICAL APPROACH

3.1 Introduction and Contents of this Chapter

This chapter sets out the rationale for the case study approach adopted and the choice of regions and sectors. The chapter is structured as follows:

- Section 3.2 starts with a general discussion of the rationale for a case study approach;
- Section 3.3 sets out the reasons for the choice of the particular regions;
- Section 3.4 describes the sectors which were the focus of the interviews;
- Section 3.5 then goes on to discuss the choice of the particular cases within the chosen sectors and regions;
- Section 3.6 summarizes the nature of the case studies, including the choice of respondent and the use of different interview techniques;
- Section 3.7 outlines the way in which the interviewers tried to characterise the general positions of the individual cases;
- Section 3.8 goes on to describe in more detail the way in which product strategy was explored;
- Section 3.9 turns to the question of how skill needs are assessed within the organisation; this leads to
- Section 3.10, which provides a discussion of how the interviewers attempted to probe on the extent to which skills 'matter' and the more general role of skills in the organisation; finally,
- Section 3.11 concludes by summarising the survey interview instruments used.

3.2 Rationale for the Use of Case Studies

Chapter 2 sets out the justification for a micro level, case study based approach. It also set out the issues which guided the choice of cases and the other considerations which needed to be borne in mind in designing the way the case study analysis should be carried out.

It is clear from the discussion in Chapter 2 that the position in the UK is very heterogeneous. Not all of the UK is stuck in a LSEq but some particular sectors and regions may be in such a position (or at least moving on low skill trajectories). The key concern here is that it is difficult to conclude the existence of a LSEq, simply on the basis that some organisations (or regions, or sectors), have lower wages and higher employment than others. As noted in Chapter 2, these patterns are consistent with a number of equally plausible hypotheses. These need to be distinguished from the alternative hypotheses associated with the LSEq argument.

This can be achieved by the development of more subtle and qualitative indicators of business practice and performance, including longevity of existence of individual organisations in their chosen product market that can only be obtained by in-depth questioning. This is, of course, a key argument for the use of a case study rather than survey based approach, since this can place more emphasis on qualitative as opposed to quantitative evidence.

Chapter 2 also highlights the fact that product strategy, product quality, HRM, work organisation, work design are all inter-related. But the links are complex and dynamic. Teasing out these relationships is not straightforward. There are often significant costs in moving to a higher skill product market strategy (*e.g.* recruitment and training, higher operating costs, R&D investment requirements, difficulties in raising funds, lower returns and hence dividends for shareholders *etc.*). Detailed case studies can throw light on such costs, as well as other aspects of the problem, in a way that more aggregate analysis cannot.

The review also highlights that when focusing on individual cases, the concept of a "*skills & product strategy trajectory*" is appropriate. It also highlights the central role for management skills, especially those related to entrepreneurship and leadership. A case study approach can explore what motivators encourage, and what barriers stand in the way of, organisations moving up market.

Another aspect that in-depth case studies can capture is whether choices are rational from a private perspective (even though, ideally, from a social perspective, some other choice would appear to be "better"). In particular, the case studies can begin to assess whether this rationality is the result of a lack of desire on the part of managers, lack of demand from market, lack of skills, lack of managerial expertise, lack of investment in R&D/new plant, *etc.*

If the choices managers and organisations make are to be changed, a further important question is what infrastructure, incentives, support, help, *etc*., would be needed to achieve this, and how (and by whom) they can be put in place. The case studies can also address these issues by focussing on respondents perceptions of the position they currently face.

The review also has important implications for the (semi-) structured interviews carried out. It suggests that the questions need to be carefully devised in order to understand the underlying reasons behind observed wage and employment outcomes and the HRM and product strategy policies which underlie them. In particular, the issue of wages needs to be pursued with some vigour, probing as to why companies pay the wages they do, and, if recruitment problems are a consequence of paying at or near to the minimum wage, why is increasing pay not a solution? This needs to be made quite explicit in the interview schedule.

3.3 Choice of Region

Regional policy over recent years has been given much impetus, as exemplified by Regional and Local Strategies. Regional Development Agencies (RDAs) have considerable autonomy to develop particular industries. Most RDAs appear to be following a strategy that aims to support (i) existing, traditional industries and (ii) develop new, high value-added ones that will provide, hopefully, high-wage, high-skill employment in the future.

The project focused on two English regions. Following consultation with DTI and various regional bodies, the East and West Midlands were selected. Although this may at first sight appear a rather narrow choice, these two regions are both very diverse and present many features which are common to many other parts of the UK.

The main issues in this choice related to:

- accessibility in terms of geographical proximity;
- accessibility in terms of contacts with relevant and interesting cases;
- avoidance of overload (many other RDAs were already involved in various research initiatives);
- given the focus on skills, regions which scored fairly badly on education and skills indicators should be a prime focus (both the West and East Midlands fell into this category).
- advantage West Midlands (AWM) and the East Midlands Development Agency (EMDA) were both approached and agreed to assist in the study.

3.4 Choice of Sector

For practical reasons it was decided to focus on just two particular sectors. In total, the study was limited to 20 in-depth case studies. These were chosen based on discussions with DTI, regional and local partners. It seemed appropriate to concentrate, at least in part, on manufacturing, given its importance in many regions. However, given its increasing importance as a source of employment a contrast with a service sector activity was also deemed desirable. Given the proposed emphasis on product strategy, issues relating to the public sector lie largely outside the remit of the proposed study, so the focus was on private sector organisations.

The following criteria were therefore used to select the sectors:

- relevance, with respect to their having a critical mass of activity in both regions and towards which regional policy was directed;
- narrow sectoral definitions, in order to ensure that, as far as possible, like is compared with like;
- examples of both manufacturing and service sector operations.

The key requirement was to be able to identify cases where there were successful, as well as less successful operations resulting from differences in product strategy. This formed the key element in the choice of cases (a key aim was to contrast the impact of different product strategies). RDA and sectoral expertise was used to help select sectors where this kind of distinction made sense.

There is, of course, a danger here of bias in sample selection. It is difficult to avoid this. It is not possible to select randomly with just 20 cases being interviewed. The aim was to construct a sample that had the highest probability of revealing information about the existence (and causes) of the LSEq phenomena. Of course, this does not enable the results to be re-weighted from this small sample to give all-economy wide population results. However, such results provide some general insights into the issues. The choice of sample needs to provide the highest probability of finding cases where local expertise suggests something interesting is going on which can throw some light on the phenomenon under investigation. DTI and the SSDA are undertaking further work of a similar nature, so it is to be hoped that a broader picture can be painted when further cases for other sectors and areas are eventually added to the evidence base.

Both AWM and EMDA have the following clusters in common:

- food and drink;
- creative industries (new media);
- health care / biotechnology / medical technologies;
- tourism (this is a cluster in the West Midlands and has been identified as of relevance to the East Midlands, by EMDA, even though it is not classified as a cluster by them).

Both creative industries and health care/biotechnology/medical technologies are, largely, high value-added industries, and the latter is, given the advanced nature of the activities carried out, at an embryonic stage in both regions. This leaves (a) food and drink and (b) tourism. It is not just a process of elimination that leads to selection of these two sectors since they also satisfy the selection criteria above.

The final choice of sectors narrowed this down to focus upon hotels whose prime markets were 'business tourism', including conferences, hospitality *etc.*. In the case of food processing the focus was upon organisations supplying different customer bases, some food processing companies supplying the major retailers, *versus* others supplying niche market outlets. Further details about the choice of sectors are provided in chapter 4.

Food processing

Food processing is a mature manufacturing sector but, given the population's taste for ready prepared food, is one that has seen an expansion in the sale of higher value-added products. Employment in the higher value-added part of the sector is often semi-skilled (if it is not wholly mechanised), but with a substantial number of technicians and associate professionals engaged in food technology, health and hygiene, and new product development activities, as well as a cadre of maintenance engineers responsible for keeping production lines running. The short-shelf life of many 'ambient' products also creates its own demand for production planning and distribution management.

There is also a premium products market. The East Midlands, for example, has developed a strong market for, amongst others products, sausages (*e.g.* Lincolnshire sausages) and cheese (*e.g.* premium quality Stilton). Quality production standards have to be maintained, often relying upon more labour intensive processes than in the more mechanised production of standard quality products. The emphasis here is on the skills and knowledge of a few key personnel.

At the other end of the market there is the low value-added sector engaged in either highly automated or labour intensive production of standard quality foods sold at a low margin. Arguably, the buying power of a relatively small number of food retailers compounds the problem of being stuck in a low-value added market given their alleged capacity to push down prices.

Elsewhere in the UK, research has demonstrated food and drink to be a classic example of an industry in low-skill equilibrium. Whilst there are potentially many premium products available there is concern that the food and drink industry is not achieving its true potential; for example, marketing is sometimes not as effective as it should be because employers are generally small and cannot afford large marketing campaigns. From a skills perspective, research has pointed to an unsophisticated demand for skills from employers and a poor supply of skills from colleges mutually reinforcing one another – and creating a low-skill equilibrium.

Business Hotels

Tourism has developed into a growth industry throughout Britain. In the East and West Midlands there are a number of tourist attractions - Warwick Castle, Stratford-upon-Avon, Chatsworth, the seaside resorts of Skegness and Mablethorpe, Lincoln Castle and Cathedral - and a mix of high and low value-added activities.

Whereas food processing is a relatively homogenous activity, tourism is much more varied, which creates problems when making comparisons. The study needed to select a sub-section of the industry across which meaningful comparisons could be made. These sub-sections can be defined with reference to either types of consumer - business tourism (both Birmingham and Nottingham are popular conference venues), short break holidays, consumer tourism - or economic activity (*e.g.* hotels, restaurants, *etc.).*

Business tourism and hospitality is a potentially high value-added market with large international chains of hotels offering luxurious comfort and 24-hour service to delegates at conferences and other events. This requires both a large number of staff but also specific skills related to kitchen activities, management of events, *etc*. There are also lower cost alternatives with universities, for example, offering halls of residence as accommodation.

It is also possible to examine a more specific area of activity, such as budget hotels. This provides a basic service where the guest may not even meet a member of staff. For example, provision of a room key and refreshments is an automated process initiated by insertion of credit card into a machine standing in place of the more usual hotel reception and receptionist. If the service is successfully but minimally produced then, potentially, a high financial margin accrues to the hotel. Management skills are likely to be important here. Other types of budget hotel might run along more conventional lines. The study therefore examined both business tourism and budget hotels (many of which are dependent upon business tourism).

3.5 Selection Criteria for Cases

The choice of individual cases was guided by a need to:

i. identify low- and high-value added performers within a selected industry; and
ii. constrain selection to those industries identified in each region as having the potential to achieve high value-added business growth (*i.e.* the AWM/EMDA clusters) but within which there were also some less well performing organisations.

With reference to (i) it was important that the study included organisations that were average or even poor performers, whatever niche they have selected in the market. Examples of poorer performing companies at the bottom of the product market spectrum who felt that they had to move up market, and those at the top of the specification spectrum who were struggling to deliver at this level were both considered. It is important to recognise the inherent difficulties associated with gaining the participation of organisations in such a research programme and the problems of over prescribing the criteria for selection. As part of the process of gaining the participation of companies there was a need for a sifting exercise where initial interviews with companies aimed to assess their suitability. With regard to (ii) it was also important to tease out how/why/in what ways the RDA believed that selected sectors could achieve high value added business growth.

To achieve a range of performers located at different points on the product market spectrum therefore required very careful pre-selection given that the sample of cases was quite small – just 10 from each industry spread between the two RDA areas. The information provided by the RDAs together with the local knowledge of the researchers was all used to inform the selection of cases.

Probably one of the most difficult aspects of this project was the choice of individual cases. It was necessary to gather information on a range of experiences at different points along the product specification spectrum and to examine how and why these companies had chosen or had ended up in their respective positions. This information was generally provided by the managers responsible for day to day decision-making at the organisation. Ideally, in some cases it would have been desirable to interview also some managers at head offices, where more strategic decisions about product position were decided, but time did not permit this.

It important to keep in mind certain key questions concerning the causes of some companies/ organisations being caught in a low skills equilibrium or on a low skill trajectory. There are two particularly important ones which the project has addressed:

- the first is essentially about product strategy for the individual organization - in choosing the cases, as far as possible all other aspects should be as similar as possible (size, precise sector and market, *etc.*);
- the second is to do with the environment within which the organisation was operating.

Given that the study is limited to the UK it needed to focus upon regional and sectoral differences. As already noted above, this includes both the product and labour market situation faced by the organisation, as well as the effect of specific initiatives and support systems such as Employment Zones and other regional and sectoral support services.

A series of in-depth interviews were undertaken with the chosen organisations. These were picked so as to represent examples of successful and less successful strategies. The aim was to try to identify "clusters" of both successful and struggling companies and then conduct "matched" case studies which could elucidate the conditions which result in a virtuous or a vicious circle and, in particular, to identify what levers there are which policy makers could use to intervene. These might include factors to do with the external environment as well as factors to do with the policies and practices being followed within the organisation.

3.6 Nature of the Case Studies

The kind of issues that need to be addressed concern whether the choice of organisation and *level of organisation* enable the link between low-skills and product strategy to be identified. There were some serious issues to be addressed here. In order to get to grips with top level strategy it may be necessary to go to the very top of an organisation. It is here where the product strategy, HRM and other strategies are decided. Such decisions may be made outside the region concerned. On the other hand, avoidance of larger organisations, with remote head offices, raises a different set of concerns about becoming too parochial.

The present case studies were conducted face-to-face, arranging such interviews with the equivalent persons – typically they were at a very senior management position in the establishment – required some considerable input of time and effort.

The cases have attempted to obtain different perspectives. In some cases it has been possible to interview multiple respondents (those responsible for product markets and human resources respectively). In other cases, managers responsible for product market development (works managers, business development managers *etc.*) have been the principal management respondent. In larger organisations the human resource manager has tended to be the principal management respondent.

It is not so much that human resource managers do not have the right perspective, just a partial one. In some of the cases in the present project the human resource manager was the principal management respondent, in many cases it was possible to interview also the works manager/business development manager who was able to give an overview of production needs and labour requirements. But the study was reluctant to let go of a good case just because it was 'only' the human resource manager that was willing to be the case guide.

3.7 Identifying a Low Skill/High Skill Equilibrium Situation

The case studies therefore involved comparison of companies in the same sector. They explored:

the internal policies of organisation, including:

- analysis of the changing product market they face;
- description of product market strategies;
- role of skills in design of product market strategies;
- role of skills in meeting (or failing to meet) product market goals.

the external environment, including:

- assistance provided by national/local institutions in designing product market strategies (and by whom) and the nature of the assistance provided.

The interviews aimed to identify how an individual company gets trapped in a low-skill equilibrium or on a low skill trajectory:

- how product market strategy fails/succeeds to address external competitive pressures;
- how product market strategy addresses the need to secure existing markets/capture of new markets but fails because it cannot be realised due to:
  - a lack of capital; and/or
  - a lack of skilled labour.
- the role of assistance provided by national/local institutions in relation to skill needs

The aim was also to:

- assess the respondents' perceptions of the institutional infrastructure they operate within;
- the constraints that these may impose;
- what motivators/barriers encourage/stand in the way of organisations moving up market;
- whether the choices being made are in some sense rational from a private perspective.

3.8 Product Market Strategy

A key focus of the interviews was on product strategy. This included an assessment of existing productive capacity and the historical legacy or 'baggage' that influences future change.

Questions on product market strategy focussed upon:

- at what stage is the organisation in its current product/innovation cycle (initiation, maturity, stagnation?);
- how have markets (existing and new/emerging) been identified?;
- how are decisions about markets to enter/withdraw from derived?;
- where are decisions made (locally, elsewhere [UK, Europe, *etc.*])?;
- what assessment has been made of existing (or anticipated) competition?;
- what assistance has been sought/obtained and from whom in devising product market strategy?;
- availability of investment capital?

Questions were also directed at trying to establish where has the company pitched itself in the current/future market, especially with respect to:

- determination of current product market range;
- determination of supply chain relationships;
- volume of production (mass production, mass customisation, *etc.*);
- price of products or services;
- choice of production method.

3.9 Skill Needs Assessment

Interviewers also probed the respondents about how skill needs are determined. This included questions about:

- who is charged with this responsibility and their influence over product market strategy decisions?;
- what institutional arrangements are in place to assess current and future skill needs?;
- questions on liaison with external organisations, with respect to:
  - development of existing workforce;
  - attracting new labour;
  - general HR issues;
- questions about the relationship between skill needs assessment and wider HR policies related to the organisation.

The respondents were also asked about matters related to the external labour market, including the following:

- to what extent has the availability or price of skilled labour affected/modified product market strategy?
- to what extent has assistance been sought/given (and from whom) with reference to skill deployment?
- how has the company attempted to recruit and retain skilled labour?

3.10 The Role of Skills

Following on from this the interviewers probed more deeply about whether skills matter:

- do skills matter?
- what skills matter?

Where skills were a problem, information was sought, including:

- occupation:
  - is it only managers and professionals that determine the product market position?;
  - what value/role is placed on routine production or service workers?;
- skill types:
  - generic *versus* technical;
  - key competencies.

It was also necessary to deal with the apparent paradox that, on the one hand, most companies report that their staff (and their knowledge and skills) are their prime asset. It is widely recognised that human capital embodied in staff, procedures and R&D are keys to competitive success. On the other hand, as argued in Keep and Mayhew (1999) and Hogarth and Wilson (2001), decisions on skills and skills mix (and hence human resource strategy) are generally regarded as a second or third order priority. Such matters are decided after first deciding on the nature of the product/service and, secondly, deciding how it is to be produced/delivered. Essentially, the demand for skills is a derived demand, which is driven principally by the decisions on the product/service and the production/delivery process. It is the underlying rationale for these first two decisions that the case studies have attempted to tease out of the respondents. The implications for skills demand follow from these decisions, and the nature of the LSEq that the current project is concerned with derives from these.

3.11 Interview Instruments

A formal, semi structured, interview schedule was developed based on the ideas set out above. It drew heavily upon previous work undertaken for DfES, especially that carried out as part of the work on the Employers Skills Survey (ESS). The survey instruments also drew upon the questionnaire used in the SKOPE Employers Perception Survey (EPS2002).[1] The general form of this is shown in Annex A1. This deals with various aspects of product and HRM strategy. The material comprised:

- **Background Notes** on the aims and objectives of the project, including Key questions to be addressed;
- **Interviewer Notes;**
- **Semi-structured interview Schedule.**

[1] See Annex A2.

4. KEY FINDINGS FROM THE CASE STUDIES

4.1 Introduction and Structure of the Chapter

Large segments of the food processing and hotel industries are low-skill, low-wage ones relying upon labour intensive production processes. But this is not necessarily reflected in low levels of performance in a more general sense. Both industries contain numerous large multi-national corporations, many of which are household names such as Hilton, Marriott, Heinz, Mars, *etc.* – these have achieved sustained levels of profitability. These sectors also include smaller, independent players. In many of the cases examined, but especially in the food industry, despite a relatively low priority on skills, they are highly successful organisations, making good profits.

Nevertheless, as industries dependent upon a relatively large input of labour, there is the potential for an improvement in the quality of labour input to raise levels of performance. As the data reported below reveal, employers had concerns about the quality of labour they were able to recruit and the impact that this had upon their production processes. Whilst problems regarding the availability and quality of labour were not of an order of magnitude to disrupt severely the production process, they did have significant cost implications for organisations. Paying overtime and agency fees, for example, increased costs.

The business hotel industry is dependent upon a labour intensive production process and there is clearly a tension between the market price for the service, profit levels, and labour costs. At the luxury end of the market the quality of service provided to customers is one that is dependent upon well-trained and skilled personnel to deliver it.

Manufacturing technologies in the food and drink industry have the potential to automate further production and consequently ameliorate recruitment problems. Low margin products can be produced in massive volume to generate high profits. Organisations appear to be more constrained by a lack of capital investment (to automate production lines) rather than the availability of suitably skilled labour.

Following this brief introduction the chapter is structured as follows:
- Section 4.2 describes the choice of sectors and regions:
- Section 4.3 discusses the selection of the particular cases;
- Section 4.4 presents the hotels sector;
- Section 4.5 then covers the evidence for food processing cases;
- Section 4.6 then concludes with an overview of the evidence, including an assessment of what the case study evidence suggests regarding the existence of a low skill equilibrium in the regions and sectors studied.

The discussion in Sections 4.4.and 4.5 presents, for each sector in turn:
- a description of the product market strategies pursued by each organisation;
- analysis of product/service specification;
- attempts to shift product market position;
- the extent to which the availability of labour constrains product market strategy;
- the support infrastructure to assist organisations to yield higher value-added.

As the evidence reveals, the product markets in which organisations operated were challenging, necessitating the on-going development of products and services. In many respects, organisations need to run to stand still in the market. But for most organisations this was business as usual. Evidence is provided of several organisations that had attempted, not so much to shift their product upmarket into higher value-added segments of their market, but to increase the profit they obtained from their existing range of products and services. Such change is, in many respects, piecemeal but has the potential to both increase market share and value-added, and has implications for the skills they needed to deploy.

4.2 Choice of Industries and Regions

As noted in Chapter 3. the choice of industries was guided by a need to:

- obtain a mix of service and production industries;
- identify low- and high-value added performers within a selected industry; and
- restrict selection to those industries identified in each region as having the potential to achieve high value-added business growth.

For the reasons set out in Chapter 3, the final choice of sectors was to focus upon:

- Food processing; and
- Business hotels (hospitality).

Regional policy over recent years has been given much impetus, as exemplified by the development of Regional Economic Strategies. Regional Development Agencies (RDAs) have considerable autonomy to promote and develop particular industries in their regions. Most RDAs appear to be following a strategy that aims to

- support existing traditional industries;
- develop new, high value added sectors that will (hopefully) provide high-wage, high skill jobs in the future.

Food processing and business hotels (hospitality) fall very much into the first category with all available evidence pointing to them being an important source of employment in both regions well into the future. This highlights a possible dilemma posed by current, possibly tight labour markets: labour intensive industries such as these currently help to maintain low levels of unemployment but possibly at the cost of crowding out the development of new higher waged, higher skilled ones.

The case studies were conducted in two regions: West and East Midlands. Both regions have developed policies to assist the food processing and hospitality industries with the specific policies varying across the regions. The East Midlands, for example, has promoted the idea of Skills Passport in the food processing industry. (see *Panel 1*)

Both regions – especially in the local areas in which the case studies were located – were experiencing something close to full employment at the time of the fieldwork. This often created exceedingly tight labour market conditions where employers were recruiting staff paid at or close to the minimum wage and/or to work unsociable hours. But labour market conditions varied between localities often in unexpected ways, such as the supply of itinerant Portuguese workers to the food and drink industry in the East Midlands. Similarly, in the West Midlands there was often a supply of labour from the Indian sub-continent through family connections in the local community.

4.2.1 Food processing

A recent press release form the East Midlands RDA outlines this region's approach to developing the food and drink industry *(see Panel 1)*

Panel 1: **Food processing in the East Midlands**

A plan to make one English region the country's most vibrant food industry economy was unveiled today (10 APRIL).

The blueprint - drawn up by a Government regional development agency - envisages one of the most radical ever approaches to development of the food industry.

A strategy that will have ramifications from 'the field to the table' is being spearheaded by East Midlands Development Agency, working closely with its industry partners and food companies throughout the region. The plan will embrace initiatives to:

- Transform the image of working in the food industry by targeting school leavers, graduates and others to highlight the opportunities in a high value growing industry. It will also put food on the education agenda by taking the industry into the classrooms of the region.
- Develop schemes such as the Food and Drink Forum's 'passport to food' and other workplace projects to encourage skilled workers to stay in the industry once recruited.
- Develop 'food villages' providing specialist facilities for growing food companies.
- Encourage clusters of food companies that will learn from each other and bring investment, innovation and greater competitiveness.
- Promote 'food heritage' and food tourism throughout the six counties of the East Midlands - building on the reputation of the region's famous products from Bakewell puddings to Melton Mowbray pork pies.

And at the heart of the development agency's initiative is the establishment of a virtual 'university of food' - to be known as the 'food campus' - that will bring together the full range of academic, research, skills and training bodies with the food industry to create a food centre of excellence. It will allow for easy exchange of ideas and best practice, ensuring that the region's universities work with food companies and farmers to make value added products.

Source: http://www.emda.org.uk/news/newsreturn.asp?fileno=118

In the West Midlands, the relative weakness of the food processing industry has been outlined as follows *(see Panel 2)*.

Panel 2: **Food processing in the West Midlands**

The regional strengths for food manufacturing in the West Midlands region currently lie in low value-added markets. Mass and specialist producers in meat, vegetables, milk, cheese and yoghurt benefit from the proximity to good quality farming country, much of which is located in the west (Shropshire) and in the south (Hereford & Worcestershire) of the region.

The region currently lacks a competitive advantage in more value-added areas of food production such as food processing and frozen and chilled ready-made meals. It is in these areas that the region needs to develop if it is to develop a larger, more profitable food industry in the future.

Chilled ready-made meals are presently a major growth area – the market for them has grown by 70% over the last five years to around £580 million. This reflects various demographic trends such as an increase in people living alone and dual-working households seeking more convenient meal options for their families.

Ready-made sandwiches is another major growth market – the estimated £2.6 billion spent in Britain in 1998 was more than that spent on the fast food sector of pizza, pasta and burgers put together. Several major manufacturers such as The Sandwich Factory and Buckingham Foods are already based in the region – more could follow.

Obviously a lot of food manufacturing is going to be clustered around farms and proprietary processing plants. For instance, fish processing plants are obviously more likely to be close to the sea. However, the region could try and attract more footloose food manufacturing investments by marketing itself, through its central position, (relatively good) transport facilities and large local population, as a growth node for food production and distribution.

Ethnic cuisine is one area in which the West Midlands region could potentially develop a strong competitive advantage. The large ethnic minority population in areas of the Regeneration Zones can provide a focus for this.

Source: http://www.advantagewm.co.uk/food-and-drink-needs-analysis.doc

4.2.2 Business hotels

The RDAs in both regions are active in promoting tourism in their respective areas. Within this there is a commitment to developing business tourism. The East Midlands is aiming to develop the area as a conference sector *(see Panel 3 below),* whereas the West Midlands has been able to develop a strong business tourism base around the National Exhibition Centre and new conference facilities in Birmingham city centre. The information provided below is intended to give an indication of the business tourism sector in each region and the policies being developed to promote it further.

Panel 3: **Business tourism in the East Midlands**

Business tourism has been growing and is responsible for much of the investment that has taken place in tourism infrastructure – especially hotels – in the East Midlands in recent years.

The easy accessibility of many parts of the East Midlands is the key advantage that the region has and can exploit.

There may be an argument for developing a regional conference and exhibition centre that can compete for international, national and regional events. It would take advantage of the region's locational advantages. The strategy is to consider this issue on a regional basis and, if there is market demand, attempt to seek a location that can best capture that demand and maximise the benefits to the rest of the tourism economy.

The strategy is also to encourage the continued development of high quality facilities that attract and serve small corporate meetings and seminars, especially where they combine lifestyle pursuits as part of the offer. The aim is to promote, in tandem, extended stays, spouse's programmes, and repeat visits. Aligned with this, the corporate activities and corporate hospitality markets offer potential for further development and can especially benefit rural areas.

Consideration will be given to creating conference ambassadors' programmes that establish links with people working in the region, especially academics, who are well placed to bring conferences and exhibitions to the area. Manchester, Liverpool and Edinburgh have successful programmes that can be emulated.

Lastly, the strategy is to ensure that the region's business tourism offer is promoted through high quality, sustainable, conference bureaux. It is likely that they will be a core function of the sub-regional destination management partnerships, although the case for a regional bureau will also be examined.

In promoting conferences and exhibitions, there is particular scope for cross-regional co-ordination of presence at exhibitions, joint mailings and so on. Many of the region's conference bureaux find it difficult to afford that activity on their own, and customers are often likely to be thinking in terms of the M1 or A1 corridors rather than individual destinations within them.

Source: http://www.emda.org.uk/documents/emTourismStrategyFull.doc

In the West Midlands the business tourism sector has the following characteristics *(see Panel 4)*.

Panel 4: **Business tourism in the West Midlands**

Business tourism, mainly concentrated on Birmingham, is another key component of the West Midlands tourism mix. It has been one of the main drivers in increasing the total number of visitors to the region and has helped stimulate the development of local infrastructure, particularly to hotels, cafés and bars.

The business tourism market also tends to be less affected by seasonality, in comparison to the region's leisure visitor markets. Therefore, the benefits of visitor spend in the local economy (in terms of both income and employment) are spread more evenly throughout the year – with particularly high levels of trade in the off-peak (autumn/ winter seasons).

The two principal business tourism venues are the International Convention Centre and the National Exhibition Centre (NEC). Measured in number of exhibitions, the NEC is the busiest in Europe and circa 4 million visitors put it second only to Paris Expo in terms of visitor numbers. These two centres are also used as leisure venues. Other venues include - Telford international Convention Centre (7th largest in UK), Three Counties Showground, Aston Villa Football Club, Stoneleigh Park and Warwick University, Keele University etc.

Much business tourism is, however, concerned with smaller conferences/ meetings and with visits to industrial companies. In these cases, the main direct beneficiaries are hotels and smaller conference facilities as well as bars and restaurants.

In 2001, domestic overnight business visitors generated £736 million, and overseas overnight business visitors generated an additional £228 million within the Visit Heart of England Tourist Board region (East and West Midlands). As Birmingham represents a significant focal point for business tourism, the West Midlands is likely to have received a large proportion of the total £964 million business visitor spend. Business visitors also tend to generate a higher proportion of spend per head than leisure visitors – business visitors accounted for 15% of domestic overnight trips to the region, however, generated 26% of all spend.

Source: http://www.advantagewm.co.uk/tourism-and-leisure-needs-analysis.doc

4.3 Selection of Case Studies in the Chosen Industries & Regions

General considerations in the choice of cases were set out in Chapter 3. The specific choices made are outlined in this section. The selection of case studies has resulted in a mix of the different types of organisation that comprise each of the two industries in each region. A brief description of each case study is provided below *(see Table 4.1)*.

Table 4.1: Case study organisations

ORGANISATION NAME	PRODUCTS	OWNERSHIP	EMPLOYMENT
FOOD AND DRINK			
West Midlands			
F&D1	Cakes and cereal bars	Independent	Small
F&D2	Bakery products	UK national	Large
F&D3	Bakery products	UK national	Medium
East Midlands			
F&D4	Dairy products	National	Large
F&D5	Dairy products	Independent	Large
F&D6	Ready made meals	Multinational	Large
F&D7	Ready made meals	Independent	Small
F&D8	Cakes, snacks Cereal producst	Multinational	Large
F&D9	Ready made meals	Independent	Small
F&D10	Bakery products	Multinational	Medium
BUSINESS HOTELS			
West Midlands			
BH1	Luxury hotel and conference centre	Multinational	Large
BH2	4* hotel providing meeting and conference facilities	Multinational	Medium
BH3	3* standard hotel serving city centre	Multinational	Medium
BH4	3* standard hotel	National	Small
BH5	Budget hotel	National	Small
East Midlands			
BH6	4* luxury hotel, conference centre, and leisure centre	National	Large
BH7	3* standard hotel serving city centre	Independent	Medium
BH8	3* standard hotel serving airport	National	Medium
BH9	Budget hotel	National	
BH10	Budget hotel	Independent	Micro
BH11	Budget hotel	Multinational	Small

Source: Low Skills Equilibrium Study: Case Studies (IER).

Notes:
Large: 250 plus
Medium: 100-249
Small: 11-99
Micro: Less than 10

Within the food and drink sector the cases for selection included:

- a mix of large and medium sized enterprises;
- a mix of independent companies and those that were part of larger organisations;
- a mix of relatively long established and newly established organisations;
- examples of higher value-added products (ready made meals);
- examples of relatively low margin products (standard bread);
- examples of cheese manufacturing strong in the East Midlands, and located in rural locations with easy access to milk supplies.

Within the business hotel industry the case studies had the following characteristics:

- located mainly city centre or at key transport nodes;
- a bias toward large chains which tend to dominate the business hotel markets;
- the inclusion of two independent hotels;
- a mix of luxury, standard, and budget hotels.

For reasons set out in Chapter 3, the sample design aimed to include organisations that were performing relatively well or badly. In practice, the distinction tends to be quite subtle and sometimes subject to a quite quick reversal in fortunes. In practice, a mix has been obtained of organisations that are currently under considerable pressures to meet their production targets and those that are performing well against budget. Identification of these companies was made on the basis of local knowledge.

4.4 Business Hotels

4.4.1 Background information[1]

Business hotels, depending upon their size, often provide a variety of services, such as:

- accommodation;
- conference/meeting facilities;
- leisure facilities;
- dining, bars;
- miscellaneous services (weddings *etc.*).

Business hotels cannot be seen simply as providing a bed and breakfast service. In fact this is sometimes not the principal source of their revenue. At least one hotel in the sample reported that it was a mix of six separate businesses: conference centre, city centre parking, accommodation, leisure centre, dining and bars. Each business generated its own clientele and required different mixes of service. At the same time there are a range of hotels - budget chains, that provide only lodging - that depend primarily upon business trade.

Large national and international chains - several of which are highly profitable enterprises - are well represented in the business hotel sector. In recent years these chains have been subject to much change of ownership. There is strong branding in the industry, with some large chains aiming to provide a standardised service across the world, with a consequence that much policy is decided at a corporate level, often abroad. Whilst the sample of hotels contains several hotels belonging to international chains, all had a degree of autonomy with respect to how they delivered their service and the price at which it was pitched in the local market. In general, development of skills was primarily an issue decided at the local level, although reference sometimes had to be made to corporate level.

4.4.2 Product market position of case studies

An attempt has been made to categorise hotels according to the level of service they offer as follows:

- **i.** **quality hotels** top class business hotels (4/5* establishments, providing a wide variety of services to business and business travellers);
- **ii.** **standard quality hotels**, typically 3* establishments, offering a more limited range of services;
- **iii.** **budget hotels** providing a basic level of service at a relatively low cost.

Table 4.2 outlines the different type of service provided by the hotels in the sample within each sub-category.

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[1] General statistical information on the hotels and catering sector is provided in Annex A3.

Table 4.2 Services provided by type of business hotel

	Customer Base	Services						
		Bar	Breakfast	Restaurant	24 hour service	Conference facilities	Leisure facilities	Business services
Quality Hotels								
Top Hotel 1	C, B, LW	√	√	√	√	√		√
Top Hotel 2	C, B, LW	√	√	√	√	√	√	√
Top Hotel 3	C, B, LW	√	√	√	√	√	√	√
Standard Quality								
Standard Hotel 1	B, LW	√	√	√	√ (limited)	√		
Standard Hotel 2	B, LW	√	√	√	√ (limited)	√b		
Standard Hotel 3	B, LW	√	√	√		√ (limited)		
Standard Hotel 4	B, LW, L	√	√	√	√ (limited)	√		
Budget Hotels								
Budget Hotel 1	B, LW		√a					
Budget Hotel 2	B, LW	√	√	√ (bar snacks)				
Budget Hotel 3	B, LW	√	√	√ (bar snacks)				
Budget Hotel 4	B, LW, L	√	√	√				

Key

B = business trade (*i.e.* guests at hotel)

C = conference business (delegates not necessarily lodging at hotel)

LW = weekend leisure business

L = leisure

Source: Low Skills Equilibrium Study: Case Studies (IER).

Notes: a) Breakfast provided in adjoining establishment

b) Small meeting rooms only

Several hotels were involved in providing conference and meeting facilities where delegates were not necessarily lodging at the hotel. Most hotels were also dependent upon leisure business at weekend to fill rooms. All hotels reported that the Christmas period was important in providing party business.

Whilst being able to outline the type of service provided in each of the hotels, *Table 4.2* is less able to indicate the quality of service provided. For example, ‘quality hotels’, are able to provide a level of *haute cuisine* that the other hotels were much less well placed to offer. The economies of scale in the large quality hotels were such that they were able to hire, for instance, chefs able to develop a reputation for their restaurants. This was illustrated with reference to one quality hotel that reported it was able to offer, because of its size, career progression through its kitchens where senior chefs could expect to earn around £40-60,000 a year.

Further details of each of the hotels are provided in *Table 4.3*.

Table 4.3 Details of hotels in the sample

	Rooms	Employees	Room/ Employee Ratio	Room Costs per night (£)	Chain or independent
Quality Hotels					
Top Hotel 1	Large	Large	1.1	125	C
Top Hotel 2	Large	Small	3.1	107	C
Top Hotel 3	Large	Medium	0.9	96	C
Standard Quality					
Standard Hotel 1	Medium	Medium	1.2	89	C
Standard Hotel 2	Medium	Medium	1.0	128	C
Standard Hotel 3	Medium	Small	1.0	110	C
Standard Hotel 4	Small	Small	1.0	80	C
Budget Hotels					
Budget Hotel 1	Medium	Small	2.2	45	C
Budget Hotel 2	Medium	Small	6.6	43	C
Budget Hotel 3	Medium	Small	2.6	48	C
Budget Hotel 4	Micro	Micro	0.4	40	I

Source: Low Skills Equilibrium Study: Case Studies (IER).

Notes:
Large: 250 plus
Medium: 100-249
Small: 11-99
Micro: Less than 10

A number of features are apparent from *Table 4.3*:

- room price is an imperfect indicator of quality. Several hoteliers noted that prices vary across the industry depending upon the demand for rooms, such that a 3* hotel can, at any one point in time, be charging more than its 5* counterpart. It is noticeable that it was a standard hotel that recorded the highest room rate although it was involved in discounting room rates over the course of a day;
- room price is only an approximate indicator of the cost to the customer. Where restaurant and meeting services are provided they can substantially add to the overall cost and revenues generated for the hotel;
- the ratio between rooms and employees – albeit an imperfect indicator – tends to be around 1.0 for the quality and standard hotels but considerably higher for the budget hotels. In many respects it is the savings provided on labour costs that allow budget hotels to offer low room rates. In many respects the hallmark of a high quality, luxury hotel is the number of staff on hand to provide a range of services to the customer.

4.4.3 Current trading position

The current trading position of hotels is summarised in *Table 4.4.* In general, hotels reported that trading conditions were quite difficult currently, mainly because foreign business travel had fallen away after events of 11 September 2001 in the USA and the slow down in the UK economy. Many of the hotels, especially in the West Midlands, were dependent for business on Birmingham Airport, the National Exhibition Centre, and conference facilities in Birmingham city centre. Overall, hotels reported that they having to work harder to maintain occupancy rates. Some reported that there was over-supply of facilities within the industry at the moment.

Table 4.4: Current trading conditions within hotels

	Current state of market		
	Competition in existing markets	**Sales growth**	**Comments**
Quality Hotels			
Top Hotel 1	Moderate to low	Static	Heavily dependent upon business traffic to local exhibition centre and city centre. This has declined since 9/11.
Top Hotel 2	Moderate since highest quality hotel in area	Static	As above; currently slightly below budget
Top Hotel 3	Moderate	Growing	Only city centre hotel with large scale conference and leisure facilities. Reorientation of hotel beginning to show results.
Standard Quality			
Standard Hotel 1	High; many hotels in city centre offering this service	Static	Dependent upon business traffic, which has declined, plus more budget hotels to compete with.
Standard Hotel 2	High; relatively poor position for airport, exhibition centre, and city centre business	Decline	Hotel has limited room for expansion of facilities that would improve market position.
Standard Hotel 3	High; many other hotels in city centre	Static	
Standard Hotel 4	High; many other hotels offering this class of service locally	Static	
Budget Hotels			
Budget Hotel 1	High; many other budget hotels in vicinity	Growing	High occupancy rates all year round; limited by capacity to expand.
Budget Hotel 2	Moderate	Growing	Not many other budget hotels in city.
Budget Hotel 3	High; five other hotels in immediate vicinity including two budget hotels	Static	
Budget Hotel 4	High; two other budget hotels locally	Static	Tends to survive on repeat business from being in operation for 50 years.

Source: Low Skills Equilibrium Study: Case Studies (IER).

Discounting room rates was reported as widespread throughout the industry. Depending upon how busy the hotels were, most were prepared to negotiate room rates and at least one hotel had a policy of discounting room rates at various points during the day according to a fixed system. Budget hotels were not prepared to discount room rates. Their aim, it was reported, was to offer a standard service at a standard price across all their hotels as part of their marketing strategy. In this way their usual customers knew that the room rate would be, say, £40. It should also be noted that the budget hotels reported relatively high occupancy rates.

4.4.4 Developing the product market position

It is useful to distinguish between the quality and specification of the product (*i.e.* the particular level of quality and breadth of service that a hotel provided) and the efficiency with which that service was produced. The first column of *Table 4.5* outlines the market in which each of the hotels operated and the second column outlines changes they were making to the way that service was produced.

Table 4.5 Change in services provided by hotels

	Types of change introduced		
	Market position	**Improve quality of existing service without moving upmarket**	**Type of changes introduced**
Quality Hotels			
Top Hotel 1	Now operating at a 4* standard and consolidating this position.	Looking for efficiency savings through use of Head Office services.	Not interested in moving further upmarket as the costs of doing so would not be returned but looking for efficiencies in existing standard of service.
Top Hotel 2	Operates at a 5* standard and this has been achieved.	Reorganisation of hotel into business units responsible for meeting targets.	Move to cost/profit centres within hotel should improve quality and efficiency of service delivery.
Top Hotel 3	Operates at a 4* standard but looking to improve current standards.		Reorientation to business/conference hotel not yet fully complete.
Standard Quality			
Standard Hotel 1	Keeping to 3* standard.	Looking for innovations in service delivery.	
Standard Hotel 2	Keeping to 3* standard.		Local hotel in chain provides the higher quality, upmarket service. This hotel used as an overspill hotel for the larger, upmarket one.
Standard Hotel 3	Keeping to 3* standard.	Have attempted to improve quality within standard range.	
Standard Hotel 4	Keeping to 3* standard specified by HQ.		

(continued)

Table 4.5 Change in services provided by hotels (continued)

	Types of change introduced		
	Market position	**Improve quality of existing service without moving upmarket**	**Type of changes introduced**
Budget Hotels			
Budget Hotel 1	Standard established by HQ.	Company as a whole trying to realise economies of scale: invoicing, ordering *etc.*	
Budget Hotel 2	Standard established by HQ.	Company as a whole trying to realise economies of scale: invoicing, ordering *etc.*	
Budget Hotel 3	Standard set by HQ.	Various changes introduced to allow cost base to be better managed.	*e.g.* chefs previously contracted out but now in-house.
Budget Hotel 4	Have attempted to move the hotel upmarket to differentiate from budget chains.		

Source: Low Skills Equilibrium Study: Case Studies (IER).

What is most readily apparent is that all hotels reported that they were not looking to move out of the market in which they were currently situated. In general, the parent company established the market position of the hotel – allied to strong marketing and brand management – such that the individual hotel had little influence over that positioning. Whilst all the hotels reported that they were not currently looking to move upmarket, one hotel had recently made that transition and had encountered considerable on-going problems in doing so *(see panel)*.

Case study: Quality Hotel No.3

The hotel operates at a 4* standard and turnover was just below £10m in 2002/2003. As a business it is not just a hotel but a conference centre, car park (generates over £600,000 a year), and leisure club. It employs 130 staff, increasing on occasion to 200 people.

The hotel had changed owner in recent years (it was now part of a large chain having been previously independent). As an independent hotel it had survived on the food/beverage basis, meeting needs of diners rather than those looking for accommodation; the hotel was designed to this specific market and it had been successful. But over the 1990s its market began to decline.

With the takeover - and the introduction of a new general manager - the hotel shifted its market position towards the business market – with facilities for conferences and meetings – being a leisure hotel at weekends. This has been a major strategic shift, requiring a change of attitude/skill amongst the staff. This shift at local level was achieved by closing restaurants and using national sales force to generate business. It also required major capital investment because some facilities (*e.g.* banqueting suite) were not geared up for conferences. A £2m investment was made.

The hotel had struggled to obtain standard of service it ideally wanted to achieve although it was still making progress towards it. In the past, staff were dealing with families, providing lots of lunches and dinners – but now it is catering to a business clientele who did not appreciate such a familiar level of service. They have had to move away from this culture. Business customers want efficiency, not a 'chummy' atmosphere, timing is important to them. When dealing with business customers it is important to meet the letter of contract (customers and hotel) and this requires skill.

This has been a major skills change. There has been a long assessment process, during which time some people left because they decided they did not like the look of the new business. The new manager and his team set performance standards and where staff have not met that standard some have been moved out of the business and others have been re-trained. All processes are now a lot more closely managed.

New management appointments have been difficult to make. They have not necessarily sought those trained in the classic hotel way but from 'parallel' industries such as retailing, but this has been difficult. It was especially difficult to recruit housekeeping and restaurant managers. There have also been some problems recruiting housekeepers.

Source: Low Skills Equilibrium Study: Case Studies (IER).

Whilst all the other hotels were not looking to shift from their current market position, most were looking to improve the way in which they delivered their services. In many instances this was simply related to the streamlining of administrative processes where activities once undertaken at the hotel were transferred to head office. In other instances, the change at an establishment level was much more profound. One quality hotel had undertaken major organisational change to establish thirteen business centres within the establishment responsible for their own profit and loss accounts, and where centre managers had ultimate responsibility for all activities (finance, personnel, customer service, *etc.*) falling within their remit. This had posed the hotel with some difficult management problems *(see panel)*.

Case study: Quality Hotel No.2

Part of a large multinational chain, the hotel is the second largest in its group and contributes a large share of profits in the UK. Sales turnover was almost £40m in 2002/2004 from conferences, banqueting, and accommodation. Approximately 45 per cent of staff are permanent, the others are casuals depending upon when the business needs them.

The market is tight currently. Last year they were down on targets and this year they are down again, due to lower levels of business traffic. Occupancy rates are currently 65 per cent, up from 63 per cent last year. Tight control of the cost base ensures that the business can adapt to these toughened conditions.

The hotel is split into several independent business units. There are four directors and beneath them business managers responsible for running each unit. Managers are responsible for meeting targets and controlling costs and have a degree of flexibility in doing so. This is a new development and the company is only six months into the new organisation – they have planned for a two-year adjustment period. If it works at the hotel, it will be rolled out across all other large hotels in the chain.

There has been a lot of turnover amongst management, in part because of the reorganisation and the fact that many managers lack the skills necessary to manage a £2m business (a typical unit) and a profit and loss account. Managers must be more entrepreneurial to achieve targets, but managers with this skill are difficult to recruit because pay rates are poor compared to the retail industry where managers with the skills required are thought to be located.

Staff satisfaction in the hotel is high: the average from staff surveys is around 74 per cent with the aim to increase it to 80 per cent. This will be achieved through training and work - life - balance type policies and a benefits package. After three months employment in the company, employees are entitled to join the Club that offers mortgage loans, medical insurance. Bonuses are paid for 100 per cent attendance at work. There is a sports and leisure club. Managers' bonuses are linked to staff satisfaction and staff attendance. Managers in the business units have a free hand as to how they achieve this end. One manager, for example, put on swimming lessons for his staff in the hotel swimming pool.

Source: Low Skills Equilibrium Study: Case Studies (IER).

In many respects the changes that many of the hotels had introduced were concerned with cost control and labour was the single largest element of their cost base.

The examples above indicate hotels that are trading well in a static market. The example of *Standard Hotel 1* indicates how the market position of a hotel has become squeezed as it neither offers a luxury experience nor a budget one. *(see panel)*.

Case study: Standard Hotel No.1

Business was 'sluggish' at the time of the study due to a fall in business traffic with the result that room rates needed to be discounted to maintain occupancy rates. The hotel aims at the business market and has conference and meeting facilities, mainly small scale ones. It tends to act as an overspill hotel for another hotel in the chain nearby that has more extensive facilities.

In an effort to maintain occupancy rates the hotel has begun to attract coach tours to fill rooms at weekends. These provide a very tight profit margin and it is difficult for the hotel to cutback very far on the service provided to these tours.

Given its town centre location there is limited room for the hotel to expand. In particular it has no leisure facilities – and no room to create them – which puts it at a disadvantage compared to some competitors, within and without the chain.

Problems in recruiting kitchen staff have limited what the hotel can offer. For example, the hotel has taken on board the national bar snack menu provided by head office which is not working well, but there is no one available within the hotel to update or change it. They also make use of pre-prepared food, especially for providing 24-hour room service, rather than freshly prepared foods. This is also related to the problems the hotel encounters in finding staff to cover nights. The hotel needs to provide cover if it is to sell itself as a business hotel, since this requires 24-hour service. Night service staff need to be flexible as they often have varied tasks: reception, room service, security, *etc*.

Source: Low Skills Equilibrium Study: Case Studies (IER).

The example above indicates how the product market position of the hotel was further compromised by staff shortages that limited its capacity to provide a bar menu for passing trade or a night service to guests. The impact of skills is considered in greater detail in the next section.

4.4.5 The role of skills

Nearly all hotels either had recruitment problems at the time of the fieldwork or had experienced them over the past 12 months, even if not currently. *Table 4.6* outlines the types of recruitment problem hotels were either facing or had faced. These have been categorised as:

- management;
- housekeeping;
- kitchen (chefs, sous chefs, *etc.*);
- front of house (receptionists);
- restaurant/bar staff (waiters *etc.*);

Most hotels could point to having had recruitment problems with finding chefs and housekeepers. Housekeeping was often sub-contracted, or where shortages occurred management could sometimes help out, although the opportunity costs of doing so were widely recognised. Finding chefs was more of an intractable problem. In parts of the market, cook-chill supplies substituted for the skills of chefs, but this was not a practical solution in the higher quality hotels that traded on the reputation of their cuisine, although it was here that shortages were less likely be in evidence.

Table 4.6: Recruitment problems encountered by business hotels

	Skills difficult to recruit				
	Management	**Housekeeping**	**Kitchen**	**Reception/front of house**	**Bar/Restaurant**
Quality Hotels					
Top Hotel 1					
Top Hotel 2	√				
Top Hotel 3	√			√	
Standard Quality					
Standard Hotel 1		√	√	√	
Standard Hotel 2	√	√	√	√	√
Standard Hotel 3				√	
Standard Hotel 4			√	√	
Budget Hotels					
Budget Hotel 1		√		√	
Budget Hotel 2		√	√		
Budget Hotel 3		√	√		
Budget Hotel 4					

Source: Low Skills Equilibrium Study: Case Studies (IER).

In several instances the shortages of housekeepers and bar staff was seen as a wage problem. Wages were often paid at or close to the minimum wage, which, in labour markets nearing full employment, meant that it was difficult to recruit at the desired quality. Some hotels had solved this by subcontracting housekeeping to Agencies.

In other instances, shortages were seen as skill problems in the sense of skill gaps amongst existing employees. The larger chains reported that they engaged in substantial training programmes, especially related to customer service, to ensure that staff were of the standard required. It was also the larger multinational chains that were able to tap into foreign - mainly German, Swiss, and French markets - for labour, where the overall average level of skill possessed by those in the hospitality industry was thought to be higher.

Responses to skill shortages included the following:

- maintaining strong links with local catering colleges to develop links with potential kitchen staff;
- where the hotel was part of a chain, advertising throughout the chain;
- developing links with institutions abroad (Switzerland, Germany, France) where people trained in the hospitality industry might be looking for work experience in England;
- identifying foreign workers (sometimes from Eastern Europe) for housekeeping tasks;
- outsourcing activities - mainly housekeeping - to agencies, although several hotels reported that this sometimes resulted in it being difficult to maintain control over this function.

In general, hotels reported that they required people with the right attitude who were able to deport themselves in an appropriate manner: some explicitly emphasised the importance of 'people skills', rather than formal qualifications. The hotels, especially the chains, were willing to provide the training (sometimes allied to programmes such as Modern Apprenticeship) to develop people. Moreover, because these hotels were sometimes part of large chains they were able to provide a degree of career progression to those willing to move around the country.

4.4.6 Evidence of skill constraints

Table 4.7 provides a summary of whether a shortage of skills has been a constraint on moving upmarket or whether it has been a constraint on improving the quality of service within the existing product market position. Generally, employers reported that a lack of skills had not been a constraint on the market position. As noted elsewhere in this chapter, product market position was usually established by head office, with a view to presenting a similar standard across a range of hotels. If hotels were to move upmarket this usually required substantial capital investment related to improving the quality of bedrooms, conference facilities, and leisure clubs. Whilst it was recognised that moving upmarket would require the acquisition of new skills amongst the workforce, this was not the key issue. In most cases, the main problem was that either capital or land was not available to make the shift upmarket. Moreover, there was a view that the high end of the market was already well catered for in each of the case study areas.

Table 4.7 Evidence of skill constraints on product market position

	Skills a constraint to moving up market	Skills a constraint to improving existing service	Comments
Quality Hotels			
Top Hotel 1	No	No	Investment in training has allowed the hotel to achieve the position it wants in the market.
Top Hotel 2	No	Yes	The new organisational structure based around profit centres within the hotel has resulted in some management lacking necessary business skills.
Top Hotel 3	No	Yes	Some staff were still not in tune with the reorientation of the hotel to a business/conference centre rather than a leisure and dining hotel.
Standard Quality			
Standard Hotel 1	No	Yes	Certain activities have not been revived – such as the bar menu – because of staff shortages.
Standard Hotel 2	No	No	Constraints are mainly space and capital.
Standard Hotel 3	No	Yes	Management could do better it was reported; they would like to add a further restaurant but skill shortages make this impossible.
Standard Hotel 4	No	No	Constraints are mainly space and capital.
Budget Hotels			
Budget Hotel 1	No	Yes	Management spent more time managing recruitment and retention than other business issues.
Budget Hotel 2	No	No	Training allows business goals to be achieved.
Budget Hotel 3	No	Yes	Skill shortages make revenue control more difficult.
Budget Hotel 4	No	No	

Source: Low Skills Equilibrium Study: Case Studies (IER).

A shortage of skills was most likely to be a constraint on improving the service within a given product market position. However, there was evidence that one quality hotel had struggled to obtain the management skills required to ensure that its introduction of a new organisation within the hotel was successful and business targets were met. Other examples are provided in *Table 4.7.* Often this related to management skills. In other cases it related more to the generic skills possessed across the workforce. In one case management reported a lack of numeracy and basic accounting skills which made revenue management more difficult than it should have been.

The example below indicates how recruitment problems and staff shortages impact on how a hotel operates *(see panel)*. The evidence indicates that it has an adverse impact on staff morale – and in doing so might worsen even further retention rates – and prevents management doing its job.

Case Study: Budget Hotel No.1

The hotel has 60 bedrooms and 28 employees. The aim is to offer a basic level of service: £44.95p *per* room (regardless of number of people) plus £6.50 for breakfast if required. No other meals are provided.

A basic level of service does not have to mean low quality the hotel manager reported. The aim is to provide to a high level of customer satisfaction given the product specification. The chain aims to be the cheapest in the market but it is always looking to improve its product by re-evaluating what is provided: recent changes have seen phones provided in rooms, data points, coffee/team making in rooms, provision of shower gels (all rooms en-suite). They have invested heavily in providing disabled access by working with disabled groups in the design of access. They are also looking to install lifts even though ground floor rooms are available.

The hotel has problems recruiting: housekeepers; receptionists; and staff to work Friday nights. They had advertised in the Jobcentre but have found problems with quality, plus not many people turned up for interview. Adverts in the local press are the best means of attracting staff but this tends to be too expensive when jobs are being repeatedly advertised. Because property taxes are so high (says the company) the hotel can not afford to pay high wages otherwise their profit margin disappears. Housekeepers are paid £4.75/ hour (just about to be increased to £5/hour) and receptionists are paid £4.75/hour (going up to £5.50/hour). In addition, there is performance related pay.

Recruitment difficulties cause problems with team spirit since there is more work to do. If problems become acute it is possible to close off a section of the hotel but this is a last resort. The managers of the hotel bring staff across from a local bar/restaurant , owned by same company, to help out, but this can cause problems with quality standards. In fact, the age of recruits is getting younger (some are students) and this too can cause problems with quality standards.

The hotel has used agency workers in the past but has found them not to be good workers. In general agency workers are not considered reliable and are thought to have poor attitudes towards work. Plus the hotel really needs continuity in staffing to maintain standards. In addition agencies are paid at £7/hour on average – so there is the expense to consider.

The unique selling point of the hotel is a good, basic standard at an affordable price, a family hotel, good network all over the country, with centralised booking and open 24 hours a day. The problem at the moment is that the manager's job is concerned with recruitment and operational problems rather than developing new businesses. Managers are expected to have good local knowledge and to develop contacts with local business so that the business grows. There is no time to do this at the moment.

Source: Low Skills Equilibrium Study: Case Studies (IER).

4.5 Food Processing

4.5.1 Background information

Food processing represents a sector characterised by relatively middling levels of capital and skill intensity across Europe and the UK.[1] It is also a heterogeneous industry comprising large-scale producers of, typically, household name products, and niche producers often engaged in the preparation of low volume, premium products. The sample of case studies organisations in the current study comprises both types of producer insofar as cases are provided of mass producers (multinational companies) and medium and small enterprises engaged in the production of niche products. In relation to employment, the former tend to be characterised by automated production processes requiring relatively little labour input. The latter are characterised by labour intensive, often hand made products. Automation with respect to this latter group is often too expensive to be cost-effective given the small production volumes.

At first glance, the case studies suggest an industry characterised by low levels of skill. This is certainly true of the shopfloor, but the logistics of producing goods where the raw materials have a short-shelf life, where the final consumer can be fickle with respect to the volumes required, and the need for constant product renewal and marketing, suggests that high levels of skill are embedded at some critical levels within organisations, even if they are not represented in high volumes.

The case studies indicate the extent to which poor skills supply acts to constrain the development of organisations. This needs to be seen in the light of the competitive pressures food processing companies face and the extent to which an improved supply of skills might offset the downward pressure on prices that many food processors report. The evidence presented below initially suggests that skills are of second or third order importance for employers. This is not to belittle the importance of skills. In a labour intensive production system the quality of personnel involved in the production process can never be a trivial issue. At a time of near full employment it is apparent that the relatively low wage rates in the industry pose employers with a number of day-to-day operational problems, as do problems of absenteeism. Whilst, in general, these problems were just an inconvenience, employers trying to move upmarket reported that their impact was sufficient to constrain the performance of the organisation. This is considered in greater detail below.

4.5.2 Product market position of case studies

Classifying the products of the food processing industry is difficult. At one extreme there are simple products - such as a loaf of bread - and at the other there are ready prepared meals, requiring the precise mixing of ingredients to provide a consistent uniform taste across production runs. The value-added generated by companies in the former group can be substantial given the volumes produced. Whilst the latter has a greater margin attached to each individual product, the volume of sales can be much lower and hence aggregate value-added is accordingly lower.

[1] General background information on the industry is presented in Annex A3.

Food processors have been classified according to whether they are:

i. mass producers of standard products;
ii. niche producers of higher margin, lower volume goods than (i);
iii. producers of budget goods.

It is apparent that several producers that fall into category (i) above are listed in the DTI's 'Top 600 UK Companies by Value Added'.

The classification is imperfect, with at least one company falling into both (i) and (iii), but assigned to the latter group on the basis of its major manufacturing activity. Nevertheless, even if the companies in category (iii) are large, mass producers their dependence on producing simple goods at a relatively low margin marks them out as a separate category. *Table 4.8* provides information about each establishment.

Table 4.8 Food processing establishments in the sample

	Size	Ownership	Product range
Major producers			
F&D 1	Large	UK national, multiple sites	Cereals and cakes
F&D 2	Large	Foreign Multinational	French breads and pastries
F&D 3	Large	Foreign Multinational	Prepared foods
F&D 4	Large	UK producer of various food products – multiple sites	Dairy products
Niche products			
F&D 5	Small	UK, single site	Ready made foods
F&D 6	Small	UK, single site	Cereal bars and cakes
F&D 7	Large	Co-operative	Dairy products
F&D 8	Small	UK, single site	Ready made foods
Budget products			
F&D 9	Large	UK, multiple site	Bread
F&D 10	Large	UK, multiple site	Bread

Source: Low Skills Equilibrium Study: Case Studies (IER).

Notes:
Large: 250 plus
Medium: 100-249
Small: 11-99
Micro: Less than 10

Table 4.9 provides further justification for the classification of each organisation. In many respects the large producers, as a consequence of their size, had a degree of protection from their major customers: food retailers. Most of the case studies drew attention to the downward pressure exerted on prices in the food processing industry by the food retailers, although this form of downward pressure on prices is probably true across the manufacturing sector as a whole. Arguably smaller organisations had less insulation from the demands of a few major intermediate consumers. Indeed, several of the niche producers were looking to develop markets other than the major retailers. The principal outlet for the budget producers was the major food retailers. These plants were also involved in third party manufacturing; that is producing bread with the major retailers' brand names attached.

Table 4.9 Classification of food processing establishments

	How classified	**Growth in market/turnover**
Major producers		
F&D 1	High volume producer of cakes, snacks and cereals	Static. Looking to new products to consolidate existing position against other major producers in European market.
F&D 2	UK producer for multinational brand of patisserie products	Growth stemming from demand for authentic products.
F&D 3	Multinational manufacturer of ready prepared meals	Long term decline of major product, development of new lines.
F&D 4	High volume dairy products manufacturer	Static: decline in core market but strong growth in new product range.
Niche products		
F&D 5	High quality ethnic cuisine	Growth
F&D 6	Handmade cereal bars and cakes	Static
F&D 7	Dairy products	Static
F&D 8		
Budget products		
F&D 9	Low price bread	Decline
F&D 10	Low price bread	Decline

Source: Low Skills Equilibrium Study: Case Studies (IER).

At the time of the fieldwork several employers reported that sales growth was static. They were also facing pressure on margins. Bakers, for example, had encountered increases in the cost of flour and those engaged in the production of cakes reported, additionally, an increase in the cost of sugar. The impression was that these costs were not being fully passed onto the consumer, with a consequential narrowing of the margin on key products. In some cases employment was reported as in decline, principally through natural wastage because new technologies reduced the demand for labour.

4.5.3 Developing the product market position

Table 4.10 illustrates the principal pressures faced by food processing companies. The greatest pressure related to the downward pressure on prices from the major supermarkets. Large employers were sanguine about this and reported that they were developing production processes that would provide efficiency savings. In the large organisations productivity increases could be captured through automation.

Table 4.10 Product market development

	Product market drivers	**New product development**	**Developments in manufacturing processes**
Major producers			
F&D 1	Downward pressures on price from major customers	Variations around major products	Increased automation
F&D 2	Expanding outlets for goods	On going development of new products for UK tastes	Increased automation
F&D 3	Downward pressures on price from major customers	Diversification away from major product line	Increased automation
F&D 4	Downward pressures on price from major customers	New cheeses – mixes of standard cheese and fruits Looking at packaging and marketing	Labour intensive production but more automation being introduced
Niche products			
F&D 5	Identification of new markets	New recipes constantly being developed	Hand made products, limited scope for automation
F&D 6	Downward pressures on price from major customers	Around five new products introduced each Christmas	Hand made products, limited scope for automation
F&D 7	Downward pressures on price from major customers	New cheeses – mixes of standard cheese and fruits	Hand made products, limited scope for automation, but increasingly looking to affordable automation
F&D 8			
Budget products			
F&D 9	Downward pressures on price from major customers	Limited product development/consolidation of existing products	Highly automated production
F&D 10	Downward pressures on price from major customers	Limited product development/consolidation of existing products	Highly automated production

Source: Low Skills Equilibrium Study: Case Studies (IER).

The larger companies were also better placed to negotiate or stem price reductions. One of the companies in the study reported that, as a large multinational, it was well placed to fend off discounting. For smaller organisations this could be more of a problem, with some small producers looking to develop markets outside the major supermarket chains.

It should also be noted that developing a relationship with major food retailers required investment, especially in logistics, to ensure that products reached distribution centres at their allotted time. Failure to do so can result in products being returned and no payment being made. In fact penalties can accrue, since the retailer has lost the opportunity to sell a product. Orders with the major supermarkets can fluctuate and there are high quality standards to be maintained. One employer, for example, reported that their product had to be of an exact uniform size and consistency for it to be accepted by one retailer. This was considered impossible with a hand made product – the particular marketing strategy developed by this company – and so they withdrew from that market. Another small producer reported that it was exceedingly difficult to manage the variations in volumes required by the major retailers given the limited production capacity available. Expanding production to meet the needs of one customer was considered too much of a risk in this instance.

Clearly there is a choice for producers: whether they want to remain as small scale producers or become high volume ones, supplying the main supermarket chains. In choosing the latter option, they enter an economic regime where price is exceedingly important. This is true across all manufacturing sectors engaged in high volume production. The key issue is to develop the processes and skills that allow effective operation in this market, where large profits are to be made.

There was little evidence that the organisations interviewed in this sector were looking to move upmarket. In fact the very idea of moving upmarket was a curious one for manufacturers, especially the mass producers *(see Table 4.11)*. Most companies were engaged in piecemeal modification of their product market range. Several manufacturers said it was expected of them, and their competitors, to introduce new products each year but these tended to be variations around an existing product. (*i.e.* marginal innovations rather than major ones). Others were looking at how they could improve the margin on their products through marketing and branding. One manufacturer for example reported that they were able to obtain £7 to £9 a kilo for their premium product range compared to £14 for comparable French products.

Other companies were looking to increase their export share. Both dairy products manufacturers and the cake manufacturer were engaged in the export of their premium products to Europe and North America, although the smaller producers reported that there were formidable barriers to entry to the US market.

Table 4.11 Potential to move upmarket

	Scope to move upmarket	Attempts to move upmarket	Skills as a constraint on moving upmarket
Major producers			
F&D 1	Limited within high volume market	No	No
F&D 2	High value patisserie products	Constantly developing range of products	No
F&D 3	Limited in mass production foods	No	No
F&D 4	Limited except for niche markets (*e.g.* unpastuerised cheeses)	No, but looking at improved marketing and packaging so that products achieve the same margin as foreign competitors producing comparable products	No
Niche products			
F&D 5	Limited within existing market	No, but constantly developing range of products	No
F&D 6	Cake production generates higher value added but a crowded market	Developing cake range	No
F&D 7	Limited except for niche markets (*e.g.* unpastuerised cheeses)	No, have tried to develop export market to North America	No
F&D 8			
Budget products			
F&D 9	Move to high value added patisserie products	No	No
F&D 10	Move to high value added patisserie products	No	No

Source: Low Skills Equilibrium Study: Case Studies (IER).

In many respects the reports provided by employers suggested a relatively dynamic industry, with the introduction of new products, new processes in some cases, and sometimes strong marketing campaigns. Again, however, the innovations concerned tended to be incremental rather than radical.

Skills supply in either production skills or management skills was not reported as a barrier to improving the efficiency with which products were produced. Skills supply might have been less than ideal, and this may have had an impact on creating a dependency upon agency workers who were not only more expensive on a *per* hour basis, but they were also associated with knock on costs because they were less familiar with production processes. But overall, developing the product base was not considered to be constrained by a lack of skills. This is explored in greater detail below.

4.5.4 The role of skills

The types of skill problem companies encountered is reported below *(see Table 4.12)*. The evidence differentiates between (a) problems recruiting from the external labour market (recruitment problems) and (b) problems with the skills of the existing workforce (skill gaps).

The main recruitment problem related to production workers. In many respects this was less of a skill problem and more of a wage one. Organisations in many instances reported that wage levels were at or near to the minimum wage. Only the large mass producers (Food companies No.1 and No.4) reported that they paid relatively well for semi-skilled labour in their local labour market. Where production workers were required, it was reported that they could learn the job in a short space of time. Sometimes specific tasks could be learnt in a day, in other cases it might take a week to learn all aspects of the job. Despite the low levels of skill required, training was provided, mainly in relation to meeting hygiene regulations.

In a number of cases a small number of maintenance engineers and related staff play a crucial role as they are responsible for keeping the production line operational.

Table 4.12 Recruitment problems and skill gaps in food processing

	Recruitment problems	Internal skill gaps	Labour retention regarded as problem
Major producers			
F&D 1	None (downsizing *via* natural wastage)	Timekeeping/absenteeism	√ (at management level)
F&D 2	Production workers	None	√
F&D 3	None (downsizing)	Timekeeping/absenteeism	
F&D 4	Production workers	None	√
Niche products			
F&D 5	Production workers	Quality control on production line Language skills	√
F&D 6	None	None	
F&D 7	Production workers	Quality control on production line	√
F&D 8			
Budget products			
F&D 9	HGV drivers	None	
F&D 10	Production workers	Quality control on production line Language skills	√

Source: Low Skills Equilibrium Study: Case Studies (IER).

An illustration of the general effect of wage rates on recruitment and retention is provided by the example of the cereal and cake manufacturer *(see panel).*

Case study: Food and drink company No.6

The company was established around 10 years ago and produces hand made cereal bars and cakes (muffins *etc.*). When the company first started it was one of a few companies producing these types of product but since then a lot more competition has entered the market, with some of the major manufacturers entering the market. The company employs 85 people and has a sales turnover of around £6m a year.

The company pays £4.75 an hour for production workers, essentially semi-skilled jobs. The company has experienced problems recruiting staff. At the time of the fieldwork there were 12 vacancies that were proving hard-to-fill. The reason for this was the tight labour market in the locality and the fact that the benefit system, the company suggested, paid more than the company could to people with, for example, families.

To solve its recruitment problems the company has used New Deal, agencies, and hired refugees with a right to work. It has found refugees well qualified and hard workers. Recruitment problems limited production a little and the company had relied upon overtime to meet production needs.

Source: Low Skills Equilibrium Study: Case Studies (IER).

Difficulties recruiting staff had led to some companies looking to recruit itinerant workers from Europe (mainly Portuguese workers in the East Midlands) and from the Indian sub-continent, where family and community ties provided new sources of labour. This created conditions on the shopfloor where management did not speak the same language as their workers and were dependent upon supervisors to undertake translation. Organisations where employees did not speak English reported few problems with the arrangement, but one might reasonably expect a lack of management control over the production process to arise.

There was also evidence that Employment Zones had allowed one employer to take on two people who it might not otherwise have recruited (disabled workers) and had been satisfied with the results, such that it would consider using the services provided in Employment Zones in the future.

Wage levels for production staff in the food processing industry were generally low; at or near the minimum wage. Companies overall saw little opportunity to move away from this situation without it having an impact on their cost base that could not be passed onto the consumer. Given the dependence upon low skilled, low waged labour and the attendant problems of high labour turnover and absenteeism, it is not surprising that these were main problem employers cited in relation to their current workforce. Whilst this is not a skill issue *per se*, responses to the problem had a skills dimension.

One way of approaching this was to recognise that, even in an industry where low levels of skill are manifest on the production line, there are still opportunities to provide staff development opportunities through training. Some of this is mandatory, such as food hygiene. However, there were examples of companies that had attempted to provide on-going training in recognition of the fact that in a labour intensive production system ultimately the production process is dependent upon those people who are manning it. An example of skill based employee development is provided by both a niche producer and a mass producer *(see panels)*.

Case study: Food and drink company No.5

The company produced a range of relatively high cost ready made ethnic *haute cuisine*. It had grown rapidly over the late 1990s into a company that employed almost 50 people at the time of the case study. All products were hand made in that there was no automation at the factory. Production line staff were expected to mix ingredients according to the recipe and ensure that taste was both correct and uniform across batches.

Hiring staff was difficult due to the reported near full employment in the local labour market. The company reported that it had been dependent upon Portuguese agency workers – whom it commended most highly – because of the difficulties of recruiting locally. Nevertheless, the company was working towards developing a human resource policy that would attract recruits to the company and retain them. Part of this was based around developing policies associated more with major corporations. To this end the company had obtained IiP. It was also participating in the RDA's Skills Passport programme for the food and drink industry. By developing its production line workers and beginning to share some of the benefits of the company as it grew, the company believed it would be able to improve labour retention.

Human resource policy was developing as employment grew. It was regarded as an integral part of the process of developing a business that was largely labour intensive and required products to be produced to a consistent high quality.

Source: Low Skills Equilibrium Study: case studies (IER).

The example above is of a small employer with a relatively small budget to expend on staff development. The example of *Food and Drink Company No.1* provides an illustration of an organisation that paid relatively well in its locality and was tackling absenteeism through a range of human resource development measures *(see panel).*

Case study: Food and drink company No.1

The company was the largest employer in the area. It had a reputation as a good employer - people "cry out to work here" reported management – and had a reputation for providing lifelong employment. The business, long established, was renowned for its good rates of pay benefits, and the fact that there have been no redundancies in recent memory. Staff turnover and recruitment were not particular problems, but dealing with *absence* was a problem.

Employees' lack of motivation was tackled, in part, through a commitment to developing the workforce. The company was "committed to training". Basic skills training was undertaken – as is felt that the company had a 'duty of care' to staff to ensure that they have basic skills. Ideally, the company reported, one would have expected the education system to equip people with basic skills, but the company had adopted a pragmatic attitude and recognised that it was very much in their own interest to develop people.

NVQs were provided through on-the-job training. The company was also keen to develop a Foundation Degree – emphasising "the practicalities" of the manufacturing process. The company had also developed links with Learndirect to offer staff a wide range of development opportunities.

The commitment to employee development was seen as part of a wider set of human resource policies that sought to create a reciprocal commitment between employer and employee.

Source: Low Skills Equilibrium Study: case studies (IER).

There are also a wider set of issues relating to human resource policy other than skills. Large producers drew attention to the need to develop 'work-life balance' type policies so as to retain staff. *Food and Drink Company No.9* reported that its relatively low level of labour turnover was due to a mix of remuneration levels (high for the local area) and work-life balance practices developed in consultation with the workforce.

4.5.5 Skills: a constraint?

Employers reported that they encountered poor labour supply, especially in rural areas. The main remedy to this was to resort to agency workers, but here employers complained about the quality of staff provided and their tendency to disappear quite quickly. Yet, given that several employers reported recurrent recruitment problems, this must have an impact on the efficiency with which the organisations operate. If managers' time is spent sourcing labour rather than engaged in production then there are opportunity costs to consider, including time that could be spent on product strategy development. In some cases these were recognised.

The problems of recruiting and retaining staff in rural locations is provided by the example of a dairy products manufacturer *(see panel).*

Case study: Food and drink company No.8

The company was a large establishment producing a range of dairy products.

Retaining skills was its biggest problem; and when staff leave it is difficult to replace them. This is due to the rural location of the dairy and near full employment in the locality.

A shortage of skills is not holding the company back at the moment, as labour demand had been met through the use of agency workers (30-40 were currently employed). Portuguese workers were employed by the company on six month contracts. They have been impressed with these workers, as they have a strong work-ethic, the company reported. However, the cost of employing agency workers has increased cost pressures.

The company has not had problems recruiting managers and supervisors, but recruiting shopfloor staff is a real problem. People do not want to work shifts, the company said, but the plant requires a 24-hour operation, seven days a week to meet output targets. Employees have to work shifts and weekends on a rota. Recruitment problems are common in the area, with local farms also struggling to recruit staff.

Work at the plant is not highly skilled and mechanisation makes it even less so, although this is limited at the moment. It takes around six months to fully train a shopfloor worker. Pay is around £5 an hour although there is a graduated pay scale leading to up to a supervisory post. All training is carried out in in-house.

There are several other food manufacturers in the area and recruitment depends very much on what these companies are doing, since some other companies can pay more. They have looked at offering part-time/term-time jobs around school hours – but they have limited scope to develop this because of the demand for continuous shift operations. Increasingly they are looking at new technology to substitute for labour on the shopfloor.

Source: Low Skills Equilibrium Study: case studies (IER).

The cases reveal a labour intensive industry. As organisations move to mass production, automation is more commonly found, with a consequential reduction in the number of semi-skilled production workers and a demand for maintenance engineers. Amongst the niche producers the demand is still very much for semi-skilled staff paid at relatively low wages. It is likely that niche producers will remain such over the medium-term and their demand for semi-skilled labour will continue. That said, there is evidence that where organisations recognise the value that even semi-skilled personnel can bring to the production process by investing in their development, then the possibility remains that this will reduce labour turnover and improve the efficiency of these workers. The impact of this will be piecemeal but, since most of the changes being introduced in the product market are piecemeal, this should not be devalued as an indication of progress.

4.6 Evidence of a Low Skill Equilibrium

The majority of jobs in each of the two selected industries were relatively low paid and required only a modest input of skill from their incumbents. As labour markets have become tighter at the local level these companies have found it increasingly difficult to recruit and retain staff.

The environment in ***business hotels*** was such as to ameliorate the situation somewhat, in that sections of the market were slightly depressed. The evidence confirms that even at the top end of the market the production of the service remains labour intensive. Whilst this is dependent upon a large number of relatively low skilled staff, often paid at around the level of the minimum wage, it also involved a large cadre of more highly skilled staff, especially in the kitchen and amongst management.

At the other end of the scale are the budget hotels that typically employ relatively few staff. These hotels aim to provide a room and breakfast and few if any other services. Typically there are managers, receptionists, and housekeepers to provide a limited range of services. There has been a growth in this type of hotel and occupancy rates of those in the current study were generally high. In many respects the profit margin is maintained by minimising staff costs.
Management in the hotels reported that they possessed the staff and skills consistent with their product position. Where skills posed a constraint it was in relation to:

- managing a process of change within the current product market position; and
- tying up management time where recruitment was likely to be a problem.

Within the middle group of hotels there was some evidence that their product market position was being squeezed by those above and below them in the quality stakes. To some extent their position was exacerbated by skill shortages, insofar as they were hindered in their attempts to manage a process of change to secure their current product market position.

The evidence of a low skill equilibrium is most manifest in relation to budget hotels: they employ relatively few staff, mainly in relatively low skilled activities. At the same time the evidence points to them enjoying a degree of commercial success through tight control of costs. A shortage of skills is not a constraint on them achieving their desired product market position.

At the other end of the scale there is evidence that skill shortages inhibit at the margins the top quality hotels offering the type of service they want to achieve. This appears, in part, to be a process of on-going improvement. It is less obvious that these hotels are operating in a low skill equilibrium even if a large percentage of their staff are relatively low skilled since staff development is to the fore, providing a high quality service *via* employees is the goal, and there are a substantial number of employees at an intermediate and managerial level.

The evidence is more ambiguous in relation to the middle group of hotels. As noted above the main constraint here would appear to be a lack of capital.

Problems of recruitment have been exacerbated in the ***food processing*** industry, where working conditions (*e.g.* shift work) make jobs less appealing than they might otherwise be.

Organisations have tried to address this issue as follows:

Recruiting staff:
- developing links with local colleges ;
- identifying new sources of supply – including immigrants (which can raise language problems).

Retaining staff:
- provision of training;
- development of career structures;
- work-life balance practices;
- profit sharing/performance related pay.

What is clear is that the wage levels can play a key part in resolving such problems. It is apparent that two of the food processing establishments – both parts of large multinational companies – experienced few problems recruiting and retaining staff because they had a policy that allied above average wage rates (for the local area) to policies designed to foster job satisfaction.

In the hotel industry there was near unanimous agreement that skill levels were increasing in the industry but the need to provide a labour intensive service meant that there were limits on the extent to which wage rates could be increased. Automation in the hotel sector, whilst in evidence, is of more limited importance than in the manufacturing sector and, outside of the budget hotel sector, delivery of the service is likely to remain labour intensive. In the food processing industry mass production is met through automated production. Where this is in evidence, companies are able to generate high levels of value-added. The trend here is to employ fewer people, with productivity gains realised through the use of increased automation.

So long as a production process is labour intensive within a price sensitive market it is difficult to see how organisations can break out into a high-skill, high-wage employment sector of the economy. There was little evidence in the case studies that they were looking to do so, not so much because they did not want to but because the characteristics of that market segment and how to enter it was far from obvious to the companies. They were, in the main, engaged in a process of change to increase the efficiency with which they produced their existing range of goods and services. Admittedly there was also improvement to the range of goods and services currently provided, but these were improvements very much within their existing market segment.

The key low skill equilibrium argument is that of a systems failure: the poor supply of education and training and a poor demand for skills from employers feed off one another. This is some evidence of this within each of the industries. But perhaps the more revealing result is that employers in areas of excess labour demand struggle to find labour because labour finds its way towards more highly remunerated and/or more satisfying work in other industries. Employers, for example, reported that they struggled to match the wage rates of the retail sector.

A further dimension of the low-skill equilibrium argument is that the education and training system fails to provide a skills supply that might foster the development of higher value production. But, it is lack of demand rather than supply that is the key issue. It is apparent that at a regional level there were policies in place – such as the Passport to Skills in the food processing industry in the East Midlands – as well as national programmes such as Modern Apprenticeships. The impression from those employers that had engaged with these types of policy or programme was that it has assisted with their recruitment and retention of staff. What is much more difficult to ascertain is whether there is selection bias, insofar as organisations more likely to engage in these types of activity are more dynamic in some respects. There is indicative evidence from the case studies that this is so.

The overall conclusions from the case studies are as follows:

- most employment in food processing will continue to be semi-skilled, with further automation and loss of jobs in the high volume manufacturers;
- at present automation represents too costly an investment amongst the niche producers where the dependence upon labour intensive production is likely to continue over the medium-term;
- amongst the business hotels, employers reported that the demand for skills is increasing, as staff are required to take on a wider range of tasks and provide on-going improvements in the quality of service provided.

Insofar as these industries represent a low-skill, low-wage segment of the national economy there is little to indicate that they currently are, or will be able to shift out of this position in the foreseeable future.

5. CONCLUSIONS AND POLICY IMPLICATIONS

5.1 Overview and Conclusions

This final chapter draws together the arguments and findings from the study and develops their implications for policy. It is divided into ten further sections.

- Section 5.2 rehearses the aims and scope of the research;
- Section 5.3 summarises the key findings from the case studies concerning the current products and processes adopted in the selected cases, the competitive pressures they all face, their choice of product strategy and the link to skills;
- Section 5.4 moves on to focus on the labour market experiences of the cases, including the external labour market environment, training and the skill trajectories adopted;
- Section 5.5 moves to a consideration of innovation and change, focussing on links between product strategy and skills;
- Section 5.6 assesses the extent to which the cases, sectors and regions chosen can be characterised as in a low skill equilibrium or on low skill trajectories, as well as the barriers and problems they face in trying to break out of this position;
- Section 5.7 moves on to a consideration of the general policy implications;
- Section 5.8 follows this by focussing more specifically upon implications for skills policy;
- Section 5.9 concentrates upon the wider implications for business support;
- Section 5.10 rounds off the policy implications with a discussion of the implications for regional policy; finally,
- Section 5.11 concludes by outlining the scope and need for further research, highlighting in particular the need to extend the present analysis to cover the situation in other sectors.

5.2 Aims and Scope of the Research

The present research was undertaken to throw light on the hypothesis first put forward by Finegold and Soskice (1988, p. 22) that Britain is trapped in a low skill equilibrium (LSEq)), associated with poorly trained and low skilled workers and managers, producing low quality goods and services. They argued that a low skill equilibrium is both stable and the result of rational choice by the actors in the economy, given the broader institutional and economic framework within which they operate. It is the vast range of actors, institutions and incentives at play, which conspire to result in an undesirable economic outcome that lead Finegold and Soskice to argue that a low skill equilibrium is an example of a general "systems failure". The implication is that there is no simple policy solution to such a failure, and any move towards a high skill equilibrium would require wide ranging policy initiatives, much broader in scope than those aimed at the labour market alone.

It has been argued here that there are some difficulties in seeing the British economy as a whole as being in some form of "absolute", low skill equilibrium. For one thing, the British economy is a developed and sophisticated one, in which there are many highly skilled workers employed. On the other hand, it is abundantly clear from a large number of case studies undertaken by the NIESR (see, for example, Mason and Wagner (2002)) that the skill levels of German employees in the two sectors investigated in the present study are, on average, significantly higher than their UK counterparts.

It has also been argued that it is difficult to see British companies in general as all following a one-way, negative trajectory towards a complete loss of all skills. It is clear that, while skill levels in some areas may be low and even falling, in others skills are rising and some companies are following product strategies and skills policies which are in many respects "leading edge". The problem is that not enough British companies are following this route. The key questions then are why this is the case and what (if anything) can be done to change this situation.

The case studies reported in Chapter 4 provide considerable insights about the skill levels and trajectories amongst organisations in the two chosen sectors, (food processing and hotels). These exhibit many features in common with a situation that can be characterised as a low skill equilibrium or a low skill trajectory.

The discussion in Chapter 2 makes it clear that a low skill equilibrium is a "systems problem" and, as such, it is a macro (or at least meso) issue. Thus, the micro-level, case study approach taken in the present research needs to be viewed in this context.

The case studies were intended to illicit information about the following:

- product market strategies pursued by each organisation;
- product/service specification;
- attempts to shift product market position;
- extent to which the availability of labour constrains product market strategy;
- support infrastructure available to assist organisations to yield higher value-added.

The present study focuses on:

- what evidence there is that the case study companies can be argued to be in a low skill equilibrium or on a low skill trajectory; and, if so,
- establishing the factors causing this outcome; and,
- identifying what policies (if any) might enable them to escape from this position.

Thus, the strength of the present research lies in obtaining company perspectives about the various factors influencing the present skill demands and skill trajectories of the cases selected, rather than the broader meso/macro institutional and economic environment within which *all* such companies operate. Nevertheless, the choice of case studies has been undertaken to allow variation in this external environment in at least two respects: first, cases have been chosen from two regions (the East and West Midlands) and from two sectors (food processing and business hotels, the former in the manufacturing sector and the later in services). In addition, the micro level focus allows a picture to emerge of how the case study organisations chosen perceive the external environment: for example, in terms of the quality and availability of potential recruits but also in terms of the various structures and systems of support available from the state or sectoral and regional bodies.

Before discussing the detailed case study evidence it is worth summarising the characteristic features of a LSEq:

- intense competition in the product market, leading to a focus on prices and, in particular, labour costs;
- low product specification (or quality), requiring only low level skills in production;
- low levels of labour productivity and low wage rates, resulting in internal labour market problems, often associated with a lack of training;
- problems in recruitment because the level of skills supplied by the market is inadequate;
- concentration on cost strategies with no focus on product improvement or the development of new products and, relatedly, a lack of product and process (including organisational) innovation;
- skill levels of existing employees that fail to equip them to cope with shocks and/or situations of significant change.

5.3 Products, Product Strategies and Market Pressures

5.3.1 Competitive pressures, prices and costs

A key finding relates to the degree of cost pressure under which the case studies organisations were operating. This is clearly the case across the board for the organisations in the food processing sector, although there was some evidence that the larger major food processing companies were better equipped to negotiate a better deal. Similarly, price and cost pressure was a common feature of the business hotels sector, although less so for the quality hotels (which also tended to be larger in size). For the latter, competitive pressure might be categorized as moderate, rather than intense. While the position in the hotels sector may have been accentuated by the post-September 11th climate, the result would probably be similar during more normal periods. In the case of food processing, the pressure on prices and costs was being exerted by the retailers, which may have been accentuated by some degree of monopsony power (*i.e.* arising from a small number of powerful buyers) present in this market. There is no doubt that the intensity of competition appears to have focused all of the case study companies' attention firmly on minimizing costs and, in particular, labour costs which are significant for both sectors.

5.3.2 Low product quality and/or specification

While there is a clear distinction in the specifications of the products and services offered by quality and budget hotels (see *Table 4.2*, for example), nevertheless the response of the budget hotel sector would indicate that they do not perceive themselves as being of low quality. This highlights an important distinction to be made between product or service ***quality*** and product or service ***specification***. *Budget hotel No.1*, for example, argued that the aim was to provide a "high level of customer satisfaction given the *product* specification". This was the case despite the fact that the chain in which the hotel belongs also "aims to be the cheapest" (see the discussion in Chapter 4). Thus, 'quality' needs to be viewed in the context of product niches, defined by the product specification. Nevertheless, it is clear from the case study evidence that the lower specification of the products and services in the budget hotel cases studied does depress the level of skills required.

While somewhat more difficult to measure, the same argument appears to be applicable across the range of food products (across the categories - major producers, niche products and budget products - adopted in the study). Niche products largely rely on either their specialist nature or details of the product specification (such as hand-made or finished), while, at the other extreme, the budget products have a very basic specification. While niche markets might be perceived as commanding a potential price premium, the results suggest that this is limited by the degree of competition, both from outside the niche – *i.e.* from major producers – and from within. Thus, the outcome looks more like monopolistic competition (*i.e.* a large number of relatively small producers of somewhat differentiated products), where there is still considerable pressure on prices and costs. Such producers are also squeezed by their small size and their inability to introduce more capital intensive techniques, which would facilitate automation.

The results from Chapter 4 suggest that, in order for the case study organisations to demand significantly higher skill levels, they would need to make important changes to their product specifications and activities – in effect to move up-market. This is discussed further below.

The use of case study material does not allow the present research to say anything about the *proportions* of organisations that produce low specification or low quality products or services. This requires more macro level and broader ranging evidence. Nevertheless, it seems that the literature focusing on this issue points to the UK as a whole, being too heavily involved in low specification products (Bono and Mayhew, 2001; SIE, 2003; Bosworth, 2004). The results of the case studies throw new light on the issue of quality and specification and the subsequent discussion provides powerful evidence of the problems that organisations would face if they attempted to move up-market.

5.3.3 Scale, skills and labour productivity

The productivity literature – mostly focussing upon the manufacturing sector – has generally linked scale with higher capital intensity, a greater use of higher skill levels and greater labour productivity. In the case of hotels, at least, there is a direct link between the product specification and scale (as shown by combining information from *Tables 4.2 and 4.3*). The average room capacity of the quality hotels is 420, compared with 106 for the standard and 58 for the budget hotels in the sample. The large, quality hotels were not only offering a greater range of hotel facilities, but one at least was involved in other, non-hotel businesses. While the larger hotels clearly have a significant amount of capital tied up in their buildings and facilities and, as the results show, are on average more highly skilled, this does not necessarily imply either that they are more capital intensive or that they have greater labour productivity.

In practice, the perceived quality of service in hotels is partly dependent on having large numbers of employees present. Thus, the results show that the room/employee ratio (*see Table 4.3*), on average, is highest for budget hotels and significantly lower for the standard and quality hotels. In practice, there is significant variation around these average figures – compare, for example, *Quality Hotel 2* and *Budget Hotel 2* with the other hotels in their respective niches.

There is much more evidence of the standard productivity linkages in the food processing sector. Indeed, the issue of labour costs and problems with labour supply appear to have induced a number of the larger companies to seek more capital intensive techniques that reduce their reliance on low skilled production workers. There was also evidence of a more HR-oriented approach amongst at least two of the larger (major) food processing companies – both parts of multinational companies. As noted above, this does not appear to be a viable option amongst the low-scale niche producers.

5.4 Labour Market Experiences

5.4.1 Labour absenteeism and turnover

The general emphasis on recruitment issues, against a background of static demand amongst the case study organisations, suggests that labour turnover is likely to be an important feature of low paid, low skill situations. While it was not true of every case study organisation, the food processing sector reported significant problems of labour absence and turnover. These problems appear to arise from their dependence upon low skilled labour, paid at or around the minimum wage, often coupled with unsocial hours or times of work. The case studies suggested that a number of companies had recently started to review their human resource policies to improve both recruitment and retention. But they seemed unable for various reasons, including product market pressures, to consider raising their wage rates. In the absence of further statistical data, it is difficult to be certain whether increased wages might pay for themselves in terms of lower absenteeism and labour wastage, but there was some evidence that wages played a significant role in some cases.

5.4.2 Recruitment and external skills supply

It is interesting to ask to what extent the external skills supply was sufficient to meet the demand for skills amongst the case study companies. A feature of a low skill equilibrium is that organisations attempting to follow a higher skill trajectory would face significant difficulties in finding the required skill levels externally and, thereby, significant recruitment problems. A common feature across almost all of the companies interviewed (there were one or two notable exceptions) was the difficulty that they faced in recruitment. In keeping with the features of a low skill equilibrium, there is clear evidence, for example, of the quality hotels experiencing problems in finding key skilled staff (*i.e.* managers, chefs, and other kitchen staff, *etc.*). However, it is a little difficult to draw a hard and fast conclusion that this is a feature of more highly skilled organisations operating in a low skill environment, since (more often than not) the wage levels offered appeared to be too low to attract the necessary skills.

5.4.3 Training and low skills

While there appeared to be a view that skill levels were rising in the business hotel sector, generally speaking, skill levels required in both sectors (with the exception of one or two pockets, such as logistics, engineering maintenance, management, *etc.*) were low. There was some evidence that the larger companies, in particular, had HR policies in place and, also, that some training took place. Some of this was mandatory, such as food hygiene, but the study found some examples of companies providing on-going training in recognition of the fact that a labour intensive production system ultimately depends upon the people who man it. Chapter 4 *(see panels)* provides examples of skill based employee development, provided by both a niche producer and a mass producer.

Nevertheless, overall, the results suggest that the period of time needed for training and the degree of skill development to successfully carry out the vast majority of jobs in the two sectors (again, excluding the few pockets of high skill) were small. Thus, as Chapter 4 notes, the skill needs overall are sufficiently low, for example, in the case of budget hotels that a shortage of skills is not a constraint on them achieving their desired product market position and, in the main, only the minimum of training is required.

5.4.4 Low skill trajectories and the employment of low wage minority groups

One of the main skill shortfalls noted in both sectors was that of language skills, related to the intensive used of immigrant labour, for whom English was not the first language.

The business hotel sector appeared to value recruits from other parts of Europe, where they had been exposed to higher quality training. There were also several examples of the employment of foreign itinerant workers or family members from the Indian sub-continent in the food processing sector. Again, this is interesting because the Portuguese itinerant workers appeared to be of relatively high quality and employers appeared to be satisfied with their skills and application. Their employment is a reflection of the low pay rates and the difficulties in recruiting employees from within the UK to undertake these relatively low skilled, low paid jobs.

5.5 Innovation and Coping with Change

5.5.1 "Fire-fighting" – the wrong management and employee focus

It is clear that various labour market problems, including the difficulties posed by absenteeism, wastage and recruitment, tie up a considerable amount of management time. This is in stark contrast to the results for similar enterprises in Germany (see Mason and Wagner, 2002). The consequence is that UK managers are necessarily fixated on maintaining current production activities, in essence, fire-fighting, and are thereby prevented from devoting time and effort to more dynamic activities, such as exploration of market opportunities, product innovation and organisational innovation.

Potentially, this appears to be a crucial area where skills play an important role – if skill levels were higher amongst the companies in the sample, both management and employee time could be freed for product or market development and for the introduction of minor process changes that could improve efficiency (*op cit.*). This, in turn, could have beneficial effects in terms of raising the level of skills demanded in the future. This is not so much a management development issue as one of business organisation, although current deficiencies in management skills could be an explanation of why such problems are not identified as affecting longer term performance.

5.5.2 Innovation and skill demands

There are some key differences in the product market strategies adopted. The main distinction is between organisations which are focused on cost (*i.e.* with a view to increasing production efficiency or using lower skilled and lower wage labour), as opposed to those more concerned with product specification and quality (*i.e.* improving the range or specification of existing products or services, or the introduction of new products and the scrapping of old products or services). The extent and nature of product or process innovation, including organisational innovation, differed between the two sectors. In particular, the food processing sector reported regular changes to the product ranges and attempts by niche producers to broaden their product and market base. While for some higher quality food producers, this can involve an element of research and development (as well as market research) effort, for the companies in the sample, it seemed a fairly marginal and incremental activity. The business hotels sector had examples of organisational changes and one case provided an example of a shift up-market. Despite this evidence of some innovative activity, overall it is probably fair to say that neither sector could be argued in any way to be associated with radical innovation, and the skills required to deal with such change are therefore that much lower.

5.5.3 Product market strategies and skill demands

In both sectors there was little evidence of any significant interest or exploration of moving up-market. In essence, with one major exception, which is discussed later, the organisations were locked into established segments of the market. In some cases, this was determined by head office and the local organisation itself had little say about the matter. In the case of food processing, for example, the responses not only indicated that there was little evidence of "looking upmarket", but also that the manufacturers viewed this as a "curious idea" (Chapter 4).

5.5.4 Coping with change: the imposition of new regulations

Manipulation of the regulatory framework has been argued to be one way of raising the level of skills demanded (Bosworth, 2004). The present case study results, however, indicate that even changes to regulations may not elicit the expected response unless, for some reason, the company is effectively forced to comply. The discussion of one of the food processing organisations, in Chapter 4, indicated that, faced by the need to produce snack bars with a uniform thickness of chocolate coating to meet with supermarket standards, the company in question chose to withdraw from that market. While the reason offered by the respondent may not indicate that this is an issue of skill deficiencies (but of the lack of the equipment needed for this task), it does suggest the inability to find an innovative solution that would have kept this market opportunity alive.

5.5.5 Coping with change: product market strategy

One of the key features of carrying a more qualified workforce is that it enables organisations to cope with situations of change, such as a shift in product market strategy. In a recent study based on the 1999 Employers Skill Survey, Bosworth *et al*. (2000) argued that a high proportion of companies were doing the same thing that they had always done and, therefore, it was not surprising that they rarely reported skill problems. The authors argued that it was during situations of change that skill deficiencies amongst existing staff would emerge. Thus, it was argued that enterprises faced *latent* skill shortages in the sense that, if government policy stimulated the degree of innovation, skill shortages would then emerge.

This is precisely what the case study of *Quality Hotel No. 3* shows (see the relevant panel in Chapter 4). This hotel had been taken over recently and had shifted its market position towards the business market – which was described as a major strategic shift, requiring changes in attitudes and skills amongst the staff. It is clear that the hotel struggled to achieve this change. A significant proportion of the staff struggled or failed to meet the new, and more closely monitored, performance standards set by management. As a consequence, staff who did not meet this standard were moved out of the business. In addition to the internal skill deficiencies generated by the change, the hotel reported difficulties in recruiting to key posts (as outlined above).

Confirmation of this result can also be found in the case of *Quality Hotel No. 2* (again see the relevant panel in Chapter 4), which had been involved in significant organisational changes, and had also experienced significant skill problems. This was manifested in significant turnover amongst managers at the hotel, who did not have the entrepreneurial skills required or were unable to manage cost centres involving about £2 million of business.

5.6 Breaking Out of a Low Skill Equilibrium

5.6.1 Evidence of low skill equilibrium and low skill trajectories

The results from the case studies are consistent with the idea of most of the cases considered being stuck in a low skill equilibrium or low skill trajectory as outlined in Chapter 2. The companies operating with the lowest product specifications require little in the way of skills and, even those with the highest product specifications, the demand for high skill levels are limited to a few key areas. However, this equilibrium is neither absolute (with a range of skill levels present) or static (as there is some evidence of training and skill development).

Many of the characteristics of a low skill equilibrium were observed in the case studies, although not all of these were observed in every organisation:

- the majority of organisations had a clear and unambiguous focus on costs and, in particular, labour costs;
- product specifications were low;
- skills were low;
- wages were low and often at the legal minimum;
- there were problems with absenteeism and labour turnover;
- recruitment was a problem – not so much because of the external supply of skills, but because of the wages on offer and, in some cases, the unsocial hours of work;
- training was, by and large, rudimentary;
- innovation was minor in nature;
- skills were lacking in situations of new regulations, product change and organisational change – in particular, the example of a organisation moving up-market and the example of a major organisational change were both characterised by major skill problems.

5.6.2 Barriers to breaking out of the low skill equilibrium

There seems to be little scope for major changes in these two sectors in terms of immediate developments that will raise the levels of skills demanded. It appears likely that employment in food processing will continue to be semi-skilled with further pressures to automate jobs in the high volume manufacturers. Amongst the niche food processing companies, automation represents too costly an investment and, thus, the dependence upon labour intensive production is likely to continue over the medium-term. While the business hotels employers reported that the level of skills required was increasing, as staff take on a wider range of tasks and improve the quality of service, these changes are likely to be modest. Given the present situation, and in particular the various incentives faced by organisations operating in these markets, there is little evidence that they will be able to shift out of this position in the foreseeable future.

The incentives they face are, in part at least, a consequence of the "systems" failure spelled out in Chapter 2. A LSEq may emerge because it is a rational optimum, given the constraints and incentives perceived by the managers involved. But this may not be optimal from a social perspective. Changing this involves much more than initiatives on skills.

However, there is one important aspect which may be skill related. It may be that it is not simply a case of the incentive structures themselves being in some sense inappropriate. The choices made by managers depend heavily on their own characteristics and skills and their *perceptions* of the problems they face. What is most intriguing from the study is the capacity of managers and organisations to rationalise their product market position even where that position is being challenged. As noted in Chapter 4, there were few examples in the cases chosen where companies actually wanted to move upmarket. Organisations rationalised this with respect to the level of capital investment required to move upmarket (new machinery, marketing, *etc.*) and uncertainty as to whether they would obtain any return on such an investment. Management development may have a part to play in helping to break out of these vicious circles (albeit probably a modest one).

5.6.3 Regional skills development: achieving a balance in the demand for and supply of skills

Some might argue that a low skill equilibrium is not necessarily a "bad" thing, for the following reasons:

- compared to the situation in the UK just a few years ago, when unemployment level rates were at a record high, most governments would probably have been happy to accept a high employment, low wage situation as a preferable alternative;
- from a consumer perspective, there are individuals who prefer, for reasons of income or taste, to buy low specification and low priced products;
- at the present time, there are also a large number of low skilled individuals in the UK economy that require employment, which they can find in the production of low specification products and services.[1]

Thus, whilst recognizing that society would prefer a high skill, high wage equilibrium, in the presence of significant numbers of low skilled individuals, society might be prepared to accept a low skill equilibrium situation with high employment despite low wages. Certainly, many Government policy initiatives in recent years can be interpreted as weighted more towards the quantity of employment rather than the quality of the jobs.

This ignores the issue of sustainability. Low pay, low skill jobs too frequently turn into no pay situations (*i.e.* the work is simply transferred abroad!) In such circumstances, low skill individuals can suffer disproportionately from unemployment spells. Such low skill jobs are especially vulnerable to competition from lower wage employment abroad (*e.g.* call centres now moving to India). Hence, the LSEq, even if stable over the short to medium-term, remains a less desirable option than a High Skills Equilibrium, in principle, since the latter offers a more open ended set of possibilities. The key issue is sustainability. In the long term, of course, market forces can be expected to root out all companies following non-sustainable strategies.

Acceptance of low skill, low wage employment also seems something of a counsel of despair, offering no hope of advancing the job quality and pay levels of a large part of the workforce. The problem is one of increasing both the skills and the demand for skilled individuals so as to achieve an approximate balance of supply and demand, so that as many jobs as possible are both highly skilled and well paid.

The key problem arises where a large proportion of organisations within a particular geographical area all follow a low skill strategy, leading to a vicious circle and an outcome of a low skill, low wage economy at a local, regional or

[1] Although this argument appears to be partly undermined from the case study evidence on the growth in employment of itinerant Portuguese and other non-British workers, because the wages are too low to attract domestic workers. Nevertheless, for 'full employment' to be achieved, there is a need for jobs at a variety of skill levels.

national level. This then begins to bring in the need for more macro level interventions to shock the economy out of that state.

It is clear that the dichotomy between high & low skills equilibrium is an over-simplification. Normally in an economy there is a diversity of skills trajectories (and relative positions). This is well illustrated by the example of business hotels in the cases discussed in Chapter 4. Heterogeneity is the norm: some companies are on a high skills trajectory, others are not. What matters for the company, organisation or region concerned is the mix of these trajectories. It is not necessary for all organisations in a region to be on a high skills trajectory. The question is one of *balance* – such 'balance' is central to the concept of 'healthy labour markets' (as espoused in the FRESAs).

Skills trajectories are linked to the organisations' goals and product strategies (and innovation). But "new product" launches are risky and associated with heavy investment. Respondents generally recognised the costs/disadvantages of trying to change strategies and in these particular cases studies thought they outweighed the potential benefits of trying to make a move up market.

As argued above, the skills trajectories associated with different phases may be very different:

- the period leading to a product launch may require a high skills trajectory;
- the period of exploitation, maturation may be a low skills trajectory.

The key issue for a particular organisation is whether or not the balance of skills trajectories is appropriate given the level of product innovation. At a broader regional level, the issue is more one of the balance or mix between different organisations, some of which may be following higher skills trajectories than others.

A further dimension of the low-skill equilibrium argument is that the education and training system may fail to provide a supply of skills that might foster the development of higher value production. This does not seem to be the issue in the two sectors and regions investigated. At a regional level there were policies in place, including the Passport to Skills in the food processing industry in the East Midlands, and national programmes such as Modern Apprenticeships. Those employers that had engaged with these programmes reported that the programmes had assisted the recruitment and retention of staff. The case studies, however, suggest that there may be a certain selection bias, in that organisations more likely to engage in these types of activity are more dynamic in some respects. Improved methods need to be devised to expand participation on the various schemes outlined in Chapter 4.

The case studies give renewed support to the argument that regional development is not just about skills. Initiatives on this front need to be linked to other regional and sectoral policies, including DTI Industry Forums, cluster strategies, innovation initiatives and support for key sectors. The work on raising skills demands points to the need to engage all of the actors involved (*i.e.* government, local authorities, companies, further or higher educational units, *etc.*) (SIE, 2003; Ashton, *et al*. 2003). While many of the difficulties highlighted have a national dimension, there is much that can be done at regional level to shift resources towards a more general business demand agenda and away from a narrow focus upon skill supply.

5.6.4 HR practices and improved wages

Absenteeism, labour turnover and the resulting recruitment activity are not only expensive in a direct sense, but tie up key management time and undermine the morale of the remaining workers. There is some evidence from the cases that this can be alleviated either by higher hourly rates or through innovative schemes, such as the attendence reward, that one of the case study organisations had introduced. Moreover, it is becoming clear from other empirical work, such as Mason and Wagner (2002), that "fire-fighting" activities divert management and worker attention from making product and process changes. Unless such changes are made this can have a very detrimental effect on the longer term performance of organisations. Likewise, there is evidence that there could be significant benefits from the adoption of other employee-oriented HR policies (Wilson *et al,* (2003); Bosworth, (2004)).

The problem is how to get this message across. Some form of web-site or other forms of dissemination to inform organisations about ideas that other organisations have tried (*i.e.* attendence incentives/other incentives related to the length of tenure of the employee) might generate ideas to overcome common problems. However, it seems unlikely that such initiatives will do more than scratch the surface of the problem. Exhortation and presentation of evidence in a traditional manner seems to have had little impact in the past.

The recent policy initiative to introduce a miminum wage may have helped to force some employers to adopt policies and practices that put a higher priority on raising skills and productivity. However the level at which it has been set means that its impact has probably been marginal. Raising the level could have significnat effects but this is unlikely to be a popular policy amongst most employers.

5.6.5 Raising the product specification

An important way in which regional and government policies might help is through encouraging companies to raise their product specifications. It is difficult to be precise about how this might work, but the discussion of the development of high skill ecosystems in Bosworth *et al*. (2003) suggests a few pointers. Of course much of this discussion is in the context of high tech. sectors, but there are many analogies which apply to more low tech. industries. In particular, in the context of the sectors which have been the focus of attention here, further or higher education institutions might work with individual or groups of companies to experiment with new food products, new marketing or export activity. Co-operation with local catering colleges, for example, might be beneficial in experimentation with new food products, as well as a source of staffing for key areas in hotels. Again, participation across the whole range of relevant actors is required.

In addition, regional policies can help in promoting various product demands, such as leisure or business tourism, regional dishes and foods, local speciality producers markets, *etc*. Local and regional agency (as well as national government) procurement policies can help as well, angled at helping local organisations to improve their product specification and, thereby, their skills. This might be accompanied by attempting to provide access to companies where stricter regulations are in operation (*i.e.* the supply of food to local hospitals, residential homes, *etc.*), which may mean offering skill development and overcoming other barriers.

5.6.6 Changing the product market

It is difficult to see how the competitive pressures on the two sectors might be eased. Indeed, it can be argued that it is in the customers' interests to have the cheapest possible supply of the products and services in question. Nevertheless, the issue of market power and regulation of markets is a very real one. It is clear that the size of national wholesalers and retailers, the market regulations that govern their operations and the market power they wield do have a significant effect on the product market development of many food processing companies. In addition, it seems that a number of the organisations in the sample would like to develop new markets for their products and could be aided in a variety of ways to help achieve these goals, if these problems were more widely recognised and addressed.

The results of the present study confirm that recognition of the importance of product market structure is very important. Legal controls and systems of market regulation, which set the framework for how organisations operate, have important skill implications. The example of bread and bakers in the UK compared with the situation in France and Germany is indicative, but this also applies across a much wider spectrum. For example, supermarkets in France are not allowed to undercut local craft bakers in the same way as happens in the UK. More generally, high levels of market concentration can results in a trend towards de-skilling within the organisations themselves.

5.7 General Policy Implications

The evidence that emerges from looking at these two sectors suggests that quick and easy solutions to moving the UK closer towards being a more knowledge driven, high wage, high skill, high productivity economy may not be readily available. Many organisations are happy with the results of doing more or less what they have done in the past, and few are contemplating anything like the step change, in either investment in skills or product market strategies, that government and its agencies might wish to see (H.M. Treasury, 2002).

Moreover, it is clear that, for many of these organisations, their current strategies are delivering the desired results, in terms of profitability and business success. The bulk are not failing businesses. Their owners and managers can therefore argue that they are acting rationally in the face of the product markets that they deal in and the incentive structures that these create. Many cater to relatively low value added market niches, not because they are somehow lazy or insufficiently ambitious, but because the patterns of demand that sustain such markets have to be met, and they are the companies that do so. If they did not, another organisation would fill the gap. For example, in a country where the mass of consumers demand relatively cheap food, and which has a retail sector dominated by a handful of very powerful supermarket chains that can enforce low prices and margins on many food sector producers, mass markets will have tight margins and the space to move into higher value added niches will often be quite limited.

The problem, for policy makers, is that while the individual organisations may be acting and investing rationally, and thereby maximising their individual returns, the outcome for society, particularly in terms of many relatively lowly-skilled and low paying jobs, may be sub-optimal. This tension is all the more important because, in at least some cases, a proportion of the workers in these organisations are probably being supported by the state via in-work benefits. It might thus be argued that the employers involved are having their product market strategies (and the low wages that support these) subsidised by the taxpayer. In-work benefits are a subsidy to the low waged individual, but also an indirect subsidy to their low paying employers. The level at which the minimum wage is set is also a critical factor in this equation.

The case studies demonstrate that there continue to exist a substantial number of relatively lowly skilled jobs that offer often fairly limited opportunities for upskilling, growth and progression. The research therefore reinforces Toynbee's (2003) recent assessment of the UK labour market, which indicated that there is a thriving marketplace for goods and services sold on the basis of low cost and supported by low wages, not least in contracted out public services. A similar picture emerges in the USA (see Applebaum *et al*, (forthcoming); Milkman (1998): Ehrenreich (2002); Cormier and Craypo (2000); and Lafer (2002)).

Given the fact that, for the owners and managers of these organisations, radical change frequently appears unnecessary, the government's role in seeking to stimulate substantial and sustained change is exceedingly problematic. Exhortation by ministers and government agencies is liable to be ignored because the case for the change is not at all clear to those inside the organisations concerned.

It is possible that raising the minimum wage by a significant margin might provide such a shock to the system. This would force employers away from low skill trajectories. However, such a policy has a high risk of backfiring, especially in the short term, if the consequence is simply the loss of many low skill jobs rather than the creation or of more highly skilled ones.

The key policy question is what can be done by region and/or by sector to change things in these two regions, based on the evidence from the case study evidence. As noted in Bosworth *et al.* (2003), The UK has many of the elements necessary for generating "high skill eco-systems", including:

- public sector R and D spending – although with weak exploitation and commercialisation R and D tax credits for business;
- venture capital support in the regions and support for venture capitalists;
- encouragement for entrepreneurs in general and for business start up and spin off (backed up by expanding the supply of entrepreneurial skills, e.g. offering business start up courses to scientists and engineers and making greater use of the talents of foreign students);
- Better coordinated business support;
- Growing awareness of the importance of innovation as one of several means of supporting competitiveness and productivity.

However, this has mostly been discussed in the context of rather high tech. sectors, rather than the more basic technologies used in food processing or hotels. While many of the elements to support a high skills eco-system, such as state support for R&D, and knowledge transfer arrangements, are therefore either in place or being set up in various parts of the UK, the problem is that they are less obviously relevant to the types of sector and organisation described here. More effort therefore needs to be made to expand the coverage of such initiatives to cover such sectors.

The case studies also demonstrate the likely limited impact of skills supply initiatives by themselves on the general direction of business strategies. Skills were not, in most cases, a major constraint on the business studied here, and they are also not liable to be a direct driver of change. It is thus hard to see how, even if outside agencies supplied many of the organisations covered in this study with an entire workforce qualified to Levels 2 or 3, that it would necessarily impact on either their basic business and product market strategies or on their overall performance. Many of the work processes and systems of job design found in the organisations studied would offer very limited room for substantially higher levels of skill to be productively deployed in production or front line work.

It is also apparent that increasing the supply of skills will, in many cases in the sectors covered here, prove to be a relatively weak lever for promoting wider organisational change. Skills are not the key issue for many of these organisations – they are a third or fourth order issue, dependent upon product market strategies (1st order), organisational structures to deliver that strategy (2nd order), and the human resource/people management policies within which skills issues nest (3rd order). However, this may not be the case in other, more knowledge-driven, sectors.

5.8 Implications for Skills Policies

These findings have significant implications for current skills policies. The general direction of policy across the whole UK over the last twenty years has been to concentrate attention and resources upon the development of a supply-side skills revolution, whereby a step change (or in reality a series of changes) in the supply of skills – largely through expansion of the tertiary education system – will enable the transition of the UK to a knowledge driven economy (KDE). Major elements of this strategy have included:

- massive expansion of post-compulsory education;
- massive expansion of higher education;
- massive and unceasing changes to the organisational structures that plan, manage and fund VET;
- attempts to reform and revitalise a work-based route for initial VET;
- reform of qualifications and of the qualifications structure (still ongoing);
- increasing central government control of all aspects of VET;

Until very recently, there have been only limited attempts to link these reforms with any wider economic development agenda, or to draw meaningful connections between skills policy and issues such as employee relations systems, work organisation, job design, or quality of working life. Indeed, the argument from policy makers has often been that skills and skills alone will provide a sufficient lever to generate the economic transformation that is desired (see, for instance, H. M. Treasury (2002), which advanced the view that the UK can escape from a low skills equilibrium simply as a result of the government supporting more skills creation). These case studies suggest that this may be a necessary but insufficient step along the road to a high skills, high wage, high productivity economy.

The nature of the labour market and the patterns of skill usage within the organisations being studied here also raises serious issues about the ability of upskilling and entitlements to obtain qualifications to shift large swathes of the working population out of low skill, low paid, dead end jobs. Qualifications do not attract a premium in themselves, they do so because an employer values the skills they signal and is able to put these to some productive use. Many lower end jobs in the economy, as currently designed, can be undertaken with no prior qualifications and little or no formalised training (Toynbee, 2003, p. 222).

Without significant changes to product market strategies, service standards, work organisation and job design, upskilling those who undertake these jobs may achieve only limited results. True, individuals may be able to move up and out to find better work, but someone else will still have to undertake what they have left behind them (unless automation of the most basic and unpleasant tasks can be achieved).

The danger of relying on upskilling to somehow ‘magic away’ low skilled, low waged work is that it may lead to over-qualification and to skills that are under-utilised or not used at all. On this point the warning offered by Crouch (1997, p.369) is apposite:

The fact that the educationally successful tend to be occupationally successful is the result of a competitive process; if everyone becomes educationally successful according to some existing criteria, then those criteria shift to a higher level. Improved education can be an individual solution because it assists one in the competitive process, but that very characteristic means that it cannot be a general or collective solution. If education standards are generally rising, then the educational level of persons engaged in any particular occupation will be seen to rise. It does not necessarily follow from this that the skill level of the work has risen. In the long run it is possible and often likely that employers will notice the increased capacities among their work-force and start to make use of them in new activities: this is the assumption on which the whole upskilling strategy rests. However, the long term might be very long, with considerable disillusion being experienced meanwhile among those who find their increased education has served only to submit them to increased competition for jobs.

5.9 Wider Implications for Business Support

One of the key messages within the Cabinet Office PIU project on workforce development (Cabinet Office, 2001a; 2001b; 2002) was the belief that the limits of what could be achieved by skills supply interventions was being reached. For further major progress to be made, new policy actors who had greater leverage over the demand for and usage of skills, such as the DTI and RDAs, would need to become more heavily and visibly involved in policy formation. This requires the development of a more integrated approach, wherein VET is incorporated into a wider business development agenda. The outline of this broader agenda is now gradually emerging, and the recent White Paper recognises that, "improving skills will not be sufficient on its own to drive greater productivity. But taken together with enterprise, competition, investment and innovation, it (*sic*) has a crucial role to play" (DfES/DTI/HMT/DWP, 2003, p.17-18).

The government-commissioned Porter Report suggests that the UK is faced with the need to make a step change in the way it chooses to compete, but is trapped in a series of deep-seated, structural-embedded path dependencies that make achievement of the desired paradigm shift in the competitive model very problematic indeed.

The central argument of Porter and Ketels (2003, p.5) is that:

> *The UK currently faces a transition to a new phase of economic development. The old approach to economic development is reaching the limits of its effectiveness, and government, companies, and other institutions need to rethink their policy priorities….We find that the competitiveness agenda facing UK leaders in government and business reflects the challenges of moving from a location competing on relatively low costs of doing business to a location competing on unique value and innovation. This transition requires investments in different elements of the business environment, upgrading of company strategies, and the creation or strengthening of new types of institutions.*

Unfortunately, they offer few pointers as to how this transition might be managed, and this now arguably forms the key issue facing policy makers.

Many in business are committed to at best small, incremental changes and have, as indicated by the present set of case studies, little appetite for more drastic attempts to upgrade their product market strategies or production processes. For as long as the current formula produces winnings, it will remain in place. If it starts to fail, the normal response is to do what has always been done, but do it harder (often to try another round of cost cutting). The research outlined above indicates that many organisations are following paths that are fairly clearly imprinted by earlier decisions, and shaped by the structure of the markets that they face. As Mason (2003) has demonstrated, using data from the DfES large scale Employers Skill Survey, the vast bulk of businesses see the horizons of the product markets in which they compete as local, regional or, at best, national. No more than 10 per cent of organisations saw the prime focus of their product markets being at international level (for details, see DfES/DTI/HMT/DWP (2003, p. 49)). Given the structure of income distribution in the UK, this means competing in product markets that have a limited capacity to pay for higher value added, higher specification goods and services, and where a mass market for low cost strategies continues to operate. In this competitive environment, the impetus for radical change will be limited.

Something of the scale of this problem emerges from the research undertaken in support of the work of the National Skills Task Force (NSTF), which indicated that when organisations were asked (as part of a very large scale survey exercise) whether or not they were implementing or about to implement plans to move into new higher quality product or service areas with higher profit margins, no less than 60 per cent of organisations responded that they were happy where they were and had no plans to move upmarket (NSTF, 2000, p.117). This is the size of challenge facing the RDAs, SSCs and business support services. The added problem is that if many organisations are locked into a low skills equilibrium, are subject to path dependency problems, and are managing (for the time being at least) to make reasonable profits via this route), government support may simply make them slightly better at what they are currently doing, rather than actively encourage them to raise their game and undertake a step change.

In tackling this challenge, an opportunity comes in the shape of new players whose central remit potentially aids their ability to link skills to wider economic and structural issues. The DfES has been focussed upon skills supply, in part at least, because that is what it controls. It has no real remit for, nor understanding of, competitiveness or people management issues.

These new opportunities are best exemplified in the shape of the DTI, which is well-positioned to work with other partners, such as the LSC, SSDA and SSCs, the Small Business Service, and RDAs, and to evolve less narrowly-focussed solutions to the skills problem. As the central government department with prime responsibility for competitiveness and innovation, as well as employment relations (including work organisation and job design), the DTI is well placed to develop and take forward the kind of policies that the PIU project suggested might be needed to begin to stimulate long-term demand for skills within employment and to ensure that those skills are then used to maximum productive effect.

Much of the evidence from business research in the UK indicates that the gap between the policies and practices in the leading edge companies and those at the trailing edge continues to widen. It is also clear that different sectors and sub-sectors of the economy address profoundly different markets, which carry with them divergent demands for skill. The case for training is a function of organisational purpose and trajectory. An investment in the skills of high quality chefs that would make good sense to a Michelin ** restaurant would probably make little sense to a Burger King outlet. Far from a simple, blanket universal demand for radical upskilling, demand is much more concentrated and patchy. The same goes for the demand from organisations for help in upgrading their product market strategies. This means that the efficacy of one-size-fits-all policy interventions are more and more problematic.

The German federal government currently uses the phrase 'whole government approach' in describing how it is seeking to ensure that all the relevant ministries engage with the design and implementation of policies towards lifelong learning issues. It can be argued that the recent White Paper on skills policies in England seeks to replicate this form of co-ordination through the Skills Alliance and that there is a case for a similar approach in the UK. This would seek to stimulate business change – a whole business approach that takes as its starting principle the need to base policies, diagnostic tools, and interventions and initiatives around the integration of business strategy, organisational structure, people management systems and policies, innovation and R&D investment and so on. Rather than start with skills and treat them in isolation from all else that the organisation is seeking to accomplish, it makes sense to see skills as an important, but ultimately dependent variable. As one expert on SMEs recently put it, "training is not stimulated by government training policies, but is a derived demand driven by changes in the workplace" (Blackburn, 2003). Pulling other levers and stimulating other drivers could open up the demand for more and higher skills and help ensure that, once delivered, they are put to maximum productive effect.

One potential lever is the use of public purchasing policy. The state (in terms of the NHS, central and local government and their many agencies) are major purchasers of labour – the moreso with the contracting out of many aspects of public services. Using as a criteria in awarding contracts issues such as quality of work and aspects of job design and work organisation that allowed frontline staff to deploy (and be rewarded for) higher levels of skill, would be a significant step forward and one that would have an impact on a substantial swathe of low skilled, low paid employment. As Toynbee's (2003) experiences in a range of contracted out public service employment demonstrates, the current situation is far from optimal and encourages and sustains jobs whose training and skill requirements are close to nil.

A whole business approach would require strong co-ordination between the many agencies and actors (public and private) with a potential involvement in this kind of policy. The real challenge comes in designing these other, wider forms of intervention and support. This task in turn suggests the need to develop wider multi-disciplinary fora within which those with common interests can meet to start to develop new tools for intervention and support. These might include those with expertise in SMEs, skills and training, business development, regional economics, supply chain management and other fields of experience.

The other issue that this research underscores is that of targeting government support for businesses. It is apparent from the case studies that different organisations have very different needs and demands. In part, these are determined by their underlying product market strategy, but also by what stage or phase of business development they are currently in. Help and support on skills issues that would be valuable to one organisation might be deemed irrelevant by another. This suggests that the efforts the DTI and others have put into the development of diagnostic tools for companies to help them see the different components of their business development strategies can add significant value to the management of the VET system. It also reinforces the importance of the SSCs (and the DTI's sectoral clusters) as bodies that are in close touch with employers and hence potentially able to provide closely targeted support that goes beyond skill supply and which can embrace wider business development objectives.

Finally, the overall policy message from the case studies is that the kind of step change in economic performance and competitive orientation being demanded by the Treasury and others will be a long process, with some sectors and organisations much more able to make rapid progress than others towards a high wage, high skill, high productivity future. This raises big issues for policy makers, at national government level, but also within SSCs and RDAs. If time, energy and resources are finite, where should they be directed – towards those organisations and sectors that are already on the high rather than the low road, or towards those who are making the least progress and whose workers are hence in danger of getting left behind in low wage, low skill employment? The former orientation might produce quick wins but may fail to address the real problem. The latter, while focused more upon the areas where there are real difficulties, might require very protracted support (as the case studies discussed above show) and generate much slower and more limited gains. However, unless some of the issues and barriers that face these less well placed sectors, not least the structure of demand and the incentives it generates, are tackled, the danger is greater and greater labour market and income polarisation.

5.12 Some Lessons for Regional Policy

The research carries with it a number of implications for RDAs, not the least of which is that skills interventions, conceived of in isolation from wider efforts at business improvement, are liable to have at best minimal impact on overall economic outcomes. This underscores one of the prime messages of the Cabinet Office's workforce development project, that upskilling needs to be sold on the back of wider business improvement strategies, and that skills may have an important, but not necessarily the central, role to play within such strategies.

Other messages include:

- some industrial clusters will have more potential to benefit from injections of skill among the bulk of their workforce than others. In some clusters, including the two sectors which are the focus of attention here, skills may be a relatively minor issue.
- within clusters or sectors, some firms will be better positioned to move up market than others. In a world of limited resources, efforts need to be targeted towards those recipients with the greatest potential and where the wider economic benefits and spin-offs will be greatest. This suggests the need for a diagnostic process that can support such targeting.
- moving substantial parts of regional economies up the value chain represents a long-term project. It is necessary to start to build momentum and then maintain it, perhaps over a 15-year period.

At a broader level, the research illuminates some of the issues concerned with the implicit choice of models of competitive advantage being adopted by many UK organisations. As the DTI's 2003 R&D Scoreboard concluded, "UK companies, unlike their US counterparts, chose to pursue growth via acquisitions with less emphasis on long-term investment in capital spending and research & development" (Harding, 2003, p19). This approach to securing competitive advantage has major implications for skills policies, since research suggests that the opportunities for skills to contribute to competitive performance are maximised when combined with investment in innovation, product development and R&D. If longer term approaches to securing competitive advantage through organic growth linked to research, innovation and higher skills are eschewed in favour of a gamble for short-term results via mergers (which as the DTI Scoreboard analysis makes clear is often a risky route), then there are two likely outcomes. First, the impact of public policy on skills, and of publicly-funded R&D, upon firms' behaviour may be more shallow and limited than expected. Second, for as long as merger and acquisition remains the route conferred priority by strategic management teams, the ability of public agencies to pursue policy agendas posited on the factors that support organic growth will remain problematic.

The research also reinforces one of the general messages from the report the DTI and ESRC commissioned from Michael Porter – that low wage competition in a highly de-regulated labour market still works as strategy, though the payoffs may be diminishing and will prove increasingly unsustainable in the longer term. The problem is that, for as long as this escape route is open, it is hard to see how some of the firms covered in this research can be motivated/incentivised to change direction and shift towards the kinds of higher value added strategies that Porter sees as vital to future economic success. Given these difficulties, and the point about a very heavy reliance on mergers and acquisitions as a source of strategic competitive advantage (far higher than even in the USA – Harding (2003)), the task of shifting a substantial proportion of the economy from an existing, familiar and well entrenched competitive paradigm to a new paradigm is plainly a tough one. It will require the engagement of both state (central, regional and local) and its agencies, but also other interests. Perhaps one of the key tasks for central government and the RDAs is to find ways to promote the kind of fundamental political and economic debate that might underpin a wider realisation of the need for fundamental change.

5.11 Further Research

The case study research has proved a rich source of information about the nature of companies operating in a low skill equilibrium or on low skill trajectories. They show a close link between product specification and skills, as well as the existence of latent skill shortages, which metamorphose to actual deficiencies during periods at the time of a shock or some innovatory change.

There are strong grounds for further research on a number of issues raised by the present study. There is a need for a more detailed exploration of the conditions under which the organisations would make a strategic product market change (*i.e.* move up-market) and, related to this, what internal skills or external support might induce such a change.

In addition, there is a need to develop the current research in the context of other sectors. While the business hotels and food processing are extremely interesting because they are located at the lower end of the skill spectrum, they are also limited by this fact.

Further analysis of cases within the existing choice of sectors might also be valuable, perhaps covering some other geographical areas. In particular it would be useful to make an even greater effort to develop matched samples of companies in the same sector which have chosen quite different product market and skill strategies – one company moving up-market and the other adopting cost-based strategy and, in effect, moving down market.

A further development, which would probably pay rich dividends, would be to focus on the more strategic level decision making of some of the current cases where the establishment forms part of a much larger organisation.

Finally, as noted in Section 5.6.7, there is a strong case for a more general study of the impact of market regulation on longer term economic development and skill demands, at both local and national level.