

# Management of older workers and evolution of the psychological contract in Japan

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## **Abstract**

Developing a conceptual and practical understanding of employee-employer relationships is a central concern to the practice and research of human resource management (HRM). HRM is fundamentally a people-focused activity 'manifested in a series of investments in observed human behavior and perceived potential, as assessed or inferred by employers and their agents such as HR managers, line-managers, supervisors, project team leaders, and so on, with the objective to add value to organizations as they pursue strategic business objectives' (Rowley and Jackson, 2011). In Japan, traditional notions of employees pursuing their career within one organization and exchanging loyalty for a sense of employment security can be seen as a form of deal between individual employees, individual organizations, and the government and other public institutions. This paper develops an HRM perspective on the management of a specific segment in the labor market; namely, older workers in the context of a developed economy with a rapidly ageing society (Jackson and Debroux, 2016).

## **The basis of the psychological contract in Japan: practice and concept**

An individual's career can be assumed to develop over time through made and received experience and through self-perception and through processes of self-expectation. The assumption at this initial stage is that human (social) relationships are formed through interaction between individuals as members of social groups. As Giddens states it, (1991) it can be assumed that these interactions and the relationships they form and nurture are bounded by space and time: they also express purpose, fundamental among which is physiological, psychological and sociological survival and, based on it, a fundamental sense of security, well-being, and optimism in response to current and in anticipation of future events.

Once individual workers have been selected, they continue being selected until they are either de-selected, or they de-select themselves. HRM practitioners make worker selection decisions

on the basis of past experiences, current perceptions, and future expectations: in this sense they are strategic from both the employer and employee perspectives and are culture-specific in terms of the normative values, expectations and behaviors they elicit (Rowley and Jackson, 2011). In HRM practice, strategic decisions leading to staff selection and/or de-selection are influenced by the formal and perhaps implicitly institutionalized policies that, when made explicit, might be interpreted as artefacts or observable expressions of organizational or sector-based cultures. In Japanese contexts for HRM policy-making, such 'common sense' assumptions are likely to be communicated and 'learnt' only implicitly, much as the psychological contract appears 'implied' when compared against a written tangible contract of employment (Jackson, 2013).

Other factors that contribute to influence decisions related to employees' selection and/or de-selection are for example, social perceptions of what is or is not available in the labor market, internal and external to the organization, for a particular work function or role. In other words, it relates to the extent of the possibility of replacement of an individual worker. Economic factors also exert a key strategic influence: for example, in Japan older workers are generally considered 'more expensive' than younger workers, due to the traditional wage calculations that are based on Lazear (1979) theory of differed wage. Similarly, regulations based on chronological age are key factors as shown by the pension reform that lift up the eligibility age for access to public pension. It determines at what age an employer might or must de-select an individual worker (Minister of Health, Labor and Welfare – MHLW, 2014).

As Jackson (2013) points out the term 'older' workers suggests, invoking the definition of HRM stated here above as the strategic management of 'assets' or human capital, a perceived boundary between older and younger workers. It suggests a chronological advancement from 'younger to older', thus reinforcing notions and assessments of biological and chronological age in the wage system and career development schemes. However, invoking HRM contexts for managing 'older' as opposed to 'younger' workers might carry with it some stereotypical viewpoints from broader social contexts. For example, prejudices may emerge that 'older' workers are likely to be less productive than their 'younger' counterparts and slower to learn or be retrained. It could be argued that: 'IT business is not suitable for old people' or that 'we need salespeople who are able to grasp the latest trend on the market in order to know what our customers want. In many respects older employees struggle to make sense of new things; it is very hard to retrain them, all the more that large differences exist between old workers potential and that health issues may hinder their involvement in projects' (Jackson, 2013).

Rousseau defined psychological contracts in terms of 'individual beliefs' that, when expressed and negotiated over time and across contexts for employment, inform the terms and conditions of a

reciprocal exchange agreement between the employee and the organization' (Rousseau, 1995). Once selected for employment, and again through early stages of the employment relationship, new employees are assumed to receive and / or infer 'promises' that guide their current experience and future expectation of employment and career (Rousseau, 1995). These promises are filtered through the individual worker's perception. Indeed, an individual worker's assessment that employer-made promises are not being kept can lead to loss of trust in the relationship and thus of perceived contract violation or breach (Briner and Conway 2005).

For Rousseau, psychological contracts are guided by promises, actual and or inferred - and binding power such promises exert. They suggest that all participating parties are bound by a set of reciprocal obligations when agreements are concluded, regardless of whether these agreements are captured visibly and tangibly in the form of a written document, or whether they are perceived by one or other party as being such. The employment system determines the type of relationship that the organization shares with its employees and negotiates with them over time. To illustrate, it is traditionally argued that workers in Japan who have been selected and granted an expectation of continued employment tend to adopt an organizational identity ahead of an individual professional identity (Jackson and Tomioka, 2004). The extent to which this expectations and thus psychological ties of contracted obligation to the company still holds true is a question addressed later on in this paper. There is still a debate about the extent to which the perceived need for a new kind of psychological contract comes as a result of employee and employers expectations of employment relations converging with the more transactional type of contract considered closed to what is considered as 'American' model or whether if a hybrid form of governance incorporating American and Japanese practices and values is emerging (Jackson and Tomioka, 2004).

### **The lack of a strategic vision on older workers' employment**

Evidence suggests that Japan has been successful in social and economic terms in the management of older workers. Historically, policy-makers in Japan have tended to encourage through both incentive-driven and coercive measures the unemployed or inactive back into jobs or urge those in employment to delay retiring. Unemployment allowances (amount of allowance and duration of eligibility) are not generous compared to what is available in most Western European countries (Debroux 2016). The workfare policy was put in place in order to avoid a long disconnection from the labor market that was thought to be detrimental to the workers and to society. To some extent it may be said that is is attuned to the socio-cultural norms inducing Japanese people to continue to remain active in one capacity or another in order to contribute to society and to avoid becoming a burden to others, especially family and community (Martine, 2012). As claimed (Fujimura 2015)

on the basis of a 2008 survey commissioned by Japanese government the willingness to work at old age in Japan seems to be higher than in European countries. It may be argued that those figures must be taken cautiously because they may also reflect the relatively low level of pension in Japan, especially compared to the European welfare states (OECD 2014) and the still lower level of health and welfare support. Those elements may induce elderly people to stay on the labor market although they may prefer to retire completely.

Despite this caveat it is true that older Japanese people tend to stay in the labor market in larger numbers and for longer time than in most European countries (ILO, 2014). It has given the opportunity to companies to utilize retired dedicated human resources at reasonable cost and to the public authorities the possibility to slow down the rising deficit of the social security system. In view of the demographic decline and to answer to societal need for inclusiveness of elderly people in society Japanese public authorities go even further in the direction of longer career through initiatives launched in the 2000s 'to create a society where it will be possible to work without age limit' or with the project of 'concretization of employment up to 70' of the Japan Organization for Employment of the Elderly, Persons with Disabilities and Job Seekers (JEED) in 2010 (JEED, 2010). Those initiatives are in line with those followed in the European Union that also aim to create a society that gives the opportunity to remain in the labor market without any kind of discrimination, including age discrimination (Yamazaki and Ide 2015).

However, such workfare-based policy comes with complications, even paradoxes. Overall, it could be argued that traditional policies and practices of Japanese human resource management in relation to employing older workers require significant revamping under the impact of demographics, the socio-cultural context, the regulatory environment and the subsequent need for changes in the social security system. In addition to the challenges regarding labor policy, changes in the labor supply structure (overall reduction in the labor force on the one hand, increase of women and older people in the labor market on the other) urge public authorities and companies to consider utilizing elderly workers more efficiently and effectively as part of a new employment deal (Debroux, 2016).

Japanese authorities and companies (with a number of exceptions, though) have never really thought until recently about policies that would favor old workers' work in good conditions (decent wage, consideration of age limitation in term of working hours, mobility, scope of work). Many elderly workers occupy under-qualified jobs. They are also not given the opportunity to acquire new skills and they are not paid fairly. Other older workers occupy qualified jobs similar to those they were performing before retirement and are reasonably rewarded. However, it has so far reflected more an opportunistic behavior of the organizations, i.e., the opportunity to utilize existing skills at

low cost, and not a strategic policy aiming to optimize the talent of older workers.

HRM system was never static and with the rapid progress of technology and market changes doubt over the relationship between productivity and age under the seniority system started to emerge since the 1980s. Since that time Japanese companies have had increasing difficulty justifying the wage levels of workers (especially old workers) with highly firm-specific skills. Besides the traditional practice of transfer to affiliated companies, they have attempted to manage a transition toward retirement with age curve flattening for the over 50 workers and early retirement schemes in order to cope with their high cost associated to seniority-based wage system (Sueki, 2013). This has led to claims of breaches of the psychological contract increasing rapidly from the 1990s onwards because of wage and career stagnation, forced retirement or transfer in another organization offering lower working conditions than what was promised at the time of the selection (Martine, 2012).

By and large management of pre-retirement senior employees over 50 was largely based on the premise of long-term trust and loyalty during the all post-war period. Companies are overall still committed nowadays to take care of the older workers in a legal environment limiting drastically the possibility of lay-off of permanent workers and imposing increasingly coercive measures in order to foster employment of older workers (Debroux, 2016). This still occurs in the framework of a relational-type psychological contract in an internal labor market, albeit with increasingly flexibly interpreted promises and the subsequent problems of breach and violation pointed out here above. Employees who perceive themselves 'marketable' in the labor market tend to welcome more and more clearly HRM systems that explicitly recognize individual achievement, rationalization and efficiency'. Furthermore, they no longer automatically 'perceive their employers as benevolent' and as a consequence 'do not expect them to be so' (Debroux, 2011).

But, they still broadly expect the organization to respect its promise of long-term job guarantee up until mandatory retirement, to give the opportunity to enjoy welfare corporatism and to reward long-term commitment to the organization. Both management and workers seem to believe that adoption of performance-driven appraisal and reward systems is not incompatible with long-term commitment. Although some of them links it partly to individual performance, the very large majority of companies continue to pay a retirement allowance based on tenure that reward significantly better the workers who stay in the organization for more than 20 years (Sueki, 2013).

At the same time, though, the relatively low level of investment in training of the over 50 years old workers indicates that the logic of constant up-skilling of workers expected to be given increasingly complex types of jobs does not fully apply to the large majority of them (Debroux, 2016).

Since 2004 companies of more than 50 employees are obliged to devise measures in order to keep

workers at work until 65. However, until 2013 they were allowed to re-hire the retired workers they wanted (Sueki 2013). As a result they were able to devise policies enabling them to take advantages of existing skills and experience and to keep selected older workers beyond mandatory retirement age at relatively low cost. For similar full-time jobs workers could be paid wages about 30-50 per cent lower than before retirement, which made them competitive compared to younger workers. This was made possible because of the characteristics of the in-work pension system but also of financial incentives complementing the pension of retired workers. The immense majority of them lose permanent status when they retire and are re-selected under contractual status offering lower reward and no fringe benefit (Debroux, 2016). For example, companies receive subsidies for offering reemployment or extended employment. Wage subsidies are also available through the unemployment insurance system to full-time workers aged 60-64 who earn less than 75 per cent of their former wages, so the take-up that is paid through the unemployment system is low (Martine, 2012).

So, it could be argued that mandatory retirement age for permanent employees at 60 in large companies combined with *de facto* acceptance of age discrimination, and large differential of treatment between regular and non-regular employment, has largely contributed to explain the higher labor force participation rates for older workers after retirement. Some marginal elements of the pre-retirement relational contract are maintained so far in the sense that many companies often keep retired workers in jobs of ancillary nature that are not absolutely necessary for corporate performance. It gives the opportunity to some retired workers to complement their pension income before smoothly retiring for good. However, overall the psychological contract significantly changes of nature after retirement. Reflecting the cost-driven strategy it departs from the relational contract of implicitness, flexibility of the interpretation of the promises, and informality of the agreement. It becomes mostly of transactional nature, i.e., based on contractual clear time frame, scope of occupations, monetary valuation, specificity and explicitness of promise. A set number of defined tasks with limited commitment become the rule. The separation between pre and post retirement is clear-cut.

### **The difficulties to implement the recognized necessary changes**

The current political legal, demographic and socio-economic changes force companies to reconsider relationships with the pre-retired and retired workers in a different light. The evolution cannot be separated from the relationships with the younger segments of the workforce. The legal obligation since 2013 to keep on payroll all workers wishing to work until they are 65 years old is bound to have huge implications on the manner Japanese companies manage the whole workforce.

The Lazear (1979) logic does not appear to be sustainable anymore in an aging society and with retirement at 65 without complete transformation of the existing HRM policy in regards of wage and career development. Since 1998 the law forbids to set the mandatory retirement age of permanent employees at below 60 years old but companies are now free to keep age at 60, set an higher age or scrap the retirement limit all together. For the time being few companies (around 15% of listed companies) are shifting mandatory retirement of permanent employees from 60 to 65 (Ministry of Health, Labor and Welfare, 2015). However, pressure can be expected to mount in the following years alongside with the gradual (one more year every three years ending up to 65 years old for all workers by 2025) moving up of the eligibility age of the earning-related based part of the pension (MHLW, 2014).

Financial support is expected to remain in place to compensate somehow the income drop but, nevertheless, it will be increasingly difficult to have over 60 years old workers accepting to shift to a lower contractual status as it used to be casually the case. Without receiving any pension and with the quasi impossibility to increase substantially the financial incentives in view of the cost it would mean that in current conditions of shift to non-permanent status many of them would received only about 40% of their former pre-retirement income (Nabeta, 2016). Most of them would be unable to keep decent standards of living and could end up as old working poor. In the current environment pushing for end of discrimination in the labor market in asking for respect of 'equal salary for equal work' the pursuit of the traditional policy is politically unpalatable.

The high number of concerned older workers means that companies have to think about a more drastic revamping of the entire wage curves and career development schemes for all segments of the workforce in anticipation of the future changes. It means that they have to reconsider the contribution of older workers in a more dynamic perspective (Sueki, 2013). Concretely, it means that they have to devise specific training and career development schemes that integrate better the older workers in the global HRM strategy. On the one hand, from the viewpoint of human capital theory (Becker, 1964) aging of the workforce does not entail major risk for the organization in so far that higher compensation corresponds to higher contribution linked to the accumulation of competences, qualifications and workers' experience. From the other hand, however, the concern of companies to maintain balanced workforce age breakdown and to ponder the benefit and cost of their strategy towards older workers is legitimate.

The point is not that individual performance suddenly drops at the age of 60 but companies need to recruit young workers to remain dynamic and to control labor cost. The current mandatory retirement age of 60 is an efficient way to control both labor cost and intergenerational age balance (Debroux, 2016). The arguments given in case studies (Debroux, 2016) for not formally moving up

the mandatory retirement age of permanent employees to 65 are that it is not cost-wise feasible in view of the large number of older workers. Managing a significantly larger number of older workers can be done only with the prospect of legislative changes that would facilitate de-selection of permanent workers. Respondent companies want to keep enough flexibility through the use of non-permanent status that is much less costly. They claim that it is almost impossible to imagine that they can offer working conditions traditionally bestowed to permanent employees to all of those wishing to stay in the organization after 60 years old (Debroux 2016).

Moreover the difficulties to cope with the issue of skills and knowledge puts in question the applicability of Becker theory in the case of old workers in a fast changing environment. Respondent companies understand the rational of keeping selected old workers and to invest in them in an aging society. But there are mixed overall opinions about older worker costs, technological competence, and flexibility. The ability to adapt to new work patterns often undermine efforts to get companies to recruit and retain older workers and limits the options for continued employment. In general terms it can be recognized that productivity decrease is observed in job tasks where problem solving, learning, and speed are important, requiring 'fluid' abilities, whereas for work tasks where experience and verbal abilities matter more that requires 'crystallized' abilities, less or no reduction in productivity occurs among elderly workers (Skirbekk, 2008).

Respondent companies are globally appreciative regarding older workers' loyalty, dependability, and judgment. However, they make rather negative assessments of attributes that could be considered 'fluid' abilities such as technological competence (including but not limited to IT literacy) and functional flexibility, which are viewed as critical in today's workforce and may be more important than the 'crystallized' abilities that workers have accumulated overtime. Therefore, despite initiatives to find new jobs inside the organization it is considered unavoidable that new types of careers (self-employment for example) outside of the organization must be developed at the same time. Respondent companies already devise support schemes serving to help older workers to find another job. They help them in negotiating with prospective employers, propose specific training programs or give days off to prospect the labor market. But companies argue that higher public involvement in training schemes is a must to alleviate the burden (Debroux, 2016).

### **Towards the emergence of an hybrid type of psychological contract**

Nevertheless, despite the difficulties, a growing number of companies are moving up the mandatory retirement age to 65 with workers keeping permanent status of a kind. Analysis of the discourse of respondent companies that have lifted up mandatory age in a recent survey (Martine and Jaussaud, 2016) shows that they put their policy in a traditional long-term perspective. In a

seller labor market due to shrinking population it can be considered part of a 'talent strategy'. In order to remain an 'employer of choice' it could be an argument to reassure the prospects that their job will be safe until the time they are eligible to receive public pension and that career development can be projected more easily in the future. In so doing, companies could be able to have those workers remaining loyal to the company and dissuade them to move to another organization (Martine and Jaussaud, 2016).

In another survey (Nabeta, 2016) of companies having lifted the mandatory retirement age, it is pointed out that the shift to higher mandatory retirement age generally goes with a system according to which part of the over 55 workers' wage is deduced before retirement, so that decent reward can be bestowed after 60 years old in taking account of adjustment of the working patterns. Workers remain in the skill-grading system, meaning that they are still expected to learn. After 60, they mostly work under so-called limited regular employment status according to different criteria (geographic mobility, working time, scope of duties). The status guarantees about 70% of the before 60 income, even without receiving any pension and, with some adjustment, gives right to fringe benefits. Much more thoroughly than before the psychological contract becomes more based on tangible, time and space bound explicit elements. Quantitative calculation (working time, internal mobility, scope of work, etc) is more important with working conditions negotiated according to specific criteria that lead to formal precise agreements (Nabeta, 2016). However, at the same time the maintenance of permanent status (even limited) after 60 indicates the continuation of the long-term commitment that started with the selection at recruitment stage. Workers are not de-selected as it used to be the case. They remain full member of the organization.

It is plausible that policies of such nature will generalize for over 50 years old workers in many companies when they will move up mandatory retirement. It will go alongside changes for all segments of the workforce. Recent surveys show that majority of Japanese companies are still committed to long-term HRM policy for permanent workers (MHLW, 2015). On the one hand, adoption of performance driven appraisal and reward systems aims to increase productivity (motivation, sort out of fast track elites, emulation through internal competition) while reducing the total cost of labor. The skill-grading system is much more strictly linked to actual performance and training is more specific and focusing on measurable outcome, and the retirement allowance is now often based on points gained through assessment of individual performance and not only based on tenure as it used to be (Sueki, 2013). Growing monetary and non-monetary differential for workers of the same cohort appears in many companies. Nevertheless, on the other hand, the long-term commitment is exemplified by the continuation of recruitment based on new graduates, the still strong emphasis put on the skill-grading system, and the maintenance of the retirement allowance

itself (Sueki 2013). Companies still do not expect new recruits to have skills and working experience in recruiting processes and they continue to pay much attention to new graduates' education (degree and school' name value) (Nagano 2014). They are less involved in their employees' personal and social life and traditional fringe benefits (welfare corporatism) are on the wane. But they still devote important resources to train the new recruits at the beginning of their careers and consider the employees' socialization very seriously, all the more that the risk of premature leave of young employees is higher in a labor market that is bound to remain a seller market in many industries in view of the shrinking of the size of the young population.

Nevertheless, for the time being companies acknowledge that they could end up with low productivity elderly 'trapped' workers if they do not manage well the transition imposed by aging of the workforce. This is all the more a plausible hypothesis because of the emphasis on acquisition of firm-specific skills that makes Japanese workers (especially older workers) much less mobile than those in other advanced economies. As a result, once unemployed, the chances for reemployment are not good and the duration of unemployment is long. In the longer perspective a smooth in-out flow of workers can be expected provided that companies are able to remain employers of choice in monetary and non-monetary terms. In the following years a growing pool of more specialized middle-age workers is likely to emerge in many companies as a result of the performance-driven system that goes alongside with the shift towards occupational-type of training. It means that companies can reasonably expect to keep at their disposal a pool of over 55 years old workers who can still be trained and given work commensurate to their capabilities. At the same time, if they are trained adequately specialized older workers will be more employable and with the emergence of larger external labor markets some of them can be expected to move to other organizations in good conditions, reducing the financial burden.

It is traditionally assumed that Japanese workers would prefer to stay with their companies for a long time because the companies give them sustained access to new skills. However, a recent survey (Takahashi 2012) indicates that having firm-specific skills has a negative effect on being in a position of authority and income. If it reveals to be the case, it would significantly change the basis of the long-term social contract. Many Japanese companies have started to outsource training programs to specialized human resource companies. Therefore, workers perceive that they are developing general skills through such training. Economically, as long as companies offer them useful occupational training they may remain willing to stay. In the case of the older workers it may be the only solution to keep them in the organization in good condition until they retire.

The shift towards occupational training is bound to accelerate the change in the selective basis of training, i.e., their content, objectives and the persons who should have access to the programs. As

a direct consequence, it could change the nature of the psychological contract because it would put in question the traditional view that Japanese workers identify themselves with their organizations rather than occupations (Sano, 2016). From a cultural perspective, a Japanese worker who changed his/her job was supposed to be stigmatized as a “betrayers” of his/her firm as a community. Moreover institutional cost of living employer prematurely (the amount of the retirement allowance, for example) and the fact that few companies were ready to offer work treatment commensurate to experience and capabilities to the recruited mid-career personnel meant that it was not common for them to receive a higher income after changing a job. However, with the emergence of an external labor market for many specialized occupations where the employees can expect to have higher income it seems that changing a job has becomes socially acceptable (Takahashi 2012). This has already started to change with the emergence of professional managers but also of researchers, engineers, architects, programmers, lawyers, accountants, and other professionals working as salaried person but it may become true for other categories of employees as well, including the older workers. The logic of the new model suggests that worker perception of the nature of the deals will impact on motivation and hence on the evolution of expectations. With acquisition of general skills those with marketable skills are more likely to prefer to de-select themselves and change employers as compared to the past. As Jackson (2013) claims the worker might ‘give up’ on a particular employer or supervisor, de-select or (mentally) quit, and redirect their career expectations elsewhere. In this way, actual or potential psychological contracts and relationships with other employers will take precedence; the original ‘psychological contract’ could become – in the individual worker’s expectation – overlaid by new contracts and relationships (Jackson, 2013).

## **Conclusion**

So far the results of the surveys on older workers in Japan shows a large variety in practices and positioning. In the balance found in companies that decided to continue to utilize over 60 years old workers as permanent employees (Martine and Jaussaud, 2016) it is pointed out there are elements that are linked to the willingness to control labor cost. However, at the same time efforts are observed that show the willingness to adapt to the workers’ expectations. For instance efforts are made to accommodate the factories and offices equipments and work patterns (timetable, work pace, collaboration with younger workers for physically hard tasks, etc) in taking into account physiological and psychological needs. Generally, those efforts require the expertise of experts in ergonomics, physicians specialized in work-related medicine, managers and specialist in gerontology (Martine and Jaussaud, 2016). In some companies policies are devised out of necessity but in others they seem to be more deliberate.

Although it is too early to draw conclusion, such examples might indicate the beginning of a gradual evolution toward a more dynamic mix of transactional and relational types of psychological contract in a growing number of companies. It would make management of older workers more manageable until they retire at 65 and could trigger the launch of a life-cycle approach to labor force activity, in line with the projects of the public authorities. Eventually, it could mean that work and career would not be necessarily only based on chronological age. As a result, it could increase the chances of prolonging employment by ensuring higher and more adaptable skills at work.

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