



# Employment relations in micro and small enterprises - literature review

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## The role of small firms in the Japanese economy

Among OECD countries, Japan - together with Italy - has the highest proportion of small and medium sized enterprises (SMEs). According to data published by the Management and Coordination Agency, in the manufacturing sector alone in 1996 were operating 665,540 SMEs - defined as enterprises with less than 301 regular employees. These firms accounted for 99.7 per cent of the total of Japanese manufacturing enterprises. In the same year, manufacturing SMEs employed 7,311,993 people, or the 62.1 per cent of the total.

According to the same source, in 1996 there were in Japan 593,823 small-scale enterprises in the manufacturing sector, or 88.9 per cent of the total (small-scale enterprises are defined as sole proprietors or companies with less than 21 regular employees). Although the number and the percentage has constantly decreased since 1985 (when small enterprises were 712,588 and accounted for 90.4 per cent of the total), small firms still do represent an important part of the Japanese manufacturing system at least in quantitative terms.

Of these SMEs and small firms, the majority are at least partial subcontractors of larger enterprises and therefore their degree of independence and autonomy is to some extent limited by the formal and, more often, informal arrangements with the larger firms. However, as pointed out in several studies, many SMEs are not dependent producers. According to Whittaker, in the 1990s over 40 per cent of manufacturing SMEs did not subcontract at all, and many subcontractors had a plurality of customers. Moreover, even dedicated subcontractors are not simply appendages of larger firms but maintain a significant degree of autonomy (Whittaker, p. 1).

On the actual role of SMEs in Japan, scholars and policy-makers have been arguing and debating for several decades. A school that emerged in the 1980s sees SMEs in a mainly positive light, pointing out their dynamic behaviour and enterprising capabilities. SMEs are seen as 'seedbeds of creativity', generating economic vitality, competition and individual and community prosperity. This school, lead by scholars like Professor Tadao Kiyonari of Hosei University, has succeeded in influencing the bureaucrats in charge of SMEs policies that have been reoriented in order to provide active support for dynamic and innovative 'venture business'. However, another school takes a more pessimistic view. This school, that has its root in the study of the dualistic structure of Japan's economy, tends to point out the weaknesses and the inefficiencies of SMEs and small firms in particular. The researches of this school emphasize the problems of rising bankruptcies, firm closures and the obstacles limiting the growth of small firms.

In reality, the world of small firms in Japan is indeed an extremely dynamic and diversified one, including both type of firms. As a whole, however, it is a reality facing a major challenge now that the Japanese economy is undergoing a profound structural transformation. In this phase of Japan's economic development characterized by economic stagnation and a severe credit crunch, many small firms have been unable to service their loans and have been forced to close their business. These negative trends have also resulted in a large decline in employment by SMEs in 1998 and 1999. However, many scholarly research, media reports and official publications have also pointed out that many small firms are among the most fast-growing, dynamic firms both in traditional and in technologically advanced sectors. Thus, while being among the most severely affected by the crisis, small firms do also represent the solid foundations on which rests the future of Japan's economy and industry.

## **The legislative framework**

The contemporary legislative framework regulating union activities, procedures for the resolution of labour disputes, and labour standards has its roots in the major post-war reforms introduced by the Allied Powers during the occupation period (1945-1952)<sup>1</sup>. In those years, Japanese workers were granted the rights to organize and to engage in collective bargaining by the Labour Union Law (Roudou Kumiai Hou) and the Labour Relations Adjustment Law (Roudou Kankei Chousei Hou) enacted in 1946. Standards concerning the working environment and wages were set by the Labour Standard Law (Roudou Kijun Hou) of 1947.

The Labour Union Law and the Labour Relations Adjustment Law have remained almost wholly intact to the present and do constitute the basis of the legal framework dealing with industrial relations in Japan. The Labour Union Law grants virtually all employees in the private sector the right to organize independently, to engage in collective bargaining with employers on an equal footing, and to carry on collective actions, including strikes. The Labour Relations Adjustment Law forbid employer practices that limit the workers' exercise of these rights.

To administer these laws, tripartite (employer, union and public or neutral members) labour commissions were established at the national level and at the prefectural level (Chuuou Roudou Iinkai and Chihou Roudou Iinkai, respectively). These commissions have the responsibility to mediate and offer solutions in case of labour-management disputes; investigate unfair labour practices and provide remedies for them; and to certify unions as autonomous and democratic organizations. The commissions, with large professional staffs, give special attention to conciliating nascent disputes as well as settling unfair labour practice charges, often on an informal basis. As for the formal procedures, the law provides three possibilities: conciliation (assen), mediation (choutei) and arbitration (chuusai). In the case of conciliation and mediation procedures settlement can only be applied if both parties agree, while arbitration results in decisions that are binding for the parties. However, arbitration too can only commence with the consent of both parties. Compulsory arbitration is not practiced in Japan. In case disputes cannot be resolved through the conciliatory procedures, the parties can always bring the matter to courts, although the notorious length of judiciary proceedings discourages this practice.

The Labour Standard Law provides the basis for minimum protection of workers in industry. The law covers a wide range of matters including employment contracts, wages, working hours, rest and holidays, plant safety and hygiene, protection of minors and women, apprentice training, compensation in case of accidents, work regulations, factory facilities and the establishment of supervisory institutions. Over the years, the government has frequently revised the Labour Standard Law with the enactment of special laws and provisions. In particular, in 1959 the approval of the Minimum Wage Law (Saitei Chingin Hou) established for the first time a procedure for setting minimum wage rates by region, industry or occupation, mainly on the basis of agreements by employers with workers or union representative. Other important revisions concern the regulation of part-time work (Paato Roudou Hou) and the Law for Equal Employment Opportunities for Men and Women (Danjo Koyou Kikaikintou Hou) of 1999.

Besides the three major labour laws mentioned above, there are laws for the promotion of the employment of disabled and elderly persons, the law on employment security, and the law regulating the activities of agencies that offer the services of temporary workers. These laws have been approved and enacted in recent years.

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<sup>1</sup> The information provided in this section is mainly based on Yamazaki Kazuyoshi, *Yoku wakaruru Roudou Kijun Hou*, Nihonjitsugyō Shuppansha, Tokyo, 1999

## Collective representation

Collective representation in Japanese small firms is the exception rather than the rule. In Japan, as it is well known, factory workers and office clerks normally have been represented by enterprise or company unions (*kigyō-kumiai* or *kaisha-kumiai*), which with lifetime employment and seniority (in reality, seniority and merit related) wages and promotion schemes have formed the three mainstays of the Japanese management system (*nihonteki keiei*). However, this pattern is prevailing in large and medium-sized firms.

In small firms the reality is different. In particular, there is no tradition of collective representation by the labour union. The scattered evidence available shows that only a few per cent of the workers in small firms belongs to a labour union. According to data published by the Ministry of Labour, quoted by Whittaker, in 1991 almost 60 per cent of workers in firms with more than 1,000 employees belonged to a labour union, compared with less than 2 per cent in small firms with less than 100 workers (Whittaker, p. 150).

The lack of collective representation is the result of cultural, historical and social factors. In post-war Japan, there is clearly a sharp divide between employees of the large firms and their colleagues in small firms. Workers in large firms show little interest or support for fellow workers in other enterprises, including the employees of suppliers belonging to the same business group or *keiretsu*. The strongly closed and hierarchical structure of Japanese enterprises leaves no room for solidarity with employees belonging to different firms. Consequently, labour unions of large companies do not provide resources or support for the organization of workers in small firms.

## Collective bargaining

As collective representation is not diffused in Japanese small firms, so is collective bargaining. In some cases there are regular wage discussions and regular wage increases agreed by both sides, management and workers. For most firms and employees, however, wages and conditions are not bargained over collectively, either by a union, or by employee associations. The employees associations are rarely involved in collective bargaining on behalf of the members. Nor are rates determined collectively on the employer's side. Information about wages are not officially disclosed by the firms or their owners, but are only made available to close associates and friends.

As pointed out by Whittaker, more than collective agreements, "labour markets act as a powerful constraints on owners. Unless they offer a certain level of wages and conditions, firms have found increasingly difficult to attract workers, especially young workers" (Whittaker, p. 152).

The British scholar describes an interesting case of a manufacturer of moulds for precision instruments, electronic and medical goods. In this company with 10 employees, decisions about wage and wage increases are left entirely to the founder (the company chairman), the son (the company president) and the factory manager. They refer to the increases in the steel industry and also held informal discussions with other members of their association. Then, the decision is presented to the employees individually with a chart showing the different components of the monthly salary and bonus. Employees are formally interviewed in advance, in order to listen to their problems, expectations and grievances. The result of the process is a carefully tailored individual wage and bonus. The latter, in particular, can be very different from worker to worker.

To sum up, in Japanese small firms the relation employee-employer is basically of an individual nature, and only a marginal role is played by the employee associations in determining the terms and the conditions of employment. Labour union play an even more marginal role and normally only in relatively larger firms.

## **Working and employment conditions**

Employment status in small firms is very diversified and is even more so in the last years in the wake of the stagnation of Japan's domestic economy. Firms of all sizes have reduced hiring of full-time employees since 1994. Moreover, as already pointed out in the literature analysis, a comparison of attitudes to lifetime employment between 1990 and 1999 reveals that the number and the percentage of firms that do not place special emphasis on lifetime employment has increased (JSBRI, p. 39).

SMEs, in particular, have traditionally made active use of part-time employees. According to the Employment Status Survey of the Management and Coordination Agency of the Japanese government, in 1997 81.9 per cent of the employees in firms with more than 1,000 employees were so-called regular employees (assumed with a lifetime employment "agreement"). In small firms with 10 to 29 employees this percentage declines to 61.4 per cent, and in the case of firms with 1 to 9 employees to less than 50 per cent. Conversely, the percentage of part-timers is 14.0 in large enterprises, 24.5 in small ones and 24.8 in the very small ones. Small firms employ also a fairly large number (14.2 per cent) of non-regular employees, including family aid, seasonal workers, daily temporary staff and workers hired from manpower agencies. Moreover, compared with large firms, SMEs have traditionally recruited a greater proportion of their employees in mid-career.

As pointed out in the reports and studies examined, recruiting talented personnel is a major issue for managers of SMEs and small firms, in particular. The 1997 Survey of Employment of Young People by the Ministry of Labour shows that about 20 per cent of firms with less than 100 employees are unable to recruit young full-time employees. One reason for the difficulties in hiring qualified personnel is the fact that large firms offer higher wages and guarantee better job security. Large firms also offer more paid holidays and provide more attractive fringe benefits for the employees, including factory workers.

The wage differential between large and small firms emerges clearly from the available statistics. For example, according to the statistical survey of the Ministry of Labour, in 1999 the average total monthly cash payments to workers in the manufacturing sector amounted to 509,134 yen in firms with more than 500 employees, 389,692 yen for firms with 100 to 499 employees, 305,817 yen for firms with 30 to 99 employees and 276,269 yen in small firms with 5 to 29 employees. In other words, the total amount of wages and bonus received by the employee of a very small firm was almost half the amount of the employee in a large enterprise. It should be noted that during the Nineties this ratio has further deteriorated. It was, in fact, 57.1 in 1992, 55.8 in 1995 and just 54.3 in 1999 (JSBRI, p. 189).

The large wage differential reflects a conspicuous gap also in the productivity and in the capital-labour ratio between large and small firms. The Japanese Ministry of Finance provides data on value added productivity (measured as the valued added divided by the number of employees and directors) and capital-labour ratio (capital stock divided by the number of employees and directors). In the case of value added productivity, large enterprises (here defined as firms with paid-in capital of at least 100 million yen) recorded in 1998 a productivity of 9,696,000 yen, while SMEs productivity was only 4,837,000 yen. As for the capital-labour ratio, this was 24,073,000 yen in large firms and 7,354,000 in SMEs (JSBRI, p. 186).

Concerning the criteria for wages determination, SMEs are more inclined to set pay in accordance with experience and performance than large firms. Data on the variation in wages between employees reveals in fact that there are more discrepancies in the wages of employees in the same age group at SMEs than at large enterprises (JSBRI, pp.41-43). This is due to the fact that SMEs do not give excessive importance to seniority and do not consider employees who entered the company in the same year as a cohort to be equally treated. They do assess individual performance more carefully. At SMEs policies concerning promotion are less influenced by seniority.

Regarding working time, we have already mentioned how the five-day working week is not yet the common practice in small firms. Data referring to a large sample of firms with 10 to 29 employees - data collected for 1999 by the Central Association for Small and Medium Sized Firms - shows the following result:

Six days working week	8.4 per cent of the firms
Five and a half days	2.3 per cent
Five days, once a month	5.8 per cent
Five days, twice a month	19.0 per cent
Five days, alternate weeks	8.7 per cent
Five days, three times a month	5.3 per cent
Five days	13.2 per cent
Other (according to a calendar decided by the firm)	31.0 per cent

If compared with data for the early Nineties, there is a gradual but steady diffusion of the five day working week. However, if compared with large enterprises, small firms are clearly lagging behind.

The same survey shows that in 1999 at least one fourth of small firms have a regular working time of more than 40 hours per week (44.8 per cent in the case of very small firms). Translated in annual working hours, it means that for most of the workers the regular working time - excluding overtime - is above 2000 hours, as can be seen in the following table.

Annual regular working hours	Number of employees		
	1-9	10-29	30-99
Less than 1800	5.7	3.8	3.0
1800-1900	9.5	8.8	8.5
1900-2000	18.0	21.4	24.1
2000-2100	30.3	49.0	56.7
2100-2200	16.0	10.2	5.5
2200-2300	9.3	4.1	1.7
2300-2400	6.4	2.0	0.4
2400 and more	4.7	0.7	0.2

All the literature on the subject also point out that workers of small firms have more limited access to fringe benefits such as company pension schemes, company houses, loan facilities, and many more others that in Japan are normally and, at least until recently, generously provided by large enterprises.

To conclude, employment and working conditions in Japanese small firms are far from ideal. Moreover, informal and flexible employment relations conduct to discretionary treatment of workers. On the other hand, the less bureaucratic organization of small firms allows for more individual recognition of each worker's merit and performance.

### **Conflicts**

Japan is a society that tries to avoid conflicts at all levels. This is true also for small firms. The strong sense of community and the weakness of organized labour in SMEs do reduce the scope and the possibility of serious conflicts. Normally, grievances are dealt directly by the worker or group of workers concerned with the managers or the owner of the firm. Work disputes, strikes and lockouts are extremely rare in Japan, even in the Nineties when the country faced an acute and prolonged recession.

If a problem cannot be solved there are arbitration panels and procedures at the local and regional levels that can be used to arrange a settlement agreed by both parties. Rarely a dispute is brought to a court. The major obstacles to initiate formal legal procedures are: 1) the cultural tradition of avoiding conflicts: 2) the high cost of legal procedures in Japan and 3) the great length of the court procedures that might take several years before it is settled.

### **Size and sector considerations**

The above mentioned points clearly show that in Japan size matter and matter considerably. Differentials in wages, working conditions, employment status and industrial relations are strong and persistent. Indeed, the long stagnation of the Nineties has further increased differences in wages and working conditions according to the size of the firms.

Apart from size, there are also differences among sectors. Obviously small firms in dynamic, innovative sectors of the economy can offer better terms and conditions than many SMEs in traditional sector. There is also an evident difference between manufacturing and services. In the case of small firms, general working conditions are better in the manufacturing sector. The already quoted survey by the Central Association for Small and Medium Sized Firms shows that the working week and the weekly working time is longer in SMEs (up to 300 employees) operating in the service sector. In 1999, more than 30 per cent of the firms surveyed in the service sector recorded a working time above 40 hours weekly, while 11.5 per cent of the firms still adopted a six days working week.

As for wages, they are lower in the distribution sector compared with manufacturing. The Ministry of Labour data shows that in 1999 the amount paid monthly for wages and bonus in a small wholesale or retail firm with 5 to 29 employees was, on average, 243,002 yen against 276,269 yen in the case of similar firms in the manufacturing sector. This differential has grown even larger in the last three years characterized by a pronounced decline in the payments to employees in the distribution sector (JSBRI, p. 189).

The differences reflect the persistent productivity gap between manufacturing and service in Japan. This is due to a variety of factors, but in general the manufacturing sector has to cope with the pressure of international and domestic competition which has fostered the adoption of more efficient, productive methods. On the other side, the service sector and retailing in particular has been protected (from foreign and domestic competition) for a long period. The protection granted by the central and local governments has allowed the sector to grow fat but not necessarily efficient.

## Policy implications

The main problem confronting Japan today is how to promote the birth and the development of dynamic, efficient and competitive small firms that can contribute to the economic recovery and the upgrading of the industrial structure of the country. As pointed out in the White Paper of the Small and Medium Enterprise Agency, “the goal of small business policy has changed from that of reducing the gap with large enterprises to promoting the growth and development of a diversified, dynamic and independent small business sector” (JSBRI, p. 164).

To this end, Japan has developed a complex system of instruments and policies aimed at supporting and promoting SMEs development. Several laws and policy initiatives have been launched for this purpose. For example, the Temporary Law for the Smooth Transition of SMEs Into New Business Areas (law approved in 1993 and revised in 1995). MITI (from January 2000 METI - Ministry of Economy, Trade and Industry) has strengthened the Venture Enterprise Centre, an institution for the promotion of new enterprises. In addition, Japan has experienced a boom of business incubator, set up by central, regional and local authorities (Whittaker, pp. 209-210).

More recently, in addition to expanding lending to SMEs by government-affiliated institutions, new measures were introduced in fiscal year 2000 to reduce the tax burden on SMEs and their investors. Measures were also adopted for the promotion of technical innovation, through - for example - subsidies provided for R&D programs on original technologies. The co-operation between SMEs, universities and research centers is also being promoted (JSBRI, pp. 169-173).

However, as pointed out by Whittaker, “there is a growing belief in Japan that industrial policy has become on balance counterproductive. The medicine prescribed is deregulation” (Whittaker, p. 209). Whether the new approach will be successful is to be seen. Certainly deregulation can improve two of the major problems or bottlenecks hampering the growth of SMEs today: the reluctance of financial institutions to support SMEs and the difficulty to acquire qualified human resources.



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