LONDON
Work Based Learning Alliance

Looking ahead to 2020: What will the introduction of a Levy mean for the future of apprenticeship delivery?

LWBLA Briefing Paper

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1. Overview: How significant is the introduction of an apprenticeship levy?

The concept of a levy was not in the Conservative manifesto for 2015. Perhaps ironically the levy was actively considered by the Labour Party but shelved for fear of being seen as 'anti business'. The levy has received a cautious welcome in Parliament from all the main political parties.

The CBI who represents most employers likely to have to pay the levy have opposed the imposition of a mandatory levy but are believed to have failed. The Government has recently completed a consultation exercise that the LWBLA contributed to and key decisions are anticipated as part of the Comprehensive Spending review to be announced in the Autumn Statement on the 5th December 2015.

Why is the Government introducing a levy? In simple terms the Government has an ambitious target to generate 3,000,000 new apprenticeship starts that is close to a 35% increase on the previous Parliament whilst firmly controlling public expenditure. In simple terms the Government needs to find significant extra funds to pay for the cost of this pledge.

Many organisations engaged in the organisation and delivery of apprenticeships see the introduction of a levy as potentially a highly significant and positive move by Government.

In the LWBLA's view the levy is not just a 'pot of money' paid for by employers: the ripple effect will amount to the most radical change to public policy on apprenticeships since the late 1980's/early 1990's. In effect an industry 'game changer'.

The levy will in time come to replace the central role of Government as the primary paying customer. Levy paying employers have a fundamental choice: either treat the levy as lost income, or recoup (as the customer) as much of this cash as possible: by employing and training apprentices.

The Government has three essential and connected strategic decisions to make with respect to the levy:

- How much aggregate cash does the Government wish to raise through the levy and see spent on an annual basis,
- How many employers does it want to make mandatory payees into the levy, (by lowering the employee headcount more employers are required to pay the levy but at a lower cost per employer), and
- As a 'tax' on employment what is the rate applied through the payroll per member of staff.

Consequently there are three key public policy questions the Government can and no doubt will take a position on:

- What is the relationship between levy funds and tax payers cash. This is fundamental to defining the scale of 'red tape' that the system will require. If the two funding streams remain separate it makes the levy simpler to operate but may (deliberately) restrict its use.
- What do they (the Government) want to do with any unspent levy funds; the choices are relatively simple: leave the funds in the levy: allow the Government to keep the money as a 'windfall', or redistribute levy funds to employers and/or contribute to other complimentary programmes. This will be the focus of intense lobbying outside of Government.
- Define who an 'apprentice' is: either continue with the 'status quo': both vacancies and in-situ employees, or restrict the use of the levy to a new vacancy. Although unlikely, if the later approach is adopted the Governments 3,000,000 starts target will collapse, and fundamentally refine the long-term rate of take up. This is a key point in any proposed legislation across any one of five bills in the current parliamentary session.

The impact of a levy will be felt on Government, all employers both large and small, and critically the organisations responsible for making this work - the training providers.

2. Headline Numbers & Impact of adopting a Levy

If the Government uses Employers NI as the levy instrument then a 0.7% increase is estimated to raise close to £2bn across the UK from 9,500 employers (assuming all employers with a headcount greater than 249). This generates a charge of over £200,000 on average to the levy-paying employer.

If you apply an average annual spend of £4,000 to train an apprentice each employer is fully funding over 50 apprentices a year. It is the aggregate UK wide impact that is so significant: the levy would pay for up to 475,000 apprentices every year.

The introduction of a levy will in time transform how the suppliers of apprenticeship training shift from within a state regulated sector into a highly competitive customer led marketplace.

The table below is an illustration and by comparison in 2014/15 the Government used £1.5bn of tax-payers cash (from both DfE and BIS) to fund over 800, 000 apprentices of whom 470,000 were in year starts. The higher the headcount the more funds are directly raised in the levy.

Using Employer NI Contributions to finance the levy

0.3%	**0.5%**	**0.7%**
£1.3bn	£1.5bn	£1.7bn

3. Why did the Government choose the levy as a policy solution?

The Government has partly stumbled into this policy outcome by recognising that employers spend less on training staff than they did 10 years ago.

Employers appear reluctant to invest in training despite having had the benefit of sustained reductions in corporation tax yet continue to critically complain of 'skills shortages' across the UK.

In terms of the UK's comparative productivity within the OECD this relative 'failure to invest' in its workforce by UK PLC has increasingly frustrated Government. The key issues or 'culprits' depending on your point of view are that:

- 70% of all apprentices in the UK are employed by SME's, so the failure to invest is predominantly by large corporate employers: leaving Government over reliant on small employers (who compared with PLC's have limited internal resource and infrastructure), and
- Total public service employment although declining collectively employs close to 20% of the UK's total workforce yet are estimated by Government to recruit less than 7% of all apprentices.

The UK Government has the support of the OECD. Many high performing economies have strong systems of vocational education with successful models of apprenticeship often backed by the use of a levy on employers.

The OECD's approach broadly supports and reinforces the use of a levy to enable employers to drive training solutions that tackle both deep rooted/structural unemployment and secure productivity gains within individual firms. This in turn has long-term benefits in producing a higher skilled workforce for the country.

The typical British worker will spend five days: all week at work when the German worker achieves the same level of productivity by Thursday evening. This is known in Government as the 'productivity puzzle'.

That is why apprenticeships are increasingly viewed by Governments within the OECD as generating high economic returns for both the individual and employer.

In proposing the introduction of a levy the UK has found a credible solution that the previous Government via the Richard Review and its subsequent iterations had failed to achieve.

The Government achieves two major advances: firstly it no longer carries the primary risk of delivery with its suppliers, and over time has the power to extend the levy to replace all tax payers/ public money. In effect what the Government is doing is transferring volume and outcome risk from the state to the market.

Politically the Government can exhort a target without fear of being directly accountable for performance. As the new levy beds down over time the Government will inevitably be encouraged to lower the headcount threshold to capture as many employers as possible.

4. Designing the Levy: the current strategic Fault lines

The Government accepts the levy is a 'tax' on employment (although it would never use this word presentationally), and will redefine its role as the 'market making'.

The headline risk proposition for Government can be summed up as the following:

- *That within an18 month time line the Government can design, commission, build to budget and launch a fully functioning Levy system able to raise up to £2bn annually with individual employer accounts, and an E-voucher system capable of accurately holding the individual records of over 500,000 apprentices each with an individual price point and rate of progression.*

This will be the obvious point of holding the Government to account for such an ambitious reform programme.

The current consultation document has exposed a variety of design 'fault lines' on the establishment of apprenticeship levy. They are set out below:

Devolution versus 'ease of use'

The single issue that could torpedo the Government approach is by allowing the issue to be devolved to the four nations. A nightmare scenario could emerge with employers having to manage four different systems, levy rates and accompanying regulation/'red tape'.

The Government either has a brilliant technical solution that 'hides all the wiring' (that these differing national approaches may produce) or reaches a sensible agreement with all of the devolved Assemblies/Governments on how the levy will operate. How the Government hangs this all together strategically and what operating system the Government builds is fundamental to the outcome. Time is of the essence.

'Red tape'

Inevitably all eyes will focus on the scale of 'red tape' and compliance that the Government legislates for in the coming months.

Business led lobbying should see a sympathetic Government respond by creating a highly deregulated light touch approach; but if this is linked to tax payers cash in any way - is that realistic? Will the regulations be limited to a few pages or a 500 page technical manual as at present? How will the Government tackle basic questions such as define the employer's headcount, complex business structures, and simple measurements of quality and performance? If an employer has a lot of apprentices but very few complete the training what happens next?

Perceptions of 'red tape' could will define businesses sentiment and potentially damage 'dent' take up. For example any reference to using Ofsted to inspect employers would be fiercely opposed.

The CBI wants to see the whole process of levy policy overseen by an independent commission as used in low pay. But as the levy is a £2bn fund overseen by Government there are likely to be subtle but significant differences between any body independent of Government to be able advise and/or enact key money raising and spending decisions.

Actually two models are being created not one:

The Government is creating two different funding models for employing apprentices: the levy paying large employer who has no choice but to pay up to 100% of the cost, and the non levy paying small employers who voluntarily choose whether to employ an apprentice but is expected to pay up to 50% (frameworks) or 33% (standards) of the cost of training. This approach both complicates and will create different tensions over pricing and risk management.

'Fully funding' 16- 18 year olds & Split Departmental Budgets:

Can the Government confirm that apprentices aged 16-18 year olds remain 'fully funded, and that 'fully funded' actually means at no cost to the employer? The DfE budget for 16-18 year olds is 'not protected' within the CSR, but in BIS the apprenticeship budget is: so will employers face hidden cost/bills if the cost of training exceeds the income received.

Additional or substitute Government funding:

The Government will be under increasing pressure to reallocate funds in year, either to fund high performing employers, be used by itself to progressively reduce/dilute the taxpayer's financial commitment to apprenticeships, or to fund new 'pet projects'. The latter issue will be pushed heavily by AoC/ FE Colleges who need replacement income streams given the planned scale of reductions to the adult skills budget by 2020.

EU Competition law:

The Government will need to satisfy itself and the wider business community that the design and operation of the levy is fully compliant with all aspects of EU Competition law and the so-called 'de-minimus' rules. For example the principle of allocating unspent levy funds to another levy payer – a potential commercial competitor will no doubt be tested. The levy as a policy instrument would collapse if a claim in law resulted in damages or court fine to an employer or Government.

The power of the Civil Service:

The future of the BIS Department is under scrutiny as part of the budget reductions being sought within the current CSR. BIS officials see the levy as a direct replacement for taxpayers cash to mitigate the full impact of major reductions to the BIS budget: despite the Government stating the apprenticeship budget is 'protected' this is the debate currently taking place behind closed doors.

Inflationary or deflationary effect on the cost training:

Funding apprenticeships through existing frameworks have an established cost base. The proposed new trailblazer 'standards' and associated funding bands for apprenticeships will drive up the aggregate cost of training (inflationary) particularly where employers establish 'in house' training functions to recoup as much of the cash as possible.

However if the Government deflates the cost of training many industry sectors will abandon apprenticeship recruitment as the cost of training exceeds the price point/income available (deflation). The crude and arbitrary nature of banding apprenticeship standards remains completely untested.

This is the most likely 'Achilles heel' for the Government in 2/3 years time; the levy works well its just that no one can make the unit pricing fit the cost of delivery without fundamentally compromising the quality of outcomes.

Who do HMRC trust to collect and manage the levy funds?

Perhaps the obvious answer is the SFA: but they are remarkably unloved and widely perceived by Providers in particular to be 'part of the problem' not the solution. Why: because their track record in making systems work properly and collaborating with customers is poor. No one would mourn the SFA's closure if the current BIS commissioned McKinsey review recommends merger with other Government sponsored Agencies. A decision will be taken by Government within the next 6 months as part of the CSR and commissioning of the levy operating system. If the SFA is not chosen to manage the levy, then who?

And finally,

Public Policy overload:

The Government has a timetable where it wishes to enact major changes across Post 16 education: all in one year: 2017.

This includes: devolution in England of the adult skills budget which currently contains the funding for all adult apprentices, completing the area wide reviews to determine the future sustainability of FE Colleges, the radical curriculum switch from apprenticeship Frameworks to Standards, and of course the introduction the levy for April 2017. The LWBLA view is that the scale of change management within such a condensed timetable is a key strategic risk across a number of very sensitive policy areas.

5. How Employers respond to the introduction of the Levy

In simple terms the introduction of the levy is a 'blunt' instrument creating winners and losers across UK's business community.

Employers face a simple choice: either accept the loss of income the levy generates to the fund, or recoup as much of this lost revenue.

For employers whose recruitment strategies are a complex comparative choice, academic graduates will continue to offer a relatively low risk option allied to discretionary in-house training costs. Individuals will be required to invest in there own 'human capital' by taking out loans and in return employers cherry pick the best.

For many large employers whose brand is closely identified with its profitability critical questions are likely to be asked at Board level: Will apprenticeships endanger or enhance the value of the employer/brand reputation for what is overall a relatively insignificant amount of money? The crude conclusion could be: Pay the levy and move on.

Alternatively Levy paying Finance Directors will instinctively assess the opportunity to recoup lost income.

The HR team in a large corporate employer will have broadly one of three risks / return strategies to pursue in recouping the levy fund. This will be driven by the approach taken by the Board /Finance Director. Three obvious strategies stand out:

- Build an in-house training team and charge the maximum price on the levy by employing a set number of apprentices to secure at minimum risk a break-even position. The merit of this approach being it is relatively simple to execute, directly accountable and potentially profitable. Or alternatively:
- Outsource the apprenticeship service on a fixed price to a single contractor within the HR supply chain. This transfers all delivery risk and opens up the prospect of securing an operating margin for the HR Department.

  For example for every £1 recouped via the levy the training supplier discounts or rebates a % to the employer, who in turn aims to deliver a margin through a combination of an exclusivity contract, with cross selling and economies of scale.

  This is an obvious choice for national recruitment companies to exploit through existing relationships with HR decision makers in managing the 'talent pipeline'. As the levy and apprenticeship take-up matures an important defensive strategy amongst competitor HR service companies will be to develop a superior apprenticeship training offer particularly in driving professional status such as in IT, Accountancy and law.
- For a number of PLC's who have long-term HR strategies to grow the 'talent pipeline' of the workforce the HR Department will look to create a specialized supply chain of providers to dilute risk. Different levels of expertise and variable pricing depending on the industry, firm type and size will be adopted. Different delivery models will be developed either headed up by recruitment agency to manage or a consortia of training organisations.

For traditional 'high value' industries such as power, gas and engineering, apprenticeships offer a means to plan, benchmark and control recruitment costs whilst extending license to practice with new technical standards and critically a route to professional status.

However for other newer industries such as retail changes to NI thresholds and introducing the living wage will have a complex, cumulative impact on low margin industries that already employ large numbers of people.

Definitions of what counts as an apprentice will be central to take up.

If apprenticeships are restricted to new vacancies the Governments target will collapse, if it allows all staff to receive standards driven by in house training the levy will run out of cash as in-house training is rebadged.

So where will the line be drawn? Can apprentices progress in terms of qualifications/skill acquisition, and if so will the levy pay more than once for same individual? The so-called progression debate. This will be a key question posed by businesses driven by the journey to technical and professional competence or license to practice arguments.

In the long term the Government accepts that business sentiment and the prevailing macro economic conditions will determine the Governments success or failure to achieve the planned increases in apprenticeship numbers and the quality of outcomes.

The challenge for Government will be to decide what to in a down turn when employers are reducing the headcount whilst trying to stimulate the demand for apprentices.

The experience of the recession in 2008 to 2013 demonstrated the importance of training providers in stimulating demand as overall volumes significantly increased at a time of rising unemployment.

6. How can providers manage risk with the shift from a predominantly regulated sector into a price sensitive customer led marketplace?

Who delivers apprenticeship training?

In England over 75% of all apprentices are trained by non FE College providers: the so-called independent training provider.

These independent training organisations have highly diverse ownership and management structures; including charities, family businesses, in-house company training teams, privately owned companies, PLC's and private equity owned/ managed organisations who collectively deliver the overwhelming volume of training across the UK.

The rapid expansion of sub contracting as the SFA restricted issuing new contracts has made much of the delivery invisible. Whilst FE Colleges may draw down 30% + of all public funds they actively outsource and subcontract delivery of up to 50% of the funds on a college-by-college basis. A management fee is charged top slicing a % of the taxpayer's money that would otherwise be spent on training the apprentice. This is the outcome from the implementation of Government policy and internal management decision-making within the SFA since 2012.

For example in London the LWBLA estimates there are over 150 different organisations delivering apprenticeship training in a highly competitive environment, of which less than half of whom are believed to hold a direct contract with the SFA. FE Colleges outsource significant levels of apprenticeship funding in London with up to 85% of actual delivery of apprenticeship volume outside of FE Colleges.

The future of Government funding agreements:

If all apprenticeship funding is routed through the employer why does the Government need to directly manage a relationship with training providers?

This is the fundamental risk impacting on all current training providers including FE Colleges. For over 25 years the system of annual funding allocations (with in-year variations) has been the defining principle upon which commercial providers are valued enabling the sector to grow and mature.

In London with more than 50% of all new entry level vacancies requiring degree level qualifications class room based vocational learning will decline as high skill high wage and low skill low wage redefine labour demand. Apprenticeships will grow in popular demand from individuals as they seek a salary and training and avoid the debt trap of going to university.

The pressure on FE Colleges to collude in setting/fixing prices will reinforce invisible oligopolies. Many FE Colleges are going resource 'hungry' and face a real prospect of insolvency.

The recently announced Area Wide Review process will reveal over the next 18 months the scale of indebtedness, the requirement for institutional mergers and facilitate new low cost organisational structures to be established.

In England across many town/country settings the FE College has no real competition other than from another FE College. In effect competition between different state owned providers is largely a 'zero sum' game.

By contrast in London the levy will form part of the debate that accelerates mergers between the existing 49 FE & Sixth Form Colleges.

Recognising the value of the training provider sales team:

This is obvious as Providers recognise employers as the paying customer and refine there operating strategy accordingly. Those providers with first class sales teams will thrive and new norms will be established most familiar to or closely aligned with private employment/recruitment industry. Bigger clients will be professionally account managed by providers offering a total solution. Those providers who choose not to invest in professional sales teams face the prospect of rapid decline.

The commercial strategy for providers is whether to openly explain how to maximise levy recoupment for the employer, be price sensitive, or use there acknowledged unique expertise and market position to max the fee per apprentice. No doubt an enterprising independent consultant will target levy paying employers with an 'I can get you free training.com' website. Big private providers will look to squeeze out/buy out the competition from other providers to reinforce a total workforce solution for there large clients.

The shift from Frameworks to Standards:

Apprentice curriculum will drift increasingly towards level 3 becoming the new norm. English and Maths criteria will squeeze out many capable people because employers and providers will be fundamentally risk averse. The English and Maths debate will be fundamental to the success of apprenticeships. The rigidity of using the GCSE curriculum will be exposed and new functional models will develop. In the short-term individuals who have already achieved a grade c or above in English and Maths will get recruited.

Apprenticeship training has been treated like a culinary recipe; if in doubt add more ingredients.

The new standards will introduce new learning content, take longer and require more off the job training. The end test will control the performance and satisfaction levels of employers and apprentices alike. Providers may struggle initially as no one knows how to make the end test work, what new skill set staff will require, and fundamentally employers will have no appetite to accept an unknown level of performance risk.

Do not be surprised if there is major crisis of implementation as the number of Standards mushroom but appear undeliverable. Subtly a number of Standards may turn out to be frameworks in disguise. The Government doesn't really know what is and isn't 'old wine in new bottles' as there is no organisational oversight of all Standards. More importantly as the Standards become deregulated comparisons and validation by the OECD and domestic industry groups potentially becomes more complex.

Private sector employers of all shapes sizes and industries will not accept an Ofsted style regime, have no capacity to control the so-called 'Prevent' agenda and the Government should consider a radical new type of Office of Apprenticeship ombudsman

The turning point for the provider base/industry will be whether the Government continues with or abandons the system of annual publicly funded allocations within a single contract agreement. The introduction of the E-Voucher opens up this prospect and would trigger a transition into a wholly commercially industry shifting away from a cash positive to a more typical invoice driven cash negative trading position.

For providers who do not adjust the operational business model they run the serious risk of commercial decline or worse: exit.

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