Skills, Government Intervention and Business Performance: implications for the Regional Skills Partnership

A policy position paper prepared for *emda*

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June 2011

This document forms part of the *emda* Knowledge Bank

east midlands development agency

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Introduction

The aim of this briefing paper is to provide an understanding of the factors that determine the level of skills in the economy, the level and type of skills demanded by employers, and how these are translated into performance improvements by individual employees. The paper deals with these questions at the national and regional level, at the level of the firm and finally of the individual employee. It then uses this knowledge to identify the range of alternative measures available to policy makers.

Different forms of government intervention to drive up skills

Governments have devised a range of ways of intervening in the economy in order to drive up the skills of the workforce and, through that, improve business performance. In the German economy there are strong institutional supports for a comprehensive apprenticeship system, underpinned by statutory legislation, which provides a system of initial training, lasting between three and five years, culminating in certification at level 3 or equivalent for almost three quarters of all young people. The training combines learning on and off-the-job and provides a very high level of skill for the labour force as a whole. There is a similar system in Denmark, Austria and Switzerland. The existence of a pool of highly skilled labour has encouraged German employers to demand a high level of skill from their employees and use that labour to produce high quality goods and services. Comparative research has shown that the high level of skill among the German workforce is a major explanation for the higher levels of productivity found in German firms and the German economy as a whole[i].

Another approach is to use legislation to compel employers to contribute to training through the use of a training levy or tax. This is done in France, Malaysia, South Korea, Singapore, South Africa, and the province of Quebec in Canada. The funds generated by the levies are used to support training that would otherwise not be done, or as in the case of France, the tax is reduced if the employer can prove that they have already undertaken a given level of training. A similar system

operates in South Korea. In Malaysia the government uses the income from the levy to direct training resources at areas of national skill shortages. Research evidence suggests that in France this approach has been successful in driving up the level of skills in the labour force[ii] but for other countries the evidence is mixed.

In the UK, our approach has been to rely largely on government targets to improve the level of qualifications among individuals and thereby improve the supply of skills. In addition, other measures, such as the Modern Apprenticeship, have been introduced to encourage employers to provide basic training for young people. However, these are voluntary measures aimed at encouraging individuals and employers to engage in training. There is no compulsion as in the German apprenticeship system or the French and S. Korean training tax. Neither are there strong institutional supports for training which would ensure that the majority of school leavers reach level 3, or pressure through taxation to oblige employers to engage in their own support for workforce development within the firm. In addition, our qualification system is complex and largely used by employers primarily as a screening device, and not necessarily as a means of obtaining skills relevant to the firm[iii]. Indeed, there is increasing pressure from some employer bodies (including Sector Skills Councils) for the development of a unitised vocational qualification system which would allow employers to pay for 'bite-sized' units of say NVQs and to move away from funding full qualifications for employees already at work.

Infrastructures to support skills policies

Within the UK there are some institutional factors that encourage training and learning. For example, legislative requirements such as Health and Safety, which establish legally enforced minimum standards, are thought to account for a considerable amount of employer spend on training as reported in national surveys. In addition professional and other regulations also establish minimum standards of performance, such as those in the medical profession and those imposed on the delivery of financial services and similar licences to practice. Where the UK has had some success is through the use of IiP to encourage firms (again on a voluntary basis) to introduce a more systematic approach to its training provision. However, these have not produced the levels of skill found in many of our European competitors[iv].

We have noted the importance of institutional support in countries such as Germany for programmes such as apprenticeship. This also ensures that there is a cadre of experts who can advise employers about workforce development strategies and work with training providers to ensure their courses are relevant and comply with sector defined standards. In Germany, for example, the Chambers of Commerce play this role. At a national level, many European countries also have a dedicated vocational R&D facility (e.g. the BiBB in Germany) which works closely with sectors to define medium to long-term skills needs, design new curricula, and revise and innovate in relation to the training for vocational teachers and trainers.

Policy options at the national level

Although the RSP have no direct remit at the national level there are a number of ways in which it can influence the national system.

- Perhaps the most effective channel is through the RSP 'development dialogues'.
- Another avenue is through the wider representational role on behalf of the regional interest.
- In the UK there is no dedicated R&D facility and much of the development work related to vocational education and training is fragmented (e.g. across SSCs, the LSDA, further and higher education, professional bodies, awarding bodies etc) and piecemeal. The establishment of Centres of Vocational Excellence (CoVES) could play a key role in helping to build a regional infrastructure to support the skills agenda.

Determinants of the level of skills demanded by employers at the regional level

In the regions, the *level of skill* demanded by employers and the level of learning and training that takes place varies significantly. This is determined by a number of factors but of major significance are the product market strategies of the employers in the regions. The market within which the company operates, whether local, national, or international and the product market strategy, whether high value-added or low value-added, are two of the main determinants of the *level* of skill demanded within a company.

If the company operates within highly competitive international markets, producing high value-added, quality products using a sophisticated technology, then they demand high levels of skill from their employees.

This is the case in the knowledge intensive industries, e.g. pharmaceuticals, information and computer-based industries, advanced engineering and business services. In these sectors, the skills of employees frequently form the main source of competitive advantage in the market (see Box 1.).

If the firm operates in a product market with a low value-added strategy, producing standardised items or services at low cost, then the demand for skills from their employees is low. This is frequently the case in the food processing industry, hospitality and fast-food industries among others[v]. There the emphasis on low cost production leads to narrow job definitions requiring low levels of skills so that the cheapest form of labour can be used.

At the regional level, the demand for skills is made up of the combined effect of these factors. In the East Midlands, the demise of engineering and other skilled manufacturing industries has resulted in a decline in the demand for level 3 skills, "a hollowing out of the middle" of our manufacturing industry. This has left a small demand for higher level skills in the more higher value-added industries and a strong growth in demand for low level skills in the lower value-added industries. One consequence has been that the East Midlands fell from third from top in the UK regional skills league table in the early 1990s, to third from bottom in the late 1990s, as the proportion of jobs requiring high levels of skills dropped from 17 to 11% and those requiring the lowest level of skill rose from 28 to 36%[vi]. The problem in the East Midlands is not so much one of low levels of qualifications in the labour force as the low level of demand for skills from employers.

There are ways in which public regulation can influence the product market strategies of firms. It does this by specifying minimum standards of service delivery thereby reducing the ability of employers to use untrained, low cost labour as a source of competitive advantage. Thus, Health and Safety regulations in the electrical contracting industry help ensure that customers will pay a premium because the costs of getting health and safety wrong is higher than the premium for getting the quality of the product or service right. In the utilities, the imposition of guaranteed customer service standards by the regulators serves as a significant support for employers who pay attention to training because it limits the extent to which untrained labour can be allowed to undermine standards of customer service. This allows firms to compete on the basis of the quality of their service and not just on cost.[vii] In the construction industry the use of public procurement policy to specify that employees

of contractors must have the skill passport also illustrates the possibilities of procurement policy as a means of increasing the demand for skills.

Policy options at the regional level

At this level the RSP can have a more direct impact on the demand for skills.

- In the area of procurement the there is scope for the RSP to champion a more consistent approach across the public sector to ensure that it makes a significant impact on the demand for skills. While such an approach would need to ensure that it complies with current regulations for competitive bidding, there is considerable scope for extending the use of the purchasing power of the public sector to help ensure that companies bidding for contracts meet minimum quality standards and take account of skills outcomes. In this way it would help shape product markets in the region and drive up the demand for skills.
- Cluster policy is another means through which the RDA could drive up the demand for skills, for example by giving priority to those industry sectors which generate a demand for high level skills.
- The public sector could also play a much more prominent role in setting an example in demonstrating a commitment to skills and training. For example, the public sector has recruited far fewer individuals to the Modern Apprenticeship programme than private companies.
- The recent decision to give Regional Development Agencies (RDAs) the status of statutory consultees in planning decisions with economic implications could be valuable for their skills agenda. RDAs could, for example, recommend that construction companies make a contribution to increasing the stocks of related skills in the area in which new buildings are being planned.

Drivers of training/ learning and performance in the firm

In this section we look at individual firms to identify the factors that affect *the acquisition of skills* and how that translates into *performance*. Recent research has identified a number of factors that drive employers to increase the demand for skills and workplace learning and through that the performance of the company. Here there are two main lessons for policy makers. One is that the demand for skills and learning in the workplace is a *derived demand*. The other is that *the most effective form*

of learning for improved performance is that which takes place in the workplace[viii].

The demand for skills is a derived demand

Extensive research has revealed that there are two main components which drive the demand for skills within firms. The first is the product market strategy of the firm which affects the demand for skills in a fundamental manner as stated above[ix]. If the company is in a high value-added market, producing sophisticated products or services tailored to the needs of the consumer then there is constant pressure on employees to stay up-to-date and their skills represent a significant part of the firm's competitive advantage (Box 1)[x]. If the firm is in a low value-added product market, producing a standardised, mass produced product or service where the emphasis is on cost reduction, the demands for skills is low and there is no pressure for skills upgrading or improvement (Box 2).

Box 1. Media Marketing. This company produces one-off marketing campaigns for its clients. These are created by teams of highly educated professionals who negotiate with the client over the form of the campaign and produce the contents. This requires knowledge of the requirements of the client, the latest developments in the profession, the use of different forms of media, the financial position of their own company as they negotiate the contracts and of its business strategy and objectives. All this involves continuous learning both from outside the company in terms of developments in their profession and the characteristics of their clients, but also from other colleagues within the company. Here the product market strategy requires the continuous development of skills

Box 2. Confectionary Co. This company produces a limited range of confectionary items marketed through retail outlets. The product has changed little over the last few years as has the way in which it is mass produced. The majority of operators work on lines dedicated to the manufacture and packaging of specific items of confectionary. Their jobs take only hours to learn and once they have achieved an appropriate level of speed, in say packaging then there is little or nothing to learn. They require no qualification and have no opportunity for any further learning. Here the product market strategy requires only minimal skills.

The other factors which affect the demand for skills and learning in the firm is the use of management practices and the organisation of the workplace[xi]. Where employers have introduced high performance working practices such as self-managed work teams, multi-skilling, TQM and continuous improvement and supported these with enhanced opportunities for training and appropriate rewards for improved performance, then we see the emergence of what have been termed

expansive forms of learning[xii]. Here employees are constantly challenged to increase their involvement in training and learning (Box 3).

Box 3 Components Co. This company had mass-produced plastic components for a number of different manufacturers in the car and consumer goods industries. Work was organised in terms of production lines dedicated to specific products. It then introduced cellular production using self-managed teams to organise the flow of production and to link directly with the customer.
As opposed to performing one simple task, under close supervision, on an assembly line, workers now had to work in teams, organise the flow of the work, undertake a range of job tasks, solve production problems and ensure that the products were delivered on a just-in-time basis to the customer.
From requiring little or no learning they now had to master the financial implications of their decisions regarding the organisation of their work flow, acquire an understanding of the whole production process, acquire problem solving and teamworking skills and the ability to relate effectively to customers.

On the other hand where employers use more traditional management methods, where supervisors exercise strict control of their jobs, where workers know little or nothing about the performance of their company, where they perform the same routine tasks everyday, where they exercise little or no discretion in the performance of their jobs and are paid by the piece, this produced what Fuller and Unwin (2003) have termed a 'restricted learning environment'. Here learning is less likely to be shared, is tightly bounded to specific on-off occasions, and might even be used subversively by employees to gain some feeling of control.

Policy options at the firm level

There are a number of areas which provide opportunities for the RDA and RSP.

- In the field of inward investment the RDA can seek to attract companies which operate in high value-added, knowledge intensive product markets, thereby driving up the demand for skills in the region. There is already evidence of some success by EMDA in attracting companies which operate in such markets but more could be done by targeting employers competing in the high value-added global markets. This is important because such companies not only pay higher wages but are also exemplars of leading edge practices in the field of workforce development[xiii].
- Once having attracted such companies then there is much that can be done in ensuring support for MNCs and indigenous companies in maintaining the skills of their labour force and in helping them move higher up the value chain. Countries such as Finland and

Singapore have established good practice in this area which may have lessons for EMDA[xiv].

- Business Services East Midlands provides a means of delivering advice to firms on resolving business problems and moving up the value-chain and potentially on the use of modern, high performance practices.. Here again the RDA has a potentially powerful tool with which to drive up the demand for skills.
- Finally, as an important employer in its own right, the RDA and RSP could set an example to other public and private sector employers through adopting high performance working practices. These would have the potential to improve the level of performance and certainly drive up the demand for skills.

The most effective form of learning for improved performance is that which takes place in the workplace

When we look at how learning is transformed into improvements in performance, recent research is highlighting the fact that the closer the learning is to the workplace the more effective it is in improving performance. When trainers and managers are asked which of the various training techniques are the most effective, the results invariably point to the fact that the closer the technique is to the workplace the more effective it is. Thus coaching is more effective than formal training courses but most effective of all is structured on-the-job training[xv]. When employees are asked which is the most effective way of improving performance then formal education and training courses are seen by them as less effective than informal workplace learning – the most effective of all[xvi]. Box 4 provides an example of just how this can work in the case of a small hairdresser[xvii].

Box 4. Hairdressing Co. The owner of this small company is a member of an exclusive hairdressing employers' club where they exchange experience and knowledge about good business practice. Staff have targets which encourage them to improve their performance through the acquisition of skills on-the-job, from experience and from each other. These are documented in a Salon Manual and further learning is supported through the use of formal courses. Staff are encouraged to learn from other sources including magazines, TV programmes and experiences at other Salons. This learning is shared within the Salon either by one stylist observing another or the informal sharing of ideas and by the teams and owner discussing ways to improve the image and performance of the Salon as a whole (staff are paid to use other Salons and they then share their experience with other members of the team and identify how this knowledge can be used to improve their own performance). The acquisition of greater skill is rewarded through payments and movement up the career ladder within the Salon.

Policy options at the level of workplace learning and performance

Here again there are a number of areas where the RSP could explore potential policy options.

- First, and most obvious, by ensuring that the constituent members of the RSP were adopting best practice in the field of workplace learning.
- By raising awareness among employers of the importance of work design and workplace learning in improving performance. It could do this through identifying good practice among the leading edge employers and exploring ways to cascade that down the relevant industries.
- Finally, to build the capacity within the region to make the best use of workplace learning as a means of improving business performance. It could do this through improving the knowledge of staff in the colleges and private consultants who are used to advise companies on the most effective management practices and techniques for workplace learning.

Ways of intervening to raise skill levels and performance

Given this knowledge, what levers do governments have to increase the level of skills and performance in the workplace? Our analysis has pointed to three levels of intervention[xviii].

National

- The use of legislation to strengthen employment preparation (e.g. German apprenticeship) and raise the stock of skills in the labour force.
- The use of social partnerships (as seen in several European countries) to encourage shared commitment from government, employers and trade unions to common goals vis-à-vis skills.
- The use of financial incentives such as a training levy or tax to push employers into more training. This is already used in some industries in the UK, e.g. construction and engineering but also used more extensively in France and South Africa.
- Improving the qualification level of the labour force (UK, New Zealand).

Organisation/Firm

Improving the demand for skills from employers

- Use of inward investment in the form of foreign multi-national corporations competing in high value-added product markets to increase the demand for skills (Singapore).
- The development of high value-added clusters, e.g. bio-technology, aerospace etc (Singapore, South Korea, Taiwan).
- Provision of help and advice to companies to utilise high performance working practices to raise skill levels and learning in the workplace (Finland).

Improving the support for workplace learning

- Advice and help for employers on training provision.
- Advice and help on how to support workplace learning most effectively, e.g. expansive learning.
- Provision of specialist help for SMEs in management training, workforce development.
- Help in making informal learning more effective.

Individual

- Advice on availability and suitability of formal education/training provision (note: only level 3 qualifications have a significant impact on earnings)
- Advice and help on making informal learning more effective in improving performance (perhaps through IiP?)
- Advice and help on how to maximise individuals' existing learning achievements as a basis for acquiring more formal qualifications.

Conclusion

While the UK policy of focussing on improving the supply of qualifications is useful, its likely impact on improving skills within the organisation and on improving business performance is small. If we wish to seek improvement in the *level of skills* demanded by employers, in their *use of skills* and in the ability of organisations and individuals *to improve performance* then we have to look at the other interventions cited above which impact more directly on the firm/organisation and the performance of individuals within it.

It is clear from this paper that RSPs have to make their plans and set targets within a complex economic, political, cultural and social context, the landscape of which is partly shaped by forces external to the region. Having some understanding of those external forces will be important in

terms of deciding the level and nature of possible interventions to achieve regional goals.

Key areas of possible intervention for the RSP are:

1. At the national level to utilise existing channels to government to press the importance of regional skills issues.

2. At the regional level:
    - To develop a coherent procurement policy with the objective of pushing up the demand for skills.
    - Explore the use of cluster policy to drive up the demand for skills.
    - Make use of public sector employers as exemplars of high performance working and supporters of the MA.

3. At the level of the firm to:
    - Use inward investment to drive up the demand for skills.
    - Use the Business Links advisory service to help firms move up the value-chain and introduce modern high performance working practices.
    - Ensure that the RSP are exemplars in the field of high performance working practices and skills training.
    - Support the maintenance and improvement of skills in MNCs and leading edge employers enhance the skills base of the region.

4. At the level of the workplace to:
    - Ensure that members of the RSP adopt best practice.
    - Raise awareness of best practice among employers.
    - Build the capacity of consultants in the region to deliver effective advice on workplace learning practices.

[i] See for example the work of researchers at the National Institute of Social and Economic Research, e.g.:Mason, G. van Ark, B and Wagner, K. (1994) 'Productivity, Product Quality and Workforce Skills: Food Processing in Four European Countries', *National Institute Economic Review*, (February) 62-82

[ii] See Greenhalgh, C. (2002) 'Does and Employer Training Levy Work? The Incidence of and Returns to Adult Vocational Training in France and Britain', *Fiscal Studies*, Vol. 23: 2, pp. 223-263

[iii] For a detailed discussion of the use of vocational qualifications see Unwin, L., Fuller, A., Turbin, J. and Young, M.(2004) '*What determines The Impact Of Vocational Qualifications'*, DfES, Research Report RR522.

[iv] These have been well documented and inform the government's skill strategy, see *21st Century Skills: Realising Our Potential*. Cm 5810, July 2003, HMSO.

[v] Wilson, R and Hogarth, T (Eds) (2003) *Tackling the Low Skills Equilibrium: A Review of Issues and Some New Evidence*, London: DTI.

[vi] Felstead, A. (2002) 'Putting skills in their place: the regional pattern of work skills in Britain', in Evans,K., Hodkinson, P. and Unwin, L. (Eds) (2002) *Working to Learn: transforming learning in the workplace*, London: Kogan Page, pp163-186.

[vii] This and other examples of how regulations structure markets are discussed in Deakin, S., Hudson, M., Konzelmann, S and Wilkinson, F. (2002) *Pheonix from the Ashes? Labour-Management Partnerships in Britain,* Centre for Business Research Cambridge.

[viii] See Ashton, D and Sung, J. (2002) *Supporting Learning for High Performance Working*, Geneva: International Labour Office.

[ix] For recent evidence on this see Green, F., Mayhew, K. and Molloy, E. 'Employer Perspectives Survey 2002, Department for Education and Skills, Research Report and Mason, G. (2004) 'Enterprise Product Strategies and Employer Demand for Skills in Britain: Evidence from the Employers Skill Survey', SKOPE Research Paper, forthcoming.

[x] These case studies have been taken from recent research conducted by the Centre for Labour Market Studies, University of Leicester. The companies have been made anonymous.

[xi] Much of this evidence is summarised in Ashton, D. and Sung, J.(2002) *Workplace Learning for High Performance Working*, Geneva: ILO, see also Smith, A., Ockowski, E, Noble, C. and Mcklin, R. 'The impact of organisational change on the extent of training in Australian enterprises', (2004) *International Journal of Training and Development*, 8:2, 94-110.

[xii] Fuller, A. and Unwin, L. (2003) Learning as apprentices in the contemporary UK workplace: creating and managing expansive and restrictive participation, *Journal of Education and Work*, 16:4, pp.406-427.

[xiii] OECD (2002) *Measuring Globalisation. The Role of Multinationals in OECD Economies,* Vol 1. Paris: OECD

[xiv] See Ashton, D., Sung,J. and Raddon, A. (2003) *Raising Employer Demand for Skills: Lessons from Abroad,* London: DTI

[xv] The findings are drawn from the CIPD Annual Surveys of Training and Development in Britain. These are surveys of training managers conducted by CLMS and published annually by the Chartered Institute of Personnel and Development, London.

[xvi] The findings on the views of employees are to found in Felstead, A. Fuller,A., Unwin, L. Ashton, D., Butler,P., Lee, T. and Walters, S. (2004) 'Applying the survey method to learning at work: A recent UK experiment', CLMS, University of Leicester.

[xvii] See Fuller, A. Ashton, D., Felstead,A., Unwin, L., Walters,S. and Quinn, M. (2003) *The Impact of Informal Learning at Work on Business Productivity*, DTI

[xviii] The countries named in brackets are where good practice has been established. Discussions of some of these can be found in Ashton, D. (2001) 'Lessons from Abroad', paper prepared for the Cabinet Office, PIU project on Workforce Development, and also in Ashton, D., Sung, J. and Raddon, A. (2003) '*Raising Employer Demand for Skills: Lessons from Abroad'*, London: DTI.