

The Impact of the National Minimum Wage in Small Firms

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Abstract

The introduction of the National Minimum Wage (NMW) had potentially significant implications for small firms. Orthodox economic theory predicts adverse consequences, though institutional analysis points to potential efficiency as well as fairness effects. Using longitudinal data on 55 firms, this paper examines the impact of the NMW in small firms in clothing manufacture and hotel and catering. Different patterns of adjustment were observed, explained by both size and sector characteristics. Overall, the impact of the NMW was mediated by the informality of employment relations in the small firm.

1. Introduction

The election of Labour governments in 1997 and 2001 led to a series of new regulations to bolster individual and collective rights at work. The major changes included a new national minimum wage (NMW); the first complete statutory framework for the regulation of hours of work and holidays (the Working Time Regulations, or WTR); new and improved 'family-friendly' provisions relating to maternity, parental and emergency leave; equality for part-time workers; and new rights for trade union recognition, representation, information and consultation. As a result, 'the law now shapes UK industrial relations in a way that would have been inconceivable even in the recent past' (McKay 2001: 285). This juridification of the employment relationship puts the study of small firms firmly centre-stage. Most people outside the public sector now work in small firms,¹ and it is here that the effects of the new regulations might most strongly be felt. This is not just because pay and conditions tend to be inferior to those of larger companies (McNabb and Whitfield 2000). Small employers commonly have to juggle all

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the various responsibilities that are allocated to specialist departments in large organizations — purchasing, marketing, operations, finance, and of course personnel. Authority is usually expressed in personal terms, often subjectively and with large scope for management discretion (Goss 1991). Legal regulation can therefore have potentially significant procedural as well as substantive effects in small firms.

The NMW was introduced from April 1999 with a minimum adult hourly rate of pay of £3.60 (subsequently revised to £3.70 from October 2000, £4.10 from October 2001 and £4.20 from October 2002) and a lower youth rate for workers aged 18–21 of £3.00 (£3.20 from October 2000, £3.50 from October 2001 and £3.60 from October 2002). Though the initial rate was commonly perceived to be set at the lower end of expectations, the Low Pay Commission (LPC) found that around 1.3 million workers received higher earnings as a result (LPC, 2001: 18). The LPC also concluded that on the whole, and against the background of a strong economy, the impact on prices, jobs and competitiveness was relatively benign (LPC 2001: 101). However, as the LPC concedes, such whole economy analysis 'tell[s] us little about the processes of employer and employee reactions, which will require additional research' (LPC 1999: 29). These processes of adjustment, and their outcomes, include knock-on effects arising from the restoration of pay differentials; substitution between groups in the labour market; adjustment to increased costs through changes to prices, employment levels, hours, pay structures, training, work organization or profits; and avoidance or evasion strategies (LPC 1999: 29). These were the issues that formed the basis of the present research in the two sectors most affected by the introduction of the NMW, clothing manufacturing and hotels and catering services.

2. Theoretical framework and research questions

Small firms share one obvious characteristic: their size. This underwrites two universal views of employment conditions in small firms. The first may be characterized as 'small is beautiful', and was popularized by the report of the Bolton Committee in 1971. This rests on the observation of a close physical proximity between manager and workers, which it is argued promotes a mutual and informal 'give and take' that undermines collective organization and conflict. Wages might be lower than in large firms, but workers willingly concede this in return for a more congenial work environment. More recently, small businesses have been seen as less 'bleak house' than representing 'the ideal site for the development of a HRM approach', because of their direct communications and flatter hierarchies, the directly observable contribution of each employee to organizational performance, and the more immediate ability of the owner-manager (OM) to envisage and bring about change (Bacon *et al.* 1996: 98). One implication is that there is little pressure from employees in small firms for higher pay, especially if this would result in an elimination of either the 'slack' or 'responsiveness' in terms of the

supervision, work organization or patterns of working time that they might currently enjoy.

An opposing view is that employment in small firms is likely to be harsh as a result of exposure to more competitive markets and dependence on large firms as customers (Rainnie 1989). In some ways this resembles the atomized 'price-taking' model of firms in the tradition of neoclassical economics. Small firms not only operate in highly competitive markets, but are incapable of influencing their environments. Therefore wages in such firms might be expected to be relatively low, and the firm much more vulnerable to regulatory shocks. Orthodox economic theory predicts that regulatory interference that raises the cost of labour above market equilibrium will lead to unemployment (Edwards and Gilman 1999; Bazen 1990). Profitability would be adversely affected, jobs would go, and some rational actors would seek to escape regulation by resorting to illegal practices. As Milton Friedman once put it, 'minimum wage laws are about as clear a case as one can find of a measure the effects of which are precisely the opposite of those intended by the men of good will who support it' (quoted in Hirschman 1991: 27–8).

In contrast, the institutionalist analysis of employment rejects the assumptions of neoclassical analysis as flawed. From Commons (1909) to Williamson (1975, 1985), institutionalists have analysed the firm not as an anonymous 'black box', but as hierarchical organizations with labour contracts that are inherently ambiguous. Notions of power and authority, efficiency wages and transaction costs have been used in institutional analysis to justify outside intervention to raise the 'plane of competition' (Kaufman 1998). In other words, regulation such as a minimum wage can have positive 'efficiency' as well as 'fairness' effects in terms of eliciting, motivating and retaining labour.

Though institutional analysis has been applied mainly to large firms, empirical research in small organizations shows that the relevant forces are also at work here, subject to the contingencies of product and labour market context (Curran and Stanworth 1981; Goffee and Scase 1982; Scott *et al.* 1989; Kitching 1997; Goss 1991). Small firms are rooted in what Curran and Stanworth (1979, 1981) refer to as an 'industrial subculture', shaped by factors such as the nature of the product or service itself (capital requirements; quality or quantity; high or low value added, etc.); the patterns of demand and structure of competition; the skills requirements for labour; and the structure of labour supply and patterns of engagement, including segmentation by ethnicity, sex or age. Employment in small firms remains a contested terrain, if one conducted less overtly than in larger organizations, which varies according to product and labour market circumstances. For example, Ram's (1994) analysis of employee relations in Asian-owned clothing firms described a situation of 'negotiated paternalism', where changing labour market pressures and fluctuating levels of demand formed the backdrop to a dynamically contested, if informally negotiated, order. Moule (1998) and Holliday (1995: 156) support Ram's thesis that 'relationships are not straightforward but negotiated and contested' beyond an ethnic

minority context. In small firms as in large, it seems, a balance of consent and conflict characterizes the employment relationship which is expressed in various ways at different times (Edwards 1986). The effects of the introduction of the NMW are therefore likely to be indeterminate.

Our theoretical framework bridges the universalistic and contingency approaches by acknowledging both size and sector as relevant levels of analysis. This involves three assertions which we test using our empirical data.

1. There is a 'size effect'. Because capital is personified in one (or more) individual(s), employment systems and relationships tend to be 'informal'. Small firms lack specialist managers and formal hierarchies, and to that extent share an emphasis on informality. This informality is not necessarily, however, the harmony identified by Bolton. Nor does it mean a complete absence of formal procedures or a timeless and uniform feature: we have shown elsewhere that such procedures are quite extensive (Gilman *et al.* 2002) and that formalization can in some circumstances be an important dynamic (Ram *et al.* 2001a). To say that all small firms are informal is as unhelpful and inexact as to say that all large ones are formal. Informality is an 'inevitable' feature of the employment relationship, even in large workplaces with highly collectivized arrangements (Terry 1977). We mean by the term an absence of professional structures. But perhaps the key feature is the particularistic and idiosyncratic way in which owners of small firms run their operations, including their approach to staff. In terms of the implementation of the NMW, we hypothesize that the informality of systems and relations will be a significant mediating factor.
2. Sector shapes the scope for informality as well as determining the overall conditions faced by the firm. This includes product market features, such as the level of competition and profitability, but also labour market characteristics including segmentation by race, age and sex. We therefore expect broadly different NMW effects in different sectors.
3. There remains significant scope for within-sector variation. This reflects on the one hand the decomposition of 'the sector' into different constituencies; the often local and highly specific character of the markets engaged by small firms; and the 'entrepreneurial effect' of different levels of management expertise, experience, strategies and access to capital. The very fact of shared informality also means that specific responses will be shaped by highly individual circumstances. We therefore expect differences in response to the NMW within the sector too.

Our specific research questions concern the outcomes and processes of adjustment to the NMW in its first year of operation.

- Since small firms generally lack the bureaucracy and insulation from the market of large organizations, they are an ideal test bed for neoclassical as opposed to institutional expectations. What 'adverse' or 'positive' effects

did the NMW have in its first year in terms of employment levels, profitability, efficiency, and the workers' experience of work?

- Where there was little impact, were there factors other than the (low) initial NMW rate in defusing potential wider effects? In particular, how did 'informality' mediate the implementation of the NMW in terms of management's ability to absorb or evade the legislation?
- Where significant effects were felt, was this the result of 'top down' or 'bottom up' pressures? The former refers to the imposition by the NMW of procedural requirements or substantive increases in costs, which might introduce a range of effects including job losses, investment in new technology, training, market repositioning, or possibly prompting more systematic bases for employee monitoring and redundancy selection such as performance appraisal. More specifically, the administrative requirements for monitoring the NMW could lead to the decline of individualized pay systems such as piecework. Bottom-up pressures refers to employees being more aware of their rights and how to enforce them. Relevant evidence might include the recent sharp rise in tribunal claims.² With the encouragement of the legislation, and in a propitious labour market context, workers themselves might be more inclined to articulate and present their demands for higher pay (including workers above the minimum rates) to management.

3. Methods

Much previous research into small firms is based on individual case studies and does not examine change over time, which is important when considering the impact of new regulations. To capture this, research needs a longitudinal and comparative dimension, firmly rooted in appreciation of sector as well as size (Wilkinson 1999: 214). It is also important to capture an employee as well as employer view of the firm. As Scase (1995: 569) remarks in reviewing the growing field of research in small firms, there remains 'a need for further detailed comparative research that will enable us to understand more adequately the diversity of employers' strategies and how these, within different contexts, are negotiated with employees to determine varying patterns of accommodation'. We respond to this call by examining the patterns of adjustment to the NMW in two sectors; clothing manufacture, and hotels and catering.

The sectors, one manufacturing and one service, were chosen because they are dominated by small firms and have a concentration of low pay (Bazen 1990), but have different characteristics. Clothing, together with textiles, remains the ninth largest manufacturing sector in the UK, but unfavourable exchange rates and the phasing out of the protectionist Multi Fibre Agreement mean that it is officially acknowledged to be 'currently facing the greatest challenges in its history' (TCSG 2000: 5). It also faces recruitment problems owing to a dependence on ethnic minority labour and 'the widely

held perception that [it] is in decline, that it does not offer good career prospects and that it is poorly paid' (TCSG 2000: 26). Hotel and catering depends heavily on young and female part-time employees. The work is generally low-skilled, with higher levels of labour turnover. Product market problems are less acute than in clothing, though many small catering and hotel businesses face increasing competition from the 'big chains' (Lucas 1995).

It is well known that research access to small firms is difficult (Scase 1995: 580). Managers are time-pressured because of multiple responsibilities, and often are unfamiliar with academic research. However, our efforts were facilitated by timing. At the outset, publicity and concern about the NMW was at its peak. We also used a wide range of contacts to find a range of firms to approach. In all, 22 networks were used, including 15 business and trade associations, local councils, trade unions, banks and low pay organizations. The cases were selected to provide a range of possible circumstances rather than any statistical notion of representativeness, a form of 'theoretical sampling' (Eisenhardt 1989: 537) that is often used to minimize bias in exploratory research. The objective was to capture the rich insights into the dynamics of employment relations provided by a case-study approach, but also to address broader issues about paths of adjustment across a range of small firm types. It is for this reason that mixed research designs are gaining popularity in small firms research (Curran and Blackburn 2001).

Our approach involved semi-structured interviews of owner-managers and employees prior to the introduction of the NMW, with repeat management interviews a year later (Table 1). The objective was not simply to compare a

TABLE 1
Summary of Research Methods

<i>Sample</i>	<i>Methods</i>
<i>Round 1 (1st quarter 1999)</i> 55 firms (27 clothing, 28 hotel/catering) Median employment: 27 in clothing, 16 hotel/catering	Management prior completion of background form (details of employment, hours, pay) One face-to-face manager interview (business context, management of staff, response to regulations) One formal employee interview, determined randomly or by availability (job history and motivation, work demands and supervision, pay and hours, training, employee relations, awareness of regulations) Informal discussion with other employees where possible
<i>Round 2 (1st quarter 2000)</i> Repeat management interviews (except 2 refusals and 3 ceased trading) 5 case studies (3 catering, 2 clothing)	Management interviews (business context and impact of regulations over the year) Repeat and multiple management interviews, multiple employee interviews, direct observation

before-and-after snapshot, but to examine the complexities and dynamics of the adjustment process in each case. The target population was firms employing between 10 and 50 workers (though growth or contraction meant that these bounds were breached by the time of the first visit in five clothing firms and eight firms in hotels and catering). Median employment was 27 in clothing and 16 in hotels and catering, and 55 firms were visited. In addition, we were able to develop more detailed case studies in five firms, involving wider and repeat management interviews, employee interviews, and direct observation (see Ram *et al.* 2001b).

4. The impact of the NMW

At the time of the first visit in early 1999, all but one employer in clothing and all in hotel and catering said that their firms would be affected by the NMW, with an average affected workforce of 15 per cent in clothing and 38 per cent in hotel and catering. Only a quarter of affected companies felt able to pass on the increase in costs through higher prices. Most employees were also well informed about the NMW. Around three-quarters of workers that we interviewed in both sectors were aware of the NMW and knew what the rate would be. Some had already received an increase ('he knew all the workers would say something so he did it himself' — clothing) and others were anticipating it ('they did not say anything but the staff all expect it because we are aware of it' — clothing). However, they also expected the NMW to contribute to a revised wage-effort bargain. This was especially true in the clothing sector, where market conditions had been deteriorating for some time. There, 60 per cent of workers believed that managers would try to increase work effort, 40 per cent that working practices would change, and 28 per cent that hours of work would be revised. The figures for hotel and catering were 32, 16 and 4 per cent, respectively.

In the return visits a year later, a range of adaptation was observed, reflecting different business conditions and management practice. In clothing, product market problems meant that virtually all the firms were worse off than a year before. A few had closed, and employment levels were down in many of the rest. This was blamed primarily on declining demand, though the NMW was sometimes reported to have significantly increased costs. In hotel and catering developments were more varied, reflecting greater diversity of activities and circumstances. The general picture was also less dramatic: the NMW (and in a few cases the statutory holiday entitlements provided by the WTR, which was also examined as part of the research) led to a slight increase in costs, usually passed on in prices.

Overall, there were three sets of response in each sector, which we label as 'implement', 'ignore' and 'critical event'. In the first group, comprising the majority of firms in the two sectors, implementation was generally unproblematic. The second group refers to the small number that moved into producing illegitimate goods and/or employing (some) workers 'off the books'.

The third group, also small, looked to reposition themselves in the market or otherwise used the occasion of the NMW to thoroughly revise existing arrangements.

Implement

In hotel and catering, most firms implemented the NMW without any restructuring of pay systems or organization of work. This minimalist response to the NMW was for three reasons. First, levels of pay were already around or above the level of the NMW for the majority of employees, making it easier to absorb. Though most firms were affected by the NMW, only a minority of workers tended to be paid less than the new legal minimum rate. Crucially, the fact that employees were usually unaware of pay dispersion within the firm meant that the resultant increase in pay did not have knock-on effects. Second, many managers pointed out that there were few options in small firms to offset the implementation of the NMW by introducing new technology or changes to working practices. Work such as changing beds, cleaning rooms or cooking food was simple and labour-intensive, without much opportunity for changing the labour process. There was also limited scope to intensify the work to compensate for increased costs: 'it's not like in big companies where you can cut one member of staff and get the rest to work harder. In a small firm there is no room for manoeuvre — if you cut a job it wouldn't get done' (caterer). Third, many managers did not necessarily see pay as the key factor in the retention or motivation of staff, because they targeted specific groups in the labour market. These might be older workers, women with young children or young people who might find the wage-effort balance more acceptable. However, there were a few cases of upward revision of rates over and above the statutory floor. The fact that £3.60 was widely known to be the statutory minimum encouraged one caterer, for example, to establish her new basic rates at £4.00, an increase of 50 pence an hour. Employee numbers and turnover were important factors explaining the pay hike. As a seasonal business, she had to recruit regularly, and a higher basic rate could better sieve the labour market in terms of quality of recruit. As a micro employer (usually with only one or two permanent employees, supported by a larger number of casuals as necessary), she was better able than some larger firms to absorb the increase in rates.

In clothing business conditions tended to be harsher, and implementation was often associated with some rationalization. One firm, which cut back by closing one of the two businesses at its site, blamed its hardships primarily on imports but also said that the NMW had a final effect by increasing costs and reducing pay flexibility: 'in the past when competition increased and prices reduced we could have asked workers to have less pay, but we can't now, it's illegal . . . it's closed the business down — we couldn't sustain the level of outgoings with the level of income'. The NMW was a particular complication for firms that used piecework, prompting most to abandon this as a payment system (see below). It was less harshly felt in the firms that used

day-rate pay systems, especially as the NMW was set at a relatively low initial rate. Family and ethnic ties could provide a more or less 'captured' labour force reluctant to move elsewhere (especially in the case of older women workers), but skilled machinists usually expected to obtain pay above what they could get for less skilled work such as in shops. Rates had therefore been moving towards £3.60 for some time. As one manager put it, 'it has not really affected us because we paid nearly the same, just 10 or 15 pence [less]'. In this firm employment had fallen over the course of the year, but this was attributed less to the NMW than to lower demand and more competition from 'garages' (operators from domestic premises). The response was to end CMT (cut, make, trim) operations and supply directly to shops as well as warehouses on a smaller scale.

Ignore

The temptation to indulge in illegal practices was a real one, but apparently not seriously considered by most firms. Several companies did report considering illicit practices, though few were prepared to admit to anything more than making ad hoc 'cash in hand' payments. Some managers claimed that the pressure came from workers: 'People come to the door and ask to work off the books so they can still get their benefits. We had two come the other day, but we don't do off the books. People also want to work full time but to write down under twenty hours — but we don't do that either' (clothing). This firm had recently lost a presser because he wanted to show fewer hours, and a lack of alternative labour meant growing recourse to 'retired' workers.

Deliberate flouting of the NMW was found in only a couple of cases, both in the restaurant trade, though we have other information that it may be quite common in relatively down-market operations where employees are often routinely paid on a 'cash in hand' basis (Ram *et al.* 2001a). The following cases can be taken as illustrative. In the first, a restaurant, the owner said he was aware of the NMW but said that most workers did not get it. (He also said that he had never heard of the WTR, and staff did not get paid holiday leave.) Instead, they got £15 per shift which, if it did not surpass its scheduled five hours, worked out at £3 per hour 'cash in hand'. The owner claimed that he would then 'gross it up' by paying any tax and national insurance. The workers confirmed that they picked up less than the NMW and their view of this was highly dependent on personal circumstances. One waiter, aged 50, who used to have a newsagent's shop, said that he did not mind as his current job was less pressured. For such workers, key factors were what the owner was like to work for and relations with other workers and customers. Evaluation of the 'fairness' of pay was influenced by how they personally felt treated and the fact that the job was not always very busy. ('I mean, the work isn't that hard I think. It is easier than working in a factory and maybe that is why the pay is a bit low as well because the work is easier than anywhere else' — young waiter.)

In the second example, another ethnic minority restaurant, there was more evidence of 'grey' practices. In response to the question 'how many people do you employ?' the manager replied 'do you want the official figure or the unofficial one?' The answer emerged as two chefs, two kitchen workers and two waiters, but with a further two people employed on Friday and Saturday on a cash-in-hand basis (£20 per shift, 5.30 pm to 1 am but possibly 2 am or even 3 am). Shift rates varied individually for all employees (e.g. £18, £20 or £25 a night). The mechanism for reviewing pay was also very informal, aided by staff keeping information on their earnings to themselves. Pay increases were not considered by the employer unless demanded, and were usually resisted with personal appeals and reference to the 'relaxed' work environment enjoyed by staff. In practice, this meant treating staff courteously, extending them some self-regulation of activities, providing fringe benefits such as free food and transport, and flexibility over working time, including keeping jobs open for staff when they made a return visit to the Indian sub-continent.

The clearest illustration of an evasion response was one of the clothing case study companies, 'Endco'. Research interviews extended to a supplier to the firm as well as management and employees, including home-workers. In fact, the company closed down before the end of the project after its main customer ceased operations, itself blamed on the NMW:

Our main customer employed 20 women packing. He paid each woman £90 and they were happy with that. With the introduction of the minimum wage he would have had to pay them £140–£144, that is an extra £1000 per week . . . That was his profit margin . . . An importer has taken over the company for the sole purpose of the order book, and they told us that we were going to have work but a very small amount. We calculated it wouldn't be feasible to stay in business.

Before it closed, Endco employed ten workers. Six were home-workers but only three worked 'on the card'; likewise, of the four 'on-site' workers, two worked off the books. Pay was based on a piece-rate which fell some way short of the NMW. Earnings were therefore reconciled to a nominal working week:

Interviewer: 'How much do the staff earn?'

Co-owner: 'They earn £90 to £95 a week.'

Interviewer: 'How many hours is that for?'

Co-owner: 'Work it out for yourself — it's that amount divided by £3.60.'

Employees backed up this account. An on-site worker said, 'Don't write down that I work 9 to 6, just say that I get £85 for 23 hours a week'. A home-worker reported working between seven and ten hours a day for £100–£150, though hours could be much longer:

When he needs the work, I sew 'til much later, up to 10 pm or 11 pm. On three times last year, I sewed right through the night. If I didn't do it, he'd give the work to someone else.

She was aware of the NMW, but commented 'I have to take whatever he gives me.' This opportunity to exploit dependent ethnic networks reinforced

Endco's position at the bottom end of the market. When this began to collapse, the firm experimented for a time with manufacturing 'dodgy stuff' (fake designer-label products), but still could not find enough work. They could not compete with the fully 'underground factories', i.e. 'factories that don't exist on paper'. With the rewards dwindling, the risk and complexity of ignoring the new legal minimum wage was too high, and closure was the end result.

Critical Event

In contrast, some clothing firms were able to respond to the pressures of deteriorating business and the NMW by making a shift to specific niche markets. In most companies this was not a reasonable prospect, even with 'entrepreneurial' management, given inadequate access to capital on the one hand and a shortage of skilled staff on the other. Training provision in particular was poor. (As one clothing sector owner-manager put it, 'we just recruit — not a lot is spent on training'.) Most owner-managers already felt overstretched in coping with existing commitments without trying to take on wholesale change:

I don't know what to do about it [the NMW]. We are getting all other regulations now like tax credits which have to go through the payroll and pensions. We have to rush around all the time — we can't plan, it's just survival.

Nevertheless, in one firm the response was to reposition away from volume work 'to a niche which is keeping us alive' — the high-quality, hand-made end of the market, where import penetration was much lower because orders were small and customized. The transition involved significant job losses (16 staff) and substantial training investment in the remaining workforce. In this firm the NMW served as a benchmark above which minimum pay rates were pegged at £4 per hour in order to retain staff against competition outside the sector as well as from within. Significantly, the firm had not had a piece-rate system for some time, as 'it proved a disincentive to the slower workers. It is better to pay the same so they know they are treated fair.'

The NMW was also the final factor in promoting change in another clothing firm. As a trouser manufacturer, it considered itself relatively well placed to reposition because of barriers to entry ('it takes twenty machines to make a pair of trousers but only three for a jumper'):

We have changed from wholesale to the corporate wear market because this is better quality and selling prices are better. . . . Before, say a year ago or more, this was just 5 per cent [of our business], then we were forced to go up-market . . . The £3.60 was the major factor in the change — though we were looking at it already, it was the spark to make greater efforts as soon as it came in place.

However, the shift to more profitable lines was not wholly smooth. Labour costs increased because of the NMW and variation in employee performance remained a thorny issue. This was dealt with mainly by the better performers 'balancing out' or effectively subsidizing the slower workers, with some

absorption of the cost increase through higher prices. At first some efforts were made to claw back the cost increase of the NMW. However, this led to an employment tribunal case for unfair dismissal when a worker was sacked for protesting over the withdrawal of breaks. This made the owners wary of upsetting the workforce and ultimately led to important procedural change. ('We are trying to get up-to-date on how to handle staff, laws and how to go about things, putting procedures in place.') This began with a new record-keeping system for hours and pay, a review of discipline and grievance arrangements, and consideration of employee appraisal. The firm was thus seeking new ways of balancing the expectations of workers with its market objectives as an indirect result of the NMW.

As indicated earlier, many clothing firms found that implementation of the NMW was complicated by their use of piecework payment systems. Most had used a mix of hourly pay and payment by results prior to the NMW (only five firms had wholly output-related pay and only six had none), but almost all decided to switch to wholly day-rate payment in its aftermath. This was because of practical problems in reconciling average piece wages to the NMW rate; but, again, the change was not due solely to the NMW. Piecework had been under pressure for some time because of increasing variability in the volume, style and delivery requirements of customers. It was also reported that the large retail chains disapproved of piecework because of the potential implications for quality. However, managers often complained that abandoning piecework, which was blamed at least in part on the NMW, led to falling productivity:

The minimum wage is a bad thing, not so much in actual pay terms but because there are no incentives any more. For the borderline cases it has destroyed incentives, as they will be paid three fifty [sic] whether they work hard or not.

Closer monitoring was therefore a common theme. Two companies actually moved to new premises partly to ease supervision. In one of the firms, where the NMW increased the wage bill by around 7 per cent, the owner stated that

recording and monitoring is much better in the new factory . . . it [also] gives a good impression to get the work for Arcadia . . . it is a good environment and facilities to keep the workers too . . . we are trying hard to keep hold what staff we've got — the young generation is just not interested.

There were few signs of direct attempts to recoup the costs of the NMW from workers through cuts in paid breaks and so forth, in part because there was little 'slack' to be cut.

Some hotel and catering firms also asserted that the NMW provoked a rethink on pay, and not just because of the impact on costs. The owner of one of the larger firms, with several shopping-centre restaurants, explained:

I think the minimum wage and working time regulations have focused our attention on this [pay and working time arrangements] a bit more — which is an indictment of ourselves that we needed this to prompt us! When you are small you do a

lot of things by the seat of your pants, there is no vast structure with people specializing [in HR].

As a result of the WTR, the company extended holiday entitlements to Saturday staff. In terms of pay, the level of the NMW, just below established rates, brought home that pay might not be as competitive as previously thought: 'it makes you think whether you are as good as you think you are'. As a result, two new higher pay bands of £4.00 and £4.20 were introduced, linked to skills development. Crucially, the business was starting to perform particularly well, which justified the increase in costs. A similar situation prompted another independent shopping-centre restaurant to re-evaluate its pay system in the light of the NMW. Rates were increased to the NMW shortly before its introduction and subsequently by another 15 pence per hour in recognition of increased sales, since a new metro station had recently opened at the bottom of the arcade. The manager said that the NMW also prompted the idea, and provided the opportunity, to introduce standardized pay rates to promote teamwork. Instead of individual variation, all staff were paid the same apart from the head chef and a cook on a higher rate.

Occasionally, a review of pay systems reflected a more substantial NMW impact on costs. In one hotel, where some workers' pay had not increased for five years, the NMW was estimated to have taken £40,000 off annual profits. This stimulated a wider review of the pay system, including the introduction of merit pay and a grade review to encourage 'multi-skilling'. Formal training under department heads was extended in pursuit of Investors in People accreditation, linked to the hotel's plan to expand into the conference market. A mix of market re-evaluation, training and work intensification therefore followed in the wake of the NMW:

Now we expect everyone to work twice as hard: multi-skilling. That is just the way of life now. The NMW really made the industry look at itself in a big way.

The NMW therefore sometimes prompted changes other than to the level of pay. One cafe owner/caterer said that the introduction of the NMW encouraged him to readjust the demographic mix of staff and their contracted hours by switching from part-time school-leavers to full-time mature workers. The idea had been under consideration for some time, partly because he had run into difficulties with the authorities over the employment of minors in the kitchen, and partly because of problems of turnover and time discipline. However, the increase in wages required by the NMW allowed him more easily to recruit from older age groups whom he considered more reliable. Pay increased by 35 pence an hour to £3.70, reflecting a perceived need to differentiate basic pay from the bare legal floor. In the end, the NMW was not viewed in hostile terms. ('The answer to competition is a fair wage and the right equipment. Investment is the key.') The WTR was seen as more of a burden in its provision of four weeks' paid leave (of which the owner learned from employees): 'this puts up the effective hourly rate and is a hell of a pressure on a small business'.

Perhaps surprisingly, there was only one case where the NMW led to increased employment of young people to avoid paying the full adult rate. This was a pub/hotel that changed ownership around the time the NMW was introduced. The new manager partly justified the decision by her own relative youth (aged around 30) — 'I prefer to deal with younger people as I'm younger myself.' However the lower youth rate was crucial, particularly with a local labour market (a suburb with few similar employers) which provided a ready pool of school-age and higher education students. A dozen new staff aged under 21 were taken on at the start and eight older staff let go, and by the time of the second visit there was reportedly no one over the age of 22. However, the pay expectations of potential recruits had begun to readjust in the light of the NMW:

Some people do ask for more because they treat the national minimum wage as a general minimum even for a school-leaver — one 18-year-old wanted £4 an hour.

Rates were therefore increased by 25 pence across the board, though they remained at a generally low level (e.g. kitchen £3.00–£3.50; bar area £3.50–£3.75).

In summary, then, efforts to cope with increased costs through labour substitution or better labour utilization (work reorganization, training, capital investment) were limited. There was evidence of reductions in employment levels, but these were concentrated in clothing, where product market pressures were already acute. Moves 'upmarket' or out of the legitimate market did occur, but again, the NMW was but one factor in the context of changing business conditions. The most common pattern of adjustment was to absorb the increase in costs through changes to prices and profits. In part, this reflected the relatively low level of the initial rate, though it did have a significant impact on most of the firms in this study. More fundamentally, absorption was encouraged and facilitated by the informality of workplace relations in the small firms, which manifested itself on the one hand in notions of 'fairness' and 'give and take', and on the other in individualized arrangements for pay which defused wider upward pressure beyond the minority of workers affected.

The Context of 'Informality'

It is worth pausing to look at the nature of this 'informality' specifically, not least because one lasting effect of the Bolton Committee's Report has been to shape a research agenda concerned with refuting the universalistic notion of 'harmony' in small firms. Though rightly successful in this regard, the critique has had the unfortunate consequence of under-analysing the dynamics of informality and reciprocity in small firms (Ram 1994; Ram *et al.* 2001b). Reciprocity in our firms was the product not just of management goodwill, but managements' dependence on employees. In most of the small firms labour turnover was low, which meant that personal relations were long established and characterized by some degree of mutual obligation. Perhaps more

importantly, staff were often difficult to replace. The small firms in the research were not only at the mercy of the product market, which in any case placed a premium on maintaining stability in the workplace, but also were subject to more or less intense labour market pressures. Low margins helped keep pay relatively low, leaving working time vital to recruitment and retention. This meant that there was a large variation in practices, including in wages and working time patterns, even in the same product markets and geographical areas. Certainly, there were few of the structured ways in which large firms in a sector have been found to ape each other and move in similar ways as if in a 'convoy' (Arrowsmith and Sisson 1999).

Most employees felt they had some control over how hours of work were scheduled (Table 2). This reflected their practical realities of family or educational commitments. Working-time flexibility was also a fairly low-cost way of demonstrating management's personal commitment to individual staff. The most positive aspects of the job referred to by clothing workers was usually flexibility over working hours ('to work around family life'), as well as proximity to home and relations with colleagues. Machinists commonly found jobs through relatives and friends, making the workplace more of 'a friendly place to work — everyone knows each other and their families, and most have worked here quite a while'. Similarly, hotel and catering workers referred to positive qualitative factors in the job to do with team spirit, contact with the public and work 'atmosphere', which included relations with management ('because it's small we know the owners a lot'). Working time flexibility (patterns of hours, swaps and the ability to vary working time) reflected this context. In short, as one worker put it, 'what we lack in training and pay we gain in flexibility'.

Of course, there was resignation as well as attachment. Clothing workers frequently remarked that relations with management were relaxed ('we don't work like servants: it's more like a family business'), but they acknowledged the reality of inequality in information and decision-making. ('It's good because you can tell him anything, but you need questions ready because he has all the answers.') Some older workers, especially those who spoke little

TABLE 2
Variations in Working Hours (%)

	<i>Hotellcatering</i>	<i>Clothing</i>
Incidence of variation		
Often	22	8
Sometimes	37	62
Never	41	31
Procedure for variation		
Employer simply decides	11	20
There is some discussion	11	20
I can have a significant say	78	60
N	28	27

Source: employee interviews.

or no English, felt that they had limited opportunities to work elsewhere. Several workers in both sectors also pointed out that smallness did have its downsides. The family analogy used by workers was double-edged (echoing Newby 1977), for example concerning monitoring and discipline, especially as competitive pressures increased ('It's like a little family [but] you are watched a lot and [discipline] is quite strict' — machinist). Management 'give and take' also sometimes obliged workers to work long hours because of varying work intensity. As one bar manager put it, referring to some employees who averaged a 60-hour week, 'they might well be on the premises but they are not necessarily "working" during scheduled time'. The staff seemed to agree that a significant part of the job involved just 'being there', and that the peaks and troughs averaged out to an acceptable work effort.

The second feature of informality, and the most important in terms of mediating the impact of the NMW, was the nature of pay determination in the small firms. The first round visits revealed that only one firm in each sector said that it had what could be described as a formal pay scheme. Significantly, pay-setting was usually an issue for management alone. Three-quarters of hotel and catering workers, and four-fifths of those in clothing, said their employer decided the increase unilaterally, with only one in five and one in ten respectively reporting some discussion and an even smaller minority saying they had a significant say. Furthermore, a blanket of secrecy helped managers control the determination of pay. Only one in five hotel and catering workers, and a quarter of employees in clothing, said that workers discussed pay among themselves. This was partly because of employee reticence and partly due to employer pressure. ('We are not allowed to talk — no one discusses what they get, especially the highest don't tell the lowest' — machinist; 'They tell you to keep quiet about your rise' — machinist.) As a result, employers in over a third of clothing firms, and more than half of hotel and catering establishments, implemented varying levels of pay award for their staff. Furthermore, these pay increases need not occur every year. According to both employers and employees, only about half of hotel and catering and clothing firms awarded a pay rise annually. This had the effect of removing a focus for employee expectations over pay.

Many workers therefore felt that there was little chance of their influencing the employer over pay. There was some evidence of contest over piece rates in clothing, but employer obduracy was reported as the norm. ('We've never been able to influence him even though we have a say. We make suggestions but there's no point if he's already decided'; 'If we complain they will re-time the job but it doesn't get changed that much.') Hotel and catering was somewhat similar ('We always say to the boss it is about time we had a rise but he doesn't take any notice' — catering assistant). Without an established mechanism for when or how pay was reviewed, it was often simply left to the employer to decide, 'like it or lump it' (hotel receptionist). Employee acceptance of this was explained not just in terms of individual powerlessness *vis-à-vis* the employer, or a perceived lack of alternative opportunities and inertia. ('I could move on so I can't complain much' — clothing; 'I just

stay because if I go somewhere else I have to start from the bottom' — clothing.) Also important were compensating factors in the job, discussed above, such as flexibility over working time, 'relaxed' relationships with management and 'sociability' factors to do with long-established relationships with work-mates or, in hotel and catering, the interaction with customers.

In addition, low pay was sometimes endured because personal circumstances permitted it; many workers were second household earners or were young adults in education and/or living with parents. Certainly, given this targeting of specific groups in the labour market, many managers did not see pay as the key factor in the retention or motivation of staff. By way of example, one small hotel in an area full of hotels and guest houses had to increase pay to comply with the NMW. The owner admitted that low pay did make it difficult to find good staff in the first place, and acknowledged the fact that all but one employee had been with her for over two years was 'amazing really, considering what I pay everyone'. However she argued that qualitative factors such as a 'relaxed atmosphere', job security (including retaining workers at slack times), benefits such as meals and breaks and flexibility over working time were more important to staff retention, because she employed mainly female secondary-earners with children. In contrast, the owner's sister-in-law, who ran a similar lodge in the next street, paid a pre-NMW minimum rate of £4.20 per hour with 25 days' paid leave. The NMW had no direct effects there, but the owner believed she was still 'employing at the bottom end of the market to judge by the standard of applicants'. Interviews with the staff suggested that, though pay might be higher there, there was less accommodation over hours and tighter supervision of work, which contributed to higher employee turnover. Patterns of informality and accommodation were therefore reinforced by clear lines of labour segmentation in the small firms as well as management style.

5. Conclusion

In terms of our original theoretical framework, our findings suggest that 'informality' is a tendency of small firms, but with the qualification that it can take many forms and suit different purposes, as indicated by the varied pattern of response to the NMW in our case studies. Indeed, informality can be a cloak behind which different responses can emerge, from individual but covert implementation to resistance on the basis of personal appeals and reference to what Bolton termed 'non-material satisfactions', to exploitation of ethnic and kinship ties, to pressures for illicit forms of employment. This is where sector and localized contingencies enter as explanations of small-firm behaviour, reflecting different product and labour market conditions and individual variations in how firms respond to these pressures.

In terms of our specific research questions, first, the most common response to the NMW was to absorb the increase in costs. This was primarily because the NMW did not provide a shock sufficient to jolt employers or

workers out of their customary practices and habits, though the cost implications of the NMW were significant for many of the small firms in our research. More generally, efficiency effects were limited because informal pay arrangements meant that cost implications of the NMW could be mitigated by absorbing increases individually, without implications for differentials. Furthermore, offsetting change was often constrained by practical constraints or the need to accommodate employees over the hours or intensity of work. The NMW did trigger some moves up- and down-market, and precipitated the abandonment of piece-work in the clothing sector, though it is difficult to say whether this might have happened in any case because of business conditions (see also Heyes and Gray 2001; Undy *et al.* 2002). The variation in patterns of response that we observed — implement, ignore, or critical incident — therefore owes much to the external context as well as to the particular ‘informal’ characteristics of employment relations in the small firms.

Theoretically, the threefold pattern of response indicated by the results suggests that neither the ‘positive’ (institutionalist) nor the ‘negative’ (neoclassical) account of regulation is supported uniformly. One implication is that the analysis of small firms might benefit from the ‘firm-in-sector’ approach that has usefully been applied to large organizations (Smith *et al.* 1990; Arrowsmith and Sisson 1999; Hislop 2000). Sector factors — product market pressures and labour force characteristics — interrelate with the inherent features of small-scale enterprise (the personification of capital and immediacy of work relations) in shaping employment relations in the small firm. Moreover, size is relevant not just in terms of management/worker proximity and mutual dependence, which might lend itself to reciprocity in the Bolton sense, but also in terms of the absence of collective organization, which renders arrangements for pay both invisible and individual. In this sense, in answer to our second research question, ‘informality’ was an important mediator of the NMW.

Our third research question referred to the process of adjustment. It was hypothesized that the NMW could have procedural and substantive implications for employment in small firms, other than the immediate increase in pay of eligible workers, because of ‘top-down’ or ‘bottom-up’ effects on expectations and behaviours. Top-down pressures referred to the increase in costs experienced by many small firms and the implications of the new administration requirements for pay systems and performance monitoring. Employers’ possible responses ranged from simply absorbing the cost increase to offsetting it by changes in work organization or market positioning. Bottom-up pressures referred to workers using new employment rights as a lever in their formal or informal negotiations with management. In the event, both sets of pressures were weak, leading to a varied pattern of response which was very dependent on the existing business context and management plans. Top-down pressure for wider change was limited by access to capital, a difficult trading environment and a narrow scope to actually do much work differently. Bottom-up pressures were defused in part by employee ignorance

and the absence of collective organization, but also in some cases by compensating factors to do with working-time flexibility and personal proximity and relations with management.

On the whole, the NMW had the intended 'equity' effects of increasing wages without the perversity of increased unemployment, partly because of the individualization and indeterminacy of pay. An important lesson is that employment regulations do not have impacts on small firms that are easily predictable in advance; they are mediated not just by the different external environments in which the firms operate, but by the often opaque and complex internal dynamics within the 'black box'. One policy implication, therefore, is that there needs to be a clearer integration and communication of the objectives of employment regulation to the principal recipients, which are in many instances small firms. Practically, 'multi-employer institutions' need to be established to enable learning to be shared among employers (Herzenberg *et al.* 1998). One way of doing this is by strengthening the advisory potential of business networks and associations, a theme pursued elsewhere (Edwards *et al.* 2002). These are rarely used by small employers because of issues of relevance and access, but they are potentially vital for disseminating 'best practice' given the limited managerial skills and knowledge of many small firm owner-managers.³ Perhaps, as Curran and Blackburn (1994: 101) observe, sector-based approaches would provide a more relevant means of reaching this audience. Such local, sector-based business associations could be important in reducing firms' isolation and helping them move in a direction that only a minority seem capable of pursuing on their own.

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Notes

1. Excluding agriculture, in 1997 one in five private-sector employees worked in firms with 1–10 workers (just over half of whom were self-employed); a further 26 per cent in firms with 11–49 workers; and 12 per cent in firms with between 50 and 99 workers (Labour Market Trends 2000; Maratos 1997).
2. Applications to employment tribunals increased each year from 1997/8 to 2000/1 by a total of 60 per cent, before falling by 14 per cent in 2001/2 to a total 117,090.

Around 50,000 cases relate to a ruling of the House of Lords in February 2001 concerning part-time workers' access to occupational pensions (Employment Tribunals Service 2002: 4).

3. This was brought home forcefully by one hotelier who attended a 'Management for Change' course run by the City Council. She said that it was very useful in providing new business planning and management skills as well as covering employment law, where her knowledge was 'quite embarrassing really — I've been in the job 22 years and didn't know I had to provide a written contract of employment'. The programme encouraged her to introduce more systematic training and 'has made me stand back and look at the business differently, and taught me a lot about staff and what is involved'.

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