Small Business Wage Trends: Country and industry insights
Research Note
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Small business wages growth rising

At the start of 2022 there have been signs of increasing small business wages\(^1\) growth across the three countries tracked by Xero Small Business Insights (Australia, New Zealand and the United Kingdom). At its most basic level these wage gains are underpinned by demand for employees outstripping supply, although the reasons for this differ between the UK and the two southern hemisphere countries. There are also specific sector issues that are resulting in different small business wages growth results across sectors. On balance, we expect ongoing labour market tightness to persist in the coming months and for nominal wages growth to accelerate further in all three countries.

Signs of small business wage pressures building

In February 2022 small business wages, as measured by the Xero Small Business Index, rose 4.3% year-on-year (y/y) in the United Kingdom\(^2\), 4.3% y/y in New Zealand and 3.3% y/y in Australia. These are well above the 0.9% y/y, 3.0% y/y and 2.5% y/y growth rates recorded in February 2021. These wage rates are also above the long-run average for this series in these countries (3.4% y/y UK; 3.9% y/y NZ and 3.0% y/y AU).

**Small business wages, international comparison**

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<th>Australia</th>
<th>New Zealand</th>
<th>United Kingdom</th>
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<td>3.3%</td>
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\(^1\) The Xero Small Business Index reports wages in nominal terms. \(^2\) The February 2022 UK growth rate is partly due to the low base of February 2021 - adjusting for this wages are up 2.6% y/y.

Are higher wages good or bad?

Wages are a complex indicator for small businesses.

On the one hand, if a small business is able to pay higher wages this is a positive sign that the business is performing well and is making an increasing contribution to the broader community through employing and paying staff. This can have a circular benefit as higher wages of staff flow through the community and support higher spending in small businesses. This is why the Xero Small Business Index incorporates wages as a positive indicator in terms of the 'health' of small business. If wages growth rises then the Index rises (everything else being equal).

On the other hand, we also acknowledge that if wages accelerate too fast that can threaten the future sustainability of a small business which is clearly not a positive outcome. This is particularly the case if wage rises are not accompanied by productivity gains.
Tight labour markets, hampered by COVID-related supply constraints, underpin rising wage pressure

Given what is happening in national level labour markets, it is not surprising small business wages growth is starting to accelerate and is likely to continue to in the coming months.

National level data highlights that small businesses in all three countries are competing for new staff in tight labour markets. The latest available unemployment rate in all three countries is around recent historic lows - United Kingdom (3.9%), New Zealand (3.2%) and Australia (4.0%).

The Xero Small Business Index data, unlike this national level data, looks at small business jobs growth only (see charts below).

**Small business jobs, international comparison**

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<th>%, year-on-year, monthly</th>
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<tr>
<td><strong>Australia</strong></td>
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Source: Xero Small Business Insights, Accenture methodology

**United Kingdom dealing with smaller labour market and record demand for employees**

In the United Kingdom, Xero's measure of small business jobs has been recording strong growth, with jobs growth averaging 5.8% y/y each month for the previous six months. But this strong growth is in response to substantial job losses during 2020 and, unlike in New Zealand and Australia, small business jobs are not yet back to their pre-pandemic levels. There are 8.4% fewer small business jobs than there were in February 2020. So how can the United Kingdom’s labour market be ‘tight’ and the national unemployment rate so low if there are fewer small business employees than before the pandemic?

The challenge in the United Kingdom is that the overall supply of labour has fallen. The combination of Brexit, long-COVID illness impacts, rising tertiary student numbers and ‘the Great Resignation’ means there are fewer people either in work or looking for work than before the pandemic. Office of National Statistics data shows the participation rate was 78.7% in Nov-Jan 2022, compared to 79.6% in Jan-Mar 2020 just prior to the pandemic.

In contrast demand for employees is at an all time high. In the period Dec 2021 to Feb 2022 there were 1.318 million job vacancies - a record high.

This combination is pushing wages higher and likely to continue to do so in the coming months.

**New Zealand has seen a remarkable jobs recovery in the past 18 months**

In New Zealand small business jobs growth averaged 4.3% y/y each month in the six months to February 2022 and there are now 7.1% more people working for a small business in New Zealand than in February 2020. This remarkable demand is underpinning a very tight labour market.
Unlike the United Kingdom, the overall supply of labour in New Zealand has risen since the pandemic. The participation rate has risen to 71.1% in the December quarter 2021, up from 70.7% in the March quarter 2020.\(^5\) New Zealand’s international borders have, however, been largely closed to non-citizens. This has tightened labour supply in certain industries - such as agriculture and hospitality - that usually rely on a short-term international workforce for seasonal work.

Despite the strong growth in jobs in recent months, demand for even more employees remains high. The Ministry of Business, Innovation and Employment's Jobs Online data shows vacancies grew by 36% over the year to December 2021 and by 34% over the past two years.

This strong demand for new employees is underpinning the tight labour market in New Zealand and suggests wages are likely to head higher in the coming months.

Australia has seen a slowdown in small business jobs growth but overall labour market remains tight

In Australia, small business jobs growth averaged a slower 1.0% y/y each month in the six months to February 2022. While still positive, this is below the long term average of 3% y/y. In better news, the jobs market has regained the lost pandemic jobs and there are now 1.5% more people working for a small business in Australia than in February 2020.

Australia has seen a rise in the participation rate as more people are either working or looking for work. The participation rate was 66.4% in February 2022, which is a record high, compared to 65.9% in February 2020.\(^6\)

The latest vacancy data points to strong demand from employers for new staff. According to SEEK, in February 2022 job advertisements rose 35.8% y/y and were 41.4% higher than February 2019.

One probable reason wages growth has not been as fast in Australia as in New Zealand is that the recent slowdown in the pace of small business jobs growth in Australia means there is likely to be a bit more spare capacity than in New Zealand. Nevertheless, the Australian labour market is still tight by historical standards and as the disruptive impact of Omicron subsides we expect small business jobs growth to pick up again on the back of ongoing strong small business sales growth and record high overall job vacancies. This, in turn, should push wages higher in the coming months.

Which industries are seeing the strongest wages growth?

Wages growth is not even across industries.

In all three countries hospitality is experiencing some of the strongest wages growth, despite it also often having one of the slowest industry jobs growth results. In February 2022 small business hospitality wages rose 7.7% y/y in the United Kingdom\(^7\), 5.0% y/y in New Zealand and 4.0% y/y in Australia. This reflects the challenges the sector is having in attracting people to the industry that has been one of the most disrupted by COVID and has one of the highest potential exposure to COVID through the face-to-face nature of the work.

Another industry recording strong wage growth in New Zealand and Australia is construction. In February 2022 small business construction wages rose 5.1% y/y in New Zealand and 3.8% y/y in Australia. This is a reflection of the strong sales levels in this sector in both countries and the competition for skilled employees amid closed borders.

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5 Stats NZ Household labour force survey: December 2021 quarter
6 ABS Labour Force: February 2022
7 The February 2022 UK growth rate is partly due to the low base of February 2021 - adjusting for this wages are up 1.0% y/y.
What is happening to real wages?
The Xero Small Business Index measures wages in nominal terms - before taking into account inflation. Real wages - nominal wages less inflation - is a better measure of the purchasing power of wages. If real wages are rising then small business employees can buy more goods and services. It is possible, however, to have rising nominal wages but falling real wages if inflation is rising faster. That is what is currently happening to small business real wages in the United Kingdom, New Zealand and Australia.

Using the latest inflation rates\(^8\), as measured by national Consumer Price Index (CPI), real small business wages in February 2022 fell 1.2% y/y in the United Kingdom, fell 1.6% y/y in New Zealand and fell 0.2% y/y in Australia.

This combination of rising nominal wages but falling real wages means that while the wages bill of small businesses is rising, the purchasing capacity of their employees (and thus potential customers) is falling. This combination, if persistent, could eventually see sales growth (and broader economic growth) start to slow as customers make fewer purchases despite their higher wages. This is why central banks are so keen to rein in inflation, and some have started to lift interest rates, to avoid the negative spiral of rising nominal wages but falling real wages.

What's next for wages?
Looking ahead, small business wages growth is likely to continue accelerating in the next three to six months as demand for employees outstrips supply.

There are few signs of small businesses reducing their demand for labour in the next few months. Small business sales growth has been strong in all three countries which should underpin the ongoing need for more employees.

These higher wages may, in turn, help resolve some of the supply-side labour market challenges in the United Kingdom, where they could attract some people who left post-pandemic back to the labour market.

\(^8\) December 2021 for AU and NZ and February for UK
About Xero

Xero is a cloud-based accounting software platform for small businesses with over 3 million subscribers globally. Through Xero, small business owners and their advisors have access to real-time financial data any time, anywhere and on any device. Xero offers an ecosystem of over 1,000 third-party apps and 300 plus connections to banks and other financial partners. For three consecutive years (2020-2022), Xero has been included in the Bloomberg Gender-Equality Index. In 2021, Xero was included in the Dow Jones Sustainability Index (DJSI), powered by the S&P Global Corporate Sustainability Assessment and in 2020, Xero was recognised by IDC MarketScape as a leader in its worldwide SaaS and cloud-enabled small business finance and accounting applications vendor assessment.

About Accenture

Accenture worked in collaboration with Xero on the design and methodology of the Index prior to February 2022. Accenture is a global professional services company with leading capabilities in digital, cloud and security. Combining unmatched experience and specialized skills across more than 40 industries, we offer Strategy and Consulting, Interactive, Technology and Operations services—all powered by the world's largest network of Advanced Technology and Intelligent Operations centers. Our 569,000 people deliver on the promise of technology and human ingenuity every day, serving clients in more than 120 countries. We embrace the power of change to create value and shared success for our clients, people, shareholders, partners and communities. Visit us at www.accenture.com.

About Xero Small Business Insights

The aim of Xero Small Business Insights is to create insights to help inform decision makers in support of the small business economy as a whole. These insights were produced by Xero and Accenture for Xero Small Business Insights.

The principal source of small business insights in this report is customer data from Xero - a small business platform that supports online accounting and a range of other applications. Xero are responsible custodians of our customers sensitive data and do not release any data that could identify individual businesses. The data used is aggregated and anonymised to ensure the privacy of Xero subscribers, and their counterparts.

Methodology

Full details of the methodology used to construct the Xero Small Business Index can be found here.

Disclaimer

This report was prepared using Xero Small Business Insights data and publicly available data for the purpose of informing and developing policies to support small businesses.

This report includes and is in parts based on assumptions or estimates. It contains general information only and should not be taken as taxation, financial, investment or legal advice. Xero recommends that readers always obtain specific and detailed professional advice about any business decision.

The insights in this report were created from the data that was available as at the date it was extracted. Data used were anonymised and aggregated to ensure individual businesses can not be identified.