The Relevance of Retirement Plans to Human Resource Management at Second-Tier and Small & Medium Enterprises

By Tamie Matsuura

Social Development Research Group

matsuura@nli-research.co.jp

Second-tier and small & medium enterprises are revising their retirement plans ahead of the 2012 deadline for phasing out tax-qualified pension plans. Meanwhile, their retirement plans are expected to play a growing role in human resource management, particularly to secure and retain good employees and support employee morale. Thus when determining the fate of TQPPs, companies need to look beyond funding concerns and consider the broader relevance of retirement plans to human resource management.

1. Introduction

A tectonic shift is occurring in retirement plans[1] at second-tier and small & medium enterprises.[2] Many companies are revising or even terminating their plans.

The primary trigger has been the Defined Benefit Corporate Pension Law which took effect in April 2002. Under that law, tax benefits will be abolished April 2012 for tax-qualified pension plans—a popular externally funded pension plan among second-tier and small & medium enterprises. Two other factors are also at work: (1) new accounting rules from fiscal 2000 require retirement benefit obligations to be reported on the balance sheet, and (2) the fiscal 2002 tax reform abolishes the reserve for retirement benefits, and gives SMEs ten years (four years for large companies) to unwind their reserves.

The tectonic shift raises concerns that retirement plans are becoming less relevant to human resource management. Obviously, the tax and accounting changes have a significant impact on retirement plans. But retirement plans were originally set up as part of human resource management. Thus the issue that should concern companies most is how revision or termination of retirement plans will affect human resource management.

In this paper, we first examine how retirement plans are changing at second-tier and small & medium enterprises. Then we consider the traditional role of retirement plans in human resource management, and whether that role has changed amid recent developments in employment practices.

Exhibit 1 Status of Retirement Plans

		Cos. with retire-ment plan	Plan type (companies with plan = 100%)		
			Lump sum only	Pension only	Pension & lump sum
Total		[86.7 %]	46.5 %	19.6 %	33.9 %
Employees	1,000 ～	[97.1 %]	11.0 %	19.1 %	69.9 %
	300 ～ 999	[95.7 %]	22.7 %	26.4 %	50.9 %
	100 ～ 299	[89.5 %]	34.7 %	21.6 %	43.7 %
	30 ～ 99	[84.7 %]	54.1 %	18.3 %	27.7 %

Note: First column shows percentage of all companies with retirement plans (pension or lump sum).

Source: Ministry of Health, Labor and Welfare, *General Survey on Working Conditions FY 2003*.

1 Small & medium enterprises are defined by capitalization and number of employees, and the definition varies by industry. In manufacturing and other industries, SMEs have 300 employees or less. However, no official definition exists for second-tier companies. We define them here as companies with 300 to 999 employees.

2 Retirement plans include lump-sum retirement allowances and pensions.

Exhibit 2 Funding Source of Lump-Sum Retirement Benefit

	Cos. with lump-sum retirement allowance	Funding source (companies with lump-sum plan = 100%)							
		Book reserve		SME retirement allowance mutual aid		Designated retirement allowance mutual aid		Other source	
			only this		only this		only this		only this
Total	[80.4 %]	64.5 %	55.5 %	32.1 %	22.9 %	10.8 %	6.2 %	5.1 %	3.4 %
Employees 1,000 ～	[80.9 %]	98.4 %	97.6 %	―	―	0.7 %	0.5 %	1.7 %	1.1 %
Employees 300 ～ 999	[73.6 %]	92.9 %	88.6 %	4.6 %	2.5 %	3.9 %	1.8 %	3.3 %	2.5 %
Employees 100 ～ 299	[78.4 %]	80.3 %	70.3 %	21.0 %	11.5 %	7.3 %	3.4 %	4.4 %	2.4 %
Employees 30 ～ 99	[81.7 %]	55.9 %	46.4 %	39.2 %	29.1 %	12.9 %	7.7 %	5.6 %	3.8 %

Notes: First column shows percentage of all companies with some form of lump-sum retirement plan; multiple response.
Source: MHLW, *General Survey on Working Conditions FY 2003*.

2. Changes in Retirement Plans at Smaller Companies

We first look at how the status of retirement plans has changed at second-tier and small and medium enterprises in recent years.

According to a 2003 survey by the Ministry of Health, Welfare and Labor, 86.7% of all companies—and 84.7% of companies with 30 to 99 employees—have introduced some form of retirement plan. But while retirement plans have become almost universal, the proportion of companies that offer only lump-sum retirement allowances rises among smaller companies, reaching 54.1% at companies with 30～99 employees (Exhibit 1).

Next we look at funding sources for the lump-sum retirement allowance and pension plan by the categories in the survey.[3] For the lump-sum allowance, the most common funding sources are book reserve (64.5%), followed by SME retirement allowance mutual aid (32.1%), and designated retirement allowance mutual aid (10.8%). By company size, smaller companies tend to rely less on book reserve and more on the two mutual aid plans (Exhibit 2).

As for pensions, TQPPs are the most common funding source regardless of company size, reaching 82.6% at companies with 300～999 employees (57.2% of these rely solely on the TQPP). TQPPs are thus widespread across companies of all sizes, particularly at second-tier and small & medium enterprises (Exhibit 3).

However, after enactment of the DB Corporate Pension Law in 2002, the number of TQPPs declined from 73,913 plans as of March 2002, to 45,090 plans in March 2006 (Exhibit 4).

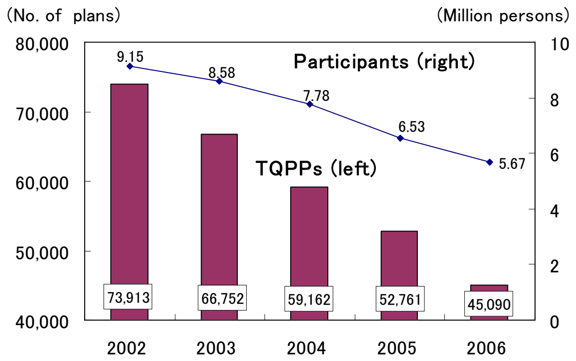
Exhibit 3 Funding Source of Pension Plan

	Cos. with pension plan	Funding source (companies with pension plan = 100%)									
		EPF		Corporate DC		TQPP		Self-administered		EPF and TQPP	TQPP, EPF and other
			only this	plan	only this		only this	plan	only this		
Total	[53.5 %]	46.5 %	26.1 %	1.8 %	1.1 %	65.8 %	46.4 %	2.7 %	1.6 %	19.0 %	1.7 %
Employees 1,000 ～	[89.0 %]	52.0 %	25.0 %	2.8 %	1.3 %	70.3 %	44.0 %	2.5 %	1.2 %	25.2 %	2.8 %
Employees 300 ～ 999	[77.3 %]	39.5 %	14.4 %	0.9 %	0.6 %	82.6 %	57.2 %	1.8 %	0.4 %	24.5 %	1.6 %
Employees 100 ～ 299	[65.3 %]	45.3 %	20.1 %	2.1 %	1.0 %	74.1 %	49.8 %	1.8 %	1.3 %	23.8 %	1.5 %
Employees 30 ～ 99	[45.9 %]	47.8 %	30.8 %	1.8 %	1.3 %	58.9 %	43.2 %	3.2 %	2.0 %	15.5 %	1.7 %

Notes: First column shows percentage of all companies with a pension plan. Corporate DB plans are omitted due to small number; multiple response.
Source: MHLW, *General Survey on Working Conditions FY 2003*.

[3] In the MHLW *General Survey on Working Conditions*, SME retirement allowance mutual aid is categorized as funding for lump-sum benefits, and TQPP as funding for pensions. But the former can also be paid out in five annual payments, and the latter as a lump-sum benefit.

Exhibit 4 Participation in Tax-Qualified Pension Plans



Note: Shows preliminary figures at end of March.
Source: Life Insurance Association of Japan.

In a study by the Institute of Labor Administration in 2004, over half of companies with fewer than 1,000 employees are phasing out TQPPs, including 10.8% who have already terminated or converted, 1.5% who have terminated or converted part of the plan, and 46.2% planning to take action. Though slow compared to large companies, second-tier and SMEs are also steadily phasing out TQPPs.

But the phase-out of TQPPs raises the question, how have corporate retirement plans changed qualitatively?

According to the same study, 66.7% of all companies have revised their lump-sum benefit plans since 2002. The percentage rises to 72.3% at smaller companies with less than 1,000 employees, where the main actions have been to terminate the lump-sum allowance (38.5% of revisions) or convert to a point system (30.8%). In contrast, at large companies with 1,000 or more employees, over half converted to a point system, while very few terminated their lump-sum plan (Exhibit 6).

3. Relevance of Retirement Plan to Human Resource Management

Given the turbulence facing retirement plans at smaller companies, our concern is whether companies see the relevance of retirement plans to human resource management.

For companies, retirement plans largely represent deferred compensation for service performed, while employees mainly regard benefits as a source of retirement wealth. The deferred compensation aspect of benefits helps companies to increase retention rates. They can also adjust the benefit curve by offering early retirement incentive plans.[4] In addition, as a

Exhibit 5 Revision Status of TQPPs

		All companies	～999 employees	1,000～2,999 employees	3,000～ employees
Total		100.0 %	100.0 %	100.0 %	100.0 %
(Sample size)		(122)	(65)	(35)	(22)
① Terminated (converted) TQP		23.0 %	10.8 %	40.0 %	31.8 %
② Terminated, converted part of TQP		1.6 %	1.5 %		4.5 %
③ Plan to terminate (convert) TQP		42.6 %	46.2 %	40.0 %	36.4 %
④ No current plan to terminate TQP		27.9 %	33.8 %	17.1 %	27.3 %
⑤ Don't know		4.9 %	7.7 %	2.9 %	
Companies that terminated or converted TQPP (or plan to) ①～③ above (multiple response)	Subtotal (sample size)	(69)	(26)	(27)	(16)
	DC plan	39.1 %	38.5 %	25.9 %	62.5 %
	Undecided, don't know	27.5 %	42.3 %	25.9 %	6.3 %
	Contract-type DB plan	24.6 %	15.4 %	29.6 %	31.3 %
	Cash balance plan	23.2 %	11.5 %	22.2 %	43.8 %
	Fund-type DB plan	7.2 %		11.1 %	12.5 %
	Pay benefits as wages	7.2 %	11.5 %	3.7 %	6.3 %
	Termination only (no conversion)	5.8 %	3.8 %	11.1 %	
	EPF	2.9 %			12.5 %
	Other	1.4 %		3.7 %	

Source: Institute of Labor Administration, *Comprehensive Survey of Retirement Allowance and Pension Plans FY2004.*

Exhibit 6 Lump-Sum Retirement Allowance Plans Since 2002

		All companies	～999 employees	1,000～2,999 employees	3,000～ employees
Total		100.0 %	100.0 %	100.0 %	100.0 %
(Sample size)		(168)	(94)	(32)	(42)
① Did not revise lump-sum retirement plan		33.3 %	27.7 %	37.5 %	42.9 %
② Revised lump-sum retirement plan		66.7 %	72.3 %	62.5 %	57.1 %
Companies that revised lump-sum plan (multiple response)	Converted to point system	45.5 %	30.8 %	66.7 %	52.9 %
	Terminated lump-sum plan	20.0 %	38.5 %		5.9 %
	Revised benefit formula	16.4 %	7.7 %	33.3 %	17.6 %
	Reduced special benefits	12.7 %	7.7 %	25.0 %	11.8 %
	Revised eligibility requirements	7.3 %	3.8 %	16.7 %	5.9 %
	Altered base pay for benefit calculation	7.3 %	3.8 %	8.3 %	11.8 %
	Offered pension as alternative	5.5 %		8.3 %	11.8 %
	Cut/abolished benefit multiplier, points	3.6 %			11.8 %
	Increased benefit multipler, points	1.8 %	3.8 %		
	Converted to fixed-benefit plan	1.8 %		8.3 %	
	Other	14.5 %	15.4 %	16.7 %	11.8 %

Source: Institute of Labor Administration, *Comprehensive Survey of Retirement Allowance and Pension Plans FY2004.*

source of retirement wealth for employees, retirement plans not only improve retention, but help foster trust among employees and allow them to focus on their work.

To further examine the relevance of retirement plans to human resource management at smaller companies, below we consider the impact of changes in employment practices.

(1) Deferred Compensation as a Way to Adjust Labor Supply and Demand

Under traditional employment practices such as lifetime employment and the seniority-based wage structure, retirement plans played a key role in encouraging long-term employment. However, these traditional practices are eroding, and companies are focusing less on long-term employment than in the past.

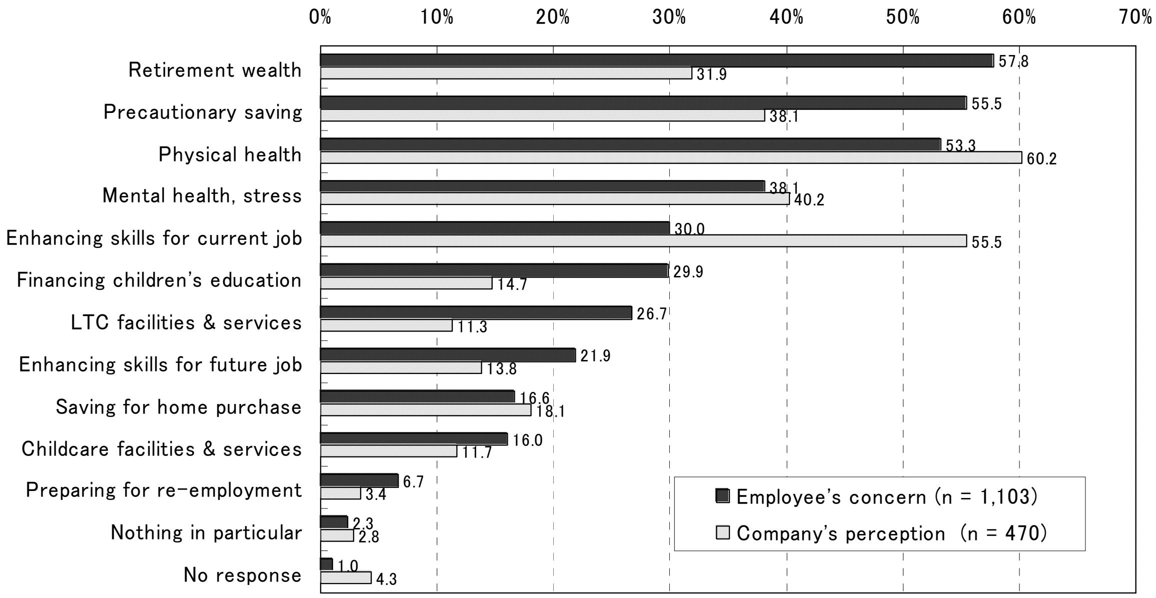
Actually, however, lifetime employment was always limited to large companies, and employee retention rates were lower at smaller companies. Looking ahead, with labor demand recovering while labor supply tapers, smaller companies will increasingly struggle to retain good workers, especially compared to large companies.

(2) Providing Retirement Wealth as a Way to Support Employee Morale

With public pension benefits being curtailed by the public pension reform, corporate retirement plans will play a greater role in providing employees with retirement wealth. In fact, our survey found that the top three concerns voiced by employees are "building retirement wealth," "precautionary saving in case of illness or accident," and "maintaining or improving physical health."

Given these concerns, corporate actions to reduce or terminate retirement plans could fuel employee anxiety and distrust. In particular, employees at smaller companies earn lower wages than at large companies, and thus receive a smaller public pension. In pondering the fate of retirement plans, companies must realize how important benefits are to employees as retirement wealth, and how high their expectations are regarding benefits.

Exhibit 7　Employees' Concerns and Company's Perceptions



Note: Shows results of employee and company surveys; multiple response.
Source: NLI Research Institute, *Survey of Corporate Welfare and Wealth Formation Plans for Workers (2002*). Study was commissioned by the Ministry of Health, Labor and Welfare.

Exhibit 8　Employees' Assessment of Retirement Plans, and Their Correlation with Work Attitudes

	Affirmative response rate (%)			Correlation with work attitude (aggregate)		
	Total of "strongly agree" and "agree"			Stability	Diligence	Contribution
				A: Want to work here long-term B: Want to change jobs if offered chance	A: Want to work hard here B: Don't want to work diligently here	A: Want to contribute fully here B: Don't want to contribute here
	All companies	～ 999 employees	1,000 ～ employees			
Benefit is high by most standards	15.3	12.1	19.2	0.169(**)	0.142(**)	0.068
Benefit is high by industry standards	11.1	10.5	11.7	0.140(**)	0.117(**)	0.057
Benefit depends greatly on performance	29.3	22.3	37.0	0.089(*)	0.069	0.050
Changing jobs would jeopardize benefit	44.9	36.8	54.4	0.209(**)	0.112(**)	0.101(*)
Retiring here ensures large benefit	17.6	13.0	22.8	0.149(**)	0.106(*)	0.070
Don't know projected benefit	40.8	46.4	33.8	−0.075	−0.084(*)	−0.067
Retirement plan may cease to exist	23.5			−0.100(*)	−0.191(**)	−0.162(**)

Notes: Survey sample contained 2,150 male and female regular employees, aged 30 to 59, in the Tokyo area (816 effective responses received). Survey was conducted by mail. Shows aggregated results. Affirmative response rate excludes respondents with no response. Shows correlation between assessment of retirement plan (left) and work attitude (upper right). (＊＊) indicates 1% significance level, and (＊) indicates 5% significance level.
Source: Analysis by Koji Nishikubo, based on Japan Institute of Life Insurance, *Survey of Life Planning, Finance and Insurance, Volume 6: Survey of Life Style and Life Planning of Retired Salaried Workers (2003)*.

(3) Effectiveness of Retirement Plans

With retirement plans now offered by almost 90% of companies, skeptics question how effective the plans actually are in retaining employees or boosting morale.

We examined the correlation between what employees think of their retirement plan, and their work attitudes regarding job stability, diligence, and contribution to the company (Exhibit 8). The biggest concern, cited by as many as 44.5% of all employees (38.8% of those at companies with fewer than 1,000 employees), is that changing jobs would jeopardize retirement benefits. This concern has a slight but positive correlation with all three work attitudes. Although the survey was limited to the Tokyo area, the results suggest that retirement plans do positively affect work attitudes.

On the other hand, the concern that retirement plans may cease to exist (cited by 25.3% of all employees) has a slight negative correlation with the three work attitudes. This result suggests that companies need to ponder the message conveyed to employees by a plan termination. In addition, companies that intend to offer the option of receiving benefits as cash wages need to think ahead about the role of retirement plans when a significant number of employees choose this option.

4. Issues for Human Resource Management

As we saw above, retirement plans continue to have relevance today in adjusting labor supply and demand and supporting employee morale. The role of retirement plans is expected to grow in importance at second-tier and small & medium enterprises.

Moreover, from the perspective of human resource management, retirement plans raise the following issues.

(1) Performance-Based Benefits

The traditional straight life benefit calculation for lump-sum benefits (final base pay x credited service x benefit multiplier) exemplifies how companies have equated service performed with seniority. Meanwhile, human resource systems at companies of all sizes are shifting from seniority to performance-based standards. Companies thus need to update how they measure service performed in their retirement plans.

The point system we mentioned earlier calculates benefits not from final base pay, but from points which are accumulated each year. Seniority can still affect benefits, but does not determine them. In addition, point systems can be designed to complement human resource systems that reward business performance and results. Large companies are intently studying adoption of the point system, and second-tier and small & medium enterprises would be wise to do the same.

(2) Communication with Employees

As Exhibit 8 shows, as many as 41.5% of all employees (48.4% at companies with under 1,000 employees) express uncertainty about their projected benefits at retirement. This suggests that despite the great effort made by companies to sponsor retirement plans, uncertainties prevent the plans from being fully appreciated by employees.

This problem can be attributed to both the widespread existence of retirement plans and their complexity. In communicating with employees, companies need to emphasize more strongly the reliability and extent of retirement benefits.

Alternatives for communicating a stronger message include allowing employees to direct the investment of plan assets as with a defined contribution plan, or redesigning plans to make projected benefits clearer as with a point system.

(3) Extended Employment to Age 65

Under the revised Law Concerning Stabilization of Employment of Elderly Persons, starting in April 2006, companies must provide job security for employees to age 65 either by raising the retirement age, introducing a system of continued employment, or abolishing the mandatory retirement age.[5]

At present, only a few companies have chosen to raise or abolish the mandatory retirement age. Most companies have responded by adopting a continued employment system which generally rehires employees after they have once retired.

However, considering the demographic trends toward aging and lower birth rates, demand is expected to grow for older workers. If employment to age 65 becomes commonplace, corporate retirement plans can play less of a stopgap role until public pension benefits start. In redesigning plans to serve as both work incentive and source of retirement wealth, companies can then consider adopting plans modeled on a lump-sum benefit paid out at age 65, and pension starting at age 65.

(4) Retirement Plan for Non-Regular Employees

The proportion of non-regular employees has grown in recent years, and second-tier and small & medium enterprises are no exception. In fact, the smaller the company, the more likely that non-regular employees form the core work force.

Not long ago, when non-regular employees were treated as a temporary or supplemental work force, companies did not even consider offering retirement plans for the purpose of improving retention or boosting morale. Even today, the few retirement plans that exist for non-regular employees offer meager benefits at best.

However, if non-regular employees are to grow further as a core work force, companies should consider offering incentives such as retirement plans or promotion to regular employment.

5. Conclusion

Second-tier and small & medium enterprises are a diverse group, with vastly different approaches to human resource management. Even after considering the relevance of retirement plans to human resource management, some may still choose to terminate them. We do not intend to reject this decision. And for companies that choose to replace TQPPs, finding another external funding source is an important concern in ensuring the new plan's reliability.

But in encouraging companies to carefully ponder the fate of their retirement plans, our intention is not simply that they find a replacement for TQPPs. We want to stimulate adequate debate at companies on the role of retirement plans in human resource management.

We believe that retirement plans will continue to play a key role in human resource management, especially at second-tier and small & medium enterprises. As such, the two priorities they must confront are: (1) to make retirement plans compatible with human resource management, and (2) to promote understanding and support for the plans by employees.

The time has come for companies to seriously ask why they sponsor retirement plans in the first place. We believe the answer lies in rediscovering the relevance of retirement plans to human resource management.

[5] The retirement age rises gradually from 62 to 65 by 2013, timed with the rising eligibility age for fixed benefits in the Employees' Pension Insurance plan.