Poor productivity? It may just be our sophistication

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The UK can seem like a sorry place to be investing. For some, the dark cloud of Brexit overshadows everything. On top of that we have the lament that the UK suffers a productivity gap with the rest of the world – a sign the country is losing the economic race and slipping down the world order.

The data on which this narrative rests is correct: it shows UK productivity as measured by output per worker has been slipping behind our peers, the world's major developed economies. However, an alternative explanation paints a quite different picture.

The UK, ahead of all other major economies, has been at the vanguard of a shift in retailing from physical stores to the internet. By November last year, some 20pc of UK retail sales were online. E-commerce has been a boon for consumers. But it is having a huge impact on the productivity of retailing.

When customers visit shops, it doesn't count as employment but when someone else delivers goods to your door they are employed to do so. In the past, retailers supplied goods to stores and left customers to deal with the messy part of taking purchases home. That has now changed.

As far as productivity is concerned, employing workers to arrange individual orders in warehouses and stores, supported by armies of drivers dropping off items to customers' homes, is costly and inefficient.

Despite 20pc of sales having moved online, employee headcount in retail is still near the same level as it was before the rise of e-commerce. If headcount truly reflected the switch in activity from stores to online, then around a million jobs should have gone. But they have not, partly because it is tough to downsize staff for a gradually reducing footfall but also because customer service expectations have gone up, which requires more staff.

On top of this we have seen strong growth in the number of people employed in the distribution business, adding 300,000 jobs in the past 10 years. Home fulfilment has not added to productive output.

These are simply sales that have switched from shops to online, although they have boosted headcount and thus reduced reported productivity, measured as output per worker, per hour. There has been a similar effect in casual dining. UK consumers have been treated to an increase in venues beyond the level of demand. There has also been the emergence of a plethora of new services offering instant home delivery, none of them fully covering their costs; great for customers but terrible for productivity.

One other major drag on UK productivity has been the financial services sector, which, since the financial crisis 10 years ago, has been reined in from its earlier excesses.

Output is below where it stood then and as a proportion of the economy it has shrunk from over 9pc to 7pc. But headcount has not reduced. Jobs in trading may have declined but they have been replaced by jobs in regulation and compliance.

The overall effect is a big drop in productivity but, in this case, a welcome and deliberate one.

We shouldn't regard these developments as a sign of malaise but the opposite. Being the quickest to adopt and adapt to e-commerce is a sign of economic sophistication. E-commerce penetration in the UK is more than double that of our major economic rivals.

It is a boom that has dragged in low-paid workers who might otherwise have been unemployed, but is that such a bad thing? The UK's boom in this type of low-paid work (in warehouses, distribution, retail and hospitality) has pushed employment to record levels and has stimulated immigration.

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While the UK looks enviously at the productivity levels of our European rivals, they look enviously back at our employment numbers.

The e-commerce boom does initially lower productivity, but it is raising the standard of living.

In time, many of these jobs may be replaced by robots in warehouses and self-driving vehicles, in which case productivity will rise but so might unemployment.

Leaving the EU will disrupt the UK economy. But our dynamism, flexibility and openness to investment and new technologies leaves us well-positioned to bounce back.

For investors, a positive aspect of this negativity is that UK equities are unloved and out of favour. There are pockets of great value. Despite stock markets generally being at all-time highs, investors can still get exposure to businesses that are inexpensive and that promise great long-term returns.

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