7 Labour regulation and SMEs

A challenge to competitiveness and employability?

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Introduction

Since the adoption of the Single European Act, European Community priorities have shifted from the task of harmonisation to the definition and implementation of minimum requirements in the area of working conditions. The encouragement of high labour standards, through legislation, as part of a competitive Europe is a central objective of the priorities in the social field of European Union policy. At the centre of the argument is the belief that the labour market is just as much a social institution as an economic one (Solow, 1990) and that ideas of fairness, motivation and morale imbue the labour market. However, without regulation such principles rarely emerge, and the result is a set of labour standards erroneously designed to serve the economic imperatives of growth. All forms of regulation, therefore, must be resisted in order to pursue greater levels of economic prosperity. Companies can more profitably respond to signals from the market place if they can reduce their core workforce and 'hire and fire' contract and/or part-time workers with the minimum of contractual complication. Such is the thinking of the economics of the new right which came to dominate much of the rationale behind labour market policy in the US and the UK.

A counter-argument, however, would suggest that attention to the social aspects of the employment contract would also provide important contributions to economic growth by delivering higher productivity and high-quality jobs. The elimination of discriminatory wage practices and a reassessment of the attitude towards traditionally low-paid groups would also contribute to the stated objectives of achieving economic and social cohesion within the EU. Such developments, driven through necessity by a legislative framework at national level, would also enhance the employability of the discouraged worker who also tends to be among the more marginalised groups in society.

In short, the European Commission's twin objectives of competitiveness and employability may not be at odds with an increase in the regulatory framework governing employment relations and employment rights

across the EU. This chapter has two themes. First, to assess the extent to which such claims are valid by looking at recent evidence from the UK where there has been an increase in the volume and complexity of employment legislation on the statute book (DTI, 2000). This legislation covers a variety of individual employment rights including working time, maternity and parental leave, wage rates and discrimination. These rights are enshrined in a number of pieces of legislation, including the Employment Relations Act (1999), the Working Time Directive (1998) and National Minimum Wage (1998).

Second, the discussion seeks to explore a range of issues in relation to the development of labour regulation in the EU and the impact of this regulation upon small firms. So, to what extent are owner-managers aware of the new employment regulations? What, if any, are the different awareness levels and effects within the small business population? What have been their adjustments to it? How has it affected their business performance? The rationale for this focus on the small firm sector is that employment legislation has excited a great deal of debate and comment from the media and pressure groups with employers' representatives expressing concern about the effects on their enterprise (see *The Daily Telegraph*, 2000; *Financial Times*, 2001). In theory, it has been argued that small firms are disproportionately affected by legislation and regulation because of the fixed costs of compliance which are more difficult for them to absorb in terms of time and resources afforded to these tasks (Better Regulation Task Force, 2000a).

EU social policy, employment relations and individual employment rights

Flexibility and regulation – some aspects of the debate

The move towards Economic and Monetary Union (EMU) has, according to the Commission (CEC, 2000), helped create a more co-operative employment relations climate as a result of shared macro-economic objectives. The social partners have, albeit slowly, responded to the far-reaching structural changes affecting industry, which has resulted in an expansion of flexible forms of employment in European labour markets. In the early 1990s, European labour markets were increasingly deregulated, albeit from very different starting points. However, recent developments at European level towards the increased protection for atypical workers (e.g. part-time workers) indicate the initial signs of the reconstruction of labour market 'institutions'. Such trends are treading a fine line between the increased need for working time flexibility in many sectors and firms and employee protection. This is clearly the case concerning the labour market experience of women who, unlike men, are more likely to experience flexible employment conditions throughout their working lives (Rubery *et al.*, 1999). The EU's Part-time Workers' Direc-

tive in 1997 provides an indication of the attempt to ameliorate some of the disadvantages confronting women in the labour market.

Arising out of the Social Charter, which was adopted by all the Member States except the UK in 1989, the EU's Social Affairs Council adopted the Working Time Directive (WTD) in 1993 which was designed to limit maximum hours of working (48 hours), and establish minimum entitlements to rest periods and paid annual leave for most workers in the EU. The objective and appeal of the policy was simple. The reduction of working time would reduce unemployment without tinkering with Welfare State regimes or affecting worker interests (Marimon and Zilibotti, 2000). But can the WTD be an effective employment policy to translate the volume of work into an increase in the number of individuals employed to deliver that volume? Even if positive employment effects are found there is always the difficulty of separating out the causal relationships from cyclical trends. It should be noted that the debate on the efficacy of working time reductions as an important tool in employment policy has its origins in the late 1970s when countries such as Belgium, Germany, Denmark and the Netherlands introduced a number of statutory or collectively agreed reductions in working time (Bosch and Lehndorff, 2001).

There was a great deal of debate over the introduction of the WTD within the EU with resistance coming particularly from the UK Government, who were more inclined to present the counter-argument that competitiveness would suffer as a result of higher employers' unit labour costs arising out of working time restrictions. According to orthodox economic theory most individuals will be working at their utility level maximising number of hours conditional on the wage they receive (Addison and Seibert, 1979). Working time restriction has the effect of lowering workers' utility and hence employers' unit labour costs rise. Another way of looking at this is that when the working time of an individual worker is cut, unit costs can be affected by the negotiated rise in wages to compensate for the reduced hours worked (e.g. raising the hourly wage). However, part of that negotiation may also involve effects on productivity and changes in operating hours which, in turn, can have an effect on unit costs (Bosch and Lehndorff, 2001). Further, there is an implicit assumption in this theoretical position that the total amount of work to be done remains constant. Finally, the way in which the total package is negotiated between the employer and the employee will determine whether or not the outcomes are cost neutral. For example, a reduction in the number of working hours may be compensated by a wage increase but this in turn may be offset by a lower annual pay rise.

A closer look at working time directives across the EU

The duration of working time has remained at the centre of discussions on the employment relationship in the last two years across the EU. With the

exception of the UK, the move towards the regulation of working time has been covered by domestic industry specific or national collective agreements. However, the move towards major cuts in the working week through collective bargaining appears to have stalled in 2000 although they are still on the agenda of many trade unions in Greece, Portugal and Spain, or governments such as in Belgium (European Industrial Relations Observatory (EIRO), 2001). France remains the stark exception within the EU, where legislation introducing the 35-hour working week was introduced in January 2000 for firms with more than 20 employees. In January 2002, firms employing less than 20 employees were required to reduce their working week to 35 hours.[1] Within the EU this represents by far the strongest policy initiative on WTD and is in no small way related to a long-standing trade union goal within France.

Table 7.1 illustrates the statutory maximum working week across the EU. In short, the countries can be divided into two groups. First, those that have set their maximum weekly hours at 48 hours (as set out in the EU WTD). France is included in this group but as noted above they have set their statutory working week at 35 hours. For these countries this maximum is well above the level of the average collectively agreed weekly working hours and indeed of actual average weekly hours. What seems to be happening here is that the 48 hours acts as some sort of a 'safety net' for workers. Second, those countries which operate a lower limit of 40 hours, which is much closer to the actual or agreed weekly hours, reflect a much more effective legislative framework for 'policing' working time.

However, despite the impression of the universality of these legislative changes, employees with 'autonomous decision-making powers' (i.e. managers and executives), or those who work in excluded sectors (e.g. trans-

Table 7.1 Statutory maximum working week (2000)

Country	*Hours*
France	48
Germany	48
Greece	48
Ireland	48
Italy	48
Luxembourg	48
Netherlands	48
UK	48
Austria	40
Finland	40
Portugal	40
Spain	40
Sweden	40
Belgium	39

Source: EIRO (2001).

port or hospital services), or where they have negotiated an agreement at the level of the firm to restrict the application of the WTD, are exempt from the directive. In short, large groups of workers are clearly not covered by the directive and what is perhaps more worrying is that there exists the ability for workers to 'self-select' themselves as possessing 'autonomous decision-making powers'. The incentive to do this will reflect the preferences of individual workers who are more likely to be motivated by more earnings rather than fewer working hours (OECD, 1998). With these opt-outs, the ability of the WTD to be an effective tool in an overall employment policy is somewhat weakened. To reiterate, there is a three-fold tension between the increase in flexible working practices, a need to create jobs across the EU and the development of regulatory frameworks designed to reduce the discriminatory processes in the labour market.

What has been the impact of working time reduction on employment?

Although it is perhaps too soon to assess the employment effects of the EU WTD, due to its very recent introduction into national legislative frameworks, the earlier moves to reduce working hours in many European countries do allow some attempt to reflect on the impact on employment. Bosch and Lehndorff (2001) show that these early working time reductions have impacted upon the trends in working time. For example, in Germany and Denmark the average weekly working time has fallen markedly for full-time workers over the period 1983 to 1993: 1,808 to 1,739 hours and 1,833 to 1,747 hours, respectively. By contrast, data from the European Industrial Relations Observatory (EIRO, 2001) indicates that in the UK, annual hours for full-time employees have increased. But has the absolute fall in annual working time hours resulted in increased employment? Bosch and Lehndorff review existing empirical studies which have used a variety of techniques to isolate estimates of the employment effects of reductions in working time. The difficulty, as noted above, is the ability to separate out the effects of reduction in collectively agreed or statutory working hours from broader effects of growth and productivity gains on employment.

In summary, and notwithstanding the weaknesses associated with each technique, Bosch and Lehndorff (2001:227) conclude that *'most empirical studies confirm that collective working time reductions can be expected to have positive employment effects'*. For example, in France the Ministry of Labour, using data on the performance of companies introducing a reduction in working hours compared to those that had not, estimated that the overall employment gain over the period 1996–99 preparatory period for the legislation was around 100,000 jobs.

What emerged from many of these studies was the need to recognise the importance in understanding the 'employment gain' which was not just

a reduction in working hours per se, but also the actions taken by the company, the social partners and the state in the period after the reduction was implemented. In other words, to understand the conditions that are necessary to ensure that working time reductions do actually lead to positive employment effects, which can best be summarised as follows:

- Agreement over the compensatory pay increases and productivity gains (importance of incremental progress on the wage–time tension – initial two-year agreements as in the case of France).
- Ensuring that the supply side of the labour market can respond to the new opportunities.
- A sensitivity between working time, the total volume of work in the company (operating hours) and the organisation of work.
- Ensuring job security in the growth of flexible working time systems.
- The role of the state in supporting a collective working time policy through subsidised measures such as lower social security contribution in the case of France.

One of the important debates concerning the WTD has been the differential effect that the legislation might have on the ability of small businesses to maintain their competitive position in the market place. For example, the French Government decided not to go ahead in January 2002 and introduce the 35-hour working week for businesses employing less than 20 employees in the face of some quite forceful lobbying on the part of the small business sector. More generally, it is important to assess the extent to which the raft of legislation within the generic framework of 'individual employment rights' may have a greater impact on small firms compared to larger firms. One might argue, *a priori*, that the introduction of Individual Employment Rights (IERs) might have a disproportionate effect upon micro-enterprises (less than 10 employees) and small firms (between 10 and 49 employees) for a number of reasons. We take a closer look at these reasons in the next section within the context of a detailed assessment of the impact of the increased scale of IERs in the UK since 1997.

Individual employment rights in the UK

When the Labour Government in the UK came to office in May 1997, one of its first actions was to sign up to the European Social Chapter in an acceptance of the existence of a social dimension to the process of European integration. However, rather than signalling a full acceptance of European social policy the reality in the detail of the legislation has been to accept the proposals and directives in a minimalist fashion, never exceeding what was required by European legislation (McKay, 2001). The following section probes in more detail the way in which the regulatory

framework in the UK has undergone a relatively dramatic change since 1997 and seeks to assess the impact of this change on the small firm sector.

The context: employment legislation and small firms

Employment legislation is amongst the most commonly applicable aspects of regulation in the workplace. Over the past 10 years or so, employment legislation has increased and since coming to power in 1997, the Labour Government has added to the amount of legislation with the aim of providing more protection and rights for individuals in the workplace. This new legislation is broadreaching and complex. Surprisingly, there has been very little research undertaken on owner-managers' awareness and knowledge levels of employment rights. Instead, the bulk of attention has tended to look at the *impact* of employment legislation. The research that does exist on awareness levels tends to focus on firms employing five or more people (Callendar *et al.*, 1999; Hogarth *et al.*, 2001). However, the volume of new employment legislation raises the question of the extent to which smaller employers are aware of, and have detailed knowledge of, these new rights. Government has attempted to communicate to employers through various media, but little is known about its success in reaching owner-managers. Evidence suggests that owner-managers are generally aware of the rise in legislation. Research conducted by MORI, commissioned by the Small Business Service (SBS) on 1,500 firms with 0–249 employees, found that over two-fifths of SMEs considered that the amount of Government regulations had increased since the election of the Labour Government in 1997 (Small Business Service, 2001).

Whilst research on basic awareness and knowledge levels is scarce, that on the impact of employment legislation is more readily available. A number of small business membership bodies and lobby groups have been vociferous in their criticism of new employment regulations. Studies have shown the new employment legislation to be expensive for employers and constrains the flexibility in their employment practices, ultimately affecting their competitiveness (see British Chambers of Commerce, 1999; *The Daily Telegraph*, 2000). Some surveys (e.g. Forum of Private Business, 2000; NatWest SBRT Quarterly Survey, 2000) have attempted to measure the costs of compliance by asking employers to estimate the time taken to deal with regulations. For example, a survey for the Small Business Service survey reported that, of the regulations employers' mentioned, complying with Health and Safety legislation was considered to take the most person hours, followed by the Working Time Directive (8 per cent) and the National Minimum Wage (6 per cent) (Small Business Service, 2001:61–3). A survey of small business advisers has also provided estimates of the financial costs of compliance with regulations amongst micro and small firms and found that government regulation has become a more

important factor in employers' perceptions upon the constraints on business performance (ICAEW, 2000).

In principle, the compliance costs of legislation are relatively higher in small firms because of a poorer level of resources in comparison to larger enterprises (Stanworth and Gray, 1991; Van de Horst *et al.*, 2000). These costs include learning the legislation, adjusting administrative procedures to meet the new legislation, paying the relevant taxes or benefits and absorbing the effects within the enterprise. In relation to employment legislation it is likely that small firms are at a relative disadvantage because of the absence of a personnel specialist and the greater proportionate contribution of individual employees to output. Academic research which does exist on the impact of recent employment legislation tends to present a more limited effect than the more popular accounts, with this evidence drawing attention to owner-managers' 'fire fighting' management style (Marlow and Strange, 2000). One of the main effects of the new legislation has been a rise in the search for external advice by employers (Better Regulation Task Force, 2000b; Harris, 2000). However, compared with the amount of legislation it can be argued that the volume of research is disproportionately low.

A research focus on employment regulations and small firms is, however, not new. Over 20 years ago, following the introduction of a series of employment rights, employers' representative groups voiced concerns and research was commissioned by government. The results of the research found that only two per cent of small employers cited employment legislation as the single main difficulty in running business. The biggest perceived constraint was on being unable to sack unsatisfactory workers; and that the expense and time involved in compliance were of secondary importance (Clifton and Tatton-Brown, 1979:Ch.11; *Employment Gazette*, 1979; Westrip, 1982). The report concluded that the legislation may have involved expenses to employers and that, as a result, the latter were being more careful about whom they employ.

In this section of the chapter we focus on three main areas of this legislation (Table 7.2). The Working Time Directive is one of the major new developments in employment legislation during the past decade. Introduced in 1998, the legislation seeks to regulate employees amount of time at work and provide certain break entitlements whilst at work. It has been argued elsewhere that the WTD is a key element of employment rights' legislation in terms of both its range and depth (IRS, 2000). Certainly the WTD has received a number of criticisms because it has improved the terms and conditions of workers at a cost to employers in addition to the compliance costs of understanding and administering new regulations (Forum of Private Business, 2000:22).

A further thrust of Government legislation has been on developing 'family friendly' employment regulations through the extension of maternity leave and pay and parental leave. The rights to reinstatement after

Table 7.2 Areas of recent legislation on employment rights in the UK

Working time (Working Time Directive, 1998) Covers rights on maximum average hours (48) compelled to work; right to four weeks paid leave (after 13 weeks); right to one day off per week; right to Statutory Sick Pay; right to rest periods
Family friendly (Employment Relations Act, 1999) Covers rights on: Maternity Leave; Additional Maternity Leave; Parental Leave; Emergency Family Leave
National Minimum Wage (National Minimum Wage Act, 1998) Sets minimum wage rates for workers in the UK. Currently £4.10 per hour (from 1 October 2001); £3.50 per hour for workers aged 18–21 and workers aged 22 and above during their first six months in a new job with a new employer and who are recently accredited training

childbirth and protection from unfair dismissal on the grounds of pregnancy were introduced in June 1976 and maternity pay in April 1977. Under the 1976 regulations, all pregnant women who met continuous service requirements had the right to return to their previous jobs before the end of 29 weeks after childbirth.[2] These rights were reinforced under the Trade Union Reform and Employment Rights Act (1993) which introduced the 'Pregnant Workers' Directive. Women who were expecting a baby on, or after, October 1994 had the right to take 14 weeks off work, regardless of their hours of work or length of service and those with 2 years service were entitled to 29 weeks leave. More recently, the rights for maternity and parental leave have changed as a result of the Employment Relations Act 1999 and the Maternity and Parental Leave Regulations 1999. Initial reactions from employers' groups to the new rights have been critical and there have been suggestions that small firms should be exempt from some of the provisions (British Chamber of Commerce, 1999). However, there is no reason to assume that this emphasis will lose momentum in the near future. There has, however, been an absence of comprehensive and reliable evidence of employers' knowledge levels of the existing and new maternity and parental rights.[3]

A final area of study in this chapter is on the National Minimum Wage (NMW). This has received a great deal of publicity and has been subject to scrutiny by the Low Pay Commission of Inquiry which reports on the impact on the NMW and makes recommendations on the rate to Government (e.g. Low Pay Commission, 2000). Arguably, because of the relative simplicity of the NMW and its high profile this may be one of the most clearly understood areas of legislation. It is also the area where most recently the bulk of research has been conducted (see for example, chapter 8). The overall aim of this section, therefore, is to provide: an analysis of employers' awareness of employment rights; to establish any differences in small employers' awareness of employment rights; and to analyse the effects, real or perceived, of employment rights on their business.

It is likely that some areas of legislation may be better known to employers than others because of the length of time on the statute books, the amount of effort put into publicity campaigns and the perceived relevance by employers to their enterprise. We also expect that knowledge levels of specific rights would be very much influenced by 'a need to know' basis. Size of enterprise was expected to be a strong influence on awareness and knowledge levels because of the increased likelihood of having to understand the range of employment rights with a larger workforce and the ability of employers to devote more time to a personnel specialism. It was also expected that industry sector and the composition of the labour force would be important determinants in awareness and knowledge levels.

Methodology

The analysis in this chapter draws on a telephone survey of 1,071 small business owners conducted in Autumn 2000 throughout Great Britain by the Small Business Research Centre at Kingston University for the Department of Trade and Industry (DTI). This was a survey stratified by enterprise size, sector and location and then weighted back to reflect their true proportions in the overall GB economy using the Inter Departmental Business Register (IDBR). This ensured that a sufficient number of firms having certain characteristics were interviewed. This was especially important since one of the main weaknesses in other surveys is that they often omit, or simply fail to attract, responses from owners of very small firms. The mean size of firms in the sample was 7.2 employees (median six employees), the minimum two employees and the maximum 49 employees. The response rate of the survey was 53.8 per cent, calculated as the number of successful interviews (1,071) expressed as a percentage of total valid firms contacted (i.e. including refusals and aborted interviews). The results in the following analysis are based on the weighted sample and therefore can be said to reflect the GB business population.

Interviewing business owners about employment legislation posed a range of special problems. For example, who should we address our questions to when there was a division of labour between owners in the enterprise? How could we approach the key informant to discuss our research questions and how detailed could our questioning of their awareness and knowledge of rights go? Prior to the telephone interview, 18 face-to-face interviews were conducted in order to help the researchers understand the attitude of business owners and see how they responded to answering questions and discussing employment rights. This helped shape the main fieldwork instruments and design of the telephone questionnaire. In the final questionnaire, on the core questions covering employment rights, we started by asking employers' awareness of a particular right such as maternity leave, and only if they said that they were aware of such a right did we

then ask detailed questions. This helped us focus on those rights which employers were able to discuss as well as avoid alienating the employer. This also helps raise the validity of the research when asking the perceived impact of particular employment rights on their enterprise, something which, we would argue, has been weak in other studies.

For businesses, individual employment rights constitute government regulation. For small businesses, in particular, it is often argued that there is a compliance burden which is regressive because of the economies of scale required in meeting or administering the regulations. The Better Regulation Task Force (2000a) for example, found that the absence of an in-house expert on legislation did mean that legislation did have a disproportionate effect on small firms. There are also suggestions that this legislation is having the effect of deterring employers from recruiting and expanding their workforce because of a regulatory burden. The last major government research undertaken on this issue was carried out over 20 years ago following protests from employers' groups over the adverse impact of the employment legislation introduced in the 1970s (Clifton and Tatton-Brown, 1979).

The next two sections present evidence on the owner-managers' actual awareness and knowledge of regulations, together with the perceived impact of employment legislation on small firms' business performance. A number of questions are relevant here. For example, to what extent is contemporary legislation promoting IERs inhibiting the performance of small firms? What are the perceptions of business owners of the effect of IERs on their businesses? To what extent are these based on actual experiences or based on perceptions? How important a factor are IERs on business performance in the context of other influences such as product market conditions, availability of finance and so on? Which specific IERs do employers perceive as having the greatest and least impact on their business? What are the effects of these IERs?

Awareness and knowledge of IERs

Although there is a great deal of publicity surrounding the impact of regulation on firms, there is relatively less understanding of owner-managers' actual awareness and knowledge of regulations. Employment legislation establishing the legal rights of workers is no exception. However, this is important to investigate, particularly in a period of growing IERs. If employers are relatively unaware of the IERs then this has implications for how government communicates to SMEs. The awareness and knowledge levels of employers are also important to understand since they will also help determine whether the reports of the effects of IERs are *perception* or *experientially* based.

Employers were presented with a sequence of questions to explore different levels of awareness and knowledge. The first question collected

information on respondents' self-assessed knowledge of employment rights. This was followed by questions designed to test awareness of particular rights. Those respondents who knew a particular right was covered by legislation were then routed to a series of further questions, to test their detailed knowledge of the provisions. In the sequence of questions on awareness and knowledge, three fictitious employment rights were included. The rationale for this was to see if owner-managers were merely claiming awareness to every right mentioned, which may be a socially desirable response, or whether they were prepared to state no awareness.

A number of major themes have emerged from this analysis of the awareness and knowledge of IERs amongst respondents. First, generally, owner-managers claimed to be aware of the major pieces of legislation in relation to IERs (Table 7.3). Whilst this awareness was 'claimed awareness' and in a telephone survey, every effort was made to ensure that employers were able to reveal their understanding or ignorance on IERs. Second, awareness varied according to particular IERs. Highest levels of awareness were amongst both new (the NMW) and older pieces of legislation (maternity rights). However, lowest levels of awareness were amongst new pieces of legislation, with the right for parental leave being the least well known. Third, employers' detailed knowledge was much lower than their claimed awareness on all issues covered. This suggests that owner-managers had some basic notion that legislation existed but they were not able to provide many accurate responses on the details of legislation. It is suggested that employers' awareness and knowledge was raised when they had to deal with a matter rather than any prior strategic knowledge acqui-

Table 7.3 Summary of owner-managers awareness of IERs

		Per cent aware that this is covered by legislation
Highest	National Minimum Wage	98.7
↑	Maternity Leave	95.6
	Right to rest break	94.1
	Right to paid holidays	91.1
	Written statement of employment terms	89.7
	Maximum number of hours worked	85.2
	Application of employee rights to part-timers	83.7
	Right to Maternity Pay	82.7
	Right to a whole day off per week	68.4
	Right for time-off to deal with emergencies	57.7
↓	Minimum size of enterprise for disability rights to be applicable	50.1
Lowest	Right to parental leave	48.8

Source: SBRC IER Survey (2000).

sition. These were small business owners and they dealt with information on employment rights on a need-to-know basis.

Fourth, the size of enterprise proved to be the most consistent discriminator in picking out sub-sample variations when the sample was disaggregated. It is argued that the major reason behind this relationship is that employers in the larger small firms (rather than the micros) will encounter a wider range of employment rights issues merely because they employ a wider diversity of staff. It is also likely that the smaller enterprises were less able to dedicate resources to keeping up-to-date with employment legislation. Fifth, business sector and labour force composition (such as proportion of females and part-time workers) proved influential on awareness levels on specific issues. Being taken to an employment tribunal also proved highly influential on knowledge levels: this not only raised detailed knowledge about unfair dismissal and compensation levels but it also sensitised employers to the wider range of IERs.

At the outset, it is expected that awareness and knowledge will vary according to employers' need to know. It is assumed that the particular explanatory factors will include the size of enterprise, business sector, employment composition and experiences during the running of the enterprise. However, the extent to which these factors are important remain hitherto unexplained. In order to provide an overview of the awareness and knowledge of IERs, a composite variable was created using the employer's responses to 21 questions asking them to indicate whether the current legislation covered a list of *possible* employee rights. Table 7.4 indicates the number of questions asked under each area of the legislation.

A maximum score of 21 could have been obtained for correct answers to all of the questions. Overall, a mean score of 16 was recorded for all the small firms in the sample indicating a less than perfect awareness of all the

Table 7.4 Owner-managers' awareness of IERs covered by legislation: nature of the composite variable

Area of the legislation	*Number of questions included*
Maternity provisions (Q14a–Q14c)	3
Time off for dependents (Q14d)	1
Terms and conditions of employment (Q14e–Q14f)	2
WTD (hours per week) (Q14g)	1
WTD (rest and holidays) (Q14h–Q14k)	4
NMW (Q14l)	1
Part-timers (Q14m)	1
Discrimination (Q14n–Q14o)	5
Unfair dismissal (Q14p–Q14r)	3
Total	21

Source: SBRC IER Survey (2000).

areas of the legislation. How does this score vary across sub-groups within the sample? In order to understand the complexities of awareness and knowledge across the diversity of the small businesses in the sample, a multi-variate approach was adopted for the analysis of the composite variable. An OLS regression was undertaken with the dependent variable specified as the composite awareness variable with a possible score in the range 0–21. The results of the analysis are presented in Table 7.5.

In this model, what could be classified as three types of variable are included: contextual (Size of firm, Age of firm, Sector, Location); internal firm characteristics and experience (Sex of employer/respondent, Workforce composition I and II, Ethnic minorities in the workforce, Major occupational grouping, Businesses taken to an employment tribunal); and perception of the Impact of employment legislation (impact of IERs). The last may in fact have two-way causality, but this is included because it is

Table 7.5 Equation for composite awareness of individual employment rights

Variable	*Coefficients*	*t statistic*
Constant	14.785	38.985
Size of firm (log of employment)	0.544	3.861
Age of firm (logged)	−0.207	−3.007
Sector (1 = Primary, manufacturing and construction; 0 = Services)	0.495	2.584
Location (1 = South East; 0 = Rest of GB)	−0.364	−2.169
Sex of employer/respondent (1 = Male; 0 = Female)	0.598	3.429
Workforce composition I (% Part-time workers)	$-1.362.10^{-2}$	−4.230
Workforce composition II (% Female workers)	$1.006.10^{-2}$	2.943
Ethnic minorities in the workforce (1 = Yes; 0 = No)	−0.407	−1.707
Major occupational grouping (1 = Operatives; 0 = All others groups)	0.431	2.033
Business taken to an employment tribunal (1 = Yes; 0 = No)	0.425	1.478
Impact of employment legislation (1 = A burden; 0 = Other responses)	0.673	4.082
	$R^2 = 0.073$ $n = 1{,}058$	$F = 8.575$
Critical values $F(11, 1{,}047)_{0.05} = 1.79$ $t\ (1{,}058)_{0.05} = 1.645$		

Source: SBRC IER Survey (2000).

significant. The R^2 is low but the equation is statistically significant and all but one variable (employment tribunal) is significant.

The interpretation of the results of the model suggests that there is a clear relationship between firm characteristics and awareness of IERs with size, age and sector being significant. In detail, the larger the enterprise the more knowledgeable employers are of the legislation, while greater knowledge is associated with younger businesses. If enterprises are in the primary, manufacturing or construction sectors (i.e. not in services), then the employers are more knowledgeable of the legislation. Connected to this, if operatives are the main occupational group in the business, the employers are more knowledgeable of the legislation. Knowledge levels increase outside the South East suggesting that in 'tight' labour markets employer knowledge is weak, perhaps due to the confidence that recruitment of workers is a relatively easy process.

Perhaps surprisingly, given the 'family friendly' nature of much of the IER legislation, male employers are more knowledgeable of the legislation than female employers. The explanation for this does not appear to lie with the composition of the workforce in the respondent's firm as these variables are also held constant in the equation. For example, the fewer the percentage of part-timers in the workforce and the higher the proportion of females, the more knowledgeable employers are of the legislation, irrespective of their gender. Employing ethnic minorities does not raise knowledge levels. As noted in other studies (Marlow, 2002), the experience of an Employment Tribunal does raise employers' knowledge levels and induces greater compliance, but although this contributes to the model, the individual relationship is not statistically significant. Finally, those respondents who stated that the legislation is a significant burden on the performance of their business are more knowledgeable of the legislation.

The overall conclusion to be drawn from this multivariate analysis is that knowledge levels of IERs are complex and vary greatly within the small business sector. The range of variables which may 'explain' awareness of the legislation, as measured by 21 factual questions on all aspects of the legislation, provides an important indication of those segments of the small business sector which require further intervention by government in terms of increasing their knowledge levels about IERs. Although the model provides some explanation of the variation in knowledge levels of IERs in the sample, the low R^2 suggests that other factors (i.e. missing variables) not included in the model are also influential.

Impact of employment legislation on business performance

Some of the most high profile studies of employment legislation have been on its constraining effects on businesses. Business owners in the survey revealed that despite a rise in legislation, 'competition' and labour markets

were considered to be the greatest constraint on business performance over the past two years (Table 7.6). However, government legislation or regulation was mentioned by a third of all respondents as a constraint and these were cited as the second most important constraint of all the factors mentioned. Of course, this can include anything ranging, for example, from taxation to environmental laws. An examination of the responses found *'Employment laws'* to be the most commonly cited followed by *'Health and Safety requirements'*.

In the Department of Employment survey conducted 20 years ago (Clifton and Tatton-Brown, 1979) employment legislation was mentioned by only 2 per cent of respondents as the single most important difficulty in running the business over the past year. Even allowing for any methodological variations between the two surveys, it would be fair to deduce that employers are now more conscious of employment regulations than 20 years ago as 'regulatory capture' becomes more widespread. This 'effect' clearly needs further investigation but we would argue that this is a result of the legislation introduced over this 20-year period and particularly since 1997. However, it should be reported in this context that a formal econometric test (logistic regression) of the impact of awareness of IERs on business performance, while holding the other variables reported in Table 7.7 constant, showed no influence on whether a firm reported growth in turnover in the three years prior to the survey (i.e. 1998 to 2001).

Those business owners who stated that employment rights had signific-

Table 7.6 Constraints on business performance over last two years

	Per cent/Weighted			
	Any mention[a]	*Main factor*	*N*	*(Unweighted N)*
Competition	50.2	33.0	538	(524)
Labour markets	33.9	11.1	363	(465)
Government legislation or regulations	*33.3*	*17.0*	*357*	*(418)*
Cash flow/bad debt	31.3	10.7	336	(319)
Premises/rent/rates	31.0	12.3	332	(318)
Interest rates/cost of finance	21.2	3.3	227	(187)
High value sterling	15.5	3.2	166	(194)
Access to finance	9.6	1.8	103	(95)
Others	5.4	4.2	58	(60)
Don't know/no main constraint	–	3.4	32	(3.2)
Total	–	100.0	961	(977)
N =			961	(977)

Source: SBRC IER Survey (2000).

Note
a 'Any mention' is based on a multiple response question.

Table 7.7 Influence of employment rights legislation on business operations by size of enterprise

	Sizeband Per cent/Weighted					
	1–9	*10–19*	*20–49*	*All*	*N*	*(Unweighted N)*
Administration workload	52.1	70.6	76.5	56.5	239	(381)
Amount of legal advice	37.4	50.0	64.7	41.2	237	(380)
Numbers employed over last two years	40.6	24.2	31.3	37.7	237	(379)
Overall business performance	34.2	38.3	41.2	35.3	237	(380)
Way employees are managed	33.2	35.3	41.2	34.0	237	(380)
Changes in employment contracts	27.3	38.2	43.8	30.0	237	(380)
Changes in employees attitudes or performance	20.4	24.2	31.3	21.7	236	(379)
Balance between full and part time	20.9	14.7	12.5	19.4	237	(380)
Use of agency or self-employed workers	15.6	14.7	17.6	15.6	237	(380)
Balance between males and females	8.6	0.0	5.9	7.1	237	(380)

Source: SBRC IER Survey (2000).

Note
Table and the percentages are based on those respondents who stated that employee rights have had a significant impact on their business as shown in final column.

antly affected their business (i.e. a third of the sample) were asked about their impact. The biggest single effect was on 'administrative workload' followed by the 'amount of legal advice' (Table 7.7). There were also important employment and management effects. Adjustments in the numbers employed, or recruited in the past two years, the ways in which employees are managed and changes in employment contracts were all viewed as important changes in business operations by employers as a result of employment rights. It is also apparent that the effects of employment rights on the amount of administration workload and legal advice seeking are higher in the larger firms (Table 7.7) This size effect may be a result of the fact that these firms employ significant numbers of staff and thus their owners are more likely to have to come to terms with effects of employment rights. However, the smaller firms appear more likely to report an impact on the numbers employed and the balance between full and part-time employees. It may be that the perception of employment rights as a constraint on enterprise is deterring some of these micro firms from taking on staff.

This emphasis on a rise in the administrative workload as a result of employment rights should not be surprising. Other surveys have shown this to be the most immediate effect. Similarly, a rise in the amount of legal advice confirms the results of other studies (e.g. Better Regulation Task Force, 2000b: 7–8; Harris, 2000). Few employers report a shift in the balance between male and female employees or a rise in the use of agency or self-employed workers. In other words, they are not making strategic shifts in their labour force composition as consciously, or immediately, as some commentators have suggested. One possible explanation for the emphasis on the rise in administration is that in many cases it is the employer who actually deals with these matters and the immediate impact of IERs may be to actually increase their workload. Given that most employers are antithetical to bureaucracy (see Scase and Goffee, 1987) it is not surprising that this effect is recorded as the highest.[4]

It was anticipated that there would be some variation in the effects of different employment rights in the sample (Table 7.8) with the greatest impact coming from the National Minimum Wage (NMW) (8.2 per cent of the whole sample), followed by basic terms and conditions of employment (7.4 per cent) and then maternity rights (6.4 per cent). However, the numbers of employers experiencing negative effects are low overall, and with a strong positive relationship between firm size and perceived impact. On a firm size analysis, it appears that the highest negative scores were in the 20–49 size band and especially in relation to maternity rights, NMW and unfair dismissal.[5]

In this research, strong sector difference and labour force composition effects were expected although, hitherto, there has been little research exploring such aspects. The data confirmed our expectations of an uneven impact as shown in Table 7.8, where the number of negative responses by

Table 7.8 Highest negative counts on impact of IERs by sector

Employment right	*Sector with highest negative count*	*(N with negative score)*	*% of sub-group stating negative effect*	*Weighted count*	*(% of total sub-sample reporting an effect)*
NMW	Distribution	(28)	77.8	36	(8.2)
Basic terms and conditions	Distribution	(13)	56.5	23	(7.4)
Maternity rights	Business and Prof. Services	(17)	60.7	28	(6.4)
Unfair dismissal	Distribution	(16)	100.0	16	(4.2)
Rights to part-timers	Hotels and Catering	(11)	91.7	12	(3.2)
Limit to working week	Distribution	(11)	100.0	11	(2.1)
Regular time off	Distribution	(6)	60.0	10	(1.8)
Parental leave	Distribution	(5)	55.6	9	(1.6)
Minimum work breaks	Hotels and Catering	(2)	100.0	2	(0.9)
Disability rights	Low VA Manufacturing	(2)	100.0	2	(0.4)
Discrimination	Distribution	(1)	100.0	1	(0.1)

Source: SBRC IER Survey (2000).

Note
The table shows the highest number of businesses recording negative effects of particular IERs. The final column shows the total number of businesses in the sector saying that this IER will have a negative or positive effect. Highest negative score ranked according to actual counts rather than percentages.

employers are classified by business sector. Employers in Distribution were especially negative about the effects of employment rights (Table 7.8). With those in Hotels and catering most negative about the extension of rights to part-timers reflecting their high dependence upon part-time labour, and minimum work breaks. Employers in Business and professional services recorded the highest number of employers expressing negativity about maternity rights. Although the precise reasons for these patterns in the data can only be covered through further qualitative research, these findings do take us away from making blanket statements regarding the effects of employment rights in small firms.

In order to explore the uneven effects of employment rights further, an analysis of employment rights according to the proportion of females in the labour force is shown in (Table 7.9). Employers with at least 75 per cent of their labour force being female were most likely to record maternity rights and the extension of rights to part-timers as having a perceived negative effect on business performance (Table 7.9). However, employers with *no* female workers were more likely to record perceived negative effects resulting from basic terms and conditions, limits on the working week and rights to regular time off work: that is IERs with no specific gender target. Again this analysis illuminates the varying effects of employment rights according to enterprise characteristics.

Conclusions

As the volume and complexity of legislation relating to business expands, employers' representative bodies in the UK have complained increasingly that this creates operational problems, particularly for small firms. In our investigation of the awareness and impact of Individual Employment Rights in the UK a major theme to emerge was the relative buoyancy of the enterprises in terms of turnover and employment. A self-assessment of the constraints on business performance over the past two years revealed *competition in markets* to be the overwhelming factor. This confirms findings of earlier studies (Clifton and Tatton-Brown, 1979; Scott *et al.*, 1989). In other words, employment legislation was not the overriding factor in business performance. However, there was evidence to suggest that employment legislation was rising in importance as a constraint amongst small firms in the UK. Compared with earlier surveys (e.g. Clifton and Tatton-Brown, 1979; Scott *et al.*, 1989) mention of employment legislation has risen in rank order. Employers were particularly affected by the rise in administration which IERs legislation had created for them.

Few employers provided evidence of a strategic response to the effects of individual employment rights on their enterprise. For example, employers were unlikely to report switches in the composition of their labour force as a result of the introduction of rights for part-timers. Thus, the argument that such rights may create prejudices against certain types of

Table 7.9 Highest negative impact of IERs by female orientation of workforce

Employment right	*% of females in workforce with highest negative score*	*(N with negative score)*	*% of sub-group stating negative effect*	*N in sub-group weighted*	*(% of total sub-sample reporting negative effect)*
NMW	1–24	(15)	75.0	20	(6.4)
Basic terms and conditions	1–24	(11)	45.8	24	(4.4)
Maternity rights	75+	(14)	60.9	23	(4.7)
Unfair dismissal	1–24	(17)	94.4	18	(4.1)
Rights to part-timers	75+	(10)	93.8	16	(2.6)
Limits on working week	0	(13)	100.0	13	(1.8)
Regular time off	0	(4)	100.0	4	(1.3)
Parental leave	25–49	(6)	50.0	12	(1.1)
Minimum work breaks	50–74	(2)	100.0	2	(0.2)
Disability rights	1–24	(2)	100.0	2	(0.3)
Discrimination[a]	1–24/75+	(1)	100.0	1	(0.1)

Source: SBRC IER Survey (2000).

Note
The table shows the highest number of businesses recording negative effects of particular IERs. The final column shows the total per cent of businesses in the sub-sample recording a negative effect. 'Highest negative score' ranked according to actual counts rather than percentages.
a Equal counts on negative score and combined negative and positive score.

employees, by for example strategic changes in recruitment patterns, were not founded in the sample. Whether or not these fears are totally unfounded, or will take time to emerge, remains to be seen.

Our evidence found that whilst the impact of IERs on the sample was not broad, in the sense of affecting many businesses, they may be affecting specific types of enterprise *at risk* in terms of their size, sector and employment composition. Smaller firms in the sample were *less* likely to report negative effects, which fits in with the earlier findings that they were also less aware of the details of employment legislation. Moreover, the survey revealed that different types of IER were affecting different types of enterprise. For example, maternity rights were more likely to affect employers with a high proportion of females and it was these employers who were most likely to record negative effects regarding maternity rights.

The results also reveal a curious, though not illogical, pattern on assessing the effects of IERs. Although the bulk of employers tended to be vague in their knowledge of employment rights, they were prepared to be critical of the effects of this legislation on their enterprise. This suggests that the results of surveys of this kind are influenced by a negative predisposition on the effects of government intervention. Clearly, this predisposition and subsequent perception needs addressing. For example, it could be that these perceptions are rooted in the self-definitions of owner-managers. Many owner-managers are resistant to external guidance or advice, let alone legislation, and even without knowing the detailed effects many start with a negative disposition. It may also be that perceptions of the effects of IERs on enterprise are also bound up with other government interventions such as taxation. A small number of employers were, however, supportive of the new employment rights recognising that legislation provided guidelines and clarification for them whilst increasing staff morale and security. However, the finding that almost two-thirds of employers did not record a benefit of the effect of IERs on their business does suggest that, overall, there is a very negative outlook such that when employers are 'captured' by legislation, they are more likely to be critical of it.

Methodologically the study poses some questions for other surveys of regulation and the small firm. From the results it appears that the greater the knowledge and experience employers have of employment rights, the more likely they are able to make informed assessments of the effects on their enterprise and that these assessments are more likely to be negative. Whilst we would not go so far as to argue that for the less informed employer, 'ignorance is bliss', it appears to be this group who record fewest negative effects. Undoubtedly, this is closely linked to their management style (Marlow and Strange, 2000). However, given the low levels of awareness recorded by employers on some aspects of recent employment legislation, the sweeping statements regarding the negative effects of employment legislation on small firms, as reported in some surveys, are

open to question. Instead, it is argued that these responses are often rooted in the negative predisposition employers have on regulation and the constituency of the surveys rather than on direct experiences.

In short, the above analysis from the UK would tend to suggest that the increase in the intensity of the individual employment rights legislation in recent years may *not* be having the detrimental effect upon business performance as suggested. Further, there is no evidence to indicate that the employability of the more atypical worker, namely the female part-time 'flexible' worker, has been adversely affected. Consequently, one implication to be drawn from these results is that the development of a set of minimum standards in the EU labour market, which seek to safeguard many of the social aspects of the employment contract, does not appear to be an obstacle to the growth of individual SMEs.

However, neither was there any evidence to suggest that such a commitment to minimum standards has delivered greater productivity with very few owner-managers reporting any positive effects of IERs on their business. From this evidence it can be argued that at best the impact of the IER legislation has been neutral for SMEs in general. As a result EU-driven policies designed to eliminate discriminatory wage practices and safeguard traditionally low-paid groups can be introduced into the regulatory framework for the labour market in order to address the twin objectives of economic and social cohesion within the EU without damaging competitiveness and growth. In short, the European Commission's twin objectives of competitiveness and employability may not be at odds with an increase in the regulatory framework governing employment relations and employment rights across the EU.

However, more recent comparative evidence from the Lloyds TSB/SBRC (2001) European Survey of SMEs carried out in 2002 would suggest that this conclusion is perhaps too optimistic. The first point to note is that owner-managers of SMEs in the UK, France and Germany regard the balance of IER legislation to be in favour of the employee (Lloyds TSB/SBRC, 2003). Probing further on the impact of this legislation on the recruitment process, this sample of owner-managers viewed the impact of IER legislation as a burden with the French and Germans more inclined to report this view. Almost three-quarters of French and one-half of German owner-managers view the impact of the IER legislation as a constraint to employing new staff compared with two-fifths of UK owner-managers. Indeed, SMEs in France were significantly less likely to employ part-time workers than SMEs in Germany and the UK, which may reflect a very pragmatic solution on the part of French owner-managers to ensure that they do not fall within the 'footprint' of certain parts of the legislation.

While in France and Germany there was no significant difference in the results by size of firm, in the UK it was the owner-managers of larger SMEs (employing 50 or more workers) who were more likely to report

that the IER legislation was a constraint on their ability to recruit workers. This reinforced the point made earlier from the DTI study and suggests that very small firms do not report effects (either negative or positive) because they are not aware of many aspects of the legislation. Overall, therefore, there are clear differences between the three EU Member States in this study which reflect the pace, and more importantly the intensity, of the adoption of EU directives concerning the regulation of the labour market. What emerges is that the regulatory framework for the labour market in the UK is perceived as being relatively more benign for SMEs than in France and Germany.

This then leads on to a final question which concerns the type of regulatory model for the labour market that is appropriate to achieve the objectives of competitiveness and employability within the EU, whilst adhering to the principles of economic and social cohesion. From the evidence presented above it is possible to conclude that the model currently in place in the UK may be working relatively more efficiently than those observed in France and Germany. The implementation of the 35-hour working week in France and the long-established family-friendly work environment in Germany, appear to be creating difficulties for the small business sector. The temptation, therefore, in both France and Germany is to seek to relax many aspects of the current labour market legislation and to move towards adopting the 'UK model'. However, there is, of course, a macroeconomic context to these cross-country comparisons with Germany and France at different stages of the economic cycle than the UK. The guiding principle at the core of EU social policy, which operates on the assumption that the labour market is as much a social construction as an economic one, must not, therefore, be sacrificed under the pressure of political expediency in the two major economies of the EU 15 as they seek to resolve their respective economic crises.

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Notes

1 In July 2001 it was reported that only one small firm in 30 in the Provence Alpes Cotes d'Azur (PACA) region in France had introduced a 35-hour working week.
2 Only women with 2 years service and working for at least 16 hours a week (or 5 years if working less than 16 hours) qualified.
3 Hogarth *et al.* (2001) reported that only a modest proportion of employers

where aware of the changes in maternity leave and parental leave regulations introduced in 1999. However, this survey was in workplaces employing five or more employees. Callender *et al.* (1999) provide a more detailed, though now dated, analysis. The DTI Employers' Survey on Support for Working Parents, recently conducted for the Work and Parents Review, provides more up-to-date material although is unfortunately restricted to firms with five or more employees.

4 Although the overwhelming bulk of research has reported negative views by employers on the effects of employment rights on their business performance, a minority in our survey perceived some positive effects. One in five employers stated that legislation provided them with guidelines and clarification in setting the conditions for their workers. Almost 10 per cent of employers stated that IERs raised staff morale and engendered a feeling of security.

5 The positive relationship between the size of firm and negative effects is confirmed elsewhere (Small Business Service, 2001:63–5). These results will be presented elsewhere but in this paper we wish to focus on differences between firms in different sectors.

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