

# Self-employment in Scotland: trends and its implications for productivity

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## Abstract

Self-employment in Scotland has grown significantly in recent years, faster than in many other countries. It has accounted for almost half of overall employment growth over the past decade and over 80% of the growth in the number of businesses in Scotland. Self-employment in Scotland, however, accounts for just over 1 in 10 jobs, lower than in many other countries. This paper outlines recent trends in the growth in self-employment in Scotland, summarises the likely reasons, highlights the characteristics of the self-employed and considers the implications for productivity and economic growth. It notes that productivity levels of self-employed businesses are significantly lower than larger businesses, as are earnings of the self-employed vis-à-vis employees. The fast growth in the number of low productivity, self-employed businesses in Scotland may, in part, explain Scotland's overall mediocre productivity performance.

## 1. Introduction

Self-employment has increased significantly over recent years in Scotland, and has contributed to almost half of total employment growth. This paper outlines recent trends in the growth in self-employment, summarises the likely reasons, highlights the characteristics of the self-employed in Scotland and considers the implications for productivity and inclusive growth<sup>2</sup>.

## 2. Trends in self-employment

The number of people classified as self-employed in Scotland has risen from 242,500 in 2005 to 304,400 in 2016<sup>3</sup> (+26%). The rate of growth, however, has been lower than in the UK as a whole (+29%). Self-employment in Scotland now accounts for 11.8% of all employment, again lower than the UK rate of 14.9%. Over the period 2005-2016, total employment in Scotland rose by 137,000 or 5.6%, with almost half of this (45%) accounted for by the growth in self-employment.

Compared to other countries, Scotland has a lower self-employment rate; however, it has one of the highest rates of growth in self-employment.<sup>4</sup>

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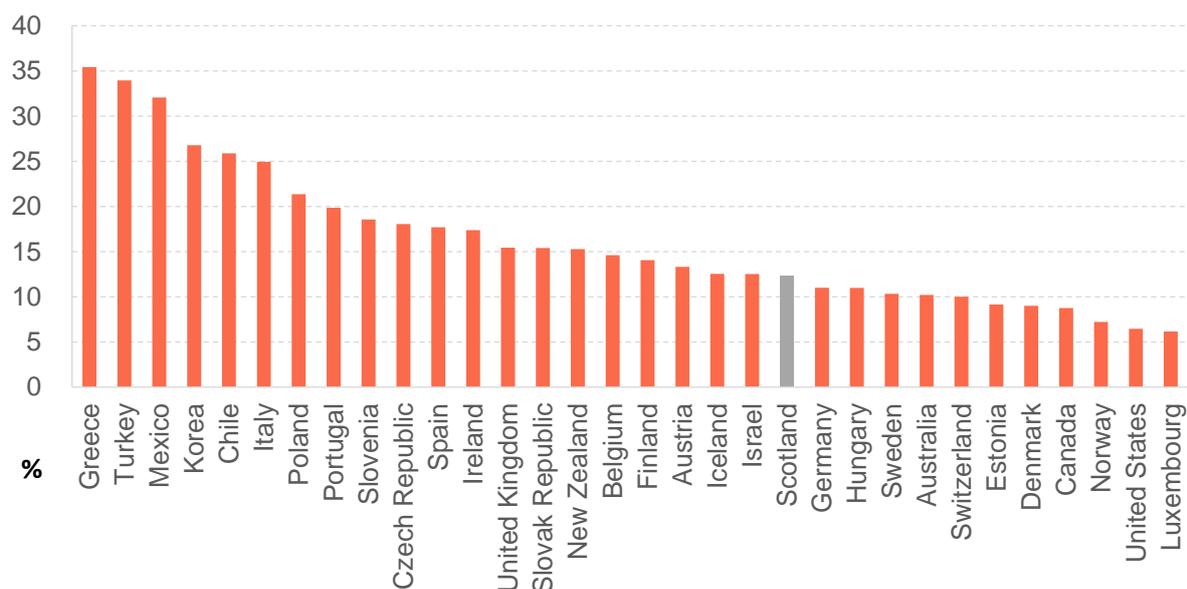
<sup>1</sup> *Scottish Enterprise is Scotland's main economic development agency*

<sup>2</sup> *There is a large body of research on self-employment and this paper is not intended to be exhaustive overview or analysis.*

<sup>3</sup> *Source: Annual Population Survey (for the 12 months to June each year)*

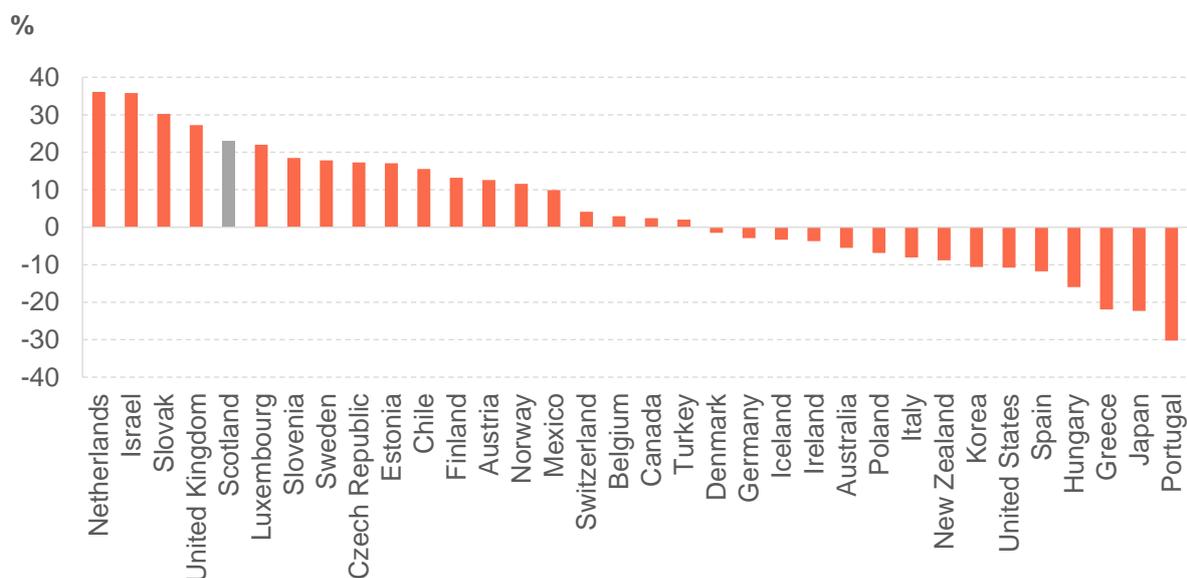
<sup>4</sup> *2014 is the latest available data for OECD countries.*

**Figure 1:** Percentage in employment who are self-employed, OECD countries, 2014



Source: ONS, OECD

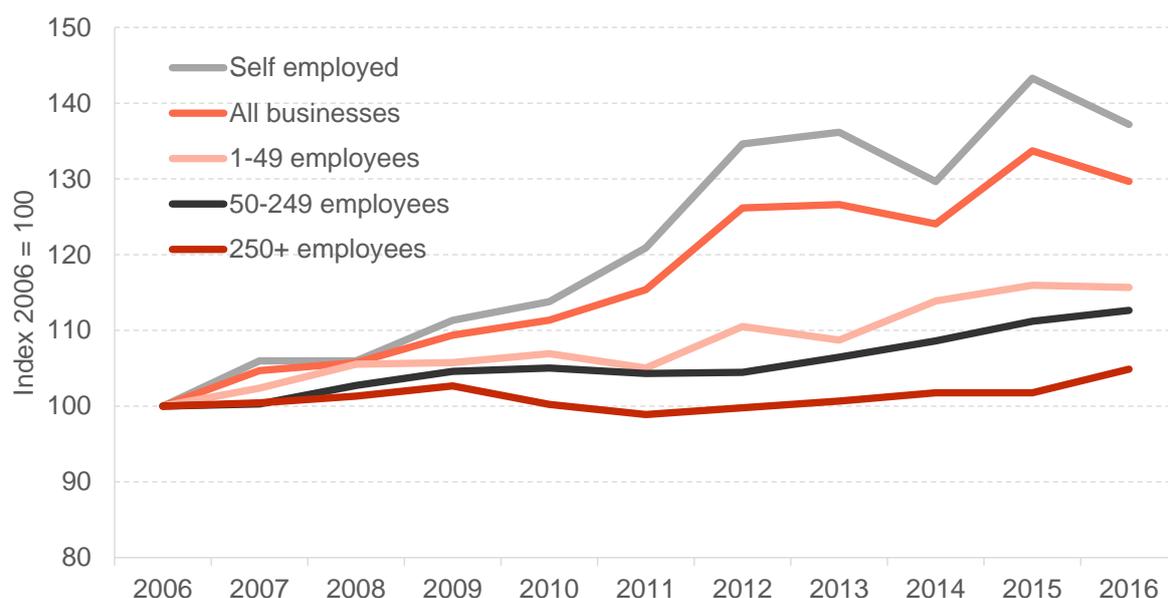
**Figure 2:** Percentage change in number of self-employed, OECD, 2005-2014



Source: ONS, OECD

The growth in self-employment has boosted the number of businesses in Scotland over the past decade, with the total number rising by 30% from 270,250 to 350,410 (+80,160). Self-employed businesses accounted for 82% of this rise (+65,950).

**Figure 3:** Growth in the number of businesses in Scotland, index 2006 = 100



Source: Scottish Government

### 3. Reasons for the growth in self-employment in Scotland

Self-employment can take a number of forms, including:

- owning or running a business (which could be described ‘genuine entrepreneurship’<sup>5</sup>)
- working for multiple businesses often via short term contracts (sometimes described as the freelance or ‘gig economy’)
- working for a single business as a self-employed contractor.

Most self-employed people in the UK consider themselves as running a business (around 65%), with 20% doing freelance work and around 10% stating they are contractors<sup>6</sup>. A similar pattern is likely for Scotland.

#### What is the ‘gig economy’?

The ‘gig economy’ has received a lot of coverage recently. The Work Foundation defines it as: *“the economic sector consisting of freelance workers who survive by taking on a series of small jobs, particularly when those jobs are arranged using a website or app”*<sup>7</sup>.

<sup>5</sup> For example see Department for Business, Energy & Industrial Strategy ‘Business Population Estimates For The UK And Regions, 2016 Methodology Note P5’ and Self-employment, Small Firms and Enterprise, Institute of Economic Affairs,(2011)

<sup>6</sup> Understanding self-employment, UK Government (2015)

<sup>7</sup> ‘In search of the gig economy’ Work Foundation (2016)

The gig economy can also be defined as 'portfolio working', where people work on a number of different projects for different organisations, sometimes combining this with other more formal employment<sup>8</sup>.

The gig economy includes workers across a range of skills levels, for example web and software designers (higher skilled); construction workers (medium skilled); and delivery/taxi drivers and personal services (lower skilled).

Being self-employed can often be by choice (proactive); for example, identifying a market opportunity to provide goods/services; choosing to work as a contractor for another business due to the benefits of flexibility; or, as a way to supplement income.

However, self-employment can also be through 'necessity' (reactive or imposed); for example, if there are no other 'suitable' employment opportunities available (in terms of job type or job flexibility), or if an employer changes its business model to outsource functions and re-hires former employees as self-employed contractors<sup>9</sup>.

Data from ONS show that the proactive reasons for self-employment (e.g. identifying a market opportunity, moving to a chosen career or for better work conditions or job satisfaction) outweigh the reactive or imposed (e.g. redundancy or could not find other employment) across all age groups<sup>10</sup>.

Similarly, UK Government research reported that 87% of people surveyed stated positive reasons as their motivation for becoming self-employed, with the most frequently cited reason being the freedom, flexibility and independence of being self-employed compared to working for someone else<sup>11</sup>.

Research at the UK level – and it is assumed to be the same for Scotland - shows that<sup>12</sup>:

- self-employed workers are broadly content with their labour market status;
- the main reported benefits of being self-employed are increased flexibility over working patterns, independence, and job satisfaction - the main motivations are opportunity-based, not financial
- many expect to be in self-employment in three years' time;

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<sup>8</sup> *What does the gig economy mean for HR? Personnel Today*

<sup>9</sup> See *'Independent work: choice, necessity and the gig economy'*, (McKinsey) for a discussion

<sup>10</sup> *Trends in Self Employment in the UK: 2001-2015 ONS (2016)*

<sup>11</sup> See *Self Employment Review BIS (2016)*

<sup>12</sup> ONS (2016) *'Trends in self employment in the UK 2001-2015'* and ERC (2016) *'Understanding self employment – a report from a seminar held at Middlesex University Business School'*

- very few have any ambition to be employers or significantly increase the scale of their operations (86% of Scottish self-employed people in 2015 did *not* expect to recruit over the next year<sup>13</sup>);
- there is little evidence that large numbers want to stop being self-employed; less than a fifth planned to leave in the next three years and, of these, for over half they wished to simply retire;
- most of the self-employed feel their lives are 'better off' overall compared to being an employee, and half believe they are better off financially (although evidence shows earnings are significantly lower relative to larger businesses).

Overall, therefore, it seems that self-employment is viewed as a 'positive choice' by most, despite relatively low incomes; people appear to value independence and flexibility over financial returns.

#### 4. Possible drivers for self-employment

There are a variety of reasons for and drivers of the growth in self-employment<sup>14</sup>:

**The economic cycle** - difficulties in finding a job has pushed some unemployed workers to become self-employed, and low wage growth has led to some people choosing self-employment as a way to supplement household income.

**Less stable working arrangements for employees** - following the financial crash, many businesses have been forced to make organisational changes and cut-backs through redundancies, freezing pay and offering less financial rewards to employees. This, combined with the increase in other workplace practices such as zero hours contracts, have likely led some to view working for an employer as less stable or advantageous. In such circumstances, self-employment becomes more attractive.

**Demographics** – in many developed economies the population is ageing, and older workers are more likely to be self-employed than younger ones (perhaps as they have more knowledge, funding or experience to start businesses<sup>15</sup>). Wealth losses following the financial crisis (for example, lower pension values) may have led to some older self-employed workers to choose to work longer, and older employees postponing retirement from the labour market and becoming self-employed in order to boost their retirement income. Some older employees are also

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<sup>13</sup> Source: *Small Business Survey*, UK Government

<sup>14</sup> See for example *Self-employment: what can we learn from recent developments?* Bank of England (2015); *The self-employment boom: Key issues for the 2015 Parliament*; *UK Parliament 2015, Trends in Self Employment in the UK: 2001-2015* ONS (2016)

<sup>15</sup> See for example *Going solo Does self-employment offer a solution to youth unemployment?*, The Work Foundation

choosing to continue work through self-employment beyond retirement due to better health and/or a simple wish to work.

**Flexibility, particularly for female workers** – the choice of self-employment to seek more flexibility is a key driver in the rise of self employment. Women tend to take on the majority of family caring responsibilities, and self employment offers the opportunity to work around these obligations. Self-employment also allows highly trained female workers to retain their skills without dropping out of the labour market completely, until such times as they are able to re-enter should they wish to do so.

**Autonomy** – increasingly, workers are not solely driven by financial incentives, and other factors such as independence and autonomy are becoming more important. In essence, more people want to ‘be their own boss’.

**Changing business models** – some companies have been seeking to reduce their labour costs by using consultants and contractors to deliver services (outsourcing) rather than employing people directly. This has increased the market opportunities for self employment.

**Technology** – in recent years it has become easier and less costly to start a business. The costs of IT equipment have fallen substantially, while the use of the internet and social media has expanded, making it easier and less costly for self-employed businesses to advertise and market. New online ‘apps’ (such as Uber and Deliveroo) make it easier to access customers. Also, the growing use of online procurement marketplaces by companies allows self-employed people to more easily bid for contracts.

The significant rise in self-employment in Scotland is likely due to a combination of the factors above, although there is no specific research available that has considered in detail which may be the most important. However, as is discussed in the next section, most of the growth of self-employment in Scotland is by females, and by males and females aged over 65. This suggests that demographics, a desire for greater flexibility, and becoming self-employment to boost household income may be the key drivers.

## **5. Characteristics of self-employment in Scotland: gender, place and sectors**

Key characteristics of self employment in Scotland include:

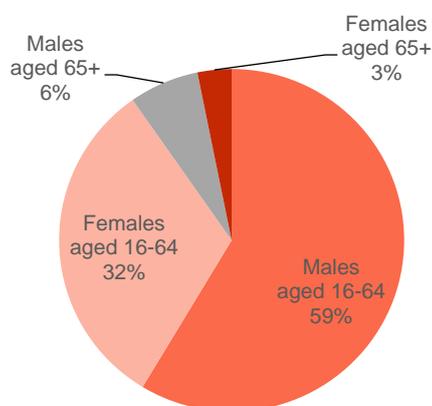
- Women have accounted for 70% of the growth in the number of self-employed (+29,400) in Scotland since 2006, although they still only account for around one third of all self-employed

- People aged 65+ accounted for 20% of the increase (+16,300), although still account for just 10% of all self-employed.
- Rural areas tend to have higher self-employment rates, for example around 20% of people in employment in Scottish Borders and Dumfries & Galloway are self-employed compared to 12% for Scotland as a whole. This is likely due to a high level of self-employment in agriculture.

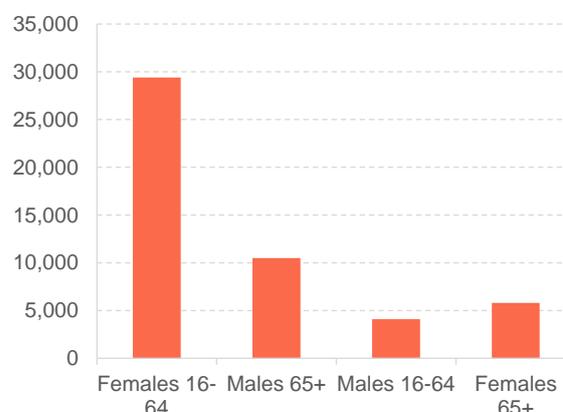
Potential reasons for the significant growth in female self-employment include:

- Increasing overall female participation rates<sup>16</sup>
- (as discussed in the previous section) self-employment allows women greater flexibility (e.g. to work around care responsibilities) and an opportunity to increase household incomes
- the growth in opportunities in parts of the service sector that are more suited to flexible working (e.g. childminding and personal services)<sup>17</sup>.

**Figure 4:** Self employment in Scotland by age and gender (2016)



**Figure 5:** Growth in the number of self employed in Scotland by age and gender (2006-2016)



**Source:** Annual Population Survey

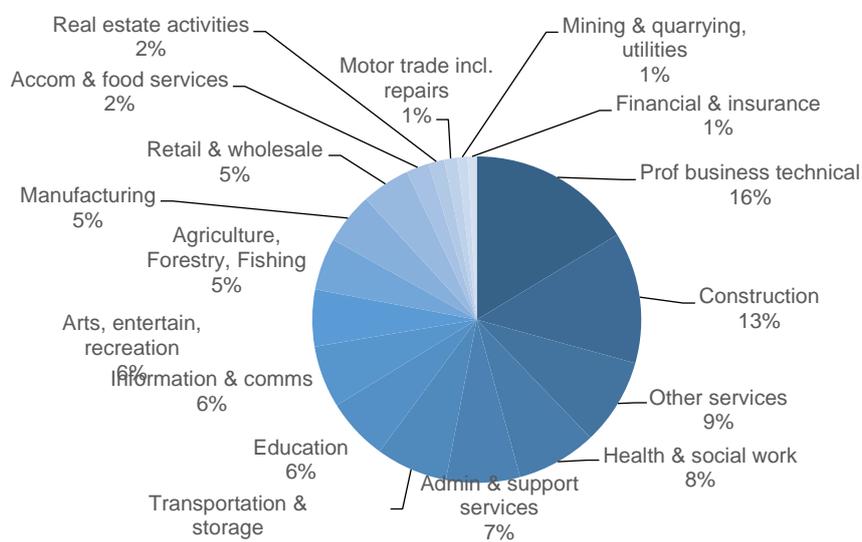
The two largest sectors for self-employment are 'Professional business & technical' (which include business and management consultants) and Construction. Since 2010, the fastest

<sup>16</sup> Over the same period male rates have decreased

<sup>17</sup> The top three occupations for self-employed women are cleaners, childminders and hairdressers/barbers [http://webarchive.nationalarchives.gov.uk/20160105160709/http://www.ons.gov.uk/ons/dcp171776\\_374941.pdf](http://webarchive.nationalarchives.gov.uk/20160105160709/http://www.ons.gov.uk/ons/dcp171776_374941.pdf)

growing sectors for self-employment have been Professional business & technical (+13,420); Other services (+7,030); and, Information/communication activities (+5,910).

**Figure 6:** Self-employed businesses in Scotland, by sector, 2016 (%)



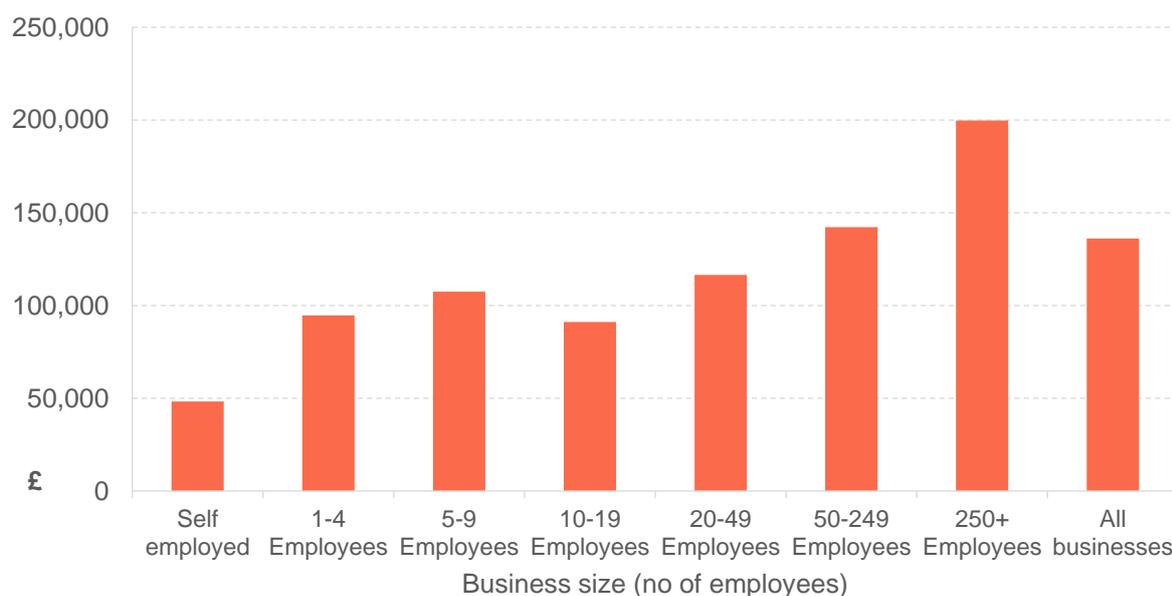
**Source:** Scottish Government

The growth in the ‘Professional business & technical’ and ‘Information communications’ sectors is likely to be largely driven by consultants, freelancers and self-employed contractors. Growth of self employment in ‘Other services’, which includes activities such as hairdressing & beauty treatment, fitness & wellbeing and repair services, is likely to be driven by low cost of setting up businesses (for example in terms of required equipment), and that the types of activities are suitable for flexible working. It is also worth noting the emergence of ‘new’ sectors and jobs, for examples digital marketing specialists and data managers, which, because they can be undertaken from home, may be accessible to self-employed people.

## 6. Impact of the growth in self-employment on Scottish productivity

On average, self-employed businesses have significantly lower levels of productivity than businesses with employees (as measured by turnover per employee), and this is true for all sectors, bar wholesale. Self-employment productivity varies significantly from a high of £148,000 per employee in wholesale to a low of £22,500 in education.

**Figure 8:** Turnover per employee (£), by business size, Scotland 2016



Source: Scottish Government

Low productivity may reflect that the self-employed do not benefit – generally - from ‘economies of scale’ as do larger businesses. Also, self-employed people may generate less output if a significant amount of time is spent ‘pitching’ for work.

In addition, evidence shows that self-employed businesses perform slightly less well on the key drivers of productivity, such as innovation, internationalisation and significantly worse in terms of capital investment, as compared to businesses with employees.

**Figure 9:** Scottish self-employed business performance, by drivers of productivity (2015)

	Self employed businesses	Businesses with employees
<b>Innovation:</b> % introducing any new or significantly improved	43%	47%
<b>Internationalisation:</b> % exporting goods or services	10%	12%
<b>Investment:</b> % planning capital investment over the next 3 years	31%	45%

Source: Small Business Survey

Low productivity levels in self-employed businesses are reflected in lower earnings. For the UK as a whole, the median annual gross earnings of self-employed people was £12,200 in 2014/15, considerably lower than that for employees (£20,450), and it is likely that the situation is similar in

Scotland<sup>18</sup>. Research suggests that hourly earnings of almost half of self-employed people are below the level of the National Living Wage<sup>19</sup> (which does not cover the self-employed).

At the UK level, median annual earnings (in real terms) from self-employment have declined by 16% since 2007/08, much faster than for employees (-10%)<sup>20</sup>. The reasons for this are unclear, but it could be due to the growth.

## 6. Conclusions and implications for Scotland

Self-employment has been growing strongly in recent years, accounting for almost half of Scotland's overall employment growth since 2005, and for most of the increase in the number of businesses. The self-employed, however, still constitute a low proportion of overall total employment in Scotland.

There are a range of drivers for this increase in self-employment, including the economic environment, demographics, technology and changing business models of employers.

The average productivity level of self-employed businesses is significantly lower than larger ones, likely due to a lack of 'economies of scale', and due to weaker performance on a number of drivers of productivity such as innovation, internationalisation and especially investment. It is not possible to assess whether there are productivity benefits to businesses that use self-employed workers (e.g. through contractors), and this could be an area for future research.

Lower earnings amongst the self-employed are likely to reflect lower productivity as well as the strong growth in *part-time* self-employment. Notwithstanding this, most self-employed people are content with their working status, including their financial status and reward.

It is likely that the relatively slow growth in Scotland's productivity in recent years is in (small) part due to the increase in self-employment. It is not possible, however, due to data availability to estimate the specific contribution of self-employment growth to weak productivity growth as compared to other factors such as innovation, investment, internationalisation and management practices<sup>21</sup>.

A key challenge is whether the productivity levels, and therefore the earnings, of self-employed people can be increased. Potential ways include raising the awareness of the benefits of:

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<sup>18</sup> *Family Resources Survey (DWP) Scottish data not available.*

<sup>19</sup> *Tough gig: Low paid self-employment in London and the UK, Social Market Foundation (2016)*

<sup>20</sup> *The income of the self-employed, Department of Business, Innovation and Skills (2016)*

<sup>21</sup> *Other reasons for Scotland's relatively low productivity growth are discussed in the Scottish Enterprise paper 'Scotland's productivity performance: latest data and insights'.*

- investing in developing the skills needed to run and grow a successful self-employed business (including how to market and bid for contracts)
- using the right technology, for example to market services, sell online, bid for contracts etc.
- collaborative working with others as part of a consortium (for example, to bid for larger contracts and achieve economies of scale)<sup>22</sup>.

For businesses that use the self-employed as contractors or consultants, adopting 'fair work' practices (e.g. not using exploitative zero hours contracts and offering a safe and supporting working environment etc.) can provide productivity gains for both the business and the contractor, for example in terms of greater engagement and motivation to provide value-added services.

Also, raising the ambition of more self-employed people to grow their businesses and become employers is a further potential way to help boost Scotland's productivity.

However, a significant number of people choose self-employment for lifestyle reasons (e.g. to maintain or increase income or as a job after retirement from full time employment). In these circumstances, they may not have the motivation, ambition or incentive to significantly invest in productivity-enhancing activities or to grow their business and become employers.

To develop further our understanding of the current and future implications of the growth in self-employment, there are a number of areas for potential research. These include:

- developing a better understanding of the potential to increase the productivity of self-employed workers in different sectors, and the policies and levers required to achieve this;
- whether and how the ambitions and skills of 'lifestyle self-employed' can be raised to encourage productivity growth;
- the scale, nature and implications of future self-employment growth, taking into account trends such as changing demography (aging population), technology developments (including the further roll-out of broadband), and increased automation (and the opportunities this may provide); and
- the degree to which the prevalence of business models that drive self-employment (such as Uber) will increase and become more common in different sectors, and their productivity implications.

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<sup>22</sup> See for example *Co-operative Development Scotland*

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