The unspoken feelings of subcontractors

Can you hear us?

“A
fter our mass-production contract ended, the same price was demanded for smaller lots,” “Although we were required to reduce the costs due to the strengthening of the yen, there was no relief in pricing even after the yen weakened,” “We were told, ‘other companies are complying,’ with a request for cooperation with the price.” “After we implemented a capital investment of tens of millions of yen to cope with the demand for increased production, the order was canceled,” etc.

Currently, METI is directly visiting the subcontractors and collecting their frank opinions. On such occasions, we often hear their honest feelings that are not disclosed to the main subcontracting enterprises (contract providers).

Why is the transactional relationship between main subcontracting enterprises (contract providers) and subcontractors being focused on now? One reason is that it is believed that the improvement of the terms and conditions of transactions for SMEs especially in the manufacturing sector is increasing on the whole, performance remains sluggish among SMEs, and in such an unbalanced state, it is not easy to maintain robust production. From a long-term perspective, it is necessary to build an environment where both large companies and SMEs can obtain reasonable profits.

First, understand what is proper for subcontracting.

The story METI compiled the policy package “Basic Policies for Future-oriented Trade Practices” (Seko Plan) in 2016. Based on the major issues of “making price setting methods more appropriate,” “making cost-burden practices more appropriate,” and “improving terms of payment,” METI will conduct thorough measures to prevent main subcontracting enterprises (contract providers) from forcing their subcontractors to pay expenses that should be covered by the main subcontracting enterprises (contract providers) in addition to the difficulty for subcontractors to express their honest opinions. Some say that they did not realize that their actions were harming their business partners or confess that they were simply following the customary practices. Especially in practice, those involved often don’t even recognize the existence of the problem itself.

No matter how large a company is, it cannot operate a business without other companies. Thus, it is still necessary to understand the difference between proper and improper actions.

In order to strictly deal with inappropriate treatment by main subcontracting enterprises (contract providers) and improving the terms and conditions of transactions for small and medium-sized subcontractors, last year, the government revised the criteria for enforcement of the Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors and the criteria for support stipulated under the Act on the Promotion of Subcontracting Small and Medium-sized Enterprises, aiming to promote proper subcontracting practices. The government has started moving forward to bring increased fairness to the trade environment.

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Watch out for these when you are subcontracting!

Is your company engaging in “unfair business practices/unethical business practices/bullying contract practices”? You may not be aware, but your business practices may be in violation of the law. Here, we picked up some of the actions that many subcontracting enterprises (contract providers) are trying to take. We explain the clauses together with appropriate patterns of business that should be followed.

Are you requiring price cuts without good reasons?

A company must not unreasonably set an extraordinary low purchase price based only on the unit pricing scheme of the company.

 Illegal Actions:

- Asking for price reductions casually due to the internal situation
- Asking for a significant price reduction during a time of recession

 Encouraged business and transaction practices:

- Show pricing after confirming the basis for the final price
- Set the price based on reasonable calculations for each individual product model
- Document the price for charging terms and conditions of transactions
- Reflect any contributions to cost reductions in the pricing

Are you ordering supplies at the same unit price as those for mass-produced goods?

When ordering supplies after mass production runs are finished, a company must not set the same unit price for products produced in small lots as for mass production.

 Illegal Actions:

- Setting the same unit price for supplies as for mass-produced products
- Not issuing documents clarifying the details of ordering supplies
- Applying sales on setting the unit price on the ordering site without considering the process and manners for producing supplies

 Encouraged business and transaction practices:

- Notify business partners at the end of mass production and discuss the price for additional small lot orders
- Demand for price for additional small lot orders before starting mass production
- When setting the unit price for additional small lot orders consider non-mass production conditions adequately

Does your company demanding designs and other technical information without compensation?

A company must not demand designs or production know-how of products that it has consigned for manufacture.

 Illegal Actions:

- Demanding designs and other technical information without prior agreement
- Thoroughly implement efforts to manage designs and other technical information

 Encouraged business and transaction practices:

- Present acceptable counterproposals and alternative plans as needed
- Always document what is decided and what has not yet been mutually confirmed

Is the increase in the costs of raw materials, fuel and labor reflected in the contract price?

A company must not set a contract price unreasonably without taking cost increases due to increase in raw material prices, etc. into account.

 Illegal Actions:

- Providing a contractor from producing on cost increases to product price that cannot be absorbed with the contractor’s efforts, while requesting that the contractor maintain the existing price
- Providing a contractor from producing on increased unit prices and other costs to product prices and imposing product prices based only on major manufacturer’s standards

 Encouraged business and transaction practices:

- Set prices by including raw materials expenses and fuel costs
- Set prices by increasing in labor cost
- Adequately pass on cost increases due to external factors through discussion between both parties

Valuable techniques to give you an edge in price negotiations

Negotiating power increases by understanding the perspective of the ordering company!

 Valuable techniques to give you an edge in price negotiations

Five must-dos to make the first move to ensure fair business practices

1. Pre-negotiation preparations

   - Highlight specific information related to the product, including the initial cost and potential changes in price
   - Understand the market price and trend in raw materials and parts before receiving orders
   - Understand the raw material prices and labor and other cost breakdowns for each product number

2. What to do during the negotiations

   - Negotiate by setting a target transaction price based on clear reasons
   - Encourage business and transaction practices

3. Routinely share information with your counterparts on external environmental factors that have an effect on pricing

4. Present the terms and conditions of the transaction before the counterpart does

5. Always document what is decided and what has not yet been mutually confirmed

6. Do not leave the subject of money ambiguous when providing estimates

7. Specify in advance matters that areas where potential problems may arise
Advice to main subcontracting enterprises (contract providers) and subcontractors from experts

Create an environment where all companies can be engaged in “independent” and “free” business transactions!

In order to realize a fair environment for business transactions, it is necessary to understand the fundamentals, including the relevant laws, e.g., the Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors. We asked lawyer Tetsuya Nagasawa about the “principle of freedom in trade” and its relation to the Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors.

The Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors was enacted in 1956. From then, the government has been mainly restricting acts which are obvious violations of the law, for instance, the contract provider reducing prices or delaying payment. On the contrary, the current focus for the reinforcement of implementation is that more essential details of the business transactions themselves, enforcing regulations of which if anything is discovered to be inappropriate. There are opinions pointing out that the Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors, which restricts the business activities of main subcontracting enterprises (contract providers), in a sense contradicts the premise of free competition in transactions. However, that is a one-sided claim. Rather, the Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors, is a law which predicts the principle of freedom in trade, because the basis of free competition is to ensure every player is able to make decisions “independently” and “freely.” This leads to the appropriate functioning of the economic mechanism for determining pricing. Consequently, actions shall interfere with the independence and freedom of subcontractors must be regulated. It is the same logic which ensures that all sports have rules and referees.

The most important keyword for fair business practices is “reasonableness.” Both the main subcontracting enterprises (contract providers) and subcontractors should always be aware of whether the details of the contract or the state of the transaction are essentially “reasonable” or not, and revise the contract immediately if any problems arise. In the case of listing business relationships, there are always human ties which come to influence business decisions. However, business relationships which are excessively based on social obligations and human emotions in contrast to rational decision-making tend to become distorted at some stage. As we all are aware, all industries now face global competition. In order for Japan to survive such competition, further innovation in terms of quality and productivity is necessary. That is not something required only for large companies. Rather, there must be many cases of transformation of medium and small-sized companies that support the activities of large companies.

However, innovation is often hindered by repressive conditions. Promotion of fair business practices is not only an issue for individual companies but will become indispensable for the entire Japanese economy in the future. I think all enterprises need to face the significance of this issue.

Advice to main subcontracting enterprises (contract providers) and subcontractors

**“Reasonable” first for both main subcontracting enterprises (contract providers) and subcontractors**

- “Reasonable” first for both main subcontracting enterprises (contract providers) and subcontractors!
- The “objective” first for both main subcontracting enterprises (contract providers) and subcontractors!
- Make a decision according to the ratio of “as a business decision on the fact that the main subcontracting enterprise is to distribute the profits to each company according to their contribution”.
- How can we ensure that adequate profit is obtained by every enterprise contributing to the supply chain? It is a critical issue for our company, since we are mainly engaged in the production of automobile parts, for which global pricing competition is becoming fiercer. Businesses cannot be maintained without adequate profit. Therefore, we seek together with our suppliers to eliminate waste in all business processes, and are promoting efforts to distribute the profits to each company according to their contribution.

Case examples: Efforts by main subcontracting enterprises (contract providers) to ensure fair trade

**How to build partnerships**

Favorable relationships with business partners are a source of competitiveness; some main subcontracting enterprises (contract providers) focus on fair business transactions from this perspective. We asked the persons in charge at two different companies about details of their specific efforts and mind-set behind them.

**FANCL Corporation**

**Consider everything as “your own problem”**

Every year since 2004, our internal audit office has implemented a survey on whether there were any problems with the staff in charge of procurement by conducting a survey of our business partners. We started such efforts from an early stage of our business because there was a strong commitment to “co-existence and shared prosperity with business partners” on the part of the founder Kenji Ikemori. Therefore, it was a significant shock when the company received verbal administrative guidance in 2013. Kenji sensing the difficulty of penetrating the philosophy throughout the workforce, we reviewed our company-wide training. It used to mainly focus on classroom lectures, but now we employ workshop-style training, discussing problems using actual case examples, with the aim of taking personal responsibility for any issues with compliance.

In order to develop communication with business partners, we also started to visit them at year-end and during the New Year. Facing them in person, they can more easily say things like “In fact, there is something troubling us.” The efforts are bearing fruit, with the ratio of “yes” to the question item of whether the subcontracting company was treated disrespectfully either through the contract provider’s speech or actions being reduced from 9.7% in 2007 to 1% in 2015. If we lose the trust of our business partners by prioritizing near-term cost savings over fair business practices, we will also lose superior materials, parts and technologies. I believe appropriate business practice is the foundation for developing any business.

**Yazaki Corporation**

**Share the benefits of cost reduction efforts achieved through eliminating waste according to each party’s degree of contribution**

In the workshop, the company allows the employees to consider whether an actual case example is适用 too much of the business partner.

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"Yazaki Group Code of Conduct Handbooks", distributed to all employees includes except from and corporate interpretate of the Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors. The content is updated on a regular basis.

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Coexistence and shared prosperity between the main subcontracting enterprises (contract providers) and subcontractors! Cooperation towards the improvement of productivity

Even though subcontractors have skills and know-how which is competitive with other companies, they often face difficulties in improving business management on their own because their management decisions tend to be largely influenced by the orders from the main subcontracting enterprises (contract providers). The new criteria makes the main subcontracting enterprises (contract provider) responsible for communication with subcontractors by visiting their offices and plants, and for reducing their burden by revising ordering methods including delivery deadlines and frequency as well as helping subcontractors’ efforts to improve their productivity.

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Eliminate unilateral and unreasonable price reduction requests

Reducing costs is an important issue for all companies. However, it is against the rules for main subcontracting enterprises (contract providers), who holds a superior (advantageous) position in a business transaction, to unilaterally demand price reductions from their subcontractors without logical reasoning or satisfactory discussions with the subcontractors. The revised criteria for support stipulate that the cost reductions be implemented in a manner acceptable to both subcontractors and main subcontracting enterprises (contract providers), and that the entire supply chain participate in efforts to improve productivity.

The rules on financial transactions and the storage of molds also changed

In order to create high value-added products and services, it is essential to develop rules with which main subcontracting enterprises (contract providers) and subcontractors can trade as partners on an equal footing.

METI reviewed the criteria for support for the Act on the Promotion of Subcontracting Small and Medium-sized Enterprises, which work as the rules for improving terms and conditions of transactions.

Increase in labor costs should be reflected in the pricing

It is not easy to secure labor in an aging society with a declining birth rate, where the population of productive age is decreasing. Furthermore, labor costs are increasing due to various effects including the revision in the minimum wage. There is a limit for which subcontractor efforts can absorb these increases in costs.

With this in mind, the number of requests from subcontractors for price increases is likely to increase in the future. Following labor cost increases, main subcontracting enterprises (contract providers) receiving these requests should seriously discuss whether the increases can be reflected in the pricing.

Voluntary action plan is formulated for complying with the subcontracting guidelines

The first step for realizing future-oriented business practices is to comply with the “Subcontracting Guidelines by the Category of Business,” for both main subcontracting enterprise (contract provider) and subcontractors. METI requested that industry groups improve the fairness of trade throughout the supply chain, formulate voluntary action plans, and implement them. In response, business groups in seven business categories, including automobile and construction machinery, committed to cooperate. Different industry groups compiled their own action plans by the end of FY2016 and published them.

Establishing rules for storing metal and wooden molds is necessary, and the main subcontracting enterprises (contract providers) should pay the storage costs

Metal and wooden molds are essential foundations of mass production. However, they are left unused after the production ends. Many main subcontracting enterprises (contract providers) expect their subcontractors to store the unnecessary metal and wooden molds. It is a heavy burden for subcontractors to store these unused molds without compensation, but in reality, they cannot dispose of them without an agreement. Therefore, according to the new criteria for support, the storage of molds must be discussed and the storage methods and the payment for storage services must be clearly defined in advance of any production. For example, a rule stipulating that molds that were unused for a certain period after concluding a contract would be returned to the main subcontracting enterprise (contract provider) or disposed of at the subcontractor’s discretion would allow for smoother and more cost-effective procedures after that product line ended. Furthermore, the cost for storing the molds must be paid by the main subcontracting enterprise (contract provider) if they ask the subcontractor to store the molds.

Cash payment after contract completion as a general rule! Target payment terms of “60 days or shorter.”

Standard payment methods which were consistent practices in the manufacturing industry for a long time were revised for the first time in 50 years. As a result, the circular notice as of 1966 and the criteria for support were abolished, and the following three points were newly added. First, the payment of the price of the subcontract should be made in cash or through direct bank transfers to the extent possible. Even for payment methods like bills and invoicing, the price must be agreed by both sides through advance discussion, and include any banking penalties or other fees that the subcontractor may have to pay through the payment process.

Regarding payment terms, it is a major premise that payment within 60 days will be expected in the future. If payments can be collected early, it will facilitate financing for subcontractors. It is expected that the main subcontracting enterprises (contract providers), especially the large companies in the category, take the initiative to improve payment methods, and the government will take a few years to conduct a survey on the improvement.
Shed light on hidden opinions and continue patiently with the effort

Improving the fairness of business practices is a long-standing problem that has yet to be resolved. Many efforts are being launched in order to discover the hidden opinions of subcontractors and bring violators into compliance.

Even though it has been more than 20 years since the enforcement of the Act against Delay in Payment of Subcontract Proceeds, etc. to Subcontractors, the number of cases of violations of the Act has been increasing in the last ten years. Under the leadership of the Minister, measures for resolving the deep-rooted problems started moving rapidly,” explains Mr. Kotaro Matsuzaki of the Fair Trade Division, Business Environment Department, Small and Medium Enterprise Agency, about the current situation of violations.

One of the factors making the situation of violations of the Antimonopoly Act, fair trade practices is the leadership of the Minister, measures in order to discover the hidden opinions of subcontractors and bring violators into compliance.

Mr. Takuya Iwase, Deputy Director of the Fair Trade Division, explains the actual situation of violations caught in transactions which violate the Act. He says, “The number of violations tend not to rise to the surface. Even if there was an unreasonable demand from the main subcontracting enterprises (contract providers), subcontractors tend to endure the situation without reporting it, because they do not want to lose contracts. In order to understand the situation, last year METI conducted interviews with about 250 SMEs that may be vulnerable to unfair trade conditions. Mr. Hirasawa has said. We drew on the results of those interviews to support subcontractors’ interests and rights, especially those who hesitate to raise their voices.”

METI has initiated a consultation desk called “Aid Offices for Subcontractors” in 48 locations in total, one in each of the 47 prefectures and one in its headquarters, since Spring 2004. About 6,000 cases are handled a year,” says Mr. Kosuke Hirasawa of the Fair Trade Division, explaining the actual situation of subcontractors caught in transactions which violate the Act. He says, “We try to be good listeners for inquiring parties. We pay attention to worries related to privacy, consultation is also available on an anonymous basis with strict information controls. A counselor working on consultation is also available on an anonymous basis with strict information controls. A counselor working on consultation is also available on an anonymous basis with strict information controls.

The Subcontracting Supervising Inspectors, who visit subcontractors throughout Japan, are currently handling various problems in transactions which violate the Act. When a Subcontracting Supervising Inspector visits a company, a key consideration is whether the company, which may be concerned about privacy, can speak openly regarding unfair conditions of business transactions with main subcontracting enterprises (contract providers). We are trying not only to listen to them carefully, but also to implement some kind of administrative solution to their problem. The solution may be improvement of trade practices or revision of the criteria for enforcement of laws and regulations.

We must address the problem with the goal of improving the situation,” says Mr. Iwase. First of all, many subcontractors are busy with their work and do not know about the Act. Mr. Hirasawa says, “We also try to improve the publicity focusing on the Act so that many people become aware of the measures. For instance, the Handbook on Price Negotiation Know-how for SMEs and Small-Scale Enterprises, prepared with the expanded role of the Aid Offices for Subcontractors, is becoming very popular, with 110,000 copies being distributed. It included opinions like, ‘I wish I had known about this earlier.’ There are many subcontractors being encouraged with the support experience that the subcontracting companies enjoy high profit.”

B) Based on this reality, METI is revising the trade rules. In addition, METI organized a special unit of Subcontracting Supervising Inspectors to monitor the permeation of efforts to ensure fair subcontracting and through implementation instead. In cooperation with the Regional Bureaus of Economy, Trade and Industry, throughout Japan, the 50 members of the team will interview about 2,000 companies a year, starting from April this year.

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“Why do similar types of violations continue to occur despite the frequent notices circulated by the government? Mr. Takuya Iwase of the Department points out, “Even though the top management or the legal affairs department has thorough knowledge of the importance of fair trade, the ideas rarely filter down to the worklevel.”

The contract providers need to repeat the violations because they are unaware of the fact that their requests transfer unreasonable burdens to their subcontractors. “In order to change the situation, it is essential that entire industries work together to address the problem. We asked for cooperation from the main subcontracting enterprises (contract providers) in formulating a voluntary action plan, which was published. With the action plan in place, we will also request a flexible review of the plan to determine if there are any lingering problems,” says Mr. Iwase.

Our goal is to listen to the opinions of subcontractors and approach the industry to realize fair business practices while encouraging the main subcontracting enterprises (contract providers) to take action. Although they are grassroots efforts, all four agreed that, “there is no blanket prescription that can stop all violations immediately. We will need to persist in addressing the problems.”

**METI Journal** Opinions of the person in charge

**Shed light on hidden opinions and continue patiently with the effort**

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