

Ipsos MORI



# Non-compliance with the National Minimum Wage

Research report prepared for the LPC

03 February 2012

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# Executive summary

# Executive summary

## Introduction

The Low Pay Commission (LPC) commissioned Ipsos MORI and Community Links to undertake research with employers deliberately non-compliant with the National Minimum Wage (NMW). The research aimed to foster an understanding of how and why businesses pay below the NMW and to shed light on the impact of the recession on employment practices. The study was conducted in two stages, including:

- **A literature review** looking at existing research on NMW compliance and the informal economy; and
- **Qualitative research**, comprising 18 face-to-face in-depth interviews with employers deliberately not paying the NMW to at least some of their staff.

## Employer characteristics

All employers interviewed as part of this research were aware that they were paying at least some of their employees under the NMW rate.

The type of employers interviewed matched a great deal of previous research on non-compliance with the NMW and with informality more generally, particularly that done by the LPC on the NMW, in that businesses were smaller, tended to be more transient, often employed many part-time workers and had a high staff turnover. The employers interviewed were typically drawn from the catering, hospitality, hair/beauty, retail and construction sectors i.e. those which are known for being low paying industries and sectors where informal working practices are common.

Most of the businesses we spoke to in the research had been set up relatively recently. Turnover was generally low with some businesses reportedly making little or no profit. Interviews were conducted with both men and women, with most employers concentrated in urban environments.

## Awareness of the NMW and attitudes towards it

In general, awareness of the NMW was high, although knowledge of the specifics was low with much of employers' information on the subject being gathered via word-of-mouth. No employers interviewed were able to give the exact amount of the NMW, with most assuming it would be higher than in fact it is, at around £6.50. This was in spite of the fact that well publicised and regular events, such as the annual rises in the NMW rates, were something that employers were aware of, although most said that it made no difference to the way that they paid their employees.

Most employers felt that their employees were at least aware that they should be paid a higher rate. A minority of employers, however, believed that their employees were unaware of the NMW rates. This was most prevalent among workers who had recently arrived in the UK.

Employers emphasised the complicit nature of the underpayment, with most saying that their workers took on the job knowing what they would be earning, and thus perceiving that they were happy with the wages that they were getting. This was particularly felt to be the case since the economic downturn given the demand for jobs. However, even for these employers there was a limit under which they thought it would be unacceptable to pay

workers without being exploitative. For many, this was around £4 per hour. In saying this, employers were keen to distance themselves from ‘gangmasters’.

Although employers said that they could see a purpose to the NMW, there were some who were cynical as to the reasons for the introduction of the legislation, feeling that it was more a way of ensuring that the government receives all the taxes and National Insurance Contributions (NICs) owed to it, which would not happen if workers were paid cash-in-hand. Ultimately, however, most employers saw the NMW as being a worthwhile piece of legislation but one that was not applicable to their own business. Consequently, many treated the NMW rates as a guideline rather than legally enforceable.

That employers regard NMW rates as a guideline was largely driven by the fact that most of the employers who took part in the research were struggling to keep their business afloat. Previous research has suggested that the key drivers for non-compliance with the NMW are competition, market saturation and business survival<sup>1</sup>. These factors were all heightened by the current economic situation, with several employers saying that profit and wage rates had both dropped significantly over the past few years.

Some employers justified the balance between profit and compliance by paying employees according to the amount of profit they generated in a particular work period. As most businesses did not have a significant reservoir of funds, this often worked on a short-term period with an employee receiving 20% of the profit from a week of trading, for example.

## Non-compliance with the NMW

Employers gave two main reasons for their non-compliance with the NMW; those who said that they could not afford to pay and those who said that they were unwilling to pay. The latter group are interesting as they have myriad reasons to justify why they do not believe that they should pay. These included:

- **The need to be competitive.** This was particularly evident in those cases where employers perceived that other businesses had a competitive advantage, such as the need for fixed base retailers to compete with those working on market stalls.
- **Employee demand for work.** Employers stated that they came into contact with a large number of workers prepared to work for below the NMW. Because of this, employers did not feel it was incumbent on them to pay the NMW.
- **The lack of an incentive.** Some employers were concerned that paying a flat rate wage with no option to add to it (due to low profit margins) would not incentivise their workers. This was true both of those who paid workers on a piece rate basis and those such as restaurant workers who felt that productivity and performance improved as a result of employees realising their wages could be topped up with tips if they performed well.
- **Illegal working.** Some employers used only those workers who they knew did not have a valid permit to work in the UK (or were not allowed to work the number of hours they were contracted for) or those who were also claiming benefits. In this case, employers believed they were doing these workers a favour by hiring them, giving them access to money and skills they otherwise would not have had.
- **Additional benefits.** Many employers described the extra benefits they were able to offer their workers, such as travel, meals, free access to the trade that they worked in

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<sup>1</sup> Ram, Edwards and Jones, (2004), ‘Illegal immigrants and the Informal Economy’, De Montfort University and the University of Warwick

(such as construction work being carried out at cost), or the fact that they were giving people with no skills and experience the training to potentially get a job elsewhere. Indeed, many employers thought that were they to be inspected by a NMW enforcement officer then the financial impact of these additional perks would be taken into account.

- **The nature of employment.** There was much discussion about the idea of ‘proper’ workers and a ‘proper’ job. Many of the employers who took part in the research were employing people with no or low level qualifications to undertake unskilled work, often part-time. They did not see these jobs as ‘proper’ jobs and did not class them as being covered by the legislation in the same way as a typical 9-5 job in an office. Often this was compounded by the fact that very few employers had formal contracts with their employees.

## Experience of informal working

The research identified three main triggers which encourage employers to work informally. These primarily occur during the early days of operating a business, which indicates that more support may be needed at this crucial early stage. The triggers comprise:

- Evolution from a hobby to a business;
- A life changing event (such as a redundancy) leading to a business start-up; and,
- Inheriting or buying an established informal business.

When setting up a business, NMW was low on the hierarchy of things that should be paid, with business rates, registration fees and VAT all considered more important by employers. Although not explicit in the way that they discussed NMW, this ranking was largely dependent on whether they felt they would get caught if they were not complying. As few believed they would be inspected for non-compliance with the NMW, this was not an effective spur for them to ensure they acted in accordance with the legislation.

There were also varying degrees of informality among those businesses who were non-compliant, ranging from those who were wholly unregistered (‘ghosts’) to those who operated partially legitimately with a certain percentage of the work not going through the books. There were also a significant number of employers who were non-compliant only with the NMW.

Once businesses began operating informally they had to adopt a range of techniques to help them avoid detection. This included falsifying business records, either using an accountant to do this or by keeping two sets of books or recording hours differently to those that were actually worked. Some simply relied on keeping very few records for the business, feeling that this would make it difficult to prove that they were non-compliant.

## Employer views on non-compliance penalties

Whilst all of the employers interviewed for this research were aware that they were acting illegally, awareness of enforcement activity and non-compliance penalties was low. There was an assumption that there would be a fine to pay and this was considered reasonable by the employers we interviewed. However, views were polarised on whether the fine was fair, with some feeling that a lump sum of £5,000 would cause them to cease trading, while others suggested that such a fine would not cause them enough financial hardship to consider compliance.

Employers assumed that the likelihood of them being caught for non-compliance with the NMW was very low indeed. For instance, none of the employers had heard of anyone they knew experiencing a NMW inspection and, as such, the assumption was that in order to be subject to an investigation staff would have to complain about their wages. Employers were confident that their staff would not complain as they were happy with the additional 'perks' they got from informal working, were family or friends of the employer, or were too concerned about the potential of losing their job.

Employers were also often unaware of the responsibility they had to keep adequate records. Because of this, they assumed that even were they to be inspected, it would be difficult to prove that they were non-compliant as there would not be the evidence to support such a claim. It is possible that should it be known that the burden of proof for correct payment rests with the employer rather than the employee or the enforcement officer, employers would be more concerned about the prospect of a non-compliance inspection.

## Recommendations

From an analysis of the findings from this research, we have been able to develop a number of recommendations which may help improve levels of compliance with the NMW going forward. These should not be viewed in isolation but, instead, should be employed in tandem if an impact is to be felt. Recommendations for change include:

### Communications

- The need for a communication/enforcement campaign to raise awareness of penalties – utilise intermediaries and the press, this could consider the wider nature of informal working as well as just NMW compliance;
- Monitor how messages are communicated – in doing this it would be useful to consider applying the MINDSPACE framework which is already in use by HMRC;
- Communication to address the issue of recording hours, particularly in low pay sectors. Many employers are not aware that they have a duty to record hours accurately and that the burden of proof for correct wage payment rests on them. More information is required to ensure that employers are aware of the importance of keeping accurate records.

### Working practices

- SMEs would benefit from receiving templates and examples of best practice for record-keeping, as (as mentioned above) employers are often unaware of their statutory obligations;
- Early intervention and more intensive monitoring of SMEs may be required to ensure that businesses become formalised during the crucial business set up period;
- Greater tax breaks or financial aid for start-up businesses to encourage formality and to prevent businesses becoming entrenched in informal working operations.

### **The inspection process**

- Provide further information for employers on how evidence is gathered during an inspection so that they are aware of the evidence of correct payment that they will have to produce;
- Undertake frequent spot-checks in non-compliant sectors to increase awareness of non-compliance inspections;
- Align the processes for businesses operating informally e.g. work in conjunction with local health & safety inspectors as businesses are often operating informally in more than one area.

### **Working with employees**

- Empower employees so they know their rights and how to complain; and
- Explore the experiences of employees also complicit in the process to find out how best to encourage them to work in the formal sector.



# 1. Introduction

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The LPC commissioned Ipsos MORI and Community Links to undertake research with employers deliberately non-compliant with the National Minimum Wage (NMW). The research aimed to foster an understanding of how and why businesses pay below the NMW and to shed light on the impact of the recession on employment practices. The research also set-out to ascertain how non-compliance with the NMW links with other elements of operating informally as a business. The study was conducted in two stages, including:

- a literature review looking at existing research on NMW compliance and the informal economy; and
- qualitative research, comprising 18 face-to-face in-depth interviews with employers deliberately not paying the NMW to at least some of their staff.

This report contains the findings of a study, conducted by the Ipsos MORI Social Research Institute and Community Links on behalf of the Low Pay Commission (LPC), amongst employers who pay at least some of their employees below the National Minimum Wage (NMW).

## 1.1. Research objectives

There were three main research objectives guiding this programme of work. They were to:

- explore understanding of, and attitudes towards, paying the NMW and paying below the NMW and how, if at all, these views have changed with the changing economic circumstances;
- develop more of an understanding as to how and why employers are paying below the NMW, including exploring entry points to working in the informal economy and the impact that this has on the lives of both employers and employees; and
- ascertain how non-compliance with the NMW links with other elements of operating informally as a business.

## 1.2. Methodology

This study was comprised of two parts, a literature review followed by eighteen face-to-face in-depth interviews with employers who were deliberately evading paying the NMW.

### Literature review

We commenced this study by conducting a literature review to gain a thorough understanding of previous work on employer attitudes to and awareness of the NMW. By doing this we could ensure that this work complemented the body of evidence already in existence rather than simply replicating that which is already known. Ipsos MORI reviewed 21 reports relating to the informal economy and the National Minimum Wage, including government, policy and academic literature and reports by think tanks and charities (such as those by our partner organisation in this study, Community Links). Documents were selected using a two-pronged approach: firstly by identifying relevant published studies by Ipsos MORI, Community Links and the Low Pay Commission, and secondly, by conducting key

word searches on the internet to identify relevant and reliable sources. A full list of documents can be found in Appendix A of this report.

The results from the literature review informed the second phase of the research, enabling the development of hypotheses to test in the interviews. The review also helped to place the results in a wider context.

### **Qualitative interviews**

For this study we conducted 18 face-to-face depth interviews with employers who were deliberately evading paying the NMW. The research was focussed on deliberate evasion rather than inadvertent errors, as the principal objective of the research was to understand the opinions and influencing factors behind the *conscious decision* not to pay employees the NMW.

Due to the sensitive nature of the topic, it was considered necessary to conduct face-to-face interviews. This approach enabled us to build a better rapport with the participants, which meant they were more likely to open up and provide rich detail about their experiences.

Employers were recruited jointly by Ipsos MORI and Community Links, using specialist qualitative recruiters, who are skilled in targeting hard-to-reach audiences, with strong links within the local community. The decision was taken to geographically cluster the interviews in two areas, London and Nottingham. Concentrating the interviews in this way allowed us to build up a good understanding of the issues facing employers in each locality and to pull out geographical differences where these existed.

Recruiters were instructed to try and find employers from a range of industries, with the aim of achieving a good spread on company size, turnover, number of employees and age of business. In order to aid recruitment, 'snowballing' approaches were also allowed, as previous studies have shown that this is a useful and time efficient way to recruit individuals associated with the informal economy. Snowballing is where one participant is asked if they are able to refer anyone they know who is in a similar position who may also be eligible for interview (in this case those who are paying employees below the NMW). However, measures were put in place for this project to ensure that each snowballing chain did not exceed the recruitment of three individuals in total, as it was important that all participants were not from the same social network. The characteristics of employers recruited and interviewed are discussed in Chapter 2.

Interviews were conducted between 13<sup>th</sup> June and 25<sup>th</sup> July 2011. The interviews lasted between 45 minutes to an hour, and were recorded digitally where participants consented.

The nature of the research meant that participants may have held reservations about taking part, since in agreeing to an interview, they were admitting to breaking the law. Participants were therefore offered reassurances that they would not be identified, exposed or reported to any authority as a result of their participation in the research. It was also stressed that Ipsos MORI and Community Links abide by the MRS Code of Conduct and are bound by industry regulations to protect their anonymity and confidentiality. The only details that needed to be provided for an interview to take place were a first name and contact phone number. Additionally, to further put respondents at their ease, they could suggest a location for the interview to take place in.

To ensure we covered all the relevant issues with employers, interviews were structured with the use of a discussion guide which was designed in collaboration with the LPC. The discussion guide is included in Appendix B.

### **1.3. Presentation and interpretation of data**

This report is structured into five sections, reflecting five distinct aspects of the findings:

**Chapter 1: Introduction and background** – provides background and details of how the study was conducted.

**Chapter 2: Employer characteristics** – provides background context for the respondents and looks at the similarities and differences between those interviewed.

**Chapter 3: Awareness of the NMW and attitudes towards it** – explores knowledge and awareness of the NMW as well as the channels of communication used by employers.

**Chapter 4: Non-compliance with the NMW** – examines the reasons behind non-compliance and the perceived impact on employees.

**Chapter 5: The journey towards informal working practices** – places the non-compliance within wider informal behaviours and uses case studies to highlight employer journeys to informality.

**Chapter 6: Employer views on non-compliance penalties** – looks at awareness of the NMW enforcement regime and the effectiveness of this as a deterrent to non-compliance.

**Chapter 7: Conclusions and recommendations** – offers policy recommendations and considerations for the LPC to take forward.

It is important to note that the findings of this report are not statistically representative of the views of employers (or even employers who underpay the NMW) in general. Qualitative research is designed to be illustrative, detailed and exploratory, providing insight into the perceptions, feelings and behaviours of people rather than conclusions from a robust, quantifiable valid sample. As far as possible we have tried to state the strength of feeling about a particular point, although in some cases it has not always been possible to provide a precise indication of the prevalence of a view due to the small numbers of participants in the group under discussion.

Where verbatim quotes are used in the report, they have been anonymised and attributed with relevant characteristics such as gender, industry sector and interview location. The perceptions of participants make up a considerable proportion of the evidence in this study, and it is important to remember that although such perceptions may not always be factually accurate, they represent the truth to those who relate them.

## 1.4 Acknowledgements

Ipsos MORI and Community Links would like to thank Gerry Franks and Tim Butcher at the Low Pay Commission for their help with this study. We would also like to thank all of those who participated in the research, without whom this report would not have been possible.

## 2. Literature review

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### 2.1 Background

Non-compliance with the NMW places a business within the ‘informal economy’, a term which has multiple definitions, ranging from casual moonlighting, working cash-in-hand or fraudulently claiming benefits right through to tax evasion and crime. For the purposes of this research we intend to use the definition set out by Community Links and the Joseph Rowntree Foundation which defines informal working as work which is “unregistered by, or hidden from, the state for tax, benefit and/or labour law purposes, but which are legal in all other respects<sup>2</sup>”.

Numerous studies have looked at the informal economy but relatively little is known about the impact of the NMW on the informal sector, or why some low paying sectors are more susceptible to informal working. Consequently, the LPC commissioned Ipsos MORI to conduct a literature review, followed by exploratory qualitative research to understand why and how businesses pay below the NMW, the impact the recession has had (if any) on employment practices, the sectors most likely to be non-compliant, and whether businesses who do not comply with the NMW also operate informally in other ways, such as not paying Tax (through PAYE) and National Insurance.

The informal economy is difficult to size due to its hidden nature, but it is estimated to account for approximately 12.3% of GDP within the UK, which translates to roughly £120 billion. Although there is no official data on how many workers are employed within it, the TUC estimated in 2008 that at least 2 million workers were involved (although others suggest this is even higher), with just under half of all such work taking place within construction (including home repairs and maintenance), just under a quarter in consumer services such as hairdressing, and 14% in manufacturing<sup>3</sup>. Informal working is therefore extremely important to the UK economy.

### 2.2 The Impact of the NMW on employers

The NMW was introduced in April 1999 and is a legal right that covers almost all workers in the UK. It was introduced to prevent unduly low pay and to create a level playing field for employers. There are four rates of pay, established on the basis of recommendations from the LPC. The rates at the time of conducting the research (summer 2011) are outlined in the table below, however, it is important to note that since 01 October 2011 these rates have increased. Details of the revised rates are also shown in the table below<sup>4</sup>.

**Table 1: National Minimum Wage rates**

Category	NMW Rate (per hour) During fieldwork	NMW Rate (per hour) Since October 2011
Workers aged 21+	£5.93	£6.08
18-20 year olds	£4.92	£4.98

2 Community Links/Joseph Rowntree Foundation (2006) People in Low-Paid Informal Work; Need not Greed, Policy Press

3 Community Links (2009), ‘The Informal Economy’, Social Change Series 3 [p7]

4 <http://www.businesslink.gov.uk>

16-17 year olds	£3.64	£3.68
Apprentices	£2.50	£2.60

Although the NMW is a legal right, not all businesses have adopted it in practice. Research carried out by Ram, Edwards, Gilman and Arrowsmith (2001) into the introduction of the NMW and the impact upon small businesses found that implementation had three main effects:

- **'Business as usual'**: Firms made only minor adjustments to practice and considered the implementation straightforward and low cost. In some cases businesses passed on costs to consumers. These businesses tended to be 'legitimate', well-run and profit-making as opposed to struggling businesses or those on the periphery of informal practices.
- **Businesses implemented new working practices**: Businesses were 'shocked' into changing practices, increasing their focus on developing more efficient labour-management practices in order to grow or develop the business. Crucially, these businesses had the basic existing infrastructure in place in order to be able to adapt to the requirements of the new legislation.
- **Shift towards illegality**: The authors also found examples of certain businesses, especially those previously existing at the 'lower-end' of the market who, as a consequence of the introduction of the NMW legislation, moved *'towards the illegal and grey areas of business or indeed out of the market entirely'*<sup>5</sup>.

The 2011 LPC Report<sup>6</sup> on the NMW found similar evidence. Whilst the report states that the implementation of the NMW has greatly affected the distribution of earnings, it has not had a significantly adverse effect on employment. Instead, businesses have coped with the introduction of the NMW by, among other things, changing pay structures, reducing non-wage costs and increasing prices, as opposed to underpaying employees.

In Ram, Edwards, Gilman and Arrowsmith's study of small firms and the impact of regulatory change, researchers found evidence that the introduction of the NMW had 'tipped' previously 'legitimate' businesses into illegal work practices, such as not paying workers the NMW rate. This was particularly the case for businesses that relied on payments based on 'piece-work'.

However, other businesses in the same study actually saw improvements as a result of the introduction of the NMW (as well as other measures contained within the Working Time Regulation Act (1998)). The key differences between the two types of businesses (those who grew as a consequence of the NMW and those who 'tipped' into illegality) were attributed to the existing infrastructures that each had in place prior to the introduction of the legislation. For businesses least prepared, the years of operating as an informal business left *them "ill equipped, both in terms of financial and human resources, to consider alternative ways of handling the competition"*<sup>7</sup>.

For small businesses the introduction of the NMW therefore polarised the divide between the formal and informal sectors of the economy, with many companies taking actions such as undercounting hours of work by employees in order to appear to comply or by failing to

5 Ram, M, Edwards, P, Gilman, G & Arrowsmith, J, (2001), 'The Dynamics of Informality: Employment Relations in Small Firms and the Effects of Regulatory Change', University of Warwick

6 Low Pay Commission, (2011), 'National Minimum Wage' [p66]

7 Ibid

implement the NMW to staff at all<sup>8</sup>. The NMW was essentially a ‘tipping point’ into informality for many businesses, and compliance was largely affected by the infrastructure of the business, and its ability to accommodate changes.

### 2.3 Sectors associated with Non-Compliance of the NMW

Although it is difficult to obtain exact estimates of the extent of non-compliance with the NMW, it is found to be more prevalent in certain business sectors. Data derived from the Government’s non-economic evidence to the LPC provides an insight into the types of sectors that feature most prominently in relation to complaints around non-compliance with the NMW. In 2010/11 HMRC received nearly 2,000 complaints and identified over £3.8 million in arrears for over 23,000 workers. The table below shows the number of closed complaints via sector in 2010/11<sup>9</sup>.

**Table 2: Complaints closed by trade sector**

Trade sector	2010/11
Hospitality	503
Market service	347
Retail	261
Hairdressing	239
Production/Construction	197
Security/Cleaning	130
Social care	163
Clothing/footwear	15
Public service	27
Other services	426
<b>Total</b>	<b>2,308</b>

Although the table is helpful for showing the types of sectors where non-compliance is a problem, it is worth mentioning that the number of cases closed does not reflect the number of cases of non-compliance found. In addition, it does not reflect how widespread the problem is; as we discuss later, there are numerous reasons why employees do not lodge complaints against non-compliant employers.

Although certainly not the full picture, the closed-complaint information does reveal a general trend: that sectors which have always traditionally been associated with low pay are also more likely to be associated with non-compliance with NMW legislation. The reason for this largely relates to the type of workforce and market conditions they command.

For example, the Low Pay Commission notes that low-paid jobs are much more likely to be part-time, temporary (employment is transient and often for less than a year), in the private sector, and in small and medium sized firms. Such jobs are also disproportionately more likely to be carried out by certain sub-groups of the population, such as women, young people, older workers, disabled people, ethnic minorities and those with no qualifications.<sup>10</sup>

8 Ibid

9 BIS (2010), ‘Government non-economic evidence to the Low Pay Commission’

10 Low Pay Commission, (2011) ‘National Minimum Wage’ [p 18, 65]



Data from The Office for National Statistics (ONS) supports this, showing that:

- People in part-time work are more than twice as likely as people in full-time work to be paid less than the NMW, with 1.8 per cent of part-time jobs and 0.8 per cent of full-time jobs falling below this level.
- Jobs held by women are more likely to fall below the NMW than jobs held by men (1.2 per cent compared with 0.9 per cent). This reflects the UK labour market, where a higher proportion of women work part-time than men<sup>11</sup>.

## 2.4 Non-compliance: Drivers and Strategies

The literature identifies a number of reasons why certain employers choose not to pay the NMW to employees. Economic reasons are commonly cited, such as where supply exceeds demand for goods or where market forces dictate the need for competitiveness of the sector market (locally, nationally and often internationally).

For example, research carried out by Ram, Edwards and Jones (2004) found that a number of businesses faced three different types of competition:

- *Inter-Asian*: whereby a saturation of similar businesses was common, especially within the Asian restaurant market;
- *Large firms*: small independent retailers were increasingly ‘cannibalized’ by larger corporations e.g. the rise of chain restaurants; *and*
- *Foreign competition*: most pronounced in clothing manufacturing with the increase of cheaper foreign imports.<sup>12</sup>

Employer autonomy was also found to be a key reason why employers do not pay the NMW. This was particularly prominent within the clothing and textile economy where piece-rate work is the norm. Many employers felt that wages should be set by ‘going rates’ within the local market rather than by a NMW. They also felt that they were best placed to judge required wage levels for their employees.

Employer knowledge also affects the implementation of the NMW. There is some evidence to suggest that many employers simply lack knowledge of employment legislation and therefore do not understand their responsibility to comply with it. This was particularly the case among immigrant-origin entrepreneurs. However, many businesses simply found the NMW legislation overly complex, particularly the non-adult rates, and this was often a justification for not being fully-compliant.

The various reasons that have been outlined above as to why employers do not comply with the NMW, or the strategies they take to avoid paying it, are found within and across different sectors. The rest of the section looks in more detail at these different practices by sector.

### 2.4.1 Textile and clothing

The textile and clothing sector was commonly mentioned as a sector likely to be affected by non-payment of the NMW. Research carried out on behalf of the Low Pay Commission (2004) found that both the nature of the industry, as well as the market forces operating within it, (such as supply exceeding demand and competition) affect compliance with the

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11 ONS website (2011), <http://www.statistics.gov.uk/cci/nugget.asp?id=591>

12 Ram, Edwards and Jones, (2004), ‘Informal Employment, Small Firms and the National Minimum Wage, A report for the Low Pay Commission

NMW. Traditionally within clothing production the norm tended towards employers paying employees by number of items produced, rather than hours worked. Employees were accustomed to this way of working, and both employers and employees were more concerned with what the 'going rate' was rather than the NMW rate<sup>13</sup>.

For small and medium size businesses<sup>14</sup> working within the informal economy, research also identified the role of market pressures whereby businesses, "*given the severity of competition, narrow margins, and lack of resources to invest in technology...resorted to intensive utilization of informal networks to generate a supply of labour*"<sup>15</sup>. These pressures, combined with having a surplus workforce available who are willing to work for lower rates, means that employers are able to justify not paying employees the NMW rate.

Notably, research has also found that textile and clothing businesses who operate informally take little notice of NMW legislation, looking instead to market conditions (i.e. number of competitors, competitiveness, and market growth rate) and the rates of pay being offered by competitors to determine employee wage rates<sup>16</sup>. Employers felt that they were best placed to determine what those rates should be and that not all employees were deserving of the NMW rate. For example, some workers were deemed to be more dedicated, harder-working or more efficient than others, and therefore deserved higher rates of pay. However, these rates of pay were not necessarily at or above the NMW rate, just higher than what was paid to other employees, i.e. still within a scale dictated by market conditions.

Further research in this industry found that 'immigrant-origin' entrepreneurs tended to be over represented among employers most likely to pay below the NMW, largely because they did not fully understand UK legal employment rules<sup>17</sup>. The same study found anecdotal evidence that within the clothing industry, not only were illegal workers seen as being less expensive, but the savings made from using illegal workers were often used to subsidise the visible, legal part of the workforce. This split created in the pay gap, with illegal workers being used to subsidise the visible workforce has been seen as creating *reliance* upon the illegal workforce in certain industries. This point is important as it shows that there are various forms of illegality: that firms who in the eyes of the law are seen to be operating 'formally' (i.e. by paying tax, labour and health and safety regulations) can also have a hidden, illegal workforce.

#### 2.4.2 Home Care (domiciliary care or social care)

Home care work is another area which was identified as high-risk of non-compliance, particularly due to the 'piece rate' nature of the work carried out. As previously illustrated, work that is piece-work in nature can lend itself well to informality. Home care work is defined as care that is provided by persons who are not nurses, doctors, or other licensed medical personnel that makes it possible for people to remain at home rather than use residential or institutional-based nursing care.

Findings outlined within the Low Pay Commission 2010 report noted that UNISON had raised concerns that workers within this industry were being paid a set amount per visit, rather than a NMW hourly rate, with pay increments being determined by the length of each visit, noting

13 Ram, Edwards and Jones, (2004), 'Informal Employment, Small Firms and the National Minimum Wage, A report for the Low Pay Commission [p 25]

14 The EU defines Small businesses as companies with fewer than 50 employees and Medium size as those with fewer than 250 employees

15 Ram, M, Edwards, P, Gilman, G & Arrowsmith, J, (2001), 'The Dynamics of Informality: Employment Relations in Small Firms and the Effects of Regulatory Change', University of Warwick

16 Ram, Edwards and Jones, (2004), 'Informal Employment, Small Firms and the National Minimum Wage, A report for the Low Pay Commission

17 Ram, Edwards and Jones, (2004), 'Illegal immigrants and the Informal Economy', De Montfort University and the University of Warwick [p 101]

also that travelling time between visits was unpaid. UNISON further referenced that a number of employees within the home care sector tended to be hired on zero hour contracts (i.e. being paid per completed visit), indicating that in such cases being paid below the NMW was a strong likelihood<sup>18</sup>.

### 2.4.3 Hotels and restaurants

As indicated earlier, research suggests that competition, market saturation and business survival are key drivers to employers providing below NMW rates to employees<sup>19</sup>. Given intense competition, survival is key to employers, and as a consequence wages are seen as a legitimate target in maintaining and sustaining the business. However, there is evidence to suggest that restaurants are starting to find recruitment more difficult given that wages and conditions are increasingly being considered poor in relation to other sectors<sup>20</sup>.

Within the informal economy, research has found that certain agencies employing cleaning staff for hotels often do so on a 'piece rate' basis whereby employees are given an unrealistic target of rooms to clean to meet the NMW threshold<sup>21</sup>. In addition, there is also evidence to suggest that hours of work for these employees are being under recorded to reduce pay levels, with the 2010 Low Pay Commission report expressing concern about the treatment of those workers and the widespread nature of the problem<sup>22</sup>. The report suggested that intentional approaches to underpaying workers is largely driven by market forces and the need for a competitive advantage among agencies that employed workers in this capacity.

In addition, the research suggests that many employers also justify not paying the NMW on the grounds that they also provide other benefits to employees, such as accommodation, travel to work, equipment hire or the flexibility to work around childcare commitments. Ram, Edwards, Gilman and Arrowsmith in their study of restaurants, stated that:

*These workers were often paid below the NMW. But basic pay is seen in the context of other factors that compromised the overall reward package...workers clearly had limited options; but they valued work relationships and trade-offs around working hours. An insistence of the NMW would imperil this and the non-wage element of the overall reward package. Both parties, therefore, had a vested interest in retaining the informal status quo<sup>23</sup>.*

### 2.4.4 Internships

The literature identified a growing problem of unpaid internships, whereby certain employers were deliberately hiring individuals (mostly young people) in intern roles but assigning them work schedules. According to the Low Pay Commission 2010 report on the NMW, there is a requirement on employers to pay interns if they are conducting tasks which are defined as 'work'. In most cases, these roles were either unpaid or underpaid in line with the NMW rate. The Low Pay Commission highlighted that such roles are now the 'fastest growing source of abuse of the minimum wage'<sup>24</sup>. Although interns were not paid the minimum wage (and usually no wage at all) these businesses tended to operate formally in all other ways (i.e. registering tax, PAYE and NI contributions for paid staff).

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18 'National minimum Wage', (2010), Low Pay Commission

19 Ram, Edwards and Jones, (2004), 'Illegal immigrants and the Informal Economy', De Montfort University and the University of Warwick

20 Ibid [p 23]

21 'National minimum Wage', (2010), Low Pay Commission

22 Ibid [p 112]

23 Ram, M, Edwards, P, Gilman, G & Arrowsmith, J, (2001), 'The Dynamics of Informality: Employment Relations in Small Firms and the Effects of Regulatory Change', University of Warwick

24 'National Minimum Wage' (2011), Low Pay Commission, [p 98]

### 2.4.5 Are employers non-compliant by mistake?

Whilst the review has focused on instances of employers intentionally avoiding paying the NMW rate (as this is the main focus of the research), there was evidence to suggest that some employers may do so *unintentionally*. This issue is important as it helps to clarify the issue of unintentional error versus intentional avoidance.

A number of employers in the research reported that NMW regulations are complex, and found them particularly complex with regard to non-adult level rates<sup>25</sup>. Further evidence highlights the inadequacy of monitoring systems whereby when employees passed NMW relevant age thresholds they were not subsequently placed on the higher rate as a consequence<sup>26</sup>. Variable rates can therefore be a problem for employers. For example, a small study of hairdressers published by Middlesex Business School, found limited awareness of variable rates of the NMW beyond the main adult rate<sup>27</sup>. This is such an issue that the 2011 Low Pay Commission report has subsequently recognised the importance of making available such information to small and new start up businesses to help them avoid unintentional infringement of the law<sup>28</sup>.

Furthermore, previous Ipsos MORI research<sup>29</sup> has shown that the perceived complexity of the regulations causes many employers, particularly those running smaller businesses or those who have attained a management position by working their way through the business trade, to make errors in calculating NMW rates. In addition to errors in calculating age rates for younger employees, other common errors included:

- A lack of understanding of how deductions work with the NMW. Employers were falling below NMW payments as they were deducting expenses such as uniforms, trade tools or accommodation from the wages inappropriately.
- Issues surrounding hours worked, particularly in those industries where hours are averaged out over a period of time, or where employees are paid a regular salary despite seasonal variation.
- A lack of appreciation of the impact of overtime working on the hourly rate of salaried staff, with many employers not understanding that variance in the contracted hours of salaried staff could cause them to drop below the NMW threshold.

It is surmised that the perceived complexity of the regulations could be the cause of some employers choosing not to engage with the regulations at all, an issue which is explored further in the primary research with employers.

### 2.4.6 Detection as deterrence?

For businesses operating within the informal economy; suffering from a lack of legal protection; having limited access to capital and business support; and being at constant threat of detection and prosecution are recognised in the literature as being ever present risks. With specific reference to employers who do not pay employees the NMW, research suggests that, although aware of the risk of detection, the impact of being unable to pay the

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25 Croucher, R and White, G, (2004), 'Enforcing the Minimum Wage: The experience of Workers and Employers', A report for the Low Pay Commission

26 Ibid [p 49]

27 White, G and Croucher, R (2007), 'Awareness of the NMW in the Hairdressing Industry'

28 'National Minimum Wage' (2011), Low Pay Commission

29 <http://www.bis.gov.uk/assets/biscore/employment-matters/docs/r/11-1335-research-employers-attitude-national-minimum-wage>

legal rate combined with a perception that detection was unlikely were factors driving employers to underpay the NMW rate<sup>30</sup>.

On the other hand, researchers found that within the two industries studied (clothing and catering) some employers from non-compliant businesses were of the view that if there were a number of high profile prosecutions relating to non-payment of the NMW rate, then this could potentially affect their behaviour and encourage compliance<sup>31</sup>. However, employers also stated that if they were to abide by 'all the regulations' then their business would not survive as a consequence. These employers were typically small traders who, who in spite of supporting the NMW in principle, tried to justify why they were unable to implement it in practice.

## 2.5 Working relationships in the informal economy

Two types of relationship between employers and employees involved in the informal economy came to light from this review. The first of these was an exploitative relationship, whereby employers were identified as actively taking advantage of employees by paying them below the NMW wage. Such relations tended to be more common where migrant workers were involved<sup>32</sup>. The second was a more negotiated type of relationship where both employer and employee benefitted from working in such an informal way:

*Participants suggested that it is mutually beneficial to employer and employee to keep secret the informal nature of the work, as the employer can save on wage costs and an employee can avoid regulations<sup>33</sup>*

Even within these types of relationships, researchers acknowledged that, although supportive, there remained in existence a degree of exploitation in such relations.

### 2.5.1 Employees in the informal economy

According to the literature reviewed, certain individuals such as women and migrant groups appear to be disproportionately more likely to be employed in the informal economy. However, Community Links has found the opposite to be true, revealing how difficult it can be to obtain measurable statistics on the hidden economy. What seems evident is that the informal economy closely resembles the formal in terms of the types of jobs and industries men and women are employed in.

Research indicates that women are much more likely to work in employment that puts them at risk of being paid below the NMW<sup>34</sup>. This is often due to the particular sectors and type of employment where women disproportionately feature, such as work that is part-time, temporary or contract-based, or work that is more likely to be piece-rate, or home-based. More specifically, the cost of childcare was a recurrent issue, with evidence suggesting that having the ability to take children to work to avoid this cost was a particular driver towards entering the informal economy<sup>35</sup>. In specific relation to the NMW, research found that in some cases women did not perceive the work they were doing to be applicable to the NMW

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30 Ram, Edwards and Jones, (2004), 'Informal Employment, Small Firms and the National Minimum Wage, A report for the Low Pay Commission [p 3]

31 Ibid [p 36]

32 Ibid

33 Katungi, Neale and Barbour (2006), 'Need not Greed', A report for the Joseph Rowntree Foundation

34 Croucher, R and White, G, (2004), 'Enforcing the Minimum Wage: The experience of Workers and Employers', A report for the Low Pay Commission

35 Katungi, Neale and Barbour (2006), 'Need not Greed', A report for the Joseph Rowntree Foundation

– it was not in their eyes a ‘proper-job’. As a result, they were often more unwilling to challenge their rates of pay<sup>36</sup>.

Another group at risk of being paid below the NMW rate is migrant workers. Research carried out in North Staffordshire found that migration had been used by employers to fill skills and labour shortages, primarily in low paid sectors such as industrial and service work<sup>37</sup>. There is also evidence to suggest that these workers are also at high risk of exploitation from employers. Findings contained within the 2011 Low Pay Commission review found examples of migrant domestic workers reporting mental and physical abuse by employers as well as being refused (illegally in some cases) the NMW on the grounds that they are ineligible due to family worker exemptions<sup>38</sup>. Similarly, research carried out on the use of illegal immigrant workers in Asian owned clothing and catering firms in Birmingham and the West Midlands found that although many of the employees had low wage expectations, there was also evidence of lack of knowledge about pay levels<sup>39</sup>.

### 2.6.3 Drivers behind employee participation in the informal economy

The following section draws together findings from the literature review which reveal why some employees choose to work informally. In most cases this is due to necessity, but for some this is a choice. As we will discuss below, in some instances both employees and employers (and indeed often the economy) can benefit from informal working, and whilst this is in evidence informal working practices will continue.

A key reason employees tended to participate in informal working (obtaining wages below NWM rates) was *need*. Poverty (and in particular absolute poverty) was mentioned frequently throughout the literature as the key reason why certain employees work within the informal economy. Having large debts, being unable to find work within the formal economy (such as those with criminal records and those awaiting outcomes of asylum applications), and lacking the means to ensure even a basic standard of living were all identified as major drivers behind the decision to seek work within the informal economy<sup>40</sup>.

The combination of poverty and the informal economy is seen as a double-edged sword, whereby, on the one hand it is seen as a route out of absolute poverty, but on the other, it can trap individuals within relative poverty as ‘workers outside the ‘mainstream’ do not have access to the NMW, holiday or sick pay, or legal protection<sup>41</sup>. Individuals in such cases engaged with the informal economy because often there are no other options available. Although many individuals actually want to work more formally, they are often unable to find employment in the formal economy.

In contrast to those who need to work informally, there are also those who make a choice to do so. Research by Katungi et al found evidence that the informal economy is not only composed of those who work within it to *survive*, but there are those who used the informal economy as a means to *thrive*<sup>42</sup>. Drivers for these individuals include being able to ‘top up’ earnings made in either the formal economy or through benefits. Findings suggest that due

36 Croucher, R and White, G, (2004), ‘Enforcing the Minimum Wage: The experience of Workers and Employers’, A report for the Low Pay Commission

37 French, S & Möhrke, J, (2006), ‘Impact of New arrivals on North Staffordshire Labour market’, A research report for the Low Pay Commission

38 Low Pay Commission, 2011, ‘National Minimum Wage’

39 Ram, Edwards and Jones, (2004), ‘Illegal immigrants and the Informal Economy’, De Montfort University and the University of Warwick

40 Katungi, Neale and Barbour (2006), ‘Need not Greed’, A report for the Joseph Rowntree Foundation

41 McGoldrick, M (2009), ‘Working Alongside’, Community Links Evidence Paper No 15

42 Katungi, Neale and Barbour (2006), ‘Need not Greed’, A report for the Joseph Rowntree Foundation

to restrictions on working hours, benefits (especially passport benefits<sup>43</sup>) would be lost if additional work was undertaken formally.

Flexibility is also seen as a key benefit of informal working. Obtaining a job through social networks rather than the more formal processes of applications and interviews of the formal economy, along with the flexibility of being able to fit employment around childcare needs are key to keeping the informal sector thriving.

There are also cases of individuals who are opposed to claiming benefits (e.g. because of pride) and therefore turn to the informal economy for work<sup>44</sup>. For employees who chose to work in this way, the informal economy supplies a means of doing so. For other groups within society, such as those from the travelling community, they are accustomed to working informally and doing so is very much the norm.

Having set out the context, the remainder of the report will explore the findings from the primary research, exploring the relationships that exist within the informal economy, with particular focus on non-compliance with the NWM and the effect this has on all concerned.

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43 Passport benefits are often at the discretion of local councils but may include bus passes, discounted leisure passes, free car tax, housing benefit or job grants.

44 Ibid

# 3. Employer Characteristics



### 3. Employer Characteristics

All employers interviewed as part of this research were aware that they were paying at least some of their employees under the NMW rate. This was deliberate rather than in error.

In accordance with other research about informal businesses, those interviewed tended to operate small, more transient, businesses with many part-time workers and a high turnover of staff. The employers interviewed were typically drawn from the catering, hospitality, hair/beauty, retail and construction sectors i.e. those which are known for being low paying industries and sectors where informal working practices are common.

Most of the businesses we spoke to in the research had been set up relatively recently, however many of the individuals had started their working lives in the industry in which they now operated their business. Others had inherited an already established family business. Turnover was generally low with some businesses making little or no profit. Interviews were split between male and female employers, and most were concentrated in urban environments.

All employers interviewed as part of this research were aware that they were paying their employees at a rate below the NMW and were able to justify to researchers why this was the case, as outlined in section 3.2. In many cases, they did not pay *all* of their employees below the NMW, often just those who were the most vulnerable (for instance if their employee had English as a second language). Interestingly, for many employers that we spoke to, their evasion of NMW was the only aspect of employment law with which they were non-compliant; they tended to pay the taxes they owed and also ensured that they met their obligations with regard to health and safety.

For some, this discrepancy was a result of the fact that employers did not necessarily think that they would get caught for the non payment of the NMW and, if they did, that the punishment would not outweigh the benefits they derived from non-compliance. For others it was the case that these businesses had a fixed and visible base, such as a shop front, and thus had more invested in them. Consequently they were keen to be *seen* as formal and above board in the way that they operated even if they did not pay their employees the NMW.

While the above description fits the majority of those employers we engaged with as part of this research, we did speak to a few businesses that operated completely informally and they aimed to stay under the radar entirely. These were mostly the businesses that did not have a fixed and visible base, such as those who worked on various sites or had moveable stalls. The intersection between non-compliance with the NMW and informality more generally is discussed further in Chapter 6.

#### 3.1 Understanding the different kinds of businesses

Employers worked in a range of sectors, including those most commonly associated with the low paying industries (for instance, catering and hospitality, hair and beauty, retail and construction<sup>45</sup>). Furthermore, most employers were in small businesses with 10 members of

<sup>45</sup> Ram, M, Edwards, P, Gilman, G & Arrowsmith, J, (2001), 'The Dynamics of Informality: Employment Relations in Small Firms and the Effects of Regulatory Change', University of Warwick

staff or fewer working for them. This echoes previous NMW research by the LPC which indicated that low-paid jobs were much more likely to be part-time, temporary or transient, in the private sector and in small and medium-sized firms<sup>46</sup>. In terms of business age, most employers had set up their business relatively recently with only a few having been in operation prior to the introduction of the NMW legislation.

Many of the employers we spoke to had started their own working lives in the industry in which they now had their business. They described how this had enabled them to 'learn the ropes' before starting up a business of their own. Similarly, others spoke of how they had inherited a family business in which they had worked for some time. Because of this background, many employers therefore felt confident that, despite paying below the NMW, the wages they offered were comparable with those of their industry peers.

Financial turnover was generally low among the employers included in this research and, additionally, some businesses were making little or no profit with some even subsidising the business in order to keep it operational. For many, the reason that they were struggling financially was seen to be as a direct result of the recession and, consequently, they were of the opinion that once the economy picked up more generally they would be able to turn a better profit. However, as we know from other research, once a behaviour becomes a habit it is difficult to institute a change, therefore it is likely that an upturn in profit alone will not be enough to make many of these businesses comply with NMW legislation.

Whilst some of the employers we interviewed in Nottingham worked in a more rural location, informal work was typically concentrated in urban environments. Employers included a mix of genders.

In order to provide some context for the report, the characteristics of different employers interviewed are outlined in the table overleaf.

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<sup>46</sup> Low Pay Commission, (2011) 'National Minimum Wage' [p18, p65]

**Table 3: Characteristics of employers**

<b>Gender of employer</b>	<b>Location of interview</b>	<b>Business sector</b>	<b>Age of business</b>	<b>Number of employees</b>
Male	London	Plumber and gas engineer	2 ½ years	4 – 6 (depending on how busy)
Female	London	House cleaning firm	8 months	2 - 3
Female	London	Beauty salon	2 yrs	2
Male	London	Garage (repair of cars/vans)	8 months	1 full time, 2 part time
Female	London	Hairdresser	5 years	5 – 7
Male	London	Car wash	6 months	6
Male	London	Painter / decorator	4 years	2 full time. Around 3 casual workers.
Female	London	Nail bar	3 years	3 - 5
Female	Nottingham	Retail	8 months (although previously owned by mother for 20 yrs)	1-2 on casual basis
Male	Nottingham	Indian restaurant	7 yrs	6 - 8
Male	Nottingham	Indian takeaway	5 years	4 full time staff. 2-3 weekend delivery drivers
Male	London	Fruit and vegetable shop	10 years	3 full time + part-time help
Male	London	Removals	8 years	2 full time + informal help
Female	London	Selling African clothing	2 years	3 (family and friends)
Female	London	Catering company		As required (family and friends)
Female	Nottingham	Retail	6 months	1
Male	Nottingham	Construction	40+ years	Variable
Male	Nottingham	Contract cleaning	20 years	As required (family and friends)

The rest of this report goes on to explore employer levels of awareness in relation to NMW legislation and their attitudes to it.

# 4. Awareness of the National Minimum Wage and attitudes towards it

## 4. Awareness of the National Minimum Wage and attitudes towards it

Generally awareness of the NMW was high, although knowledge of the specifics was low with much of employers' information on the subject being gathered via word-of-mouth. This was in spite of the fact that well publicised and regular events, such as the annual rises in the NMW rates, were something that employers were aware of, although most said that it made no difference to the way that they paid their employees.

Most employers felt that their employees were at least aware that they should be paid a higher rate. A minority of employers, however, believed that their employees were unaware of the NMW rates. This was most prevalent among workers who had recently arrived in the UK. Employers felt employees to be complicit in the underpayment, with most saying that their workers took on the job knowing what they would be earning. However, even for these employers there was a limit under which they thought it would be unacceptable to pay workers without being exploitative. For many, this was around £4 per hour.

Although employers said that they could see a purpose to the NMW, there were some who were cynical as to the reasons for the introduction of the legislation: perceiving it as a way for the government to make more money from employers through Tax and NI contributions. Consequently, many treated the NMW rates as a guideline rather than something which was legally enforceable.

Many of the employers who took part in the research were struggling to keep their business afloat, and so they justified not paying the NMW for this reason. This was not aided by the current economic situation, with several employers saying that profit and wage rates had both dropped significantly over the past few years.

Some employers justified the balance between profit and compliance by paying employees according to the amount of profit they generated in a particular work period, often a short-term period like a week's trading.

This chapter explores employers' awareness of the NMW and the knowledge they have of it. It also goes on to look at the methods of communications these employers have used in order to become aware of the NMW and issues related to this. The chapter also considers attitudes towards the NMW, including what employers see as the positive and negatives of the idea of the NMW and its implementation.

### 4.1 Awareness of the NMW

Awareness of the existence of the NMW was high among employers<sup>47</sup>, although knowledge of the specifics of the legislation was generally low. On the whole, employers were aware that there was a legally enforceable NMW in place and that this took the form of a minimum hourly rate to be paid to their employees. However none were able to give the exact amount

<sup>47</sup> It should be remembered that the sample of employers for this research included only those who were intentionally non-compliant. As such we would expect them to be aware of the NMW as they were aware that they were not complying with the legislation. This research does not attempt to look at those who are non-compliant with the NMW through ignorance or through error.

payable to over 21s (£5.93 per hour at the time of this research) with many thinking the rate would be higher than it actually was (around £6.50 was commonly mentioned, with almost all thinking it would be over £6 per hour). This, in part, explains why some employers thought that their business could not afford to pay their employees the NMW.

Most information employers received on the NMW was by word-of-mouth, often from people who worked in similar industries and roles to them. Reliance on these informal communication channels gave rise to the proliferation of misinformation, for instance regarding actual rates of pay, as mentioned above. However, it did ensure that most were aware of the basics, such as that the NMW rate increased periodically with some even mentioning that this usually took place around October.

Among those employers who were aware of these incremental rises, there was a general consensus that such rises were necessary, primarily due to the need to track inflationary pressures. Indeed, while non compliant with the NMW itself, a small number of employers used the rises in NMW as a prompt for them to increase the pay of their workers – while still remaining below the threshold set by the legislation.

*“When the NMW goes up I do increase the amount I pay a little, even if the total pay is still below the NMW. I don’t think it’s right to ignore the rises in NMW”*

*Female, Hairdresser, London*

Many employers, however, admitted that they had not increased their employees’ wages for a number of years. For some, there was a sense that they simply could not afford to, while for others, employers believed that they were exempt from the need to increase wages as they offered their employees other benefits instead (such as the ability not to pay taxes through offering cash-in-hand). This, however, raises the issue of the increasing gap between NMW rates and the accepted base rate of pay in the informal economy which is discussed in further detail later in this chapter.

Mirroring employers’ own lack of knowledge regarding the specifics of the NMW legislation, they suggested that their employees were similarly uninformed about what, precisely, their rights were. There was, however, a general consensus that their employees knew of the NMW, with many assuming that they would have been informed about it via Jobcentre Plus or through conversations with their peers who were in jobs which paid the NMW or from their own previous experience of having been paid the NMW.

*“The student definitely knows because she works somewhere else...the other two, I don’t know whether they know about the NMW, we never discuss it”*

*Male, House cleaning firm, London*

However, even though many employers suspected that their employees were aware of the NMW, they were of the opinion that there was a lack of understanding as to the specifics, such as the exact rates of pay that they were owed. This is backed up by research we have recently completed among employees on their attitudes towards the NMW. In this research<sup>48</sup>, employees who were not earning the correct hourly rate were unlikely to know how much they were being underpaid by, even if they suspected that they were being underpaid.

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<sup>48</sup> <http://www.bis.gov.uk/assets/biscore/employment-matters/docs/r/11-1335-research-employers-attitude-national-minimum-wage>

"[The employees] know it exists, but whether they know about how much actually the NMW is, I don't think so. I think maybe 5-10% of people actually know how much the NMW is"

*Male, Indian restaurant, Nottingham*

A minority of employers in this research believed that their employees were not aware of the NMW, and this helped them to justify not paying it. This lack of awareness among employees was thought to be most prevalent among workers who had recently arrived in the UK and who had poor spoken and written English skills.

"I don't think my workers know anything about the NMW because they don't speak English. Even if they know, they are not interested because if they could find work paying NMW they would stop coming to work for me"

*Male, Painter and Decorator, London*

There was, however, a general sense of agreement among employers that once their employees had agreed to work for less than the NMW then they had, effectively, waived their right to be paid them in the future. Confirming this view, employers stated that there were plenty of people willing to work for the wages they were offering and, they therefore felt that if their employees wanted more money they could look for a job elsewhere.

"One of my staff told me there is a minimum wage I should be paying them...they didn't come back to work"

*Male, Greengrocer, London*

## 4.2 Employers' attitudes to the NMW

The principle underpinning the NMW was understood and articulated by employers. They believed that it helped stop the exploitation of vulnerable workers. Interestingly, in spite of this, most of the employers we spoke with did not believe that they were taking advantage of their employees – even though they paid less than the NMW. Instead, exploitation was seen as the terrain of Gangmasters and others who routinely employed large numbers of foreign workers for rates of around £1.00 to £2.00 per hour.

"In principle I think NMW is a good idea because, especially if you go to a sweat shop culture, you don't want to see people being paid £1.50 per hour...people come from India, Pakistan and they're working in these knitwear places and getting paid £1.50, £2.00 per hour"

*Male, Indian Takeaway, Nottingham*

Others mentioned that the NMW existed to ensure that employees are paid a 'living wage' (though conceptions as to what this constituted differed between employers). Indeed, several employers went so far as to say that the current rate at which the NMW was paid was too low for employees to live on, once deductions from tax and NI had been taken into account.

Indeed, most of the employers we spoke to suggested that there was a minimum amount you could pay to staff before it became impossible to recruit qualified staff who were willing to work. To illustrate, one employer mentioned that any wage below £4.00 an hour would have a damaging effect on staff morale and, therefore, may decrease productivity and performance.

"If I paid less than £4.00 per hour the staff would think, 'He's undercutting me by £2 or whatever, I don't care about that gentleman, knowing what he wants to eat or what his needs are, I just go and do my job, put the food on the table, pick it up and not talk to people, not smile to people', it makes a big difference"

*Male, Indian Restaurant, Nottingham*

This is interesting as it suggests that there is a buffer zone around the NMW wage rate; certain figures (usually below the £4.00 per hour mark) were seen to be exploitative wages by the majority of employers whereas above this was seen to be within a reasonable distance of the NMW and therefore tolerable. This perhaps explains why most of the employers we spoke to paid their employees around the £4.00 - £5.00 per hour mark. Given this, most were of the opinion that they were not underpaying their workers by a substantial amount.

This understanding of the need for a lower limit of wages did not, however, extend to all employers. Indeed, some were angry about this level of interference in their business and felt that, while the NMW brought benefits to employees, as employers they could see no advantage that they could gain from it.

Furthermore, there was some cynicism among a few that the NMW had been implemented by the government as a means of ensuring that all wage payments 'went through the books'. It was thought that this, in turn, would stop employers and employees conducting cash only transactions that would deny the government the income tax and National Insurance owed to them. Because of this cynicism, a few felt less inclined to comply with the legislation.

In turn, this led employers to debate whether employees would be better off if they complied with the NMW legislation and paid them what they were owed or if they were paid slightly less than the official rate but given their money cash-in-hand. Ultimately, most employers saw the worth in the legislation, yet also saw themselves as an exception to the rule. Instead, they tended to see the NMW as a useful indicator as to what an employee should be paid – but a guideline only and not something rigidly enforceable.

"I think there should be some guidelines. The government can set a guideline, and say this is what people should be paid. But sometimes people can't afford to pay that every week"

*Female, Shopkeeper, Nottingham*

Driving this attitude was the harsh economic reality that many of the businesses we engaged with were facing at the time of the research. Many reported struggling to keep their businesses afloat and were looking for ways to cut costs. Given wages were often a significant outlay for them, this was a natural area to which employers turned when they needed to make savings.

Indeed, some employers specifically highlighted the recession as being a reason as to why they could not afford to pay the NMW. They mentioned how the amount of business they are able to do has decreased significantly and that increasing competition has necessitated a cut in the prices they charge for the services or goods they provide. This, in turn, has had a direct impact on what they are able to pay their staff.

"I think business is down 40% compared to three years ago. Prices you can charge are a lot lower"

*Male, Painter and Decorator, London*



Employers stated that the lack of flexibility associated with the NMW made these issues worse for them. They mentioned that, as their turnover varied then so too should the money that they paid out to their employees. Indeed, some of the employers that we engaged with as part of this research based their employees' wage rates on how busy the business had been that particular day.

Other employees coped with this kind of fluctuation by paying their employees a percentage of the profit. These employers felt that what they were doing was fair, as essentially they are getting paid in the same way as the employer, with the profits being divided up among them.

"I will pay them a percentage of what we take, between 20% and 30% depending on how busy we are. This often works out at less than the minimum wage but can sometimes be more"

*Female, Nail Bar, London*

That they were not able to pay their employees the NMW caused genuine dismay among a handful of employers and there was sympathy for the fact that those they employed were struggling on less money than was rightfully theirs. In these instances, employers often justified their actions by explaining that although they were paying less than the NMW, ultimately they were still providing an individual with gainful employment and preventing them from being a burden on the state. There was a sense among these employers that, should their financial circumstances improve, then they would look to comply with the legislation and pay their employees the NMW.

"I'd love to be able to employ someone on a permanent basis, at the NMW or slightly above, but circumstances aren't permitting me to do so, and the economic climate is not permitting me to do so"

*Female, Shopkeeper, Nottingham*

Therefore, as this section has demonstrated, most employers agreed with the principles underpinning the NMW. However, a few employers expressed grievances that while the government wishes to encourage small businesses and entrepreneurialism, the cost of complying with the relevant legislation was prohibitively expensive. In these cases other outgoings (such as payment of tax) took precedence over staff wages as these were considered more important to pay, plus employers were more likely to believe that they would not be able to evade these payments.

Furthermore, although very much a minority view, some felt that only British nationals should be paid the NMW. One employer explained that he felt the NMW was there only to protect those with a legal right to live and work in the country and therefore he did not mind paying immigrants without a valid working visa below the NMW as they were not entitled to it anyway.

"I do agree with it, but not for my kind of business...if people are working for me and they don't have National Insurance, they're not really eligible to work in the country anyway. Someone who has got National Insurance, was born and bred in the country and able to work I think it's fair for them to have NMW. I wouldn't like my children to go and work below NMW"

*Male, Greengrocer, London*

### 4.3 Channels of communication

From our research it was evident that only a very small number of employers deliberately sought out information on the NMW. While employers were aware that the legislation was in place, and that they did not comply with it, few wanted to know any more than this. In some cases it was obvious that employers felt that the less information they had regarding the details around NMW, then the easier it would be to deny any wrongdoing should they be challenged on their non-compliance.

Typically, employers knew of the NMW as a result of experience gained from previous work in the sector. In particular those who had previously worked for larger chain companies mentioned that they had been made aware of the NMW from this time. Employers mentioned that this kind of information was helpful to them as it enabled them to set wage levels in line with other local businesses in similar industries, and thus remain competitive in terms of attracting staff and in terms of being able to offer services at a competitive rate.

For others who did not seek out information purposefully, then the other main source of information was the media, with many suggesting that they were aware of reports on the news about wage rates.

"I have never received any special information about NMW. I have heard about it on the news, but that's all"

*Male, Mechanic, London*

For those who did deliberately seek out information on the NMW, most turned to the internet to get the answers they were looking for, such as what the rate was or who was eligible. Simply conducting a Google search was a default option for many, though some did turn to the HMRC website for information. This is because, as we have found in other research, HMRC is a powerful brand for employers who associated it with employment law and compliance. Most, however, were unfamiliar with the Business Link and direct.gov website names.

## 5. Non-compliance with the NMW

## 5. Non-compliance with the NMW

Employers gave two main reasons for their non-compliance with the NMW; those who said that they could not afford to pay and those who said that they were unwilling to pay. The latter group are interesting as they cited a number of reasons to justify why they do not believe that they should pay the NMW, including:

- The need to be competitive in a tough market;
- A large supply of labour, along with a complicit labour force;
- The lack of an incentive to pay the NMW: as detection was unlikely, employers saw no reason to change something which was working;
- A supply of illegal workers, who they felt they were doing 'a favour to' giving them access to money and skills they otherwise would not have had;
- Many employers also described the extra benefits they were able to offer their workers, such as travel or meals, which they saw as 'topping-up' their salary;
- Many employers also did not feel that workers were doing a 'proper' job or were not in fact 'proper' workers. As a result, they did not consider them to be covered by the legislation in the same way as a typical 9-5 job in an office.

This chapter examines in more detail the reasons employers give for not paying the NMW, looking at how working in this way could be of benefit to the employer, and how employers believe it affects their employees.

### 5.1 The reasons for non-compliance with the NMW

Reasons given for not paying the NMW varied from employer to employer as would be expected. Largely, however, employers either initially described themselves as being *unwilling* or *unable* to pay.

However, on analysis, this is much too simplistic a way of looking at a very complex issue and the myriad reasons presented by employers to explain their non-compliance with the NMW legislation are explored below.

#### 5.1.1 Lack of awareness

A common feature of many of the employers we spoke to was that they had bought their business as one already operating in that sector, or had taken over the business from other members of their family. In these cases employers tended to be more ignorant of the specifics of the NMW legislation and they continued to run their business in the way it had always been done. What this meant was if they inherited a business that was non compliant, then it tended to stay that way. Indeed, one employer mentioned that it was only after a few years of running his business that he realised that he was paying his workers too little. However, he was of the opinion that as his company's working practices had become so entrenched and as he had not been caught, there was no real impetus to change.

A few employers seemed to remain ignorant of the specifics of the NMW out of choice. Although aware of the existence of the legislation, these employers actively avoided information on the precise wage levels and incremental increases in these. They felt that if they did not know about the legislation, then they could not be blamed for their non-compliance with it.

"I have no interest in the NMW, and until you told me I didn't even know how much it was. I remember 9 years ago it was £3.60 but since then I've known nothing about it"

*Male, Plumber and Gas Engineer, London*

### 5.1.2 Lack of demand

Following on from the lack of knowledge of the NMW displayed by employers (as discussed in 4.1.1 above) employers also mentioned that it took them time to realise they were not paying the NMW, as a result of the fact that their employees did not ask them for it. Given this, employers argued that as their staff were willing to work for less money than they were entitled to, there was no reason for them to pay their wages in accordance with the NMW.

"It wasn't a conscious decision to say, I'm not going to pay this, but I've never really considered doing it because I've not had people come to me and say, 'I'm not getting paid enough' or 'Is this the minimum wage?'"

*Male, Indian Takeaway, Nottingham*

Indeed, many employers mentioned that if they needed to, they could access large supplies of workers all willing to take on roles paid less than the NMW, simply as a means of building experience, gaining relevant skills and 'getting a foot in the door'. This was partly thought to be a feature of the recession in that the lack of vacancies ensured that those seeking work were less demanding about the nature of the work they took on. Because of this, employers felt it to be nonsensical that they purposefully choose to take on those who ask to be paid at least the NMW when there was a pool of labour willing to work for less.

"You don't pay it because you see people come and asking you 'please give me a week's job' and even offer to work for free because they are desperate for work. It's hard to pay NMW when you don't have to"

*Male, Painter and Decorator, London*

This issue was believed to be a particular problem in the construction sector. Employers described how potential workers wait outside construction supply stores and employers are able to select their workers for a job as they pick up their supplies. One employer described hundreds of workers waiting each morning, creating a competitive market where workers are keenly aware that they cannot charge a premium rate for their labour.

"If my employees don't like it I can find five more people like them in an hour's time...there are hundreds of guys waiting at 6am in the morning who will work for as little as £30 a day...90% of people are happy to work for what I offer, a few people have said no, but not many...they work for less than NMW because they need to survive"

*Male, Plumber and Gas Engineer, London*

Linked in with this, there was a sense from some employers that their employees did not always entirely rely on the income from their employment with them. Indeed, some mentioned that it was common for their employees to hold down a number of jobs at any one

time. Therefore, because their job for which they were paid less than the NMW was not their main source of income, employees were not always thought to feel the need to demand that they were paid more. Furthermore, employers felt less obliged to pay these employees what they were owed as they knew that they had other sources of money that they could rely on.

“You get a lot of people that may do office jobs or other jobs during the week and then at weekends they’ll come and do restaurant takeaway to top up what they are earning during the week”

*Male, Indian Takeaway, Nottingham*

### 5.1.3 Exploiting vulnerable employees

In many cases, we found that employers did not pay *all* of their workers below the NMW. It tended to follow that staff who were allocated positions of responsibility, such as shop or restaurant managers, were often given full contracts and paid wages that were compliant with the NMW. Part-time staff, casual workers and students, however, were less likely to be seen as ‘proper’ workers and so employers felt justified in paying them less. This was also felt to be the case for those employees who were recent migrants; indeed, a few of those employers we spoke to deliberately targeted workers from overseas as they knew that they could get away with paying them less.

“People are desperate for jobs, because the employees I have don’t have any qualifications. I have people mainly from Eastern Europe”

*Male, Car Wash Company, London*

Furthermore, there was a sense that the recent recession had increased the vulnerability of workers. While some may have been unhappy with being paid less than the NMW, that there was such a high level of demand for work employers were in a powerful position whereby they could easily dictate the wages their staff received. This, in turn, made it difficult for workers to escape the formal economy and be paid what they were owed; the need to work overrode any qualms employees might have had about working for less than the NMW.

### 5.1.4 Increasing internal competition

Some employers suggested that the NMW reduced the impetus for employees to work hard; they knew that they would be paid a set wage regardless of the amount they worked and the quality of their outputs. Therefore, some employees argued that by not paying the NMW they were simply ensuring that they retained an element of control in how they incentivised their staff. They stated that they would pay their employees more for good performance, but that they typically paid below the NMW meant that these bonuses were affordable for them.

“I think what I pay them is fair. If the work is harder or if the money is good I will pay them £50 instead of £40”

*Male, Plumber and Gas Engineer, London*

### 5.1.5 Affordability

As may be expected, one of the most common reasons offered by employers as to why they did not pay the NMW was that complying with the legislation was perceived to be unaffordable. Indeed, many spontaneously suggested that were they to start paying the NMW then their profits would be cut dramatically – with some even suggesting that their business would be unsustainable.

When considering the affordability of complying with the NMW, employers often made very complex calculations which went beyond factoring in the increased wages for their employees. They stated that in addition to this they would need to pay out more in NI, which some thought would necessitate the recruitment of an accountant which would bring with it another expense.

To deal with these increased costs, employers assumed they would have to take one of two courses of action. The first would be to increase the prices they charged their customers – though many recognised that this might have a damaging effect on demand.

“I would need to charge my customers a lot more. I would have to pay employer’s NI. I am charging a bit less than the market rate at the moment. I would also have accountancy costs and I would have to pay more tax myself”

*Female, House Cleaner, London*

The other solution businesses mentioned was that they would have to employ fewer staff. In some instances, this would result in the employer becoming a sole trader. This was not considered an appealing option as they believed that the burden would fall on them and they would have little or no respite from the responsibilities of running their business.

Others felt that reducing staff numbers would not be fair on those employees who remained working for the business as they would be forced to pick up the slack. They felt that this, in turn, would have a detrimental impact on how attractive their business was for prospective employees.

“I’d have to get rid of people... [those remaining] would have to work a lot harder for their wages. So right now I can keep more staff on, so their work is a little easier....instead of one person loading a big truck full of fruit I can have three people doing it, which makes it a bit easier for them”

*Male, Greengrocer, London*

## 5.2 Avoiding detection

A significant number of employers were relatively relaxed about the fact that they were non compliant with NMW legislation and assumed that either they would not get caught evading payment or, if they did, would be able to explain their actions in such a manner that they would not be penalised. Underpinning this was the fact that all employers took a creative approach to book-keeping and accounting, taking care to hide what their staff were actually earning. This was achieved in a number of ways, as is outlined throughout the remainder of this section.

Some employers recorded all employee wages in one set of books but did not record the hours that were worked by their staff. In these cases, employers typically felt that their records were as detailed as they needed to be within the parameters of the law and, should they be inspected that they would be able to produce all the information needed even though it would be impossible to deduce the hourly rate. It seemed to be the case that accountants were often involved in maintaining these books, Accountants were often involved in maintaining these books though it was unclear whether or not they were complicit in ensuring that the business remained non compliant as employers did not provide them with a record of the hours worked either.

“[I send the record to my accountant of] what nights [employees] have worked and how much they get paid per night. It’s not an hour by hour record”

*Male, Indian Takeaway, Nottingham*

Several employers also reported keeping two sets of books; one for income and expenditure and a separate book for wages. They then tended to include the amount spent on wages under another heading in the final accounts.

"I have one book where I record income and expenditure, but I do not include wages in this. I record wages in a separate book"

*Female, House Cleaner, London*

"I have two sets of books. In the public books I don't mention wages. I put the staff costs down as travel expenses and lunch for work experience only"

*Female, Beauty Salon, London*

A couple of employers mentioned how all labour time was recorded next to their names and that their employees were then paid from the employer's salary. It was highlighted by one that this meant that all of the tax and NI contributions were being paid on that salary by them, and therefore they felt that this was a useful way to reduce paperwork which, in turn, ensured they could spend more time on actually running the business.

Finally, as briefly mentioned above, a few employers accessed the services of accountants who were complicit in ensuring that the business records did not reflect the realities of the wages that were paid to employees. Accountants willing to work in this manner had often been employed by the business for some time and so knew the business owner well, or had been sourced via word-of-mouth through trusted channels.

"I have an accountant who does my accountants but he falsifies them and doesn't ask me for any information....no receipts, records of payments to staff"

*Male, Painter and Decorator, London*

### 5.3 Recruiting employees to work for less than the NMW

As the previous section shows, employees were able to call on a ready pool of workers willing to work for less than the NMW. Although all, for obvious reasons, avoided formal channels of recruitment (advertising in the local press for instance, or online or through recruitment agencies) some did mention that they placed adverts in shop windows or dropped leaflets through letterboxes as a means of finding staff.

Most employers, however, demonstrated caution when recruiting employees and were keen not to draw attention to themselves or their working practices. Consequently, some employers said that recruitment of their employees was conducted almost exclusively through word-of-mouth channels. This was thought to be a discreet means of finding people seeking work. Furthermore, given the current levels of demand for vacancies, employers stated that they had no problems filling the positions they had in this way.

"It's word-of-mouth mostly. I'll talk to people, or I'll tell somebody, or people are always ringing up...I get three, four phone calls a day looking for a job...I've got about 30 people in the waiting list now"

*Male, Indian Restaurant, Nottingham*

To illustrate further, one employer explained that they recruit staff on a relief basis i.e. they will take on people who are familiar with the business as and when they had a few hours free, simply to allow the owner some time off, or some space to concentrate on other tasks.



For some, however, recruitment via word-of-mouth was still perceived to be too risky and opened up the possibility that they would be reported. Consequently, some went so far as to say that they would only recruit family members and close friends who they could trust not to report them.

"It's all through family and friends. They are trusted people who I know will not tell the authorities how I run my business"

*Female, House Cleaner, London*

Regardless of the method of recruitment, however, common to most employers was the fact that once a suitable employee had been found who was willing to work for less than the NMW then it was common that they would be asked to conduct a trial to determine whether or not they were suitable for a longer-term position. Employers were able to do this as, in most cases, the vacant positions were not contracted.

## 5.4 The impact of non-compliance on employees

As mentioned earlier in this report, a few employers were genuinely concerned about the wellbeing of their employees, knowing that they were only able to pay them as little as they did due to the fact that they were desperate for work. Most, however, were of the opinion that their non-compliance with NMW legislation brought their employees a number of benefits, all of which are outlined throughout the remainder of this section.

Employers suggested a key advantage was that their employees did not have to pay tax or NI when wages were paid cash-in-hand. Interestingly, employers spoke entirely in terms of short term benefits to their employees in this regard i.e. that they got to take home more money now, rather than being concerned about a potential NI shortfall for their employees in years to come.

Other employers suggested that working for money paid cash-in-hand also enabled their employees to claim benefits at the same time. Indeed, there was a suspicion that this practice was rife, though employers were keen not to investigate this too closely lest they be implicated should their employees be caught.

"I think my employees do other unskilled cash-in-hand work. Some of them claim benefits like JSA and housing benefit"

*Male, Indian Takeaway, Nottingham*

Employers also mentioned the non financial benefits their employees received. For instance, most spoke of how they have some kind of reciprocal arrangements for services in place, whereby employees are able to receive free meals, car repairs, building services at cost or beauty treatments – obviously dependent on the industry they work in. It was thought that the provision of these benefits helps to top up the wages of those earning less than the NMW.

"I can pay you a set wage, whether it is busy or quiet, and that's for the whole night, or you can come in, get minimum wage paid, but you don't get your drinks free and you don't get your food"

*Male, Indian Restaurant, Nottingham*

For those working in the hospitality sector (particularly in restaurants), employers often mentioned that the tips their employee received would help supplement their income. Furthermore, one even suggested that that their employees received tips from customers meant that they did not have to pay the NMW as, once this additional income was taken into account, then the amount they earned would be well over the legal threshold. Indeed, they

suggested that were they to be inspected by a compliance officer then this explanation would be sufficient for them to be excused from any wrongdoing.

Other employers were quick to point out that although their employees were being paid less than the NMW, they were benefiting in other ways. For instance, employers spoke about how they were increasing their skill sets, and gaining valuable experience which would stand them in good stead to get a better paid position in the future.

"I know it's not enough for what they are doing and I am paying them too little, but they are happy to work for this amount because they are getting experience and I teach them about how to do beauty treatments"

*Female, Beauty Salon, London*

Whilst these benefits to the employee echo similar findings in other work on low paid jobs and informal working<sup>49</sup>, the benefits cited in this study are those given by employers who know that they are underpaying their employees. These benefits do not represent the employee view of the 'trade-off' between low pay and flexible working options, nor do they reflect the causal relationship between low paid jobs and multiple jobs or low paid jobs and potentially fraudulent benefit claims.

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<sup>49</sup> Katungi, Neale and Barbour (2006), 'Need not Greed', A report for the Joseph Rowntree Foundation

## 6. Experiences of Informal Working

## 6. Experience of Informal working

The research identified three main triggers which encourage employers to work informally. These are:

- Evolution from a hobby to a business;
- A life changing event (such as a redundancy) leading to a business start-up; and,
- Inheriting or buying an established informal business.

When setting up a business, NMW was low on the hierarchy of things that should be paid, with business rates, registration fees and VAT all considered more important by employers. Although not explicit in the way that they discussed NMW, this ranking was largely dependent on whether they felt they would get caught if they were not complying. As few believed they would be inspected for non-compliance with the NMW, this was not an effective spur for them to ensure they acted in accordance with the legislation.

There were also varying degrees of informality among those businesses who were non-compliant, ranging from those who were wholly unregistered ('ghosts') to those who operated partially legitimately with a certain percentage of the work not going through the books. There were also a significant number of employers who were non-compliant only with the NMW.

Once businesses began operating informally they had to adopt a range of techniques to help them avoid detection. This included falsifying business records, either using an accountant to do this or by keeping two sets of books or recording hours differently to those that were actually worked. Some simply relied on keeping very few records for the business, feeling that this would make it difficult to prove that they were non-compliant.

This chapter explores the intersection between non-compliance with the NMW and informal working more generally. It also incorporates a number of 'employer journeys' which illustrate how businesses have become non-compliant, to what extent they operate informally, and what the incentives and drawbacks are to becoming a formally operating business. In order to protect the anonymity of the respondents all names in the report have been changed.

### 6.1 Triggers to working informally

For many employers, the journey towards informal work was something which had evolved. For example, in the case of self-employed businesses in particular, such as catering or removals, the business had developed from initially 'helping out' or doing small jobs for extra money, to something which grew to form the beginnings of a business. In other cases, employers had inherited an established business from a relative, and continued to operate the business in a similar way. This reflects research with small firms conducted just after the introduction of the NMW legislation, which found that the NMW had 'tipped' previously legitimate businesses into illegal work practices. The key reason for this was attributed to the existing infrastructures that these businesses had in place prior to the introduction of the legislation. As Ram et al (2001) point out:

“Years of operating in this informalised manner meant that the firm was ill-equipped, both in terms of financial and human resources, to consider alternative ways of handling the competition”<sup>50</sup>

Whilst the introduction of the NMW legislation no longer provides a tipping point in the same way, being an established part of business practice at this stage, the genesis of businesses who are operating informally still often means that they do not have the infrastructure in place to easily adapt their business model to incorporate NMW payments. Informal development into a business is a key reason for businesses operating informally, and intervention at this early stage is important in order to ensure future compliance in these businesses.

Although some hoped to operate more formally in the future, largely citing economic reasons as driving their current working practices, many had no plans to change any aspects of the business, largely because it was working fine, the business was profitable and the chances of detection were small, in their opinion. However, the extent of informality was largely dependent on certain factors, as we explore below.

## 6.2 The extent of informal working

Interestingly, just because an employer was not compliant with the NMW, it did not necessarily follow that they would take the same approach in relation to other areas of their business, such as tax and health and safety.

Indeed, many of the employers we engaged with stated that they were a VAT registered business or were officially self employed. This allowed them to have a legally operating business and ensured that they felt safe in the knowledge that they would have the necessary documentation to show to officials should they be inspected. This was felt to be particularly important by employers as they perceived that the penalties in place for failing to comply with this kind of legislation were more severe than those for the NMW.

However, while they complied with these areas, often only a proportion of the work that they undertook went through the official books. This in turn allowed them to maximise the cash-in-hand profit from the other percentage of the business. Furthermore, working in this way also meant that the amount of turnover of profit and labour declared through the business would not raise suspicions that additional employees were not being declared.

The following case study provides an example of this way of working.

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<sup>50</sup> Ram, M, Edwards, P, Gilman, G & Arrowsmith, J, (2001), ‘The Dynamics of Informality: Employment Relations in Small Firms and the Effects of Regulatory Change’, University of Warwick [p858]

### **Male, BME, Removals man**

Steve runs a removals business operating principally in north London. He owns a 7.5 ton truck, and started as an independent contractor delivering goods for chain-stores. From this, he built a business in removals through word-of-mouth and advertising.

He employs two full-time staff who are paid above the NMW, and also hires extra labour as the job requires. He pays the extra labour £50 to work for a 10 hour day. The additional help is recruited from among his personal networks, and are all known to him.

Steve claims that the extra labour he employs are happy to work for the amount he offers. They are eager for cash-in-hand payment, as this means they can supplement other income from benefits without having to declare anything formally. He mentions that because the work is 'off the record' and that no tax or NI is paid on earnings, that the wage he pays the extra labour could actually work out more than the NMW. He also argues that the extra labour 'don't want to work on the books', as this would mean they would lose access to benefits. For Steve, paying cash-in-hand is convenient for him, as 'if there is no paperwork then there's no headache'.

In some respects Steve operates a formal business, as he and his full-time employees are registered for PAYE, he has an accountant to sort out his tax receipts, and he has liability insurance. However, due to the cash-based nature of his business, he admits to only putting a certain number of jobs through the books. He makes sure that this is a regular amount that is roughly similar each week. He also admits to being 'flexible' with VAT: 'If you want to pay VAT it's up to you.'

Steve is comfortable that his illegal practices are invisible to the authorities, and does not believe that he will get caught, unless 'they all just literally follow me around'. As there are no receipts for the service he provides, he believes that it is impossible to check up on the undeclared work he has done.

A key factor which determined whether a business would be registered as a formal business or not was whether the business worked from a fixed location. Those who had a shop front or a restaurant were more likely to say that they felt vulnerable to detection if they operated their business without being registered for VAT and paying income tax. Indeed, one employer spoke of how when he took over the business they now run, it was operating entirely illegally. As a result, one of the first tasks they undertook was to register for VAT to ensure this element of the business at least was above board. However, this employer made no changes to the non-compliant wages that were paid to the employees. Their experiences are outlined in the case study overleaf.

**Male, BME, restaurant owner**

Amrit runs his own restaurant in Nottingham. He took over the premises several years ago from someone who was already operating the business as a restaurant. Amrit had previous experience in the trade and had run his own restaurant before.

When he took on the business from the previous owner the business was not registered and the previous owner had not been paying tax or VAT. Amrit was concerned that being caught operating in this way would result in his business being closed down and so registered the business within a few weeks of taking over.

*"I took over the business, within two weeks applied for VAT, made sure I was registered VAT, because a lot of people come in here and ask for VAT receipts and stuff"*

Due to his previous experience in the trade he had contacts with experienced waiting staff who he knew would be keen to come and work for him again and had clear ideas on what the going rate of pay for such workers would be. He continued to pay the 'experienced' waiting staff rate of £40 a night (around 7 hours) for those staff who he had worked with before and kept on many other waiting staff at £30 per night, as this was the rate they were on when he took over the business. Amrit also works 'hands on' in the restaurant most of the time, in whatever role he is needed in.

Amrit feels that with the wage his employees earn plus the tips they get and the free meal and free drinks he provides over the course of a shift, they are earning at, if not over, the NMW. He likes to retain some flexibility in the amounts that he pays as he feels that the incentive to improve to a more experienced member of staff and earn more money helps his waiting staff to perform better. He is uncomfortable with the idea that he is breaking the law, and feels that should an enforcement officer calculate what his employers are paid including tips, food and drink, there would not be a problem with the wages he pays.

Another employer who works in catering described how they did not feel it necessary to be registered for VAT as their business was mobile and therefore difficult to pin down. However, they always ensured that their food hygiene certification was up to date due to their awareness of the inspections process and also to help build levels of customer satisfaction.

### **Female, BME, catering company manager**

Ann runs her own catering company from a friend's kitchen in London. She had always been interested in cooking and a couple of years ago started catering for friends' parties. The business grew from there and now she regularly gets asked to cater for parties, weddings and community events.

She employs Elena cash-in-hand for four days a week and if she has a larger event to cater for she will ask friends and family to help out for a few hours (paying them a standard amount). Although wages are generally set by how much she makes, and how much she "can get away with paying", they average around £30 for a five-hour shift for Elena, and £20 for a four-hour shift for friends and family. Ann works when she needs to but likes to be as hands-off as possible.

Ann argues that family and friends are happy with what she pays them, as they're only 'helping out'. Some of them have other jobs, and some are housewives so it's just a bit of extra money for them. She thinks that the arrangement benefits everyone as employees can earn some money without paying Tax or NI, and have flexibility around their working hours, whilst Ann does not have excessive labour costs.

The business is not registered for Tax or NI, but Ann does comply with the relevant Health and Safety inspections on the grounds that she does not want her customers to become ill, as this could lead to complaints and investigations. Despite being an unregistered business Ann does not worry about being caught by the authorities. She does not advertise, apart from via word-of-mouth, has regular customers, and only takes on employees that are known to her. As a result, she sees no benefit in becoming fully registered and does not want to sacrifice her current standard of living, as she knows this would be reduced if she operated formally.

However, some businesses operated informally in all senses, working entirely below the official radar. These employers were generally working in low margin, variable custom businesses and were unwilling to engage in any way with the authorities, largely because they thought they could get away without ever having to. These businesses were more likely to be smaller and less visible in terms of physical presence, with no intention of becoming compliant. A case study of this type of employer journey is described below.



**Female, White, Nail Bar Owner**

Sue is the sole owner of a high street nail bar salon in London. She's run the business for the last three and half years, where they offer manicures and pedicures. It suffered considerably at the beginning of the recession, but business is picking up again.

Sue employs five people in the nail bar, all paid a daily rate, cash-in-hand and below the NMW. She argues that as levels of business vary from day-to-day she hasn't got the cash flow to pay her staff the NMW. Sue claims that she would lose money if she did, and would have to put up her prices making her less competitive, thus damaging the business.

To recruit staff Sue puts a poster in the shop window and people come in off the street. She makes an agreement with them of how much she'll pay, depending on how good they are. They are told they won't get the NMW, but a daily rate depending on how many clients come in to have their nails done. Sue doesn't think this approach affects them too much as they don't pay tax or NI, have the convenience of being paid in cash, and they seem happy with these arrangements. Some are claiming benefits too because as Sue remarks 'they can't afford to live on what I pay them'. Sue gives her staff a Christmas bonus of £100 - £200, as well as offering free nail treatments for their family. She might even buy a toy for their children. She thinks she treats her staff well and that's why they stay.

Sue has never thought that she would be caught by the authorities, even though she is wholly unregistered for tax, NI, Health & Safety, hygiene, etc. She doesn't want to register for anything as she says it would cause her too much stress and money, for no foreseeable gain. Sue thinks operating a business as she does is about how clever you are. For example, if someone came in and asked about the NMW Sue would say the staff were doing work experience or helping voluntarily.

Consequently, as this chapter has shown, the extent to which employers work informally is often in part driven by their perception about the penalties they might face should they be caught. Employers' levels of awareness of and attitudes to the NMW compliance regime are outlined in more detail in the next section.

## 7. Employer views on non-compliance penalties

## 7. Employer views on non-compliance penalties

Whilst all of the employers interviewed for this research were aware that they were acting illegally, awareness of enforcement activity and non-compliance penalties was low. There was an assumption that there would be a fine to pay and this was considered reasonable by the employers we interviewed. However, views were polarised on whether the fine was fair, with some feeling that a lump sum of £5,000 would cause them to cease trading, while others suggested that such a fine would not cause them enough financial hardship to consider compliance.

Employers assumed that the likelihood of them being caught for non-compliance with the NMW was very low indeed. For instance, none of the employers had heard of anyone they knew experiencing a NMW inspection and, as such, the assumption was that in order to be subject to an investigation staff would have to complain about their wages. Employers were confident that their staff would not complain as they were happy with the additional 'perks' they got from informal working, were family or friends of the employer, or were too concerned about the potential of losing their job.

Employers were also often unaware of the responsibility they had to keep adequate records. Because of this, they assumed that even were they to be inspected, it would be difficult to prove that they were non-compliant as there would not be the evidence to support this claim. It is possible that should it be known that the burden of proof for correct payment rests with the employer rather than the employee or the enforcement officer, employers would be more concerned about the prospect of a non-compliance inspection.

This chapter explores employers' awareness of the enforcement regime for the NMW. It also examines awareness of the penalties for non-compliance, exploring how employers measure the risk between non-payment of the NMW and the likelihood of getting caught and subsequently receiving a penalty.

### 7.1 Awareness of the penalty regime

All of the employers who took part in this research were aware that they were acting illegally by not paying the NMW. As a result they were also aware that there was a chance that they could be caught by the authorities. However, awareness of enforcement activity and exact non-compliance penalties was very low.

Although most employers were unsurprised to find that they would be subject to some sort of financial penalty were they caught, they were unsure about how much this penalty would be in reality. When informed of the amount employers were generally surprised that the figure was as high as £5,000, particularly as this was on top of the back-payment of wages to employees (with most suspecting that this would include taxes as well). Only one employer of all those interviewed felt the fine was lower than expected as they had confidently stated that the fine for non-compliance with the NMW was in the region of £20,000.

However, while there was some surprise as to the amount of money that they would have to pay if they were found to be breaking the law, on the whole, employers felt that the benefits of underpayment still outweighed the potential penalties.

"I would have to pay back the money I owe and maybe go to prison if I don't pay...I don't think £5,000 is a very big fine, it's not enough pain to make me want to stop"  
*Male, Painter and Decorator, London*

Alongside the lack of awareness of inspection regimes, there was also a clear lack of awareness as to the responsibilities that they had to keep adequate records of employee pay and hours. Had the employers we engaged with been aware that failure to provide adequate records would be enough to convict them for not complying with the law, this may have acted as a deterrent. Indeed, we know from previous research for BIS/HMRC<sup>51</sup> that employers who have been found non-compliant from inspection are often surprised that the burden of proof of payment rests with them rather than with the employee. For this reason the inspection process was also seen as an educative process in correct record-keeping and wage accounting. Should this be more widely known it is possible that small businesses would be more concerned about detection.

## 7.2 Perceived likelihood of detection and enforcement

Awareness of the penalty acted as a deterrent for some, but only if they also felt there was a strong possibility that they could be *caught* breaking the law. If they considered this unlikely (as the majority did) then the fine had little impact on behaviour. One respondent, for example, contrasted the repercussions for NMW non-compliance with employing illegal immigrants. High profile cases of employers being inspected and fined for employing illegal immigrants had raised his awareness of the penalties associated with non-compliance in this area and had increased concerns that he may be caught if he did this. Information in this case was primarily derived from television programmes where raids on premises had been carried out and employers convicted. This particularly resonated with the employer in question as he said that the businesses featured were often Asian restaurants and takeaways and therefore he felt particularly likely to be targeted. As a result, he was always careful about the visa status of the employees who he took on in his restaurant.

"[Immigration status] is one thing I've been ultra careful with, because I couldn't pay fines of £10,000 or whatever it is..."

*Male, Indian Takeaway, Nottingham*

This case illustrates that, whilst penalties are to some extent effective and necessary as a deterrent, they are not truly effective unless they are backed-up by a strong enforcement regime. For employers this meant that they needed to know of a business, similar to them, that had been inspected and fined, as the following quotation shows:

"Have you heard of anyone being inspected? I've heard of two restaurants that have been targeted in terms of illegal workers, but nothing about non-compliance with the NMW. [I don't think the Inland Revenue] can afford to and have the resources to actually raid every single restaurant in the country"

*Male, Indian Takeaway, Nottingham*

Some employers also felt that the issue was not given the same focus as other areas of non-compliance, such as the TV License or Benefit Fraud campaigns, which had high-profile television advertisements warning people of the consequences of non-compliance. Consequently, many felt that the government were not too concerned with the issue, and that the chances of detection were therefore low. This chimes with research from the literature

<sup>51</sup> <http://www.bis.gov.uk/assets/biscore/employment-matters/docs/r/11-1335-research-employers-attitude-national-minimum-wage>

review which suggests that, although aware of the risk of detection, the impact of being unable to pay the legal rate combined with a perception that detection was unlikely were factors driving employers to underpay the NMW rate<sup>52</sup>. In Ram's study of informal employment (2004), researchers found from the two industries under study (clothing and catering) that some employers from non-compliant businesses were of the view that if there were a number of high profile prosecutions relating to non-payment of the NMW rate, then this could potentially affect their behaviour and encourage compliance<sup>53</sup>. However, employers also stated that if they were to abide by 'all the regulations' then their business would not survive as a consequence. These employers were typically small traders who, although supported the NMW in principle, tried to justify why they were unable to implement it in practice.

There was an assumption that inspections would generally stem from employee complaints and most employers felt either that their employees were happy, or that they had hired people they could trust not to talk to the authorities about their business practices, either through family connections or through a desire to protect their own working status.

"I don't think they will find out, because I know my customers and I know they won't report me and the ladies who work for me need the money. If they report me they are reporting themselves as well, because they are claiming benefits and working illegally"

*Female, House Cleaner, London*

Should they be inspected, employers assumed that the inspection would largely be a case of their word against that of the employee. Whilst some were confident that they would be able to present a second set of books, others felt that the lack of records that were kept containing details of staff wages and hours would make it difficult for the inspector to prove that they were non-compliant. Some employers also had 'stories' prepared about any employees on the premises, such as them being on work experience or on trial for their first few days on the job.

"If someone came in and said are you employing this person? I'm not employing them at all, they're just helping out for an hour or so and they're a friend...How can you prove that I'm actually paying them if you've got no way of proving it?"

*Female, Shopkeeper, Nottingham*

Some employers reasoned that even if they were found to be non compliant then there would be some latitude in the implementation of the penalty, i.e. as a first offence they may receive an initial warning before any penalty notice was submitted. Consequently, they felt that they had until their first inspection to 'cover up' any illegality. As a result, the threat of a penalty was not a successful deterrent for these employers.

"I might get a warning first of all...I have heard about the paying money back but not about the big fine"

*Male, Car Wash Company, London*

In addition to this, there are still a number of small businesses, particularly those who do not have a fixed place of business, where employers know that it would be difficult to prove that they had employees working for them. These employers often felt immune from inspection or detection and were unwilling to change the way they operated, as they saw no reason to

<sup>52</sup> Ram, Edwards and Jones, (2004), 'Informal Employment, Small Firms and the National Minimum Wage, A report for the Low Pay Commission [p 3]

<sup>53</sup> Ibid [p 36]

do so. This group of employers are particularly difficult to target. Although not a prevalent view, several employers felt that NMW legislation was not intended to apply to them. They reasoned that the Government would rather have them operating as they do and providing work for otherwise unemployed individuals than shut them down and lose the revenue that they are providing to the community as a small business. In this way they justified their actions and saw themselves as providing a service.

Therefore, although there are deterrents in place to encourage employers to comply with NMW legislation, on their own they are not enough to deter many small businesses from breaking the law. It is paramount that employers also believe that there is a genuine possibility of inspection, which is done at random, rather than as a direct result of employee complaint. In addition, should they be caught breaking the law, employers should be subject to an immediate penalty. Employers are not aware of the work being done behind the scenes to detect non-compliant businesses and therefore do not think this is a government priority. Employers need to know that the Government are taking this seriously and will take the necessary action to enforce the NMW.

## 8. Conclusions and recommendations

## 8. Conclusions and recommendations

This chapter draws out the key themes emerging from this research. We also make recommendations on what should be done to reduce the extent of NMW non-compliance in the future.

### 8.1 Key themes

Although the NMW was viewed positively in principle, acting as an important weapon in preventing the exploitation of vulnerable workers, it was generally seen as more applicable to *other* employers and employees. Indeed, most of the employers we spoke to in this research felt that the agreement that they had in place with employees was mutually beneficial and, linked to this, felt there were some people who should be exempt from the NMW, including students, those without visas, and people who were looking to do casual work to supplement their income. In those cases employers did not feel they were employing people to do a 'proper job', so they should not be subject to NMW regulations.

Employers were also vague about what the NMW rate was. Many in fact estimated that it was higher than it currently was, and often thought it should be higher still, since it did not seem like a great deal of money to live on. Nevertheless, for the small businesses we spoke to, turnover was variable, and so the need for wage flexibility was important. Not complying with the NMW was beneficial to employers as it was thought to **increase competitiveness**, which was particularly important in the current climate. It was also perceived to **provide greater profits** (or a profit at all for struggling businesses), and often **enabled greater investment in the business**.

For the employee, it was thought to be beneficial to work cash-in-hand, and therefore negating the need to have to wait for a cheque or direct debit payment, and crucially, **not having to pay tax or national insurance contributions** on wages. Often, the wage they received from the employer was over and above the benefits they claimed from the government (although this was a perception from employers, rather than grounded in fact). Employers also justified wage rates by claiming that the additional benefits reaped by workers, such as free food, free treatments in beauty salons or being allowed to keep tips, meant that they would be earning the equivalent of the NMW, but without the need to pay tax. They were also afforded greater flexibility around their working hours and were often given profit-related bonuses, or free travel to work. Despite this, many knew their employees struggled on the wages they were given, but argued that they were unable to pay more, and that if those employees were not happy with the wages provided then it would not be difficult to find other workers, something which was viewed as being a consequence of the recent recession.

In order to evade detection, employers operated different tactics, including keeping two sets of books or having an accountant who would falsify records for them. Others kept little or no records at all, particularly if they were an 'invisible' business, and therefore felt that detection was unlikely. Some employers kept detailed records but did not keep a record of the number of hours worked by each member of staff, which was felt to be sufficient not to incriminate them should they be inspected. This highlights the fact that employers are not aware of their obligations to provide detailed records of hours and labour costs under the law.

In terms of enforcement, employers generally felt that the benefits of non-compliance outweighed the risks, largely because they either felt they would not be detected by the authorities, or they would be able to provide a pre-prepared cover story to convince them of their compliance with the law. It was generally felt that the lack of evidence (such as failure to



provide detailed records) meant that inspectors would not have enough evidence to convict them of any illegality.

As is the case in other research we have conducted on the NMW, employers are generally not aware that inspections regularly take place. Whilst many were shocked by the size of the penalty they thought it was highly unlikely that they would ever be inspected, partly due to a lack of publicity around NMW compliance checks. Many cited campaigns such as the TV licence or benefit fraud adverts, which raised awareness of the need to perform a certain action and the consequences of failing to do so, but there was felt to be no such communication on the NMW, which made employers think it was not an important priority for the government, or at the very least, something which they found difficult to enforce.

Whilst many businesses said that they would like to become formalised, this was generally contingent on the amount of profit they made in the future. However, as some businesses had been in operation for a significant number of years already and were no nearer to becoming formalised, this seemed unrealistic unless something forced them to change, such as a penalty. Below we provide a number of recommendations for how such employers might be targeted and ways in which businesses can be encouraged to comply.

## 8.2 Recommendations

On the basis of these findings, we have made recommendations on how to raise awareness of non-compliance penalties and reduce the number of non-compliant businesses in the future. We would recommend the following:

### Recommendations for communications

- A communication/enforcement campaign to raise awareness of the penalties for operating informally. This should ideally involve a TV campaign, similar to that of the TV license or Benefit Fraud campaigns, and should leave no uncertainty about the consequences for those who do not comply with the appropriate business legislation. Although this could focus solely on non-compliance with the NMW, as businesses that are non-compliant in this area are sometimes not compliant in other areas, it may make sense to conduct a cross-cutting campaign, incorporating other non-compliance issues, such as non-payment of VAT.
- Given the pressure on budgets, other means of communicating these kinds of messages may also need to be considered. Using intermediaries (including trade bodies and professional organisations) to disseminate key facts could well prove useful, as could placing stories in the local press which would raise employers' awareness of enforcement activities in their area.
- Monitoring *how* these messages are communicated will also be important and it may help to learn from the government's MINDSPACE<sup>54</sup> approach to behaviour change. For instance, HMRC is currently trialling new ways of communicating its compliance messages playing on peoples' fears regarding loss aversion and their wish to fit in with social norms. It is doing this by sending targeted letters to people, stating that most people file their tax returns on time (often giving precise figures based on that individual's locality) or detailing what they would lose personally should they not comply.

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<sup>54</sup> <http://www.instituteforgovernment.org.uk/content/133/mindspace-influencing-behaviour-through-public-policy>

## Recommendations for working practices

- Small and Medium size businesses should receive not only greater monitoring by the necessary authorities, but also receive support (in terms of advice and guidance) along the way to make sure they embark (or stay) on the straight and narrow. Organisations who could perhaps provide early intervention could be Business Link or the Chamber of Commerce. It may also be helpful to have a confidential helpline businesses can call to obtain advice on employment matters and their obligations under the law.
- Helping businesses comply right from the outset would be a useful means of embedding good practice from the beginning. Most of the employers we spoke to as part of this research were registered businesses and, therefore, it may be useful to work in conjunction with Companies House to distribute guidance and information about compliance with the NMW.
- Linked to this, it was generally felt that there should be greater tax breaks or financial aid for small businesses who are starting-up. This may help businesses afford to pay the NMW and to operate more formally from the beginning. It would also mean that such businesses are known to the government and can therefore be investigated at any point down the line.

## Recommendations for the inspection process

- Sectors where non-compliance is known to be a significant problem should be subject to frequent spot-checks or 'random raids'. Businesses in these sectors who hear of these raids may therefore be encouraged to comply from fear of detection and prosecution.
- The Government should also be stricter with businesses who are found to be non-compliant with the law, issuing on-the-spot penalties as is the case currently, but ensuring that these are followed up and any arrears paid quickly. It is important there is a high level of visibility in undertaking such activities to ensure the possibility of detection is regarded as a threat by businesses.
- In addition, as accountants are often responsible for 'covering up' any misdemeanours, there is an argument for working closely with, or monitoring, the activities of accountants who work in certain industry sectors. In addition, penalties could also be given to accountants who are seen to be complicit in any illegal activities, which may encourage accountants to think twice about 'turning a blind-eye'.
- Longer term, it would be highly beneficial to align the processes for monitoring businesses who are operating informally. Key to this is data sharing. If, for example, HMRC identifies that a business is not paying VAT, this business could be examined to ensure that it is compliant in other areas. This may also work effectively with other government departments, such as the Health and Safety Executive. For example, In the case of the employer who complies with the necessary Health and Safety legislation, but was operating informally in all other ways, checks made at this stage for VAT information or book-inspection could have helped to identify any wrongdoing.

## Recommendations for working with employees

- This research found that employers can fail to comply with the NMW legislation because their employees allow them to. Therefore, it may be worth empowering employees so they are aware of their rights and know how to make a complaint if needs be. Ensuring staff at Jobcentre Plus educate jobseekers as to what wages they are entitled to will be an important first step, as will working with intermediaries to help the more vulnerable workers (such as those with English as a second language) get what they are entitled to.
- Lastly, this work has focused on the employer's perspective and experience of non-compliance with the NMW. It would be beneficial to explore the experiences of the employees themselves, as they are also complicit in this process, and therefore part of ensuring the continuance of non-compliance.

# Appendices

# Appendix 1: List of Reviewed Documents

BIS (2010), Government non-economic evidence to the Low Pay Commission 2010, Department for Business, Innovation and Skills.

Community Links (2009), *The Informal Economy*, London: Community Links

Community Links (2010), *Women in the Informal Economy in the UK*, London: Community Links.

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Jones, T. and Ram, M. (2004), "Illegal Immigrants and the Informal Economy: Worker and Employer Experiences in the Asian Underground Economy", *International Journal of Economic Development*, vol. 6, № 2, pp. 98-119.

Katungi, D., Neale, E. and Barbour, A. (2006), *People in low-paid informal-work: 'Need not greed'*, Bristol: Policy Press.

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McIntyre, D. and Stewart, A. (2009), *Invisible Workers: The Informal Economy*, Manchester: Community Pride and Oxfam.

Ram, M., Edwards, P., Gilman, M. and Arrowsmith, J. (2001), "The Dynamics of Informality: Employment Relations in Small Firms and the Effects of Regulatory Change", *Work Employment and Society*, vol. 15, № 4, pp. 845-61.

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TNS (2007), Undeclared Work in the European Union, European Commission.

White, G. and Croucher, R. (2007), Awareness Of The Minimum Wage In The Hairdressing Industry, Low Pay Commission.

## Appendix 2: Discussion Guide

LPC – National Minimum Wage Compliance Research

Employer Discussion Guide – DRAFT2 (15/06/2011)

**Outline of the research programme:**

- 18 in-depth interviews with employers who are deliberately evading paying the National Minimum Wage
- A range of company sizes, geographic locations and business sectors to be recruited
- Each interview to last 45 minutes to an hour

**Using this guide**

We use several conventions to explain to you how this guide will be used. These are described below:

Timings	Questions and Prompts	Notes
5 mins	<p><b><u>Underlined = Title:</u> This provides a heading for a sub-section</b></p> <p><b>Bold = Question or read out statement:</b> Questions that will be asked to the group if relevant. Not all questions are asked during fieldwork based on the moderator’s view of progress</p> <ul style="list-style-type: none"> <li>▪ Bullet = prompt: Prompts are not questions – they are there to provide guidance to the moderator if required.</li> </ul>	
How long it takes	Typically, the researcher will ask <b>questions</b> and use the prompts to guide where necessary. NB: Not all questions or prompts will necessarily be used in an interview	This area is used to summarise what we are discussing and is for your information only



Timings	Key Questions	Notes
5 mins	<p><b><u>Welcome and introduction</u></b></p> <ul style="list-style-type: none"> <li>• Thank participant for taking part</li> <li>• Introduce self, Ipsos MORI</li> <li>• Describe who has commissioned the research – Low Pay Commission (LPC), and that we are working alongside Community Links, a charity who have done a lot of work with employers like yourself.</li> <li>• Emphasise that we will be talking about the National Minimum Wage (NMW) and their views on paying it. Confidentiality: reassure all responses anonymous and that information about individuals will not be passed on to anyone – including LPC.</li> <li>• Give respondent written assurance of anonymity and reassurance that there will be no threat of sanctions as a result of talking to us.</li> <li>• Role of Ipsos MORI – independent research organisation (i.e. independent of LPC, government), gather all opinions: all opinions valid. Role of the LPC (independent of Gov, provides advice on the National Minimum Wage)</li> <li>• Get permission to digitally record – transcribe for quotes, no detailed attribution</li> </ul> <p><b><u>Work background</u></b></p> <p><b>Can you tell me first of all about your job and your business? PROMPT WITH:</b></p> <ul style="list-style-type: none"> <li>• What is your line of business?</li> <li>• When and how did you start?</li> <li>• How many employees do you have? (breakdown of full and part time, permanent, temporary, casual, etc.)</li> <li>• Are all paid employees?</li> <li>• Where do you sell?</li> <li>• How is it funded?</li> <li>• Are you a sole trader, a limited company? Are you the sole owner?</li> </ul>	<p><b>Welcome:</b> orientates participant, gets them prepared to take part in the interview.</p> <p>Outlines the ‘rules’ of the interview (including those we are required to tell them about under MRS and Data Protection Act guidelines).</p> <p><b>Introductory text</b></p> <p>MODERATOR NOTE – Do not use acronyms. Say “National Minimum Wage”, not NMW. Say Low Pay Commission, not LPC, etc.</p> <p>Introduction to get the interviewee talking about their job and industry</p>
10 mins	<p><b><u>Perceptions and knowledge of the National Minimum Wage</u></b></p>	<p>To gain some initial views of</p>

	<p><b>When setting up your business, how did you decide what to pay those working for you?</b></p> <p><b>What do you know about the minimum wage? How does it work?</b></p> <ul style="list-style-type: none"> <li>• Are you aware of different rates of pay for different age groups? What are they?</li> <li>• Are you aware that apprentices are now to be paid a NMW?</li> <li>• Are there any exemptions to who should be paid the NMW?</li> </ul> <p><b>Did you seek for information on the minimum wage?</b></p> <ul style="list-style-type: none"> <li>• <b>How does your business get information about the NMW?</b></li> </ul> <p>MODERATOR NOTE: Probe fully for responses. Probe on Business link, other official or government websites, friends or relatives, networks of employers, friends in the industry. PROBE on sources mentioned – why, are they trustworthy etc.</p> <p><b>What do you think about this/these sources? Do you think you have received enough information about the NMW? What information would you like to know? What’s missing?</b></p> <p><b>Has the information you’ve received on the NMW been clear?</b></p> <p>Probe for gaps and how any gaps should be filled</p> <p><b>And what do you think about the NMW? Do you agree with it? Why?</b></p> <p><b>What are the good things about it? What are the bad things? Have your views towards the NMW changed over time? What has prompted this?</b></p> <p>MODERATOR NOTE: Probe for as much detail as possible here.</p> <p><b>Do you think that government should be able to dictate what employers pay their staff? Why?</b></p>	<p>the NWM. MODERATOR NOTE: Get an idea about the overall views on the policy i.e. is it seen as a burden, a necessary evil or do they really support it?</p> <p>NMW calculator is here: <a href="http://www.direct.gov.uk/en/Employment/Employees/TheNationalMinimumWage/DG_10037277">http://www.direct.gov.uk/en/Employment/Employees/TheNationalMinimumWage/DG_10037277</a></p>
<p>5 mins</p>	<p><b><u>The impact of the NMW and the reasons for non-compliance</u></b></p> <p><b>Why did you decide not to pay the minimum wage to your employees?</b></p> <p><b>Has this decision, in your view, helped you generate more or less sales? And more or less revenues?</b></p>	<p>This section covers impact that the NMW has had on their business and the participant’s reasons for why they do not currently pay the NMW for any/some of their employees.</p>

	<p><b>Have the rises in the minimum wage affected your business? If so, how?</b></p> <ul style="list-style-type: none"> <li>• Has it had an impact? Why?</li> <li>• Tell me about when it was introduced. What happened? Did you get much information about it? What did you do about it?</li> <li>• Did it lead to any changes in how you operate the business?</li> <li>• <b>INTERVIEWER NOTE: Try and get a sense as to whether rises have impacted on non-compliance</b></li> </ul> <p><b>What do you think about these rises?</b></p> <ul style="list-style-type: none"> <li>• What has this meant for you?</li> <li>• What has this meant for your employees?</li> <li>• Are the successive rises a good thing in your opinion? Why?</li> </ul>	
<p>10 mins</p>	<p><b><u>Non-compliance with the NMW</u></b></p> <p><b>We understand that none or not all of your workers are paid at the current rate for NMW?</b> Interviewer note: please reassure employer that research is anonymous and their participation is confidential.</p> <p><b>How long have you not paid all, or part of your employees, the minimum wage?</b></p> <p><b>How many of your employees are paid the minimum wage per hour? Are they full time or part-time employees, on permanent contract?</b></p> <ul style="list-style-type: none"> <li>• How do you decide who is paid the NMW or more than the NMW and those who are paid below it? PROBE FOR: different jobs, unskilled workers, part-time employees, trainees, not on permanent contracts etc.</li> <li>• Are these older employees (the first ones you hired or the other way around?)</li> </ul> <p><b>How long have these employees not been paid at the NMW?</b> PROBE FOR: Always, since the introduction of the NMW, or more recently?</p>	

	<p><b>Do you think that paying less than the NMW affects your employees? If yes, how?</b></p> <p><b>If not, why not? How does being paid less than the NMW affect your employees?</b></p> <ul style="list-style-type: none"> <li>• Are workers aware of the fact that they are being paid below the NMW? IF SO: What makes them agree to being paid below the NMW? PROBE FOR: Haven't heard of it/new to the country? Don't think it's relevant to the industry or their job? Don't want to risk losing their job? Are compensated in other ways i.e. flexibility, housing, free travel, ability to claim benefits, etc?</li> <li>• Do they think that employees are being paid enough money for the job that they do? Why? What factors do you consider when deciding what the wage rates should be?</li> <li>• Are there any benefits to employees for being paying below the NMW? What are they?</li> </ul> <p><b>How easy or difficult is it to recruit employees to work for less than the NMW?</b></p> <ul style="list-style-type: none"> <li>• How do you hire your employees/what channels do you recruit through?</li> <li>• If it is through word of mouth and friends, do you negotiate the wage with the potential employee?</li> <li>• If you offer to pay less than the minimum wage, are all of those wanting the job willing to accept it? Is this more now given the economic conditions?</li> <li>• What other benefits are offered to employees who are not paid the NMW?</li> </ul> <p><b>As an employer, how does paying the NMW affect you?</b></p> <ul style="list-style-type: none"> <li>• Would this have a big financial impact?</li> <li>• Would the business continue trading?</li> <li>• Would you be forced to employ fewer staff? What effect would this have on the company?</li> </ul> <p>MODERATOR NOTE: Pay particular attention to the words and phrases respondents use to describe how they would be affected.</p> <p><b>Is your business profitable at the moment? How has the recession affected your business in</b></p>	
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	<p><b>particular?</b></p> <ul style="list-style-type: none"> <li>Has this changed any of the ways in which you work? (Probe for turnover details, any cost-cutting measures implemented etc.)</li> </ul> <p><b>What are your reasons for not paying the NMW?</b></p> <p>PROBE FOR AS MUCH INFORMATION AS POSSIBLE HERE. Again, pay particular attention to the words and phrases used by the respondent.</p> <p><b>Can you talk me through what happened to you/the business which has stopped you from paying the NMW?</b> <i>Interviewer note: Try and get a sense of their journey to this point, and the ‘tipping points’ along the way which led to them not paying the NMW.</i></p> <p><u>Probe for:</u> Can’t afford it, wages governed by market-rates/the industry, employees willing to work for lower wages, detection unlikely? <b>Try and get a sense as to whether it is choice or necessity which dictates this</b></p> <p><b>What do you think the reasons might be for a business not paying the NMW?</b></p> <ul style="list-style-type: none"> <li>In your view, what are the advantages of not paying the minimum wage?</li> <li>To what extent do you think it is choice or by necessity that employers don’t pay the NMW?</li> <li>What benefits do you think employers gain by not paying the NMW? Do you feel that there are there any downsides of not paying the NMW?</li> <li>When making business decisions, what are your priorities? Where do wage costs figure in these priorities? Why is that? What impact does prioritising these elements of your business have upon wage levels?</li> </ul> <p><b>How do you get around not paying the minimum wage?</b></p> <ul style="list-style-type: none"> <li>Why do you say this?</li> <li>What can/do employers do to get round paying the NMW? (Probe for keeping 2 sets of books, cash-in-hand work, under-reporting hours etc)</li> </ul> <p><b>How do you do your bookkeeping and how you reflect the wages?</b></p> <p><b>Is it easy for you not to pay the minimum wage?</b></p> <ul style="list-style-type: none"> <li>Do you think the benefits of not paying NMW outweigh the risk of being caught? Or outweigh the penalties</li> </ul>	
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	<p>you might face if you were caught?</p> <p><b>Do you think employers are more likely to pay the NMW if the business is performing well or are wage rates dependent on other factors? Why?</b> Probe fully</p> <p><b>Are there any particular industries that are more or less likely to pay the NMW?</b></p> <ul style="list-style-type: none"> <li>• What about the industry you're in?</li> <li>• Which other industries are you aware of where this is common? What is driving this?</li> </ul> <p><b>Do you think that employers don't pay NMW because of errors or because they don't understand how it works, or do you think it is something that people do deliberately?</b></p> <ul style="list-style-type: none"> <li>• If yes: What can be done about this? What needs to happen to raise awareness? Do you think that by raising awareness more businesses would comply? Why?</li> <li>• Is this a justification?</li> <li>• Could the perceived complexity of the system put some people off engaging with it?</li> <li>• Are there any types of employers that are more likely to not comply with the NMW law by mistake? (Probe for small businesses, immigrant-origin entrepreneurs, industries where overtime or seasonal work is common) what you mean here and why is this important?</li> </ul>	
<p>10 mins</p>	<p><b><u>Attitudes towards non-compliance penalties</u></b></p> <p><b>Do you think it is likely that the authorities will discover that you are not paying the NMW?</b></p> <ul style="list-style-type: none"> <li>• How do you think this would happen?</li> <li>• Who would be responsible for making sure the NMW is paid? How do they find out if it is not?</li> <li>• Does it concern you that you may be caught? Why?</li> <li>• Does the fear of being caught not act as a deterrent for you? What about other employers? Why?</li> </ul> <p><b>What do you think may happen to you if you were caught paying below the NMW?</b></p>	<p>This section establishes to what extent participants are aware of the penalties they could face if caught and tries to capture the risk-benefit balance that employers are willing to extend to.</p> <p>Good summary of the process on the business link website:  <a href="http://www.businesslink.gov.uk/">http://www.businesslink.gov.uk/</a></p>

	<p>PROBE FOR: Having to pay money back, warning to comply, fine or financial penalty, could take you to court.</p> <p><b>Officers from HMRC are responsible for inspecting business records to check that businesses do comply with the NMW. If they find that an employer is not complying, or cannot show that they have been paying the NMW, the employer will have to pay back the arrears of the underpayment to the employee/s affected (at the current rate of NMW) and will have to pay a fine of half the value of the total underpayment up to a maximum of £5,000. Further action can be taken for those who reoffend or who do not comply with the penalties. These can include civil and criminal prosecution and naming and shaming.</b></p> <p><b>What do you think of this? Is there anything surprising? Why do you say this?</b></p> <ul style="list-style-type: none"> <li>• What effect would this have on the business?</li> <li>• Do you think these penalties are fair?</li> <li>• Do they provide any deterrent to stop you from paying below the NMW?</li> </ul> <p><b>Do you see any incentive for you to become a business compliant with the NMW?</b></p> <ul style="list-style-type: none"> <li>• What would they be?</li> <li>• IF NOT: What do you think would provide that incentive?</li> </ul>	<p><a href="https://www.bdotg/action/detail?itemId=1074403472&amp;type=RESOURCES">bdotg/action/detail?itemId=1074403472&amp;type=RESOURCES</a></p>
<p>10 mins</p>	<p><b><u>Attitudes and triggers to other aspects of compliance</u></b></p> <p><i>Please reiterate assurances of confidentiality and independence</i></p> <p><b>Are you registered with all or some of the appropriate government authorities (Health and Safety, hygiene, income taxes, VAT, PAYE etc?)</b></p> <p><b>IF NO: Why not? What is stopping you?</b></p> <ul style="list-style-type: none"> <li>• Do they know they have to do this? If so, why aren't they? (lack of Information about obligations, cost,</li> </ul>	<p>The key elements of this section are the interaction between the compliance officers and the employer. In particular, the level of detail the employer had about what was happening and why they were chosen. What employers learn from the process is covered here and in the closing section</p>

<p>don't know how to or feel it doesn't apply to them, believe they can get away with it, don't agree with it?).  <i>(Interviewer note: Try and get a sense of whether they want to pay and can't or don't know how to, or whether they don't want to pay and won't)</i></p> <p>If you are registered to all, why did you decide to register?</p> <p>How was the process for you?</p> <p>Have you noticed/experienced any benefits?</p> <p>If you are registered to some, which one? And why these and not the others?</p> <p><b>IF REGISTERED:</b></p> <p><b>Why did you register with the Inland Revenue?</b> When did you do this?</p> <ul style="list-style-type: none"> <li>• Has there been any disadvantages and/or advantages to registering?</li> <li>• What do you think about trading and not being registered?</li> <li>• Has the registration helped your business in terms of access to credit, more customers, being able to advertise etc?</li> <li>• Are you only doing business formally? If not, why not?</li> </ul> <p><b>IF NOT REGISTERED:</b></p> <p><b>Have you ever thought about registering your business with the Inland Revenue?</b></p> <p><b>IF YES: Why?</b></p> <ul style="list-style-type: none"> <li>• Have you tried to? If so, did you have any problems/difficulties?</li> <li>• Are you going to try to get registered with the Inland Revenue in the future? If so, what would help you</li> </ul>	<p>Good summary of the process on the business link website:  <a href="http://www.businesslink.gov.uk/bdotg/action/detail?itemId=1074403472&amp;type=RESOURCES">http://www.businesslink.gov.uk/bdotg/action/detail?itemId=1074403472&amp;type=RESOURCES</a></p>
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	<p>complete this process? If not, what has put you off?</p> <p><b>IF NO: Why?</b></p> <ul style="list-style-type: none"> <li>• What is stopping you?</li> <li>• What do you think about trading and not being registered? Are you afraid of being 'caught' by the authorities?</li> </ul> <p>Does trading informally help/not help your business in terms of profits, expansion, access to credit etc?</p> <p><b>Do you think there are advantages in trading informally? Do you see any disadvantages?</b></p> <ul style="list-style-type: none"> <li>• What do you think about businesses operating informally? Do you think it's justified? Why?</li> <li>• What do you think about employees working in more informal businesses/sectors? Do you think it's justified? Why?</li> </ul> <p><b>Would you be interested in registering with all the appropriate authorities?</b></p> <p><b>Why/why not?</b></p> <p><b>Do you think your business operates similarly to other businesses in the same industry?</b></p> <ul style="list-style-type: none"> <li>• In what ways is it similar/different? Why?</li> </ul> <p><b>IF WORKING INFORMALLY:</b></p> <ul style="list-style-type: none"> <li>• Can you tell me about the events that led to you thinking about working informally?</li> <li>• What was the final tipping point to you deciding to work informally?</li> <li>• Do you think you'll continue to work informally? Would you like to formalise the business?</li> </ul> <p>TRY TO GET AS MUCH DETAIL AS POSSIBLE HERE ABOUT THE EVENTS THAT LED UP TO THEM OPERATING INFORMALLY. WE WOULD HOPE TO USE THIS FOR CASE STUDIES. (I.E. DID THEY START OFF WORKING FORMALLY AND THEN SOMETHING HAPPENED?)</p>	
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5 mins	<p><b><u>Conclusion and Thanks</u></b></p> <p><b>Of all the things we have discussed today, what do you think is the key message for me to take back to the Low Pay Commission about the NMW or informal working?</b></p> <ul style="list-style-type: none"> <li>• Is there anything else you would like to add?</li> <li>• Thank participants; explain the next steps (e.g. what we/LPC will do with the findings).</li> </ul> <p><b>THANK AND CLOSE.</b> Reassure about confidentiality</p>	Key messages, draws interview to a close