Industrial strategy principles, objectives and scope

The CIPD welcome the reintroduction of an industrial strategy and an Industrial Strategy Council in support of the government's economic ambitions. We believe these are potentially vital levers to deliver growth and improve productivity and getting them right will be key to unlocking the potential of the UK economy.

When the Labour party were in opposition, we were pleased to see the focus on 'the everyday economy' in its third mission:

> "Our third mission, caring for the future, recognises the vital role the everyday economy has, not just in our economy but in our daily lives. It is where many people work, where we spend much of our money and where we entrust the care of our loved ones to other people." (Labour's Industrial Strategy, 27th September 2023)

We believe this should remain an important plank of any successful industrial strategy and produced a policy paper in 2023 'An industrial strategy for the everyday economy' that details how to unlock the potential of the everyday economy.

The Government has brought many of the principles it laid out in opposition into the green paper but there appears to be much less emphasis on the everyday economy and the longer tail of currently less productive SMEs. Government has indicated clearly in the objectives that its industrial strategy is a central part of its Growth Mission to fix the foundations of the UK economy and improve living standards across the economy. It has also made clear in the principles for the industrial strategy that 'it will not repeat the mistakes of the past', where the impact of industrial strategy has been 'concentrated in certain regions and not shared across communities'. Consequently, the green paper must be judged against these ambitious and broad growth goals.

The industrial strategy green paper is right to focus attention on tackling barriers to growth in our highest potential growth-driving sectors and places, with the purpose of helping to increase investment and high-quality jobs across the UK. These are sectors where the UK has specific advantages to build on and which have significant growth potential. It makes sense to seek to capture a greater share of available investment in these key industries and to try and further accelerate their growth, some of which will also benefit the wider economy.

However, improving innovation and productivity in these sectors will not be sufficient in itself to boost productivity and living standards across the UK. Collectively the eight sectors account for only about a quarter of overall employment (23.7%) and 29% of private sector employment (see Figure 1 below), so even if there is an uplift to productivity and an increase in the number of high skilled and high paid jobs employed in these sectors, it will be unlikely to be sufficient to significantly raise growth and overall living standards across the UK.

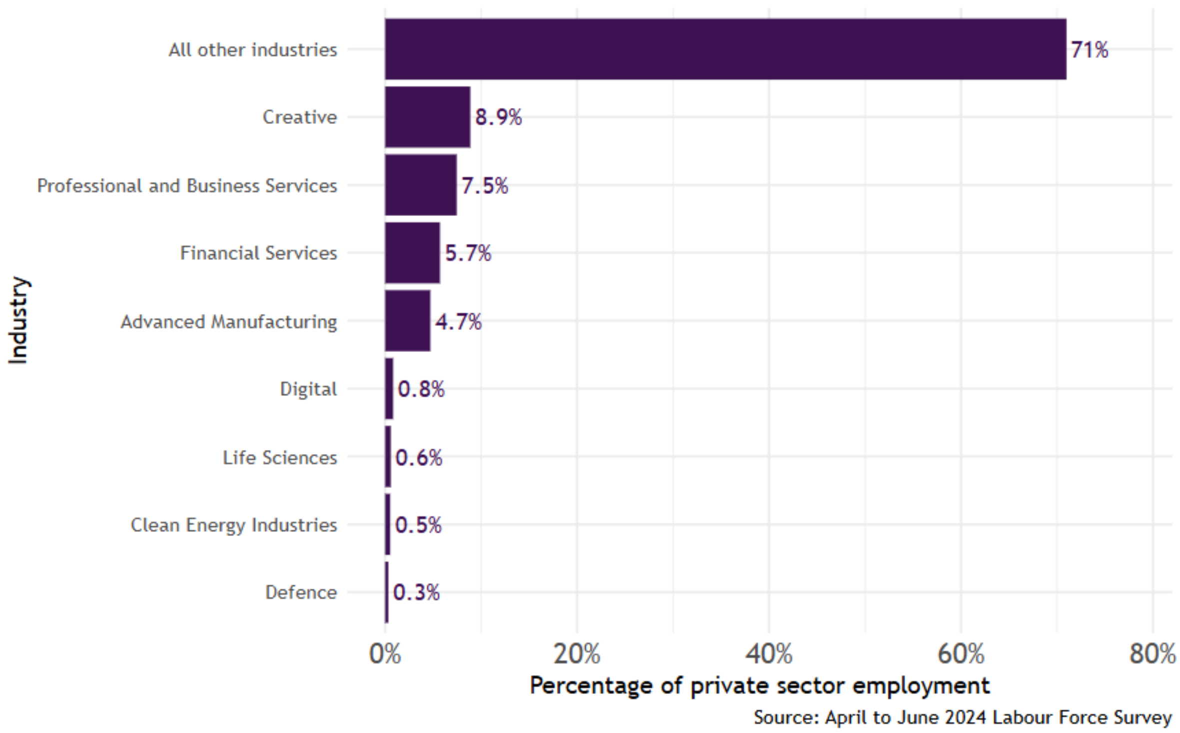


Figure 1 The proportion of employment accounted by the eight high-growth sectors

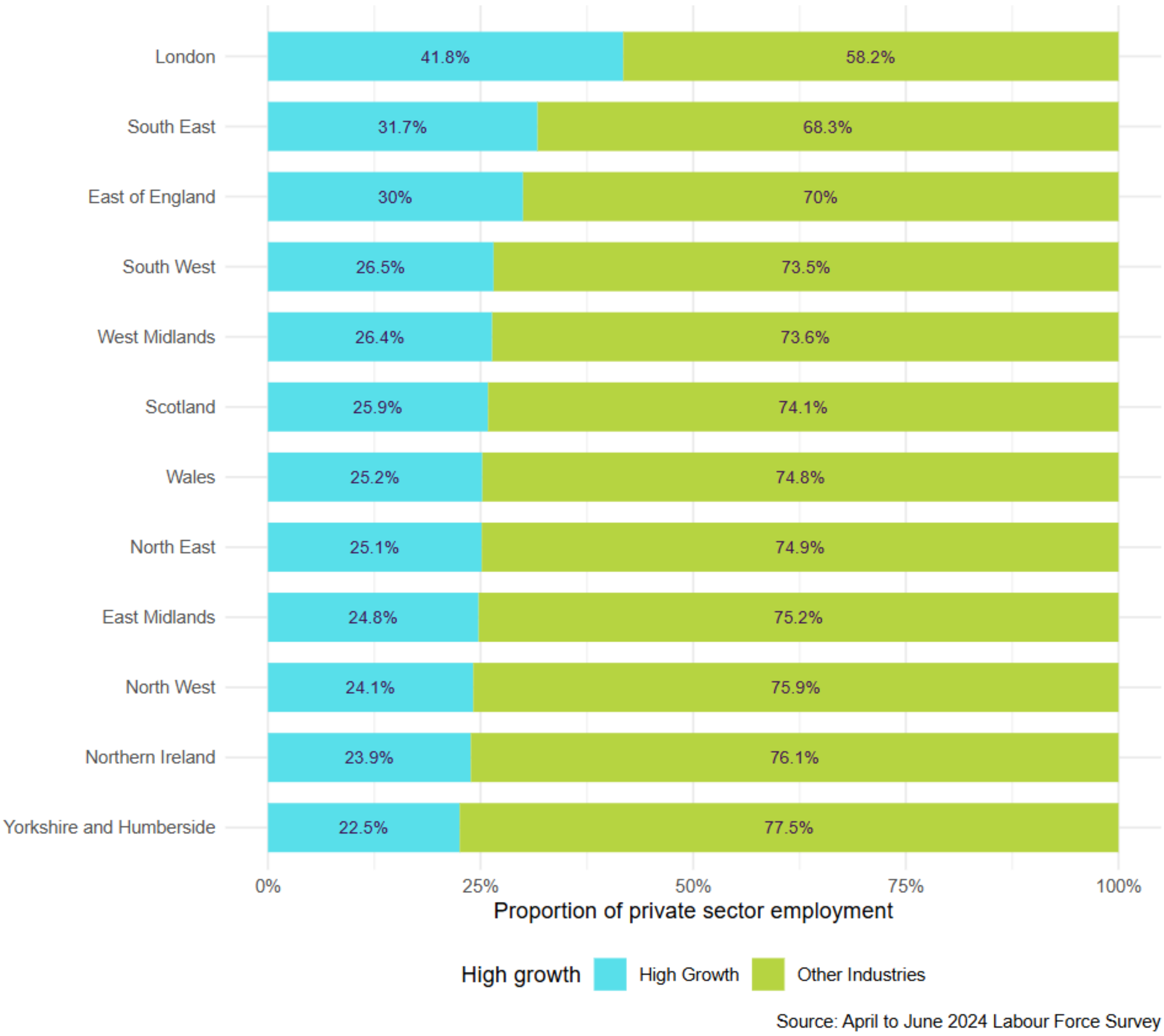
Furthermore, the high growth sectors are significantly London centric and make up a much larger share of total private sector employment in London (41.8%), compared to the rest of the UK (see Figure 2). They also represent a larger share of private sector employment in the South East (31.7.8%), and the East of England (30%) compared to other regions.

An industrial strategy that supports investment in these key sectors but largely ignores the wider economy is likely to reinforce inequalities in productivity and living standards across the UK. Analysis[1] by the ONS finds that the productivity gap with London and the South East and other regions cannot be explained by the make-up of industries but instead is accounted for by the

1 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/labourproductivity/articles/understandingspatiallabourproductivityintheuk/2019-05-03#why-do-some-firms-outperform-others-within-the-same-industry-

productivity gap within industries in each region between the lowest performing firms and the higher performing businesses in any given sector[2]. This suggests that focusing the efforts on increasing the productivity and size of a limited number of high growth sectors is unlikely to improve the UK's overall productivity performance or address regional disparities.

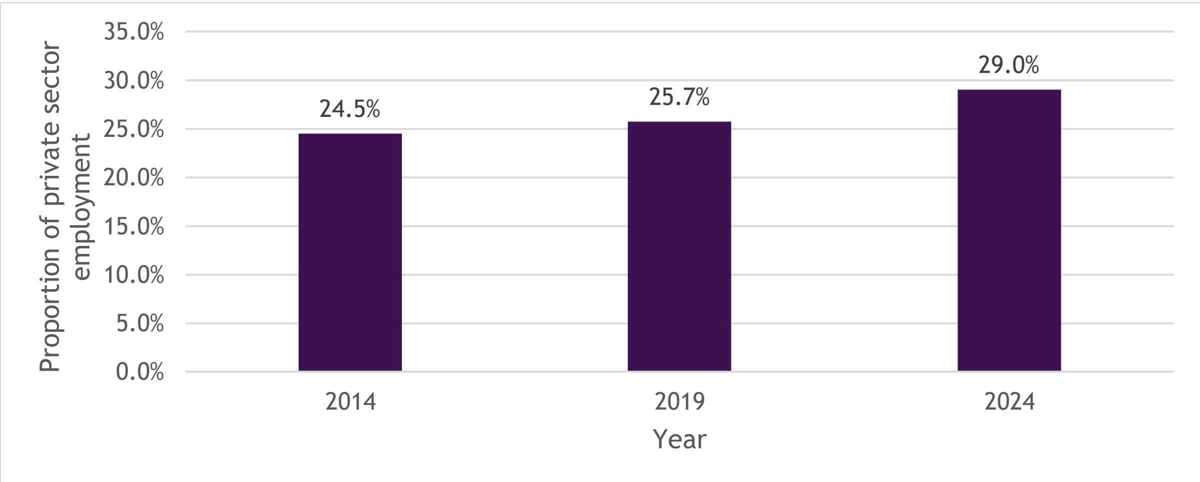
Figure 2: The proportion of private sector employment made up the high growth sectors, by region



[2] https://www.london.gov.uk/sites/default/files/productivity-trends-in-london-final.pdf

It is also likely that the benefits of a narrow focus on these eight sectors and whichever sub sectors are chosen will be relatively slow to materialise, based on past performance. Previous governments have also tried to boost investment and productivity in a number of these sectors and while the proportion of the workforce they collectively employ has grown, the increase has been relatively gradual. Based on past performance, future growth in these sectors is likely to continue to be steady rather than rapid.

Figure 3: Growth in employment in the high growth sectors, 2014-2024



There is unrealised potential to increase productivity in the long tail

Part of the green paper's rationale for focusing on the eight identified sectors is that these have been among the sectors where there has been most productivity growth between 1997 and 2022. It suggests that the UK's productivity growth has slowed as growth in these key sectors has slowed and concludes that finding ways to revitalise growth in these sectors, which have historically exhibited the most productivity growth, will boost the nation's overall productivity.

However, a narrow focus on trying to revitalise the productivity of our already more productive firms, overlooks the possibility that these firms are already likely to be working closer to the technological/managerial frontier in terms of adoption/best practice.

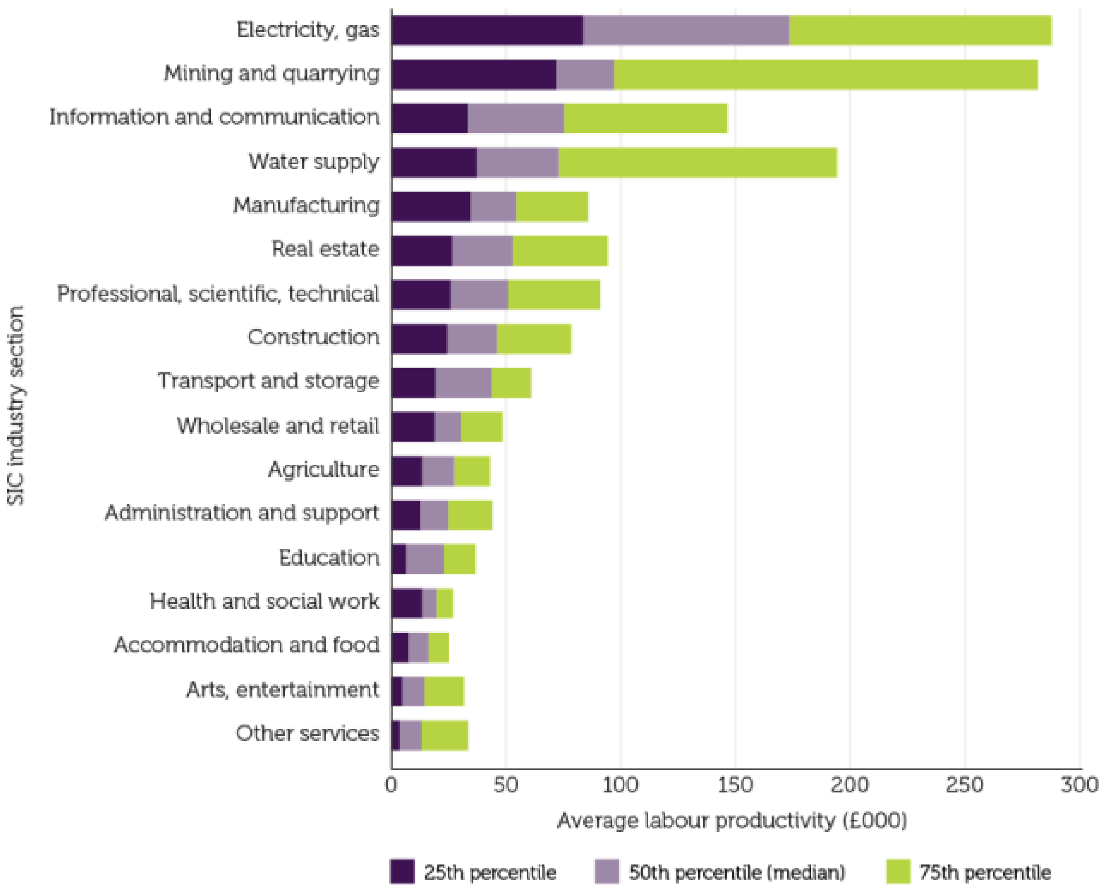
Consequently, there may well be diminishing returns to efforts to increase productivity in these sectors because the companies within them are already more likely to have invested in and reaped these returns, which could be reflected in the slowing in productivity growth in these sectors.

The laggards have much more scope for productivity improvement – and will characterise much of the economy in some of the UK's most deprived regions.

This point is highlighted by analysis which shows that productivity disparities exist in all industries in the UK – see figure 4 below. For example, in accommodation and food, the labour productivity of the median firm was £16,000. But this was twice as much as that of firms at the 25th percentile (just £8,000) and much less than firms at the 75th percentile (£25,000).

Figure 4: Productivity dispersion in UK industries, 2021
(UK, private non-financial business economy, 2019 prices, employment-weighted)

(UK, private non-financial business economy, 2019 prices, employment-weighted)



Source: Office for National Statistics (ONS).

This means there is significant potential to increase productivity in all industries if more low productivity firms could be brought towards the average in every sector. Evidence suggests this is possible even in low wage sectors, for example, analysis by the National Institute for Economic and

Social Research[3] finds that productivity in UK low wage sectors is 20-30% below that of Germany, France, the Netherlands and the US. It concludes that closing the UK's productivity gap with its competitors in low-wage sectors would make a substantial contribution towards overcoming the national productivity problem.

NIESR's analysis suggested that weakness in productivity in the UK's low wage sectors is primarily due to differences in Total Factor Productivity. Countries with more productive low wage sectors had a higher proportion of workers in training; had more extensive use of management practices such as performance-related pay; and had a higher share of employees using ICT. Other NIESR research[4] also finds that better management practices improve performance in SMEs (small and medium-sized enterprises), which tend to form a key part of many low-wage sectors.

CIPD research[5] exploring the value of providing HR support to small firms also suggests that this can help improve workplace relations, labour productivity and financial outcomes across a wide variety of participating businesses, many of which were in low wage sectors.

From a productivity viewpoint, focusing on a relatively narrow range of sectors could only be justified if these sectors demonstrated evidence of significant productivity spillovers to other sectors (for example, through movements of goods, services, people or knowledge from high-productivity sectors to low productivity sectors). We have seen insufficient evidence of these spillovers.

Do high value clusters sufficiently boost adjacent local economies?
Case study: Oxfordshire
"Although Oxfordshire is an integral and very successful part of the UK's 'Golden Triangle' (London, Oxford and Cambridge) of high-value innovation with clusters in quantum computing, the space industry and life sciences, there is limited evidence of either trickle-down or trickle-across effects in terms of the productivity of other local sectors or the earnings levels of those who live in poorer areas of the county, such as parts of Bicester and Blackbird Leys. The danger in a high-tech, 'high-end' focus is people, places, occupations and social classes that are currently 'left behind' will remain so unless we can ally a science-based innovation policy with a complementary set of policies around workplace innovation and business improvement in 'everyday' localities, sectors and workplaces. Until we can transform productivity across the economy, the chances are that we will continue to languish in international league tables of hourly labour productivity, and consequentially we will not be able to afford real-terms wage increases for a large proportion of the working population."
Professor Ewart Keep, author of *An industrial strategy for the everyday economy*

Given the above analysis, the CIPD's response to the green paper focuses on the sections and associated questions associated with the cross-cutting/horizontal areas of policy that can help support businesses across the economy, including those in the high growth sectors, to innovate and become more productive.

Creating a pro-business environment

7. What are the most significant barriers to investment? Do they vary across the growth-driving sectors? What evidence can you share to illustrate this?

The reasons why too many businesses don't invest sufficiently in order to boost productivity are complex and will vary from business to business. However, some barriers to effective investment

[3] https://www.niesr.ac.uk/blog/mind-gap-productivity-uks-low-wage-sectors#:~:text=How%20do%20levels%20of%20productivity,the%20Netherlands%20and%20the%20US.
[4] https://www.niesr.ac.uk/publications/impact-management-practices-sme-performance?type=discussion-papers
[5] https://www.cipd.org/globalassets/media/zzz-misc---to-check/hr-capability-small-firms_2017_tcm18-27313.pdf

such as a lack of management capability are likely to apply across the economy, including the high growth sectors.

Research by the London School of Economics finds a significant link between management capability and productivity, suggesting that between a quarter and a third of cross country and within-country total factor productivity gaps could be attributed to management. The same research also finds that management capability is key to ensuring firms' investment in technology pays dividends.

Evidence also suggests a strong link in particular between HR and people management practices on workforce skills development and use[6] and responsible adoption of new technology such as AI[7]. A lack of HR knowledge and capability within a firm will act as a barrier to effective investment in workforce skills and innovation, which are interdependent on each other. It is also likely to contribute to the poor diffusion and adoption of technologies, ideas, and processes among the UK's 'follower firms' identified as a particular weakness for the nation in the green paper. The need to address this problem was highlighted as a priority by the Chancellor of the Exchequer Rachel Reeves in her Mais lecture in March when she observed:

"If we want to boost our national productivity – and wages with it – we should focus not only on those frontier firms, but on incremental gains driven by the diffusion of new technologies and best practice across the long tail of firms behind the productivity frontier. Because a strong economy cannot rely only on the contribution of the few firms at the leading edge."

Accelerating the responsible adoption of AI
The CIPD is working in partnership with Innovate UK and the Institute for the Future of Work to develop an action research programme in conjunction with employers across a number of sectors to help understand the HR, people management and development practices that can support the effective and responsible adoption of AI in order to boost productivity and augment job quality. Insights from the programme will be translated into practical advice, guidance and tools for HR practitioners and inform the development of the CIPD's profession map that underpins our qualification and areas of development for the HR profession.

Improving HR and people management capability can also help efforts to improve job quality and the health, wellbeing and participation of the workforce. Creating more flexible and good quality jobs can help keep more people in work and healthy for longer, increase the productive capacity of the UK's workforce and improve the quality of people's working lives.

Firms often overrate their productivity
CIPD research into firm-level productivity shows that business leaders typically overrate their organisation's productivity relative to peers, with the majority believing their organisation is already more productive than competitors. This lack of awareness or false confidence is likely to undermine organisations' appetite for investment in new technology or in improving people management and workforce skills development.

HR/people management issues are often discounted
Even when business leaders are looking to improve or invest in their business, they may not accurately recognise the weaknesses in capability that need to be addressed. For example, people management and development issues are often overlooked or under-prioritised by SME owner-managers even though the evidence suggests these are the management practices most correlated with enhanced firm-level productivity. For example, the Government's 2019 Business Productivity Review noted that *'UK SMEs compare particularly unfavourably internationally on people management, which is the factor most correlated to productivity. Leadership and management practices therefore represent one of the greatest opportunities for firm-level productivity growth in the UK.'*

[6] https://assets.publishing.service.gov.uk/media/5a7f81c6ed915d74e622ae2e/skills-lifelong-learning-workplace.pdf
[7] https://www.wbs.ac.uk/news/ai-adoption-widespread-and-having-positive-impact-on-jobs/

However, CIPD research[8] shows that small-firm owner-managers often don't understand that people issues are holding back their business because of a lack of knowledge about HR and people management and development. Many business leaders and managers lack awareness of the people factors underlying poor business performance, particularly in SMEs which often have limited or no access to professional HR support. This means many only ever reach the point of looking for help to improve their management practices when they hit a significant problem or crisis – such as a major staff conflict, employee absence issue or tribunal claim against them. Owner-managers of small firms are also very time- and resource-poor; they struggle to find the capacity and money to invest in business improvement activities even if they do recognise the need to.

Investment is not the whole story

Even when business leaders do invest in their business it may not necessarily lead to improved performance and productivity. For example, the value of investment in new technology is only likely to be realised if complementary changes in management capability and workforce skills development happen at the same time. According to the ONS Management and Expectations survey 2023, there is a strong positive relationship between the presence of structured management techniques and the use of Artificial Intelligence in business.

The 2019 Business Productivity Review, jointly undertaken by the Department for Business, Energy and Industrial Strategy (BEIS) and HM Treasury, summarised the steps firms need to go through to initiate and embed change through the four stages of the business change cycle:

1) realisation that a change is needed
2) assessment of the costs of change and associated outcomes, quality and value of change, and of the business support available to help identify solutions
3) navigation of the business support environment to find advice, or new services and products, to deliver the desired change
4) embedding the change in the business to realise the benefits, which may require strong leadership and staff training.

This underlines how difficult achieving sustainable business change and improvement is, and why it simply won't happen for many firms without advice, guidance and support. Unfortunately, the evidence[9] suggests the quality of business support available in England in particular is fragmented and largely inadequate, with very little appropriate publicly funded support available to enhance SMEs' HR and people management capability.

Together, this analysis suggests there needs to be a coherent long-term strategy to improve management capability and build greater demand among more employers to invest more in the key areas of capability that they need to innovate and become more productive.

People and Skills

8. Where you identified barriers in response to Question 7 which relate to people and skills (including issues such as delivery of employment support, careers, and skills provision), what UK government policy solutions could best address these?

The Cabinet Office recognised as far back as 2001 that skills are a derived demand. They are derived from business need, so unless there are mechanisms in place to influence that underlying need, policy responses focusing on improving the supply of skills are likely to be ineffective and suboptimal.

As such, policy solutions are required to influence and drive employer demand for skills and improve how skills are used in workplaces. A CIPD report, *Employer Views on Skills Policy in the UK*, highlights that employers who adopt a strategic approach—through workforce planning, training

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[8] https://www.cipd.org/uk/knowledge/reports/hr-capability-small-firms/

[9] file:///C:/Users/BenW/OneDrive%20-%20Chartered%20Institute%20of%20Personnel%20and%20Development/Desktop/2024-00506-Briefing-Strong-partnerships,-good-jobs,-productive-workplaces-Version-12-06-2024%20(7).pdf

programs, and dedicated training budgets—are more likely to invest in skills, collaborate with educational institutions, and anticipate future skill needs.[10] This underscores the importance of strengthening people management and leadership capabilities within organisations, particularly SMEs that are most likely to lack awareness of their skills gaps or overestimate their understanding of skills needs.

The OECD recommends an "ecosystem" approach to better align skills supply with demand. Strategies include improved job design and human resource management practices, supported by business support programs, to enhance job quality and skills utilisation in the workplace. The design and implementation of these types of business and people management support initiatives are often most effective at local level. Localised economic development approaches are particularly relevant for small and medium-sized enterprises (SMEs) with a regional focus.[11]

Collective action is also needed at sectoral level to strengthen employer investment in skills and innovation. Sector bodies have a vital role to play here, yet, at present the effectiveness of sector institutions varies widely and many would require significant enhancement to take on a more impactful role. Strengthening these institutions can promote social partnership and help identify shared skills shortages and strategies to address these, enabling industries to set priorities and better align a skills and growth levy with their needs. This goal could be advanced through the creation of a £50 million sector-focused social partnership fund.[12] Sector bodies could apply for this funding to enhance their capacity to foster collaboration between employers and unions at the sectoral level.

The CIPD has conducted several positively evaluated pilots providing HR support to small businesses in different parts of the UK. These pilots have shown that the provision of a limited amount of free 'pump-priming HR support for small firms can be transformational, leading to better workplace relations, higher productivity, and improved financial outcomes. Building on this success, the CIPD and the Behavioural Insights Team have launched four new pilots in collaboration with Angus Council, Tees Valley Combined Authority, and Bournemouth, Christchurch, and Poole Council, as well as a UK-wide online HR consultancy for SMEs. These pilots, funded by the UK Government and designed as randomised controlled trials (RCTs), aim to evaluate how HR support can help SMEs enhance recruitment, people management/development and employee retention, and support wider efforts to improve job quality, labour market participation and productivity.

Insights from this programme, Be the Business, Help to Grow Management, as well as any publicly funded management qualifications such as management apprenticeships should be reviewed, to understand which interventions can work best to improve management capability in SMEs and are cost effective to deliver at scale. This review should inform the development of cost-effective, accessible business support services that can provide bespoke, high-quality advice to SMEs on the capabilities needed to boost innovation and growth, regardless of a firm's sector or the postcode in which they operate. The Productivity Institute made a similar recommendation in its Policy Agenda[13] report, noting that "in England the business support network has become increasingly confusing. A simpler and more stable policy environment would be beneficial for UK firms' productivity, while streamlining multiple support schemes could encourage SMEs to access them."

9. What more could be done to achieve a step change in employer investment in training in the growth-driving sectors?

As emphasised in the previous section, skills are a derived demand, so to achieve a step change in employer investment in training in growth-driving sectors, as well as the economy more broadly, it is first necessary to intervene at the level of businesses' competitive and product market strategies.

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[10] CIPD. (2022) Employer views on skills policy in the UK. London: Chartered Institute of Personnel and Development.
[11] OECD/ILO (2017), *Better Use of Skills in the Workplace: Why It Matters for Productivity and Local Jobs*, Local Economic and Employment Development (LEED), OECD Publishing, Paris.
[12] Prospect/CIPD (2024) Strong partnerships, good jobs, productive workplaces: A discussion paper
[13]

To increase an organisation's appetite, and willingness, to invest in their people will often involve support for employers to transition to higher-value-added production and/or reshape workplace practices to generate greater demand for skills. Evidence from Finland[14] underscores the benefits of providing businesses with external expertise to help upgrade workplace organisation, enhance people-management capabilities, redesign work processes, and encourage increased investment in training. Addressing these challenges is particularly difficult because many of the necessary interventions fall outside the scope of traditional skills policy and instead align more closely with economic development, business support, industrial strategy, and innovation policy.

One of the key ambitions of the apprenticeship levy was to counteract the long-term decline in employer investment in training, yet it failed to achieve this as evidenced by continued falls in employer investment, the collapse in apprenticeship starts and high levels of deadweight. To ensure that the new Growth and Skills Levy helps deliver a step-change in employer investment Skills England should consult with employers and social partners at both local and sectoral level at the earliest opportunity on the design of the levy to ensure that businesses get some support investing in agreed key skills/accredited training and to address engrained skills shortages at a sector and regional level. Lessons could be learnt from Ireland's National Training Fund (NTF) which is financed through an employer levy and supports initiatives across further and higher education and funds tailored programs developed in partnership with employers to address specific needs. Additionally, the NTF has enabled the creation of sectoral and local business networks, particularly benefiting small and micro businesses, to deliver training and upskilling opportunities.

> "Ensuring vocational training and technical qualifications better meet the needs of companies can play a key role in local and regional ecosystems that can boost productivity, not only providing skills, but also as a conduit for innovation strategy." Productivity Institute.

10. Where you identified barriers in response to Question 7 which relate to RDI and technology adoption and diffusion, what UK government policy solutions could best address these?

Our recent report on People powered innovation highlighted how government could affect the climate within which employee-driven innovation takes place. Approaches recommended in the report which could facilitate innovation include:

- Rebalancing innovation strategy and funding so that more emphasis is placed on boosting the diffusion of management best practice and technology adoption across all sectors of the economy. For example, inefficient use of R&D tax incentives such as the £1.5bn a year Patent Box should be abolished to fund much needed investment in policies to improve management practices, technology adoption and skills investment across much broader swathes of the economy. This would still leave about £7bn a year spent on other R&D tax incentives, an area of public investment the UK spends more on than any other developed economy.

> **Case for abolishing the Patent Box**
> A recent evaluation[15] found there is no evidence that the Patent Box has bought benefits to the UK economy and it appears (a) that the main beneficiaries have been companies in sectors for which there is no case for this kind of government subsidy and (b) that a company's accounting treatment can be at least as significant in generating high levels of Patent Box subsidies as investment in commercialisation in the UK.

[14] Alasoini, T (2015) Two decades of programme-based promotion of workplace innovation in Finland: past experiences and future challenges, European Journal of Workplace Innovation
[15] CBR_Report_2021_single_pgs (008).pdfrev.pdf

- Sector-level partnerships to promote collective employer action to improve management capability skill development and innovation/technology adoption (see above) at an industry level (see above)

- Reviewing existing publicly funded business support services and management qualifications as part of the Spending Review. This would help inform the development of a cost-effective, accessible business support service that can provide bespoke, high-quality advice to SMEs on the capabilities needed to boost innovation and growth, regardless of a firm's postcode.

- Broadening the remit of Catapult centres to promote the adoption of technology and help tackle the people management issues preventing this.

- Improving the labour market enforcement system with a much stronger focus on supporting SMEs to comply, raising overall employment standards and supporting wider efforts to improve the quality of people management. This would largely be achieved through doubling Acas's budget from £60m to £120m a year and increasing its capacity to provide advice and support to SMEs.

11. Do you have suggestions on where regulation can be reformed or introduced to encourage growth and innovation, including addressing any barriers you identified in Question 7?

A key area of regulation that influences the business environment and decisions that employers make on the recruitment, management and development of the workforce is employment legislation. CIPD research[16] shows that while the UK has a relatively flexible labour market compared to some other OECD economies, it performs relatively well on a range of key labour market outcomes.

The UK has an above average employment rate and relatively low unemployment by OECD standards. It also has a low proportion of people in temporary employment at 5% and a low proportion of people in temporary employment that say they want a permanent job, by international standards.

In implementing the measures in the Employment Rights Bill, it will be important to preserve the flexibility and high level of employment and permanent jobs that the current legislative framework has enabled, while addressing areas of weakness. For example, improving the UK's inadequate Statutory Sick Pay provision and parental leave framework can support efforts to improve labour market participation and job quality.

It will be important that there is meaningful consultation with employers on the key measures of the Bill to ensure that significant changes, such as the removal of the unfair dismissal qualifying period and the introduction of a new statutory probation period, can be implemented without increasing the cost and risk of hiring.

Impact of regulation undermined without effective enforcement

The Government will also need to take significant further steps beyond the creation of a new Fair Work Agency to improve enforcement of employment regulation and provide additional support to help employers – particularly SMEs – to comply.

To-date there is very little detail on the Fair Work Agency beyond the fact that it will bring together in one organisation the enforcement functions of the Gangmasters and Labour Abuse Authority, HMRC's NMW enforcement unit and the Employment Agency Standards Inspectorate.

[16] https://www.cipd.org/globalassets/media/knowledge/knowledge-hub/reports/2024-pdfs/regulation-and-the-labour-market-2024-new.pdf

However, this in itself is unlikely to address the UK's failing labour market enforcement system[17], characterised by under-resourced enforcement bodies and a swamped employment tribunal system, with average waiting times of about a year for claims to be heard.

To address this, there is the need for the development of a comprehensive strategy to improve the UK's labour market enforcement system which goes beyond the establishment of a Fair Work Agency.

This needs to cover the Health and Safety Executive and the Equality and Human Rights Commission, as well as proposals to improve the efficiency of the employment tribunal system. There is also the need for more labour market inspectors, which are resourced at levels significantly below those of most other countries in Europe.

Just as important, there is a need to increase the resources available to Acas to boost its capacity to provide advice and support for employers. We have called for Acas's budget to be doubled from £60m to £120m a year to enable it to play a stronger role advising employers, particularly micro and small firms, that have less awareness of employment law and typically little or no access to professional HR support.

Failure to significantly improve labour market enforcement and improve compliance support for employers will undermine the impact of employment regulation as a way of helping to improve management standards and capability in the UK.

32. How can the UK government improve the interface between the Industrial Strategy Council and government, business, local leaders and trade unions?

The CIPD and Prospect believe there is a case for establishing a Workplace Commission as a means to strengthen social partnership at a national level and to co-ordinate policy making across government departments and relevant agencies on workplace issues material to improving job quality, productivity and growth. It would report to and support the Industrial Strategy Council on these issues.

It would bring together key labour market 'social partner' institutions Acas, Low Pay Commission, employer representative organisations, a range of trade union and workforce representative voices and other independent expert bodies to provide expert policy advice on workplace issues.

Through its members' networks it would have significant reach to businesses and workers across the UK and could promote best practice and support efforts to join up national and regional policy development.

It could also help in the design of new employment regulation through ensuring there is more collaboration and co-development of policy at an early stage, drawing on the perspective of employers, trade unions and other experts within a shared forum.

This type of Workplace Commission would signal that the UK Government wants to strengthen social partnership and highlight the importance of consultation and compromise in dealing with workplace issues and resolving conflict and disagreements. It could help co-ordinate policymaking across government departments and relevant agencies on workplace issues and engage those bodies with the expertise and leverage to improve practice in organisations.

[17] https://www.cipd.org/uk/knowledge/reports/labour-market-enforcement-uk/