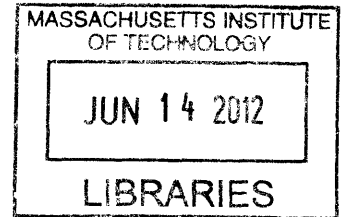


**HUMAN RESOURCES MANAGEMENT IN JAPAN:
BEFORE AND AFTER THE 1990s**

by

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Bachelor of Law, Tohoku University (1995)



SUBMITTED TO THE MIT SLOAN SCHOOL OF MANAGEMENT
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Submitted to the MIT Sloan School of Management on May 11, 2012 in partial fulfillment of the requirements for the Degree of Master of Business Administration

ABSTRACT

In this thesis, I examine the impact on human resources (HR) caused by the lengthy recession in Japan. I discuss earlier systems of human resources management, then turn my focus to human resources since 1990.

Japanese companies have a unique HR management system, with associated subsystems. I believe this system has contributed to fair and equal treatment of employees, while also allowing strong collaboration among employees, encouraging teamwork, and supporting high efficiency in operations. This system was once respected worldwide. At present, however, Japanese companies face many challenges such as declining domestic demand because of a shrinking population and an aging society, and cost pressures due to tough domestic and global competition.

My research question is this: Have these challenges changed Japan's traditional HR management system? If so, what were these changes?

In Chapter 1, I briefly trace the external environment surrounding HR management, and the characteristics of the traditional Japanese HR management system and subsystems. I find that a "Potential Abilities-Based Ranking System" has functioned as a core platform in the traditional HR system in Japan.

In Chapter 2, I introduce the major characteristics of the Potential Abilities-Based Ranking System, developed by Kyu Kusuda.

In Chapter 3, I look at changes in the external and internal environments surrounding today's HR management system. Assuming that the Potential Abilities-Based Ranking System is a core platform in Japanese HR management, the changes occurring in Japan may be influencing this core platform. I examine these influences to determine whether Japanese HR systems will be transformed or replaced by a global HR management system, similar to the American HR management system.

In Chapter 4, I introduce a case study of HR management changes at Kirin Holdings Company (my employer).

In Chapter 5, I discuss changes and challenges facing HR management in Japan.

Thesis Supervisor: John Van Maanen
Title: Erwin H Schell Professor of Management

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I am thankful to the staff of the Sloan Fellows Program office including Stephen J. Sacca. Without their helpful assistance, it would have been much more difficult to learn from and enjoy this precious and life-changing year. I am also grateful to all the members of the Sloan Fellows Class of 2012 who always inspired and motivated me with their intelligent and innovative insights.

I am indebted to Kirin Holdings Company, for sponsoring me and giving me this opportunity to participate in the MIT Sloan Fellows Program.

A few days ago, my next job was determined. I will go back to Japan and I will be in charge of developing the global HR management system in Kirin Holdings Company. I will go on a journey and try to establish an equilibrium between Japanese HR and global HR management.

Finally, I would like to express my profound gratitude to my father Takeshi, my mother Chieko, and my sister Mariko. I would never have reached this point without their constant support, patience and love.

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CHAPTER ONE

Traditional Human Resources Management in Japan

For the purposes of this thesis, I consider a company to be a “community” in which members can join and quit at any time and at their will. A company should evolve continually in order to adapt to a changing external environment. At the same time, internally, a company must also develop a set of systems and rules to (1) maintain the community; (2) enact corporate strategies; and (3) enable members to cooperate with each other. From this viewpoint, a company’s best practices should change according to changes in the external environment, corporate vision, and strategy. The set of systems and rules, applied to all the employees in a company, I consider the “human resources management system.”

Japanese companies have developed a unique human resource (HR) management system, which is characterized by (1) lifetime employment, (2) seniority-based pay, and (3) a company-based (i.e., in-house) labor union. These characteristics were first identified by James Abegglen (1958). At the same time, an HR management system is an aggregate of subsystems that contribute mutually to a corporate vision and strategy that are aligned to the external environment. These systems are shown in Figure 1-1.

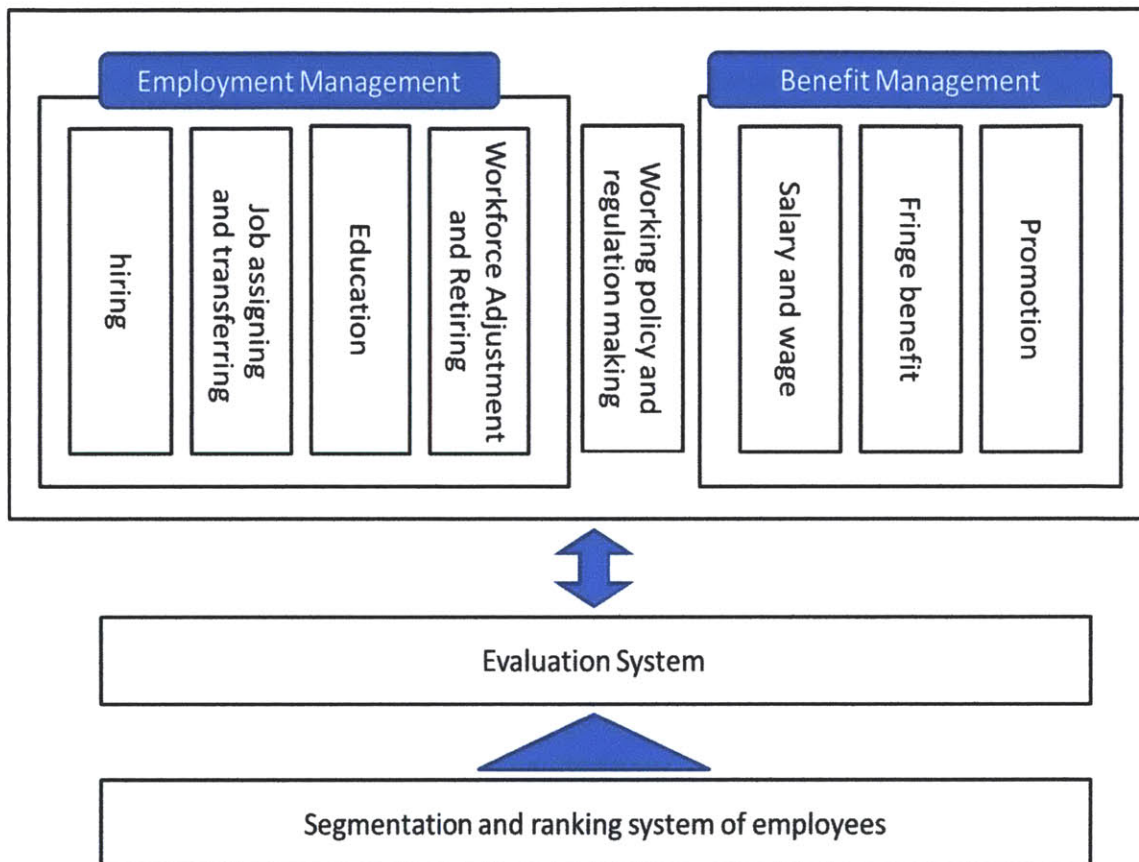


Fig. 1-1 Human resources management and subsystems in Japan

Source: Imano and Sato (2009), p.8

I next examine the external environment surrounding HR management in Japan before 1990. Then I identify and discuss the characteristics of HR management and subsystems in traditional Japanese companies.

1.1 THE EXTERNAL ENVIRONMENT

After Japan's economy was decimated following World War II, the country entered a period of rebuilding of both infrastructure and the economy. Between 1960 and

1975, the country experienced an average annual growth of 8.2%. Between 1975 and 1990, as a consequence of the oil shortages and price shocks of 1973, Japan experienced slower average growth of 4.1%. In the 1980s, Japanese companies and their management style established a strong presence in the world economy. Japan was acclaimed as “Number One” by Vogel (1999), and Japanese companies made vigorous efforts to diversify their businesses.

During this period, Japanese workers rarely transferred to new employers, tending instead to work at one company for their career lifetime. This was due, in part, to employees’ strong sense of loyalty to their companies once they joined. This phenomenon was known as *shu-sha* (joining the company), and it meant that people did not join the company to work in a specific job as a specialist; rather they joined a community and became committed to that community. This sense of permanent employment was bolstered by the fact that age 35 was set as the upper limit for transferring to a new job,¹ and employees rarely tried to transfer after the age of 35. This meant that the turnover rate in Japanese companies has been quite low historically, and there has been only a small external labor market for “head-hunting,” part-time jobs, or specific specialists. Figure 1-2 illustrates the external environment in Japan.

¹ As described in chapter 3, this limit is the typical age for promotion to manager level.

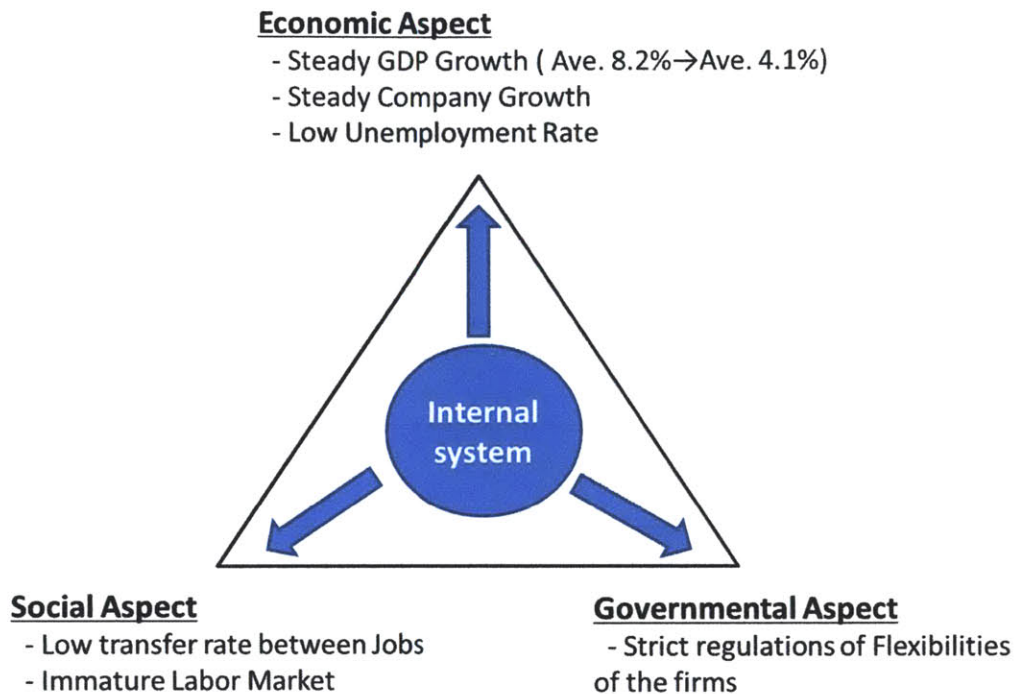


Fig. 1-2. External environment in Japan

1.1.1 Government Regulation

In terms of the regulated political order in the workplace, the Supreme Court of Japan established strict precedents that limit the flexibility of companies regarding: (1) labor contracts between a company and an employee; (2) labor agreements between a company and a labor union; and (3) work policy and regulations developed by a company. These legal precedents are extremely important, placing strict restrictions on flexibility when a company tries to change its corporate structure, HR policies or strategies. Some of these policies are discussed below.

No Dismissal Without a Rational Reason

Like the United States, the relationship between an employer and an employee is based on a labor contract. According to Japanese labor law, contracts are divided into (1) those that have a defined term, and (2) those that do not.

Contracts with a defined termination date expire automatically when the date is reached. Most part-timers and contractors fall into this category. These contracts may be renewed if desired or necessary. In comparison, contracts without a defined term allow employers or employees to terminate the contract at any time and at will. Most regular employees fall into this category.

In 1950s, the Japanese Supreme Court, as a result of cases involving Kouchi Broadcast Company and Japan Salt Production Company, created the principle “Prohibiting Abuse of Employer’s Right to Dismiss Employees.” In both cases, the court declared: “...the exercise of the right of dismissal by employers should be nullified when this exercise lacks objective rationality and is not appropriate in light of socially accepted norms.” This precedent has played a critical role in HR management in Japan. It is recognized and accepted by HR staff as a rule that means it is virtually impossible to exercise the right of dismissal for reasons of a bad social situation or because of the company’s specific economic situation. This decision was legislated into Article 23 of the Labor Law in 2005 (Sugeno, 2010).

Principles Regarding Layoffs

Layoffs are a huge hurdle for any employer. The Supreme Court developed the “Principle of Prohibition of Abuse the Right of Layoffs” through a series of lawsuits. From these, the Court introduced four criteria for judging whether a layoff is valid.

- *Need to curtail the workforce*: This criterion demands that a layoff must be “strongly needed for the company to survive.” It is not sufficient that a layoff merely attempts to reduce redundancies. Typically, it is necessary that a company must be losing money (“in the red”) for two to three consecutive years in order to justify a layoff.
- *The employer must exert sufficient effort to avoid layoffs*: This criterion demands a company to cut executive compensation, reduce overtime, reduce the number of new employees, transfer employees to another section/department/division/subsidiary, and to recruit voluntary retirements before layoffs. This criterion means that a layoff is the last measure for continuing to run the company.
- *Valid selection of employees*: Selecting employees for layoff is also a criterion as to whether or not a layoff is legitimate. It also determines whether the layoffs were consistent with standards in the selection process.
- *Validity of layoff procedures*: In order to implement a layoff, the company must explain honestly to employees the circumstances, company performance, competitive environment, and then negotiate an agreement with the labor union regarding the legitimacy of the layoff.

Disadvantageous Changes in Working Conditions

In addition to the two judicial principals described above, there is another strict rule that HR staff must observe when considering changes to workplace policies and regulations. This is called the “Principle of invalidity of making disadvantageous changes in work conditions and work regulations.” Companies develop work policies and regulations that enable them to manage employees efficiently. Work policies and regulations encompass all the areas covered by labor contracts, in effect functioning as a substitute for a labor contract between an employer and employee. In reality, an independent labor contract between an employer and an employee is not used in Japan because work policies and regulations cover all the conditions that apply to employees.

However, if a company seeks to change work policies and/or regulations, it must obtain approval from its labor union in advance. If these changes to work policies and regulations are disadvantageous, and the labor union does not agree, any such changes would be nullified by the Court.

HR staff face continual challenges and problems with this principle because work policies and regulations relate to every aspect of HR activities. In addition, the need to negotiate with the labor union every time a company tries to change its policies and regulations is time-consuming and can result in implementation delays.

1.1.2 Company Flexibility

Japanese employees tend to stay in one company for their career lifetime. As noted, this results in historically low turnover rates. In addition, companies have a

responsibility to continue hiring employee, as dictated by labor law and Supreme Court precedents. This is a constraint on the flexibility of companies.

One question that could be asked is what might have happened (or would happen today) if these Supreme Court precedents did not exist? Would Japanese companies fire employees freely when overstaffing occurs? I believe the answer is “No.”

According to Nitta and Hisamoto (2008), the Japanese employment system is a type of “social contract” for long-term employment. The authors contend that as a result of the labor disputes involving Nikko Muroran in 1954 and Mtusi-Miike in 1959-1960, companies in Japan recognized and accepted the “cost inefficiency of layoffs.”

In addition, the “three principles of productivity increases,” developed by the Japan Productivity Center in 1960, are widely accepted and endorsed by Japanese companies. The three principles are:

Principle 1: An increase in productivity enlarges employment. For transitory overstaffing and redundancy, companies should—in cooperation with the government—take appropriate measures, including transfer. From the perspective of the national economy, it is important to prevent unemployment.

Principle 2: Companies should research and discuss with their labor union any measures to increase productivity.

Principle 3: The results of productivity increases should be shared fairly with all employees throughout the company. Consumers will benefit as well.

Even in the serious recession following the oil shortages/shocks of 1973, companies did not resort to layoffs. During this period, labor unions emphasized employment security and refrained from making demands for pay raises.

Therefore, even without the labor law and the Supreme Court precedents, Japanese corporations have tried to avoid layoffs. Except for several brief periods, the Japanese economy was basically in good shape up to the 1990s, and Japanese companies did not experience serious overstaffing and redundancies.

1.2 INTERNAL SYSTEMS IN JAPANESE COMPANIES

In order to adjust to the external environment described above, what kind of HR management system and subsystems have Japanese companies developed? In this section, I describe the organizational structures in Japan and then summarize the characteristics of subsystems in the HR management system. Finally, I take a further look at lifetime employment, seniority-based pay, and company-based (in-house) labor unions.

1.2.1 Organizational Structures in Japanese Companies

In terms of organizational structures, Japanese companies share two primary characteristics: a relationship with an in-house labor union, and a huge divide between how large (traditional) companies and medium- and small-size companies treat their employees.

In-House Labor Unions

Large traditional companies have their own (in-house) labor union, which is organized to be consistent with the company's organizational structure, as shown in Figure 1-3. All employees, except for managers and higher-level employees, join the company's labor union. This means career employees (so-called white-collar workers)

and non-career employees (so-called blue-collar workers, such as factory workers) join the same labor union regardless of their job. Although collective bargaining (on issues such as pay scale, bonus system, fringe benefits, work regulations that apply to all regular employees) is conducted at the headquarters level, many other issues are communicated and worked out between the company and the labor union on a weekly, monthly, and annual basis at the headquarters and/or at the branch level.

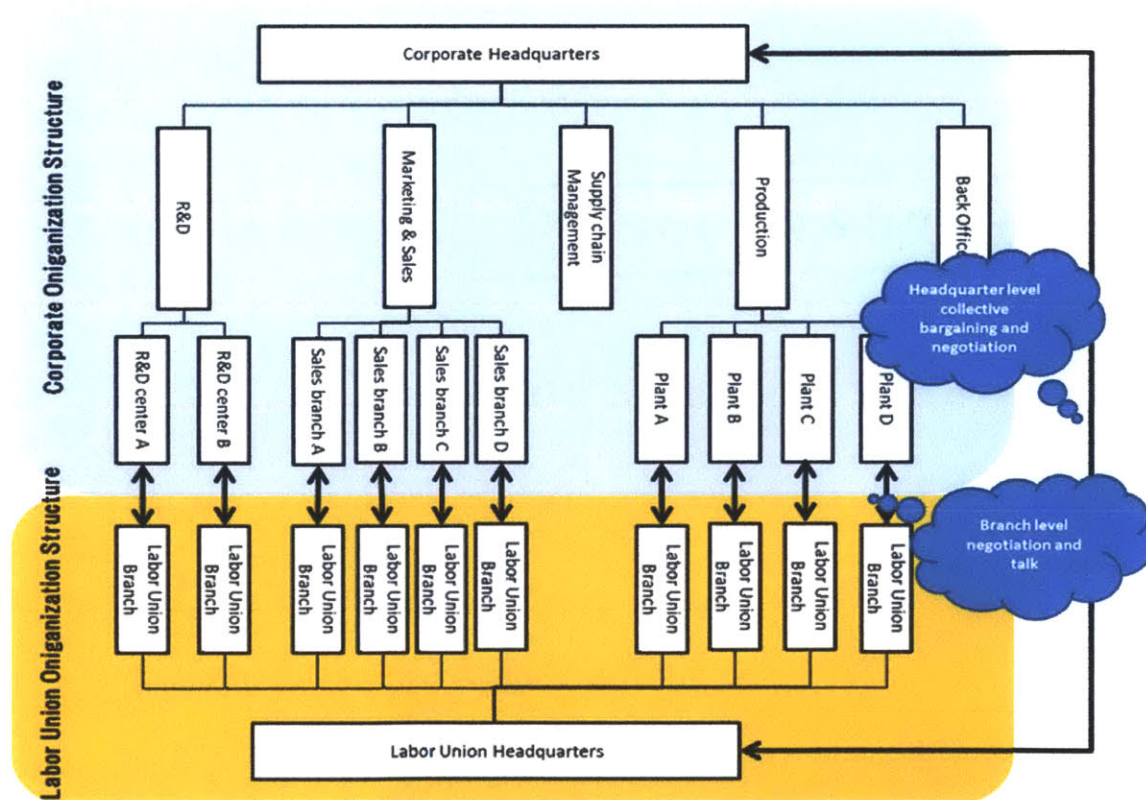


Fig. 1-3 Corporate organizational structure and labor union structure

The labor union gathers information about (a) employees' complaints and grievances, (b) employees' perceptions of company actions, and (c) work conditions, and feeds this information back to the company in the form of "voice of the employees." The

key is that labor unions screen the information in advance, which sometimes creates contradictions between the interests of white-collar and blue-collar workers. One task of the labor union is to integrate these contradictions into a unified interest that represents all employees.

In general, the company respects the “voice of the employees,” and provides the labor union with management and financial data in an attempt to encourage more cooperation and collaboration from the labor union and employees. The content of the agreements and discussions cascade through the company’s and the union’s information channels. Through this process of negotiating and reaching agreement, the company and the labor union share all the information on the company and the employees.

It is important to note that the treatment of employees differs greatly between large/traditional companies and medium- and small-size companies. It is widely believed that the characteristics of lifetime employment, seniority-based pay, and a company-based (in-house) labor union are limited to large/traditional companies. Although this thesis mainly deals with the analysis of large/traditional large companies, different customs prevail within medium- and small-size companies. For example, there is a gap in salary/wages between large/traditional companies and medium- and small-size companies. Figure 1-4 shows the difference of an average salary in 2011 between large/traditional companies and medium- and small-size companies. Compared to companies that have more than 5,000 employees, the average salary of companies that have 100-499 employees is almost 85% of what large companies pay and the average salary of companies that have 30-99 employees is about 80%.

Number of Employees	average annual salary	%
1-9 employees	37,300	68.6%
10-29 employees	44,344	81.5%
30-99 employees	43,000	79.1%
100-499 employees	46,178	84.9%
500-999 employees	51,489	94.7%
1,000-4,999 employees	53,378	98.1%
5,000- employees	54,389	100.0%

※5,000- employees = 100%

Fig. 1-4 Relationship between company size and the average salary (in US\$)

Source: Civil Sector Salary Survey in 2011 (National Tax Agency), p.13

In Japan, there is no market price in the labor market as there is in the United States and Europe. This is partly because salary and wage are determined according to each company's solvency, partly because there is no external labor market, and partly because there are few horizontal relationships between unions in Japan compared to the US and Europe.

Subsidiaries

As Jacoby (2005) notes, Japanese companies utilize subsidiary organizations because they are easy to establish. Parent companies transfer their employees to subsidiaries by means of *shukkou*. Figure 1-5 illustrates the structure of *shukkou*, which is based on dividing employees between the parent company and its subsidiary.

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schools or universities. Graduation occurs at the end of March, and new graduates join companies on April 1. Graduates who begin in the same year are called *dokis*, and from the time they begin their employment together in the company, special relationships are formed with each other that continue throughout their careers with the company.

However, they are also rivals, and they compete for promotions later in their careers.

During the hiring process, potential abilities are emphasized rather than any special work knowledge. Japanese educational institutions do not focus on practical knowledge, instead leaving it to companies to educate new employees through on-the-job and off-the-job training. When job openings occur, most are filled by promotions or transfers from within, so it is rare to depend on the external labor market.

2. Job assignment and transfer

In contrast to restrictions on dismissals and layoffs, Japanese companies have considerable power to transfer employees. Typically, white-collar employees are transferred to another section, department, branch, or subsidiary every three to five years. Most companies have a regular transfer system. This means that many employees are transferred on a fixed date once or twice per year. This transfer is often accompanied by promotion.

I am unsure when this transfer system was put in place. However, as part of lifetime employment, I surmise that these regular transfers had an economic rationale. When the company transferred an employee from one section to another, the company then had to transfer a second employee as a successor because job openings are replenished from within. Based on this assumption, it may have been more efficient to

transfer many employees at the same time because this gave the company more possible combinations and reduced transaction costs (see Figure 1-6).

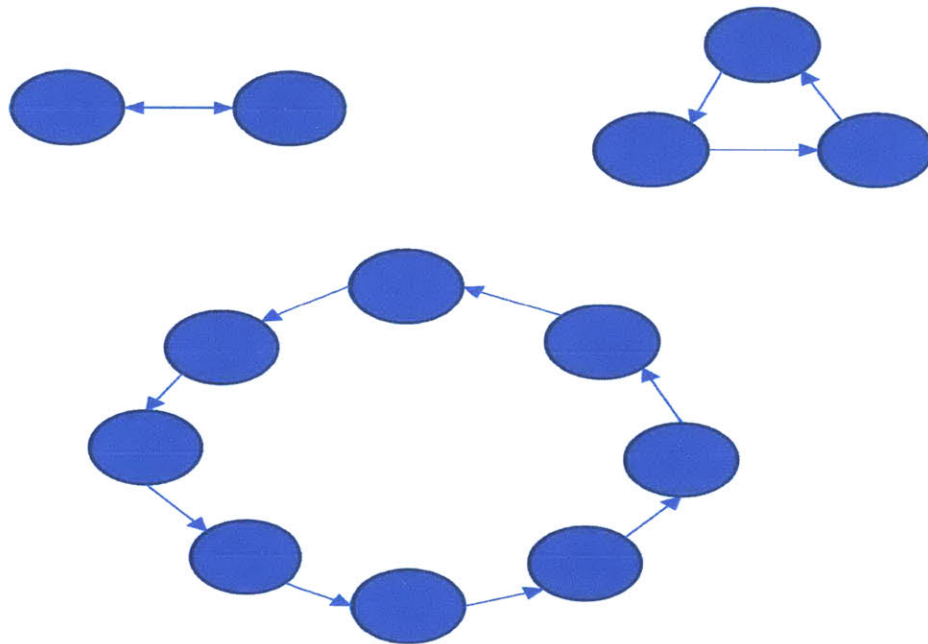


Fig. 1-6 Scheme of regular transfer system

According to Imano and Sato (2009), Japanese companies construct a virtual labor market inside the company. The authors identify specific objectives of the transfer system: (1) provide opportunities to discover aptitudes for jobs; (2) provide opportunities to cultivate abilities; (3) provide opportunities to enlarge the “width” of a career; (4) enable an exchange of human resources inside and outside the department; and (5) allow the company to balance its workforce.

3. Education

Japanese companies place great emphasis on employee education within the organization which occurs throughout each employee's career. Strong operating efficiency, fostered by intense internal education, was viewed as a competitive advantage in the 1980s. Employee education is conducted mainly through on-the-job training, meaning that the main focus is to build specific company skills, not general skills.

4. Workforce Adjustments and Retirement

Most Japanese companies have a retirement age of 60. Upon reaching 60, an employee's labor contract is automatically terminated. It is significant that there are uniform points that apply to all employees, both when they begin their careers, and when they reach the end of their careers. All employees join the corporate community just after graduation (about the age of 20), stay in a community for about 40 years, and exit the community at the age of 60 (see Figure 1-7).

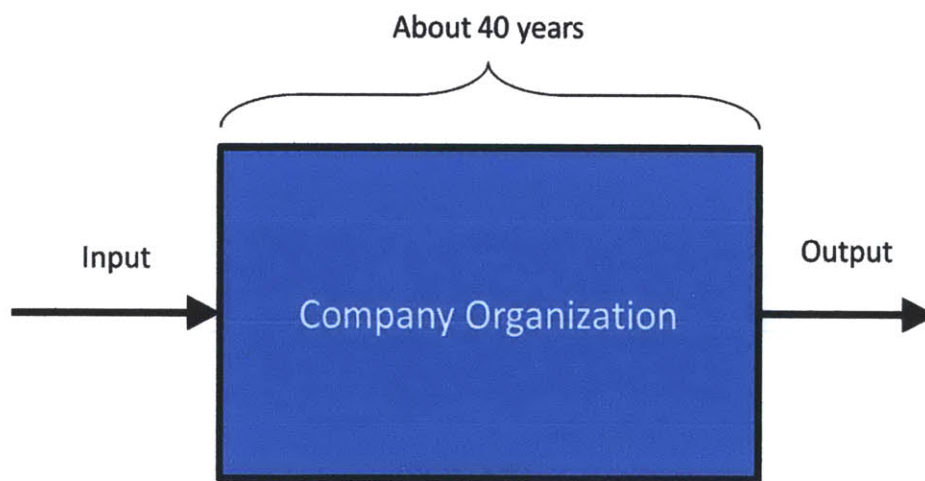


Fig. 1-7 Life in a Japanese company

5. Work policies and regulations

Japanese companies manage their employees through fixed work policies and regulations. These stipulate in detail the rights and obligations of the employer and employee. This treatment complements the independent labor contracts between an employer and an employee which are often verbal.

6. Salary and wage

I discuss the salaries/wages system in Chapter 2.

7. Fringe Benefits

Fringe benefits in Japanese companies are unusually broad, covering almost all aspects of an employee's life. Fringe benefits are divided into two categories: legal fringe benefits and not-legal fringe benefits.

Legal fringe benefits include death and injury insurance, unemployment insurance, health and dental insurance, and a national and employee pension plan. The insurance and pension plans are operated by the government. Premiums for death and injury insurance are paid by each company, whereas premiums for other insurance and pension plans are divided equally between each company and its employees.

Non-legal fringe benefits may include a company residence and associated allowances, employee stock purchase plans, various savings plans, recreation, retirement payments, various company-operated pension plans, and so on. These non-legal fringe benefit plans enable a company to hire better employees and to retain them.

8. Promotions

It is useful to quote an excerpt from Ogasawara (1998) here. The author quotes an interviewee who works in a bank:

In our bank, we are always rank ordered unofficially among our doki [the group of colleagues who joined the organization in the same year]. For example, you might rank X among 100 doki. Such ordering is not some kind of estimation that places people into high, middle, and low groups. Instead, we are given an exact rank. However, no difference is made in the salary we receive up until we are about 35 years old. Managers wait until they are 35. By then, consensus is built concerning each employee's evaluation, so the company begins promoting from among those who are given a high evaluation. This way, people will consent to a manager's decision, believing that it is only proper that those who are ranked high should get promoted first. (p.37)

The author then comments:

... appraisal for white-collar men (and some women) in typical Japanese firms is primarily a means by which to select employees to be promoted into ranks such as kacho (i.e., manager). It is an instrument to screen workers of high caliber, and its effect becomes apparent only after many years. This, of course, does not imply that men take appraisals lightly. As the interviewee illustrates, men in his bank are constantly given detailed evaluations. It is just that the result does not become official until the first major promotion. Until then, there is little difference in the amount of pay doki workers receive. The first selection usually does not take place in large Japanese companies until employees have worked for about ten or more years. (p.37)

In his book *Strategic Human Resources Management Theory* (2010), Suda describes the Japanese promotion system as “late promotion and screening.” This system appears in most Japanese companies that pursue a long-term employment system (see Figure 1-8). This system encourages *dokis* to compete with each other for a long time while avoiding discouragement among employees early in their careers because slight disadvantages that appear early can be overcome later. This system is compatible only with the traditional Japanese hiring system in which companies hire new graduates once a year immediately after they graduate from the university.

Japan	U.S.	Germany
7.85	3.42	3.71

Fig. 1-8 When promotions begin (in years)

Source: Imano and Sato (2009), p.170.

.....

In the following chapter, I examine in detail what I regard as the platform on which the Japanese HR management system stands. This platform is called the “potential abilities-based ranking system.”

CHAPTER TWO

Potential Abilities-based Ranking System

2.1 OVERVIEW OF THE SYSTEM

The potential abilities-based ranking system was developed by Kyu Kusuda. I show the detailed statistical data in Chapter 3, but this system has functioned as a platform in organizations, and about 60-70% of Japanese companies still employ this system (Hotta 2010). In the book *What Is Salary/Wage* (Kusuda and Ishida, 2004), Ishida states:

The Japanese human resources management and pay system was invented by Kyu Kusuda. Reforms of the Japanese human resources management and pay system conducted now underway at present can be said to be a denial of Kusuda's theory. This means the history of Japanese human resources management and pay system after WW II runs parallel to the history of Kyu Kusuda. (p.1)

Kyu Kusuda graduated from Kyushu University and joined the Ministry of Labor in 1948. He left the Ministry of Labor in 1970 to become a senior researcher at SANRO Research Institute as well as a senior researcher at the Japan Productivity Center. After developing the potential abilities-based ranking system in the late 1960s, he tried to spread his idea to companies and labor unions as a consultant.

Figure 2-1 shows a partial list of Kusuda's consultations with numerous companies and industries such as electronics, automobiles, oil, food and beverages, retailers, airlines, hospitals, and trading companies.

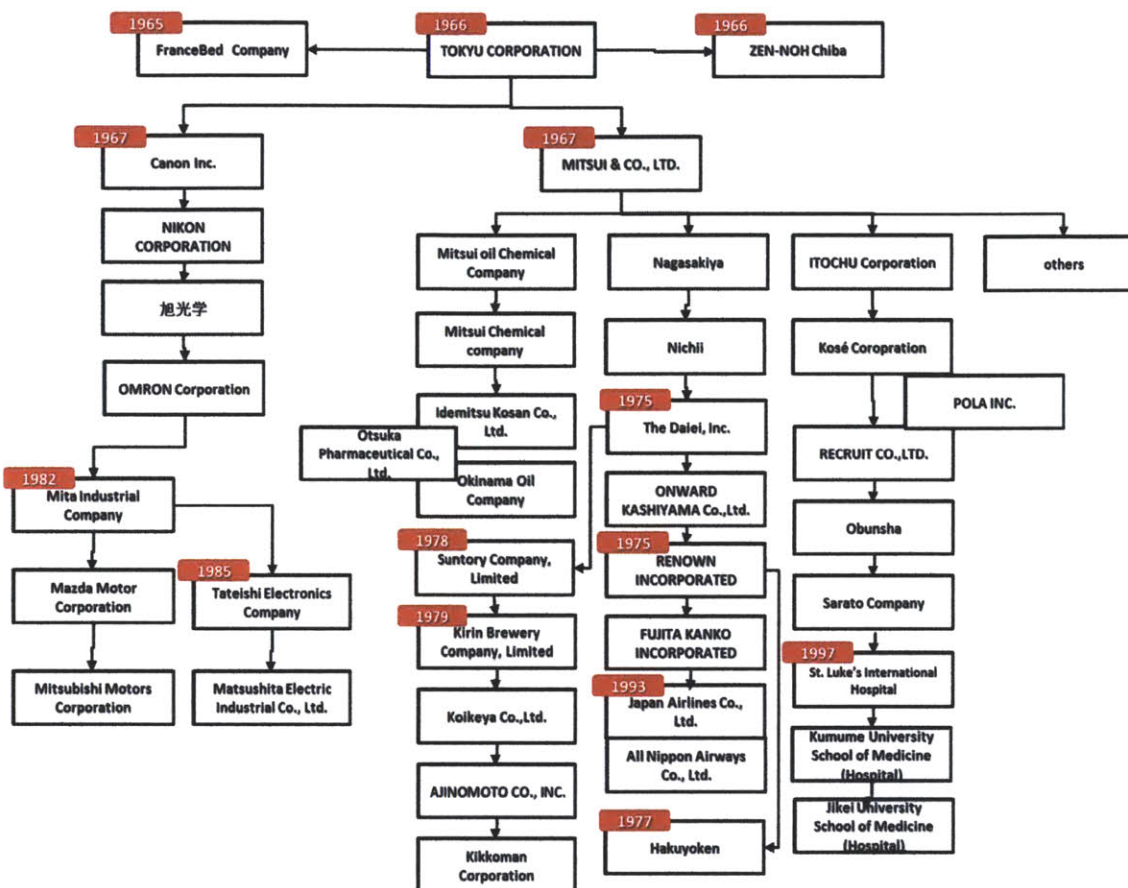


Fig. 2-1 History of Kusuda's consultations with companies

Source: Kusuda and Ishida (2004), p.165

Kusuda's effort to spread the potential abilities-based ranking system was done in five ways: (1) consultations with individual companies, (2) consultations with business associations, (3) seminars, (4) institutional activities, and (5) publication of books. The framework for the potential abilities-based ranking system is illustrated in Figure 2-2.

		Necessary years of experience for promotion		Relating position
Exempt	M-9 Grade	Jobs relating to leading whole the company level	-	Director
	M-8 Grade	Senior Management level	6	Senior Manager
	M-7 Grade	Management level	5	Manager
Non-Exempt	S-6 Grade	Team leader level	5	
	S-5 Grade	Jobs relating to tasks including judgement and coaching	4	
	S-4 Grade	Jobs relating to tasks including judgement	3	
	J-3 Grade	Operational jobs including judgement	3	← Undergraduates starting grade
	J-2 Grade	Operational jobs	2	
	J-1 Grade	Assistant jobs	2	← High school graduates starting grade

Fig.2-2 The framework

Source: Kusuda (2003), p.39

Notes:

- Ranks usually have 9 to 11 grades, based on the size of the company.
- Abilities are extracted from tasks across the company. To define abilities, the key question is: what abilities are needed in order for employees to execute these tasks? Then the abilities are summarized in 9-10 grades, abstracted, and integrated into a single expression regardless of any differences between functions.
- Specific grades are related to specific positions. The company selects an appropriate employee for the position from among the pool. This is an important point. People who hold a rank in one grade may not always be appointed to the expected position.
- When a person enters the company, he or she will be ranked according to their education. As Figure 2-2 shows, those who graduate from universities are ranked as

“J-3 Grade.” Those who graduate from high school are ranked “J-5 Grade” at the start of their career.

- If an employee stays in one grade for at least the “necessary years of experience for promotion,” he/she has the possibility of being promoted. However, the definition of “necessary years” is not a sufficient condition alone for promotion. He/she may have to satisfy other qualifications, such as “sufficient accumulative evaluations” and sufficient “potential abilities” and be “eligible to move up one grade higher”, and so on.
- There is no demotion system. All the employees climb up the ladder of the potential abilities-based ranks.

The framework for determining monthly salaries in the potential abilities-based ranking system is shown in Figure 2-3.

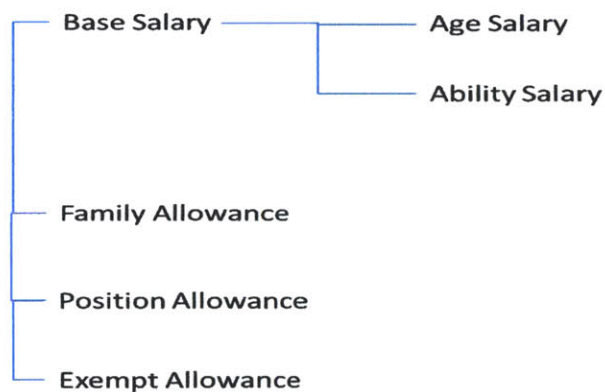


Fig. 2-3 Framework for monthly salaries

Source: Kusuda (2010), p.113

”Age Salary” is defined by the age of the employee, as shown in Figure 2-4. Kusuda recommends that “Age Salary” cover the standard cost of living which is released every year by the Japanese government.

Age	Age Salary
18	1,408
19	1,446
20	1,483
21	1,521
22	1,559
23	1,602
24	1,646
25	1,689
26	1,732
27	1,776
28	1,819
29	1,862
30	1,906
31	1,932
32	1,958
33	1,984
34	2,010
35	2,036
36	2,062
37	2,088
38	2,114
39	2,140
40	2,166
41	2,183
42	2,201
43	2,219
44	2,237
45	2,254
46	2,272
47	2,290
48	2,308
49	2,308
50	2,308
51	2,308
52	2,308
53	2,308
54	2,308
55	2,308
56	2,273
57	2,239
58	2,204
59	2,170
60	2,136




Fig. 2-4 Example of age salary (Monthly, in US\$)

Source: Kusuda (2010), p.138

There are several types of “Ability Salary” but the most popular type is shown in Figure 2-5. In this instance, “Ability Salary” is decided by a combination of an employee’s “abilities-based grade,” his/her evaluation for the previous year, and the number of years of experience. The example shows salaries for S-5 Grade. Typically, the first year is plotted as “Year 1” and “B,” which means that the abilities salary is

US\$1,091. One year later, if the employee receives an evaluation of “B” (Medium), his/her ability salary goes up by US\$45 to US\$1,136.

		Evaluation of previous year				
		S	A	B	C	D
years of experience	1	1,113	1,102	1,091	1,080	1,069
	2	1,158	1,147	1,136	1,124	1,113
	3	1,202	1,191	1,180	1,169	1,158
	4	1,247	1,236	1,224	1,213	1,202
	5	1,291	1,280	1,269	1,258	1,247
	6	1,336	1,324	1,313	1,302	1,291
	7	1,380	1,369	1,358	1,347	1,336
	8	1,424	1,413	1,402	1,391	1,380
	9	1,469	1,458	1,447	1,436	1,424

↑
Medium

Fig. 2-5 Example of ability salary (S-5 Grade, Monthly, in US\$)

Source: Kusuda (2010), p.212

Kusuda recommends that companies introduce a “Family Allowance” to adjust for an increase of the standard of cost of living.

A “Position Allowance” is paid to employees who are appointed to a specific position. According to Kusuda, the amount of the “Position Allowance” is not large. He recommends about 5% of an employee’s base pay.

Finally, Kusuda recommends that companies introduce a modest “Exempt Allowance” because there is no overtime allowance for people in these positions.

2.2 TWO MODELS

Kusuda stated: “The objective of human resources management is to create an equilibrium between work/job, people, and wage/salary.” He describes two approaches to HR management: the American system and the Japanese system (see Figure 2-6).

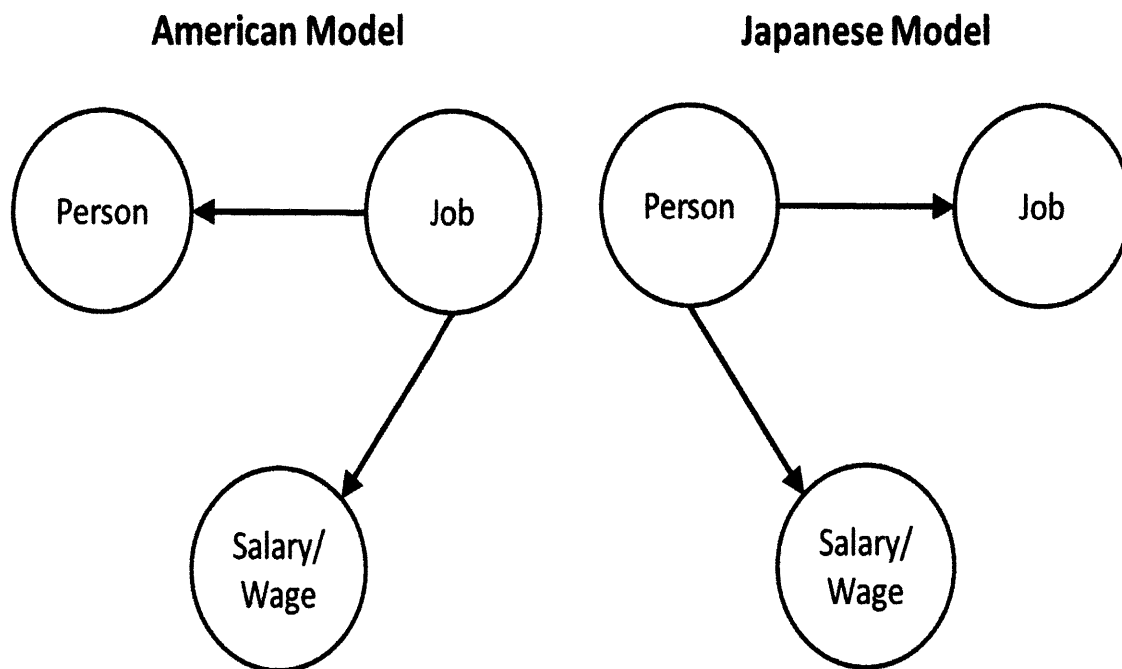


Fig. 2-6 The American and Japanese models of HR management

Source: Kusuda (2002), p.43

2.2.1 The American Model

In the American model, the starting point is the Job. The company describes and evaluates Job Requirements, then creates a Job Description. The Job or Job Description is priced compared to the market price. In the United States, there is an external labor market so it is relatively easy to price the job. In addition, the company allocates a person to the job. This means that the salary/wage expresses the price of the job.

2.2.2 The Japanese Model

In Japan, the starting point is the “person.” The company executes a job analysis (i.e., a summation of all the tasks involved in the job) and determines the requisite abilities and skills to execute each task in light of the employees who are in charge of the task. Then, according to the level of the task, the necessary abilities and skills are classified and tied to a grade. Each grade is priced according to the solvency of the company. The company allocates tasks to a person according to his/her abilities and skills. This means that salary/wage expresses the price of abilities and skills.

Thus, in the Japanese model, the price of salary/wage does not have a direct relationship to the job itself. One is paid according to abilities and skills, not according to a job. So salary/wage is an internal price based on the abilities and skills of the employees of the company. Further characteristics of the Japanese model are discussed below.

Two Hierarchies in Japanese Companies

The potential abilities-based ranking system severs the direct connection between grades and positions in the corporate hierarchy. In Japanese companies that use this system, “promotion” has two meanings. One is promotion according to the ranks or grades in the potential abilities-based ranking system. The other is promotion up the ladder of the corporation. As already described, the company selects an appropriate employee for the position from among those in the pool.

Consequently, there are two corporate hierarchies in Japanese companies: one based on the potential abilities-based ranking system; the other based on position in the corporate organizational structure (see Figure 2-7).

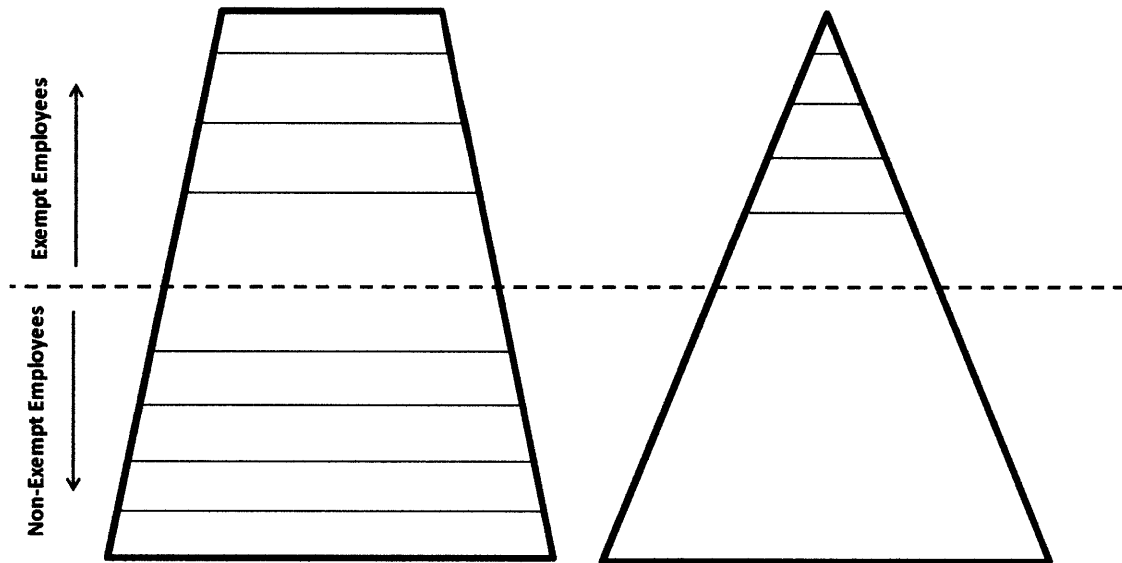


Fig. 2-7 Two hierarchies in Japanese companies

As Figure 2-7 shows, the hierarchy based on potential abilities-based ranking system is shaped like a trapezoid with a much softer slope compared to the pyramid-shaped hierarchy based on organizational position. Sometimes positions are removed or demoted, but one's potential abilities rank is never demoted because abilities, skills, and experiences are not amortized.

Easy to Transfer

Based on the potential abilities-based ranking system, employees' wages/salaries do not change even when they are transferred or change jobs, because wages/salaries are

decided by potential abilities. This makes transfers and job changes relatively easy for companies. Transfer is mainly based on rank.

Moreover, in Japanese companies that utilize the potential ability-based ranking system, there is no job description. Managers adjust their employees' responsibilities and tasks according to their rank. This enables flexible work within the team.

Cutoff from the External Market

Kusuda (2003) noted some of the differences in the salary system in Japan compared to that in the United States and Europe:

Salary is strongly related to the labor market, but in Japan the labor market is in a different situation in terms of salary/wage decision. That is to say:

- (1) A strong labor market based on new graduates is formed.
- (2) The general labor market had only a minor presence until recently.
- (3) Labor markets are divided between large companies and medium- and small-size companies.
- (4) The internal labor market plays a major role in Japanese companies.

Based on these assumptions, salaries and wages are socially separated and decided by each company. In addition, salary/wages start at the initial salary/wage based on academic background; after that pay raises will be added accumulatively every year to the initial salary. (p.15)

Based on this comment, it seems clear that Kusuda does not consider the market price of a job based on comparisons across organization.

2.3 SUMMARY

The potential abilities-based ranking system plays an important role in Japanese companies as a platform for general HR management. This system pays attention to employees rather than jobs. It considers a company to be the sum of its employees' abilities, and then constructs grades based on abilities. By disconnecting grades and

positions, the system alleviates potential conflicts between *dokis* because base salary is decided by grades. Salary is not different between people who may have different positions (except for the smaller position allowance). This system fits well with the regular transfer system because basic salary is decided by grades. One's grade does not change as a result of a transfer. Since jobs are decided according to an employee's abilities and skills, it is relatively easy to change the allocation of tasks among team members.

CHAPTER THREE

Changes in the External Environment in Japan after 1990

In 1990, the Japan's bubble economy burst, and since that time, the economy has experienced a long-term recession. This recession, coupled with declining domestic demand, means that Japanese companies now face rising cost pressures.

The potential abilities-based ranking system has been a core platform in traditional Japanese HR management since the 1970s. And most Japanese companies are still using this system as a platform even twenty years after the beginning of the recession. Figure 3-1 shows the results of research about ranking systems (Hotta 2010). This survey was conducted by Mitsubishi UFJ Research and Consulting Co. Ltd. in 2009. This survey was conducted on listed companies and famous unlisted companies in Japan. The number of companies which answered to this survey was 478 (listed companies: 318, unlisted companies: 160). According to the result of this survey, the "Potential Abilities-based Ranking System" is still the major system in use (about 75-85 % in 2000, about 60-70% in 2009), though it is gradually decreasing.

Level	Ranking System	2000	2003	2006	2009
Managing Director Level	Potential Abilities-based Ranking System	75%	62%	50%	61%
	Pay for Job system	11%	15%	17%	17%
	Pay for accountabilities system	7%	16%	16%	23%
	No system	-	13%	13%	11%
	Others	7%	0%	0%	1%
Manager Level	Potential Abilities-based Ranking System	78%	65%	51%	62%
	Pay for Job system	9%	15%	17%	17%
	Pay for accountabilities system	6%	16%	22%	23%
	No system	-	12%	13%	10%
	Others	6%	0%	1%	1%
Duputy Manager Level	Potential Abilities-based Ranking System	82%	70%	58%	67%
	Pay for Job system	9%	12%	16%	16%
	Pay for accountabilities system	4%	10%	17%	14%
	No system	-	11%	12%	10%
	Others	5%	0%	1%	1%
Non manager level	Potential Abilities-based Ranking System	84%	72%	59%	68%
	Pay for Job system	7%	11%	15%	13%
	Pay for accountabilities system	3%	9%	14%	12%
	No system	-	12%	14%	11%
	Others	5%	0%	1%	1%
Specialist employees	Potential Abilities-based Ranking System	77%	64%	53%	62%
	Pay for Job system	10%	9%	16%	16%
	Pay for accountabilities system	7%	15%	24%	21%
	No system	-	15%	13%	13%
	Others	6%	1%	1%	2%

Fig. 3-1 Results of research on ranking systems

Source: Hotta (2010), p.15

The potential abilities-based ranking system succeeded in overcoming discrimination based on the age, sex and academic background. However, it seems that the length of working period has remained the important principal of Japanese HR management. By this I mean that seniority (the length of working period) is still one of the most important factors influencing one's rank in the company even in the potential abilities-based ranking system. This assumption is backed by the results of "Civil Sector Salary Survey" conducted every year by National Tax Agency in Japan. According to the results of this survey in 2010, there is a strong correlation between the length of working period and salary (and maybe grade) (see Figure 3-2).

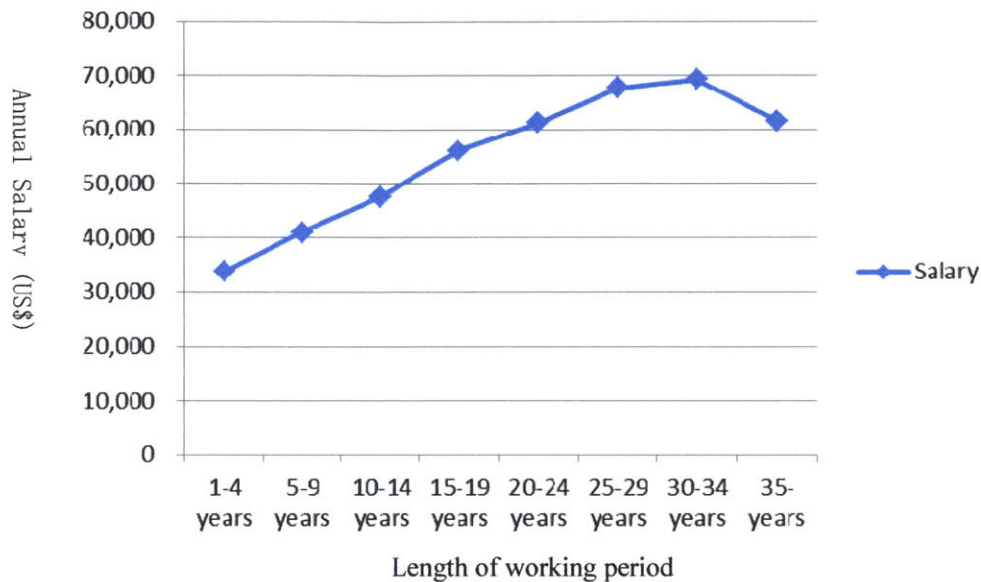


Fig. 3-2 Correlation between the length of working period and the salary

Source: Civil Sector Salary Survey in 2011 (National Tax Agency), p.17

As Figure 3-2 shows, an increase in the average length of the working period in a company largely determines increases both in grades and in salary. This puts pressure on a company's cost pressure and some HR specialists and authorities have pointed to the downside of the potential abilities-based ranking system and have recommended that Japanese companies replace the system with other systems such as a pay for job system (Shigesada 1997, Takizawa 1998, Kazehaya 2007). However, Japanese companies have maintained the potential abilities-based ranking system.

Needless to say, since the 1990s, Japanese companies have introduced many programs in their HR management system (such as a position retirement system, early retirement system, reducing the hiring of new graduates, outsourcing, spin-offs of

functional divisions as subsidiaries, and so on) in order to tackle cost pressures. What do these programs mean? I conclude that the main purpose of the new programs was to reduce labor costs while maintaining the potential abilities-based ranking system.

In this chapter, I trace the problems inherent in the potential abilities-based ranking system. I then show the relationship between the potential abilities-based ranking system and some programs that Japanese companies have introduced since the 1990s. At the same time, I describe the side effects of these new programs and the problems they cause for the Japanese HR management system.

3.1 PROBLEMS INHERENT IN THE POTENTIAL ABILITIES-BASED RANKING SYSTEM

3.1.1 Management by Seniority Continues

Before the 1970s, the seniority system prevailed; the potential abilities-based ranking system had not yet been developed. In fact, the latter, in theory, is the antithesis of the seniority system because it emphasizes employees' abilities, not their educational background, age, sex, and disregards the promotion gap between white-collar and blue-collar employees. However, since abilities are still believed to accumulate according to the amount of time employees have worked in a company, seniority has not been completely wiped out, especially since Japanese companies retain the system of hiring and retaining new graduates.

Kusuda repeatedly warned that evaluation of employees' abilities should be based strictly on the definition of each rank, and that employees should not be promoted easily

if they have not acquired the abilities, skills, and experience needed for the assigned rank or if their potential abilities do not match a higher rank. This warning was intended to overcome the seniority system. However, in reality, most companies have not followed Kusuda's warning. Companies continue to prioritize hiring and competition among *dokis* as well as the late selection system. Moreover, HR departments usually develop guidelines for promotion rates (i.e., the number of people who will be promoted).

This has contributed to maintain a management by the length of working period (seniority) inside the potential abilities-based ranking system. But companies are also coming to believe that they are overpaying their employees in comparison with their jobs. Many Japanese companies are coming to feel that the potential abilities-based ranking system is increasingly costly. Nitta and Hashimoto (2008) point out that there are too many employees are promoted who do not have appropriate abilities and skills. This leads to an increase in total labor costs.

Kusuda (1997) says that a typical salary curve in the potential abilities-based ranking system theoretically matches a performance curve in the long run (see Figure 3-3). After joining a company, an employee is paid relatively less than his/her performance. But after age 40 to 45, he/she is paid relatively more than his/her performance. Figure 3-3 shows an employee's working life in a company. Kusuda would say that Area A matches area B. In addition, he says that the recent movement to reform the potential abilities-based ranking system has come about because of the changing demographics inside companies. If the average age of the employees inside a company exceeds 40 to 45, this company will have high labor costs not matched by overall performance and productivity.

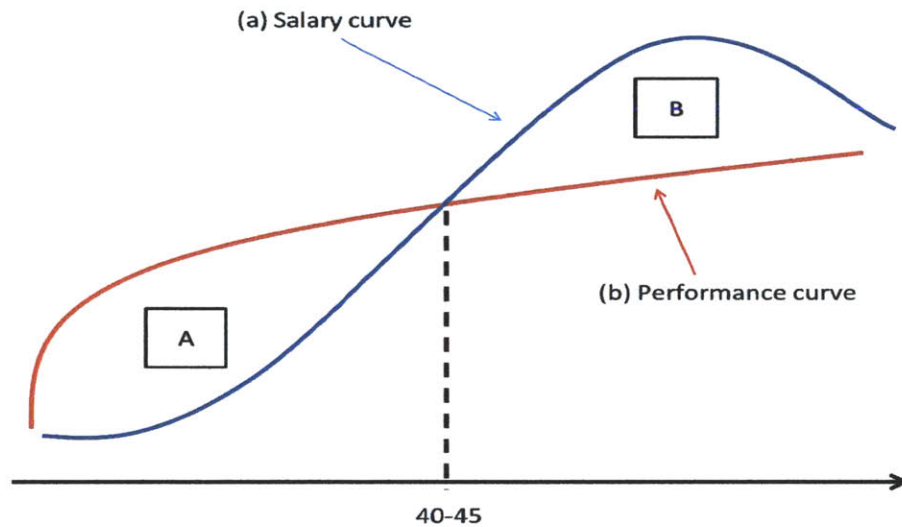


Fig. 3-3 Relationship between salary and performance

Source: Kusuda (1997), p.20

3.1.2 Increasing Mismatch between Two Hierarchies

In the potential abilities-based ranking system, employees are promoted to higher ranks according to increases in their abilities, skills, and experience. More precisely, as I said before, employees are promoted according to the length of working period. At the same time, companies are trying to change their organization structure to make them as flat as possible. This means that positions will be reduced. According to Figure 2-7, the discrepancy between the triangular area and the trapezoid area grows increasingly larger (see Figure 3-4).

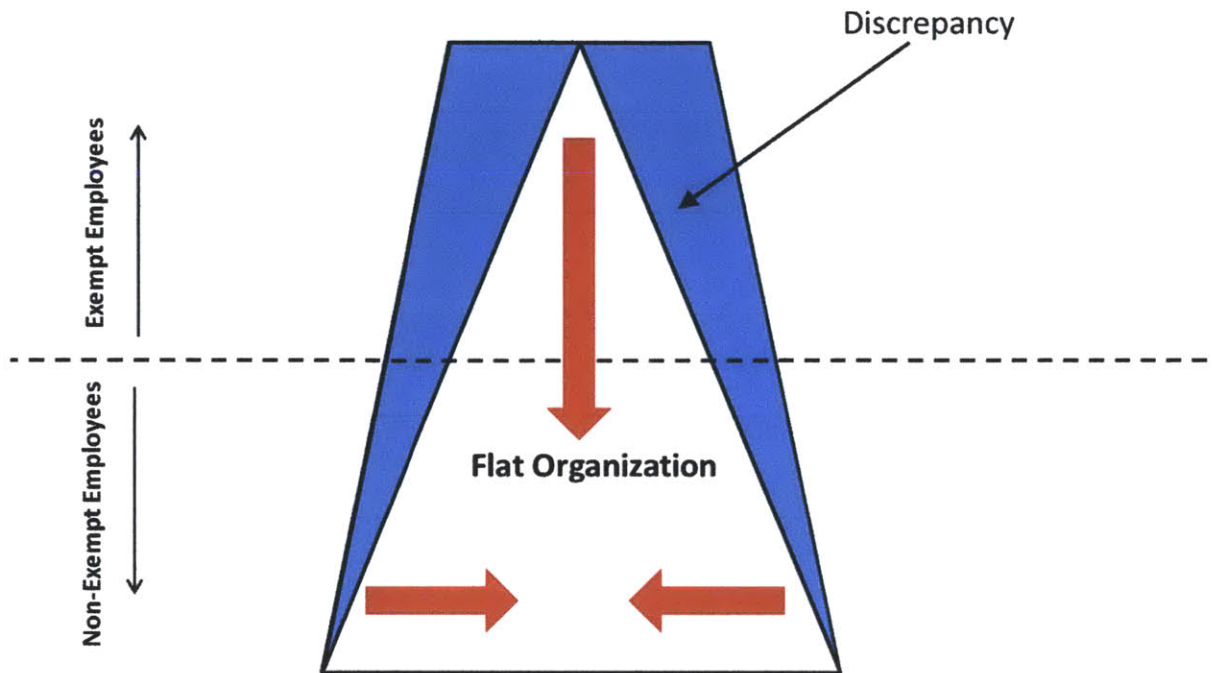


Fig. 3-4 Discrepancy between two hierarchies

Because the potential abilities-based ranking system was developed in the 1970s, I make the assumption that this system was based on circumstances that were present in the 1970s. These may be different from or contradictory to present circumstances. For instance, in the 1970s, the future prospects of Japanese companies were relatively good. Kusuda seemed to think that Japanese companies would grow steadily in the near future and that Japanese companies would steadily increase the number of positions they held. Even if the number of high-ranked employees increased, serious problems would not necessarily lead to increasing the number of positions. However, Japanese companies' growth has decreased and positions have not increased. The gap between the number of positions and the number of people on waiting lists continues to widen until it is now at a level that is hard to fill. For example, the number of managers has increased dramatically,

and, as a result, they are assigned to lower-level jobs that were once allocated to people of lower grades in the potential abilities-based ranking system.

3.2 SOLVING THE PROBLEMS

To solve these problems, Japanese companies have undertaken various actions since the 1990s. As I said before, I believe the main purpose of the new programs is to reduce labor costs while maintaining the potential abilities-based ranking system. In terms of maintaining the potential abilities-based ranking system, there are three measures being considered, or undertaken, by Japanese companies:

1. Reduce labor costs resulting from the potential abilities-based ranking system itself.
2. Make the trapezoidal area more similar to the triangular area.
3. Spin off and create functional subsidiaries.

3.2.1 Reduction of labor costs resulting from the potential abilities-based ranking system

The first measure is to reduce labor costs inherent in the potential abilities-ranked system itself.

Reduce regular pay raises

The abilities-based ranking system includes regular pay raises because it is expected that employee abilities and skills expand year by year. However, since the 1990s, Japanese companies have tried to reduce regular pay raises.

Year	(a) Pay raiserate	(b) Inflation rate	(a)-(b)
1985	5.00	2.04	2.96
1986	4.50	0.60	3.90
1987	3.60	0.14	3.46
1988	4.40	0.66	3.74
1989	5.30	2.28	3.02
1990	6.00	3.04	2.97
1991	5.90	3.30	2.60
1992	5.10	1.71	3.39
1993	3.70	1.27	2.43
1994	3.00	0.69	2.31
1995	2.70	-0.12	2.82
1996	2.70	0.13	2.57
1997	2.60	1.76	0.84
1998	2.30	0.66	1.64
1999	1.70	-0.33	2.03
2000	1.50	-0.65	2.15
2001	1.50	-0.80	2.30
2002	1.10	-0.90	2.00
2003	1.00	-0.25	1.25
2004	1.30	-0.01	1.31
2005	1.40	-0.27	1.67
2006	1.60	0.24	1.36
2007	1.70	0.06	1.64
2008	1.70	1.37	0.33
2009	1.10	-1.35	2.45
2010	1.30	-0.72	2.02

Fig. 3-5 Result of pay raise rate and inflation rate

Source: White paper on the labour economy (Minister of Health, Labour and Welfare), p.286

Figure 3-5 shows the pay raise rate between 1985 and 2010. This pay raise rate includes regular pay raise resulting from the potential abilities-ranking system (an age pay raise, a learning pay raise and a promotion pay raise) and “base-up” (the adjustment for the inflation and increases in living costs) following negotiations with labor unions. In

order to calculate the regular pay raise rate resulting only from the potential abilities-ranking system, I subtracted the inflation rate from the pay raise rate (see Figure 3-6).

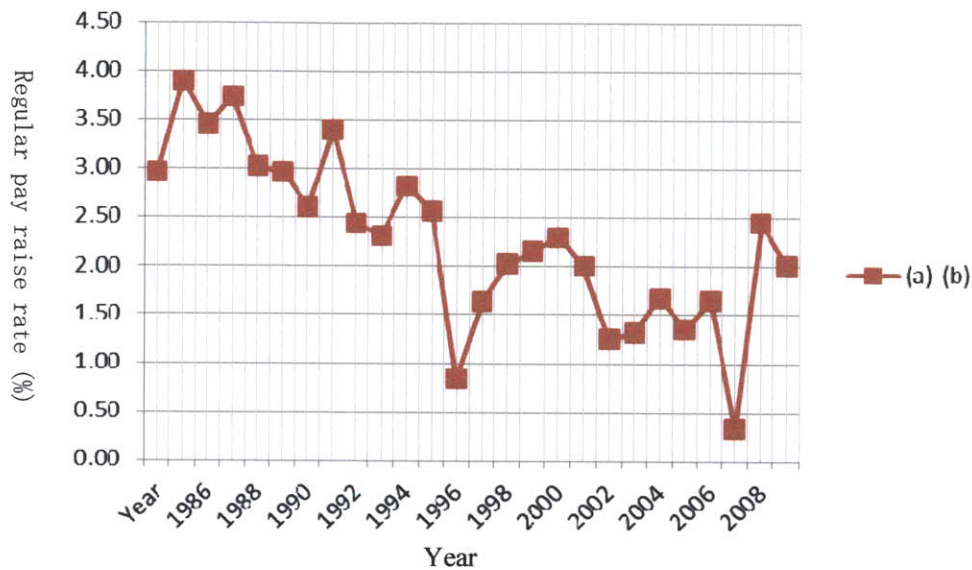


Fig. 3-6 Regular pay raise rate due to the potential abilities-based ranking system

Source: White paper on the labour economy (Minister of Health, Labour and Welfare), p.286

According to Figure 3-6, the regular pay raise rate has decreased gradually between 1985 and 2010. In the 1990s, the regular pay raise was around 2-2.5%, but this changed to around 1.5% in the 2000s. Ishida (2009) concluded the actions taken by Japanese HR management since the 1990s were aimed at cost reductions achieved by decreasing pay raises. This conclusion matches the results of Figure 3-6. According to Ishida (2009), Japanese companies achieved the reduction of regular pay raises by abolishing “Age Salary”, reducing “Ability Salary’s” increase each year, setting the limitation of “Ability Salary” in each rank, reducing the number of grades (broad banding), and reducing the promotion rate.

Increase the weight of payment decided by company performance and individual performance evaluation within regular pay

Japanese companies have tried to link regular pay more to the company's sales or profits and the performance of employees in order to offset the high cost of the potential abilities-ranking system. This includes, for example, the introduction of a bonus system linked to the company's performance and an increase in performance pay linked to an employee's performance. This approach has two effects: (1) companies shift their total labor costs from fixed costs to flexible costs; and (2) companies can use salary and bonus as a device for retaining capable employees

Side effects

This measure decreased the cost of the potential abilities-based ranking system to some extent. However, this also produced more competition among *dokis*, and a degree of distrust or dissatisfaction with the newer performance evaluations.

3.2.2 Make the Trapezoidal Area Similar to the Triangular Area

The second thing that Japanese companies have done in order to maintain their potential abilities ranking system was to make the trapezoidal area similar to the triangular area.

Introduce a position retirement system

In 2004, the Labor Law in Japan was revised to require companies with a fixed retirement age to extend their retirement age by five years. The law was based on a retirement age of 55. Accordingly, companies introduced the position retirement system. By setting a retirement age for positions, employees that have a position will lose it at the fixed age before retirement. In general, this retirement age for a position is set between 55 and 60. Usually, the salary of employees who reach the position retirement age go down because their position allowance and other allowances stop being paid. This system encourages the replacement of older employees with new ones from within the organization, and thus contributes to a decrease in the waiting-list pool.

However, the problem remains that it is relatively difficult for companies to assign specific jobs to employees who have reached the position retirement age because they are usually high-ranked employees in the potential abilities-based ranking system. So Japanese companies introduced the early retirement system, as described below, to complement the position retirement system.

Introduce an early retirement system

To resolve the problem of the position retirement system, Japanese firms rapidly introduced the early retirement system in the 1990s. Employees who voluntarily retire before their fixed retirement age are provided an additional retirement allowance. In general, early retirement is linked to the position retirement age. Employees can get the additional retirement allowance if they retire at the same time as the position retirement age. This system functions to reduce the waiting-list pools.

These two systems are becoming popular among traditional large companies in Japan (see Figure 3-7). Even though the introduction rate, across companies, is only 11.8% in the position retirement system and 6.7% in the early retirement system, respectively, about half of companies that have more than 5,000 employees have introduced these two systems.

	Total	5000+ employees	1000-4999 employees	300-999 employees	100-299 employees	30-99 employees
Position retirement system	11.8	43.1	36.6	18.5	12.0	10.3
Early retirement system	6.7	57.3	41.1	23.0	11.8	2.4

Fig. 3-7 Introduction rate of position retirement system and early retirement system

Source: Imano and Sato (2009), p.294

These two systems together control the number of exits from the community and focus on reducing the higher levels in the trapezoid area of the hierarchy, thus enabling the trapezoid area to remain smaller at the higher level (see Figure 3-8).

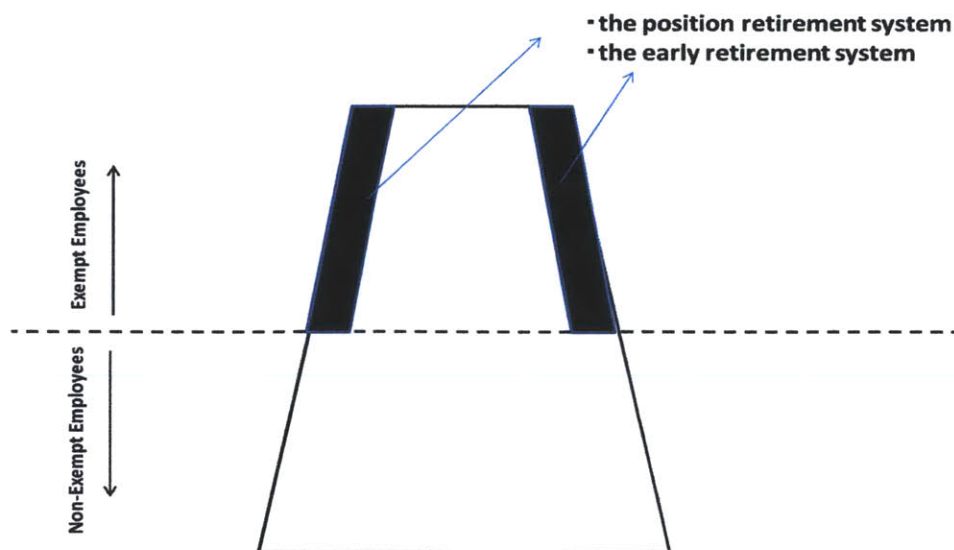


Fig. 3-8 Results of introducing the post-retirement and early retirement systems

Reduce the number of newly hired graduates

In addition to controlling the number of exits in the post-retirement and early retirement systems, companies began to reduce the number of newly hired graduates as a measure of entry control. Because Japanese companies do not have any measures for laying off redundant employees, it becomes difficult to control the overall number of employees except by reducing the number of newly hired graduates.

After the recession in the 1990s, Japanese companies drastically reduced the number of new-hire graduates. Figure 3-9 shows the number of job openings and the number of new graduates from universities between 1987 and 2011. Especially, between 1995 and 2005, Japanese companies reduced the number of job openings even though graduates from universities gradually increased during this period. Japanese companies also reduced the number of job openings of new graduates from high schools and junior (two-year) colleges.

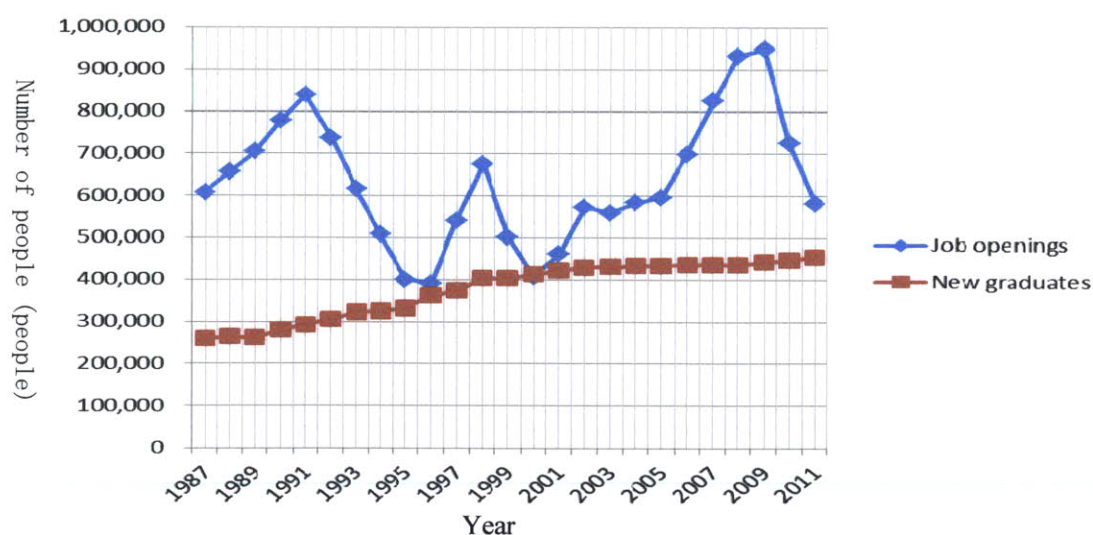


Fig. 3-9 Number of job openings and new graduates from universities

Source: White paper on the labour economy (Minister of Health, Labour and Welfare), p.294

This measure is also expected to reduce the waiting list of positions in the long run. But it is not a quick remedy for addressing the current situation. At the same time, a rapid reduction in the number of newly-hired graduates distorts the trapezoid area even more (see Figure 3-10).

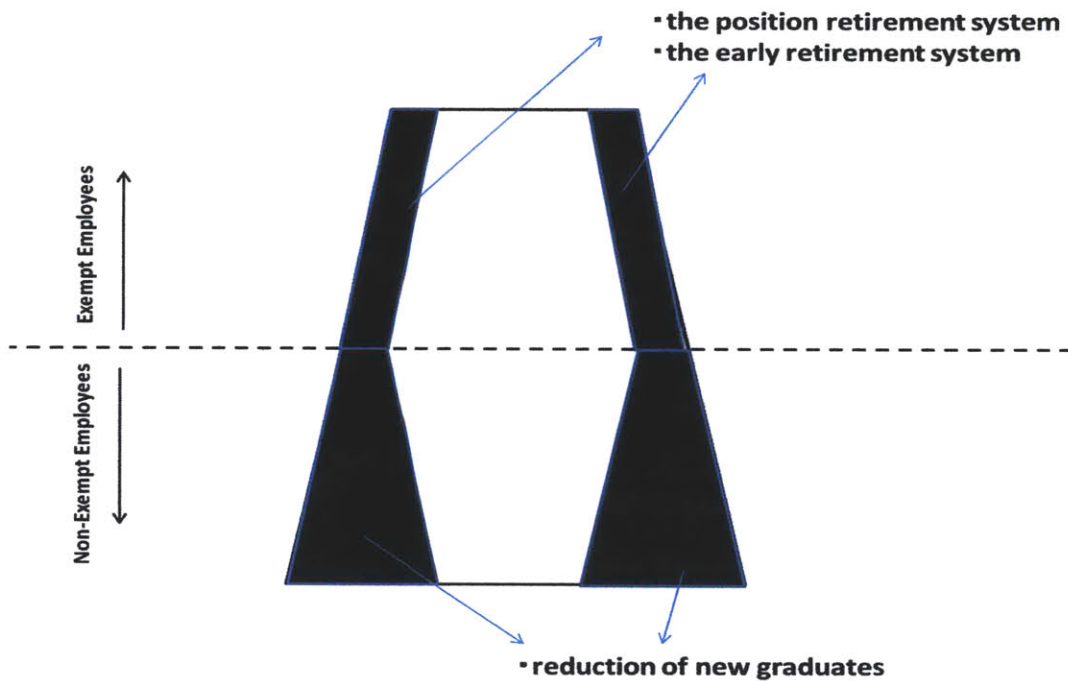


Fig. 3-10 Results of reducing the number of new-hire graduates

Diversify the workforce

In order to remedy the distorted trapezoid, Japanese firms are more aggressively making use of non-regular employees, such as contract workers, part-time workers, temporary workers, subcontract workers, and outsourcing. According to Figure 3-11, the rate of non-regular employees increased from 15% to 35% over the last 15 years. I define each employment system component in Table 3-1.

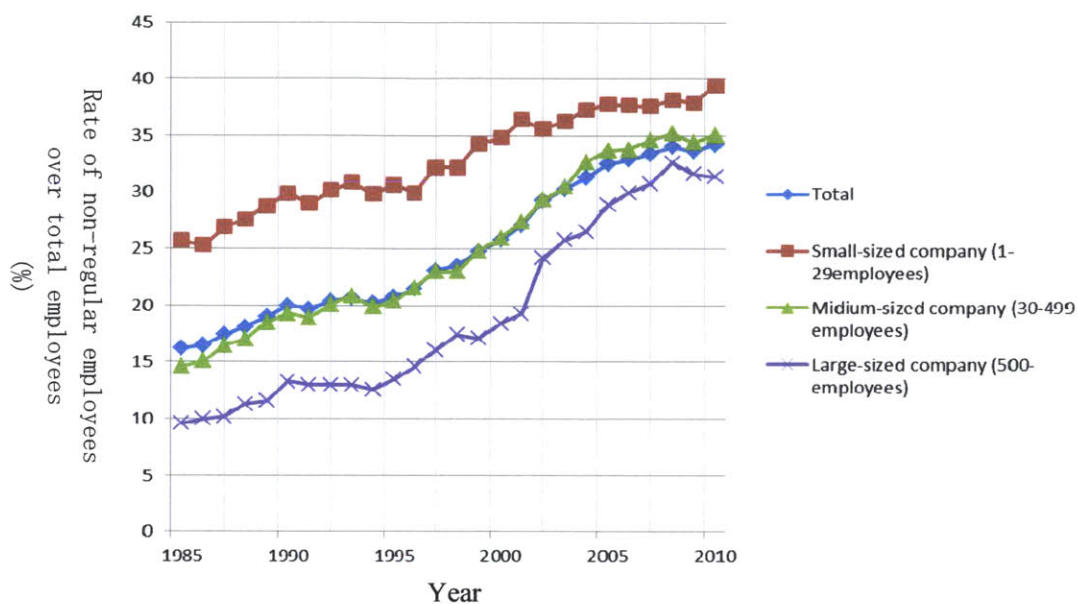


Fig. 3-11 Rate of non-regular employees over total employees

Source: White paper on the labour economy (Minister of Health, Labour and Welfare), p.310

Table 3-1. Definitions

Type of workers	Definition
Regular workers	Have a direct contract with an employer. The contract has no specified term. This type of employee works until age 60. They work in full-time jobs.
Contract workers	Have a direct contract with an employer. The contract has a specified term (i.e., six months, one year). Sometimes the term is renewed. Generally, they work in full-time jobs.
Part-time workers	Have a direct contract with an employer. The contract has a specified term (six month, one year). Sometimes the term is renewed. They work in part-time jobs.
Temporary workers	Dispatched from other firms that have a government license. They have a company contract with these firms, which dispatch their employees to the company. This is called <i>haken</i> .
Subcontract workers	Companies sometimes outsource part of their manufacturing lines to subcontractors. Workers engage in this outsourced area in subcontracted companies.

The phenomenon of a diversified workforce is seen in virtually every industry in Japan except for construction companies (see Figure 3-12). Even in corporate

headquarters, diversification of the workforce is prevalent, especially after the revised “Worker Dispatching Act” went into effect in 1999 and 2003.

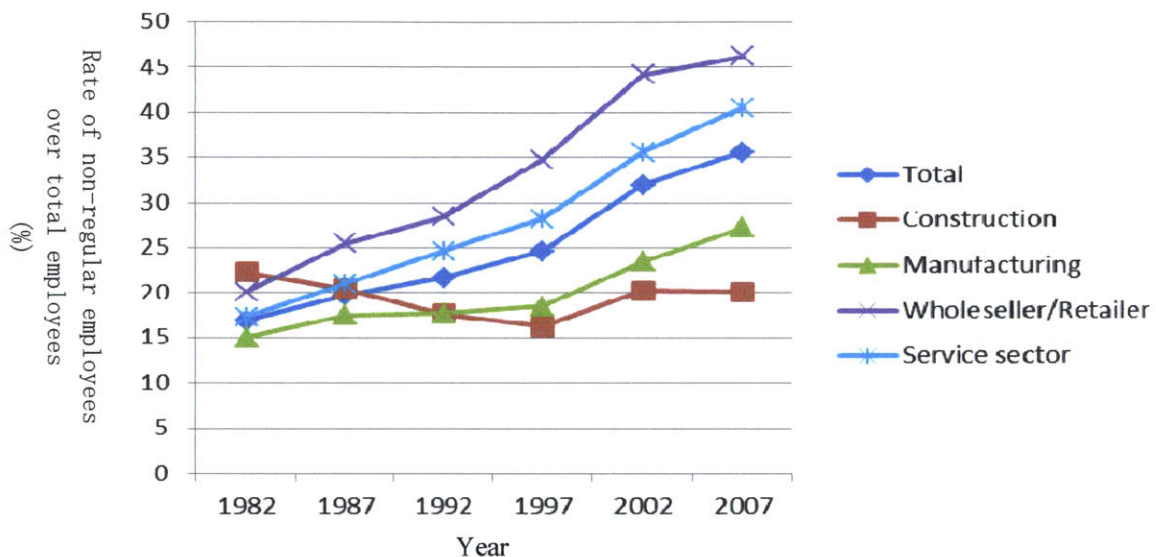


Fig. 3-12 Rate of non-regular employees over total employees

Source: White paper on the labour economy (Minister of Health, Labour and Welfare), p.309

Because Japanese labor costs remain extremely high compared to those of emerging countries such as China and the other southeast Asian countries, many Japanese manufacturers have transferred their manufacturing processes to these countries. However, some companies retained their core manufacturing processes in Japan because their processes required highly skilled labor.

How does a diversified workforce contribute to reducing labor costs? I believe there are two reasons.

(1) Japan has not introduced the principle of “equal pay for equal work.” The salary/wage of non-regular workers is lower than that of regular employees. Therefore, Japanese companies can substantially reduce their labor costs by replacing jobs once

filled by regular workers with jobs now filled by part-time or contract workers. Figure 3-13 shows the average monthly pay of regular employees and non-regular employees. Based on Figure 3-13, the average monthly pay of regular employees increases according to their age, whereas that of non-regular employees is almost flat. So the gap of the average monthly pay increases as the age increases. According to Figure 3-13, the salary of regular employees decreases between 50 and 60. I assume the reasons include:

- Decrease in Age Salary (See Figure 2-4)
- Decrease in Family Allowance (Family Allowance is paid for employees who have their dependents. When their children start to work, this allowance stops to be paid.)
- Position retirement system (When employees reach the age of position retirement, position allowance stops to be paid.)

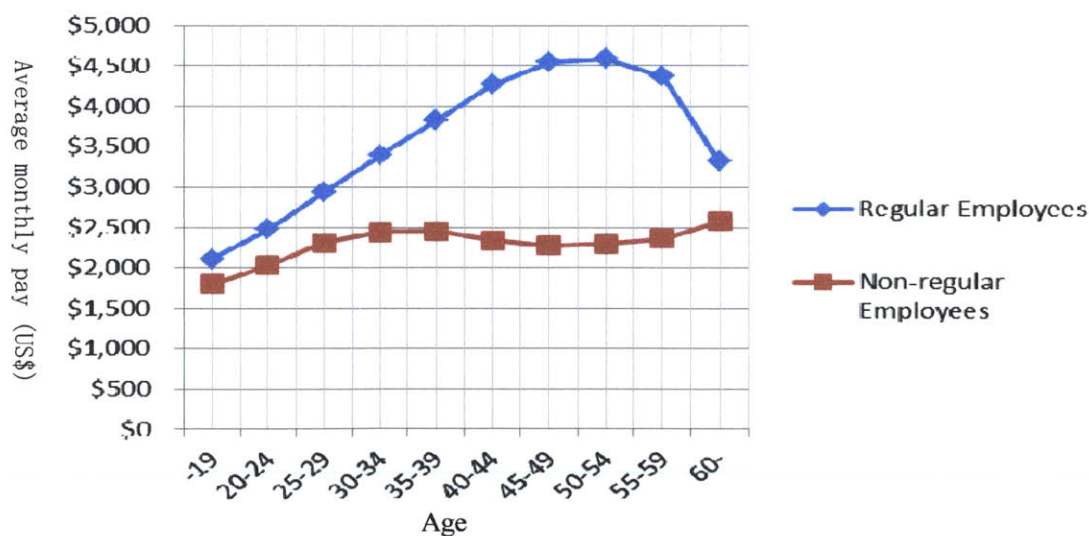


Fig. 3-13 Average monthly salary of regular employees and non-regular employees

Source: White paper on the labour economy (Minister of Health, Labour and Welfare), p.244

(2) As previously discussed, it is difficult for Japanese companies to lay off regular employees. Layoffs of regular employees are strictly regulated. However, companies do not have to renew contracts with contract/part-time workers, so contracts automatically terminate at the expiration date. Companies also can terminate at any time the contracts of temporary workers and subcontract workers. Consequently, high labor costs and the difficulty of laying off workers have driven this diversification of the workforce. For the perspective of the potential abilities-based ranking system, workforce diversification has implications. It creates an additional complement to the distorted trapezoid due to the reduction in the number of newly hired graduates (see Figure 3-14).

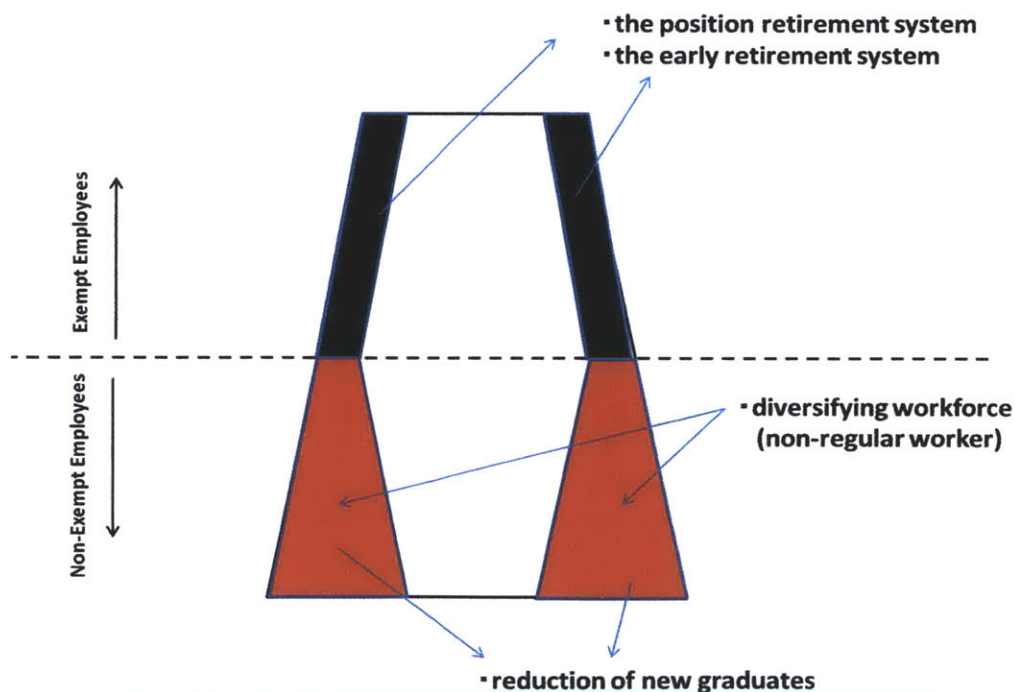


Fig. 3-14 Results of diversifying the workforce

Side effects

A diversified workforce creates side effects for the traditional Japanese HR management system. In Japanese companies, all employees feel a great sense of loyalty to their companies and, even across companies, the same values and cooperation can be found. However, as a result of workforce diversification, this spirit of cooperation has changed. Now companies have to manage diversified workforce who may have different values. Non-regular workers do not seem to feel the same level of loyalty to the company as do regular workers. The turnover rate is higher compared to regular workers (see Figure 3-15).

According to the survey conducted by the Ministry of Health, Labour and Welfare in Japan, the most popular reason why non-regular employees choose this type of working style is that they want to work whenever they want. The second popular reason is that they want supplemental income. The third reason is that it is easier to balance work and life if they are non-regular employees. The fourth reason is that commuting time may be shorter. However, as Figure 3-16 shows, university graduates put more emphasis on the corporate culture of a company when choosing a job.

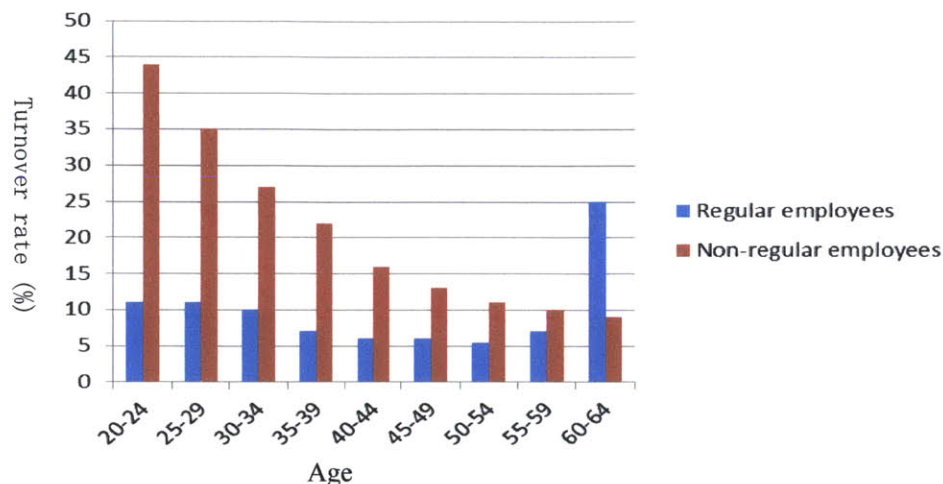


Fig. 3-15 Turnover rate of regular employees and non-regular employees

Source: White paper on the labour economy (Minister of Health, Labour and Welfare), p.244

Item	%	Item	%
Stable Companies	19.4%	Companies that you can use your abilities and specialties	10.0%
Companies that are expected to grow	12.2%	Companies that do not have any discrimination of university and sex etc	3.0%
Companies that provide good salary	7.4%	Companies that young employees can take charge of important jobs	2.5%
Companies that you can do job that you want	44.5%	Companies that have diversified business	1.1%
Well-known companies	2.3%	Companies that you feel great to work for	22.2%
Companies that provide many holidays	4.3%	Companies that have business that you want to enter	4.1%
Companies that provide good fringe-benefits	9.8%	Companies that you feel familiar with	6.3%
Companies that do not have transfer system to other area	5.2%	Companies that have good corporate culture	16.8%
Cpanies that you can work abroad	5.7%	Companies that you can work for your life	9.8%
Companies that you can experience many types of jobs	4.9%	Companies that have good educational program	3.9%

※multiple selection
 ※N=6708

Fig. 3-16 Important factors university graduates use to choose a company

Source: The Survey of University Students' Mind for Work (2012, MyNavi), p.7

3.2.3 Spinoff

Since the 1990s, many companies have reorganized and divided internal functions to create new functional companies as subsidiaries (Kusuda & Oshima 2011) (see Figure 3-17). And the revision of Commercial Law in 2000 and the Act on the Succession to Labor Contracts upon Company Split in 2000 encouraged corporate restructuring (Sugeno 2010)

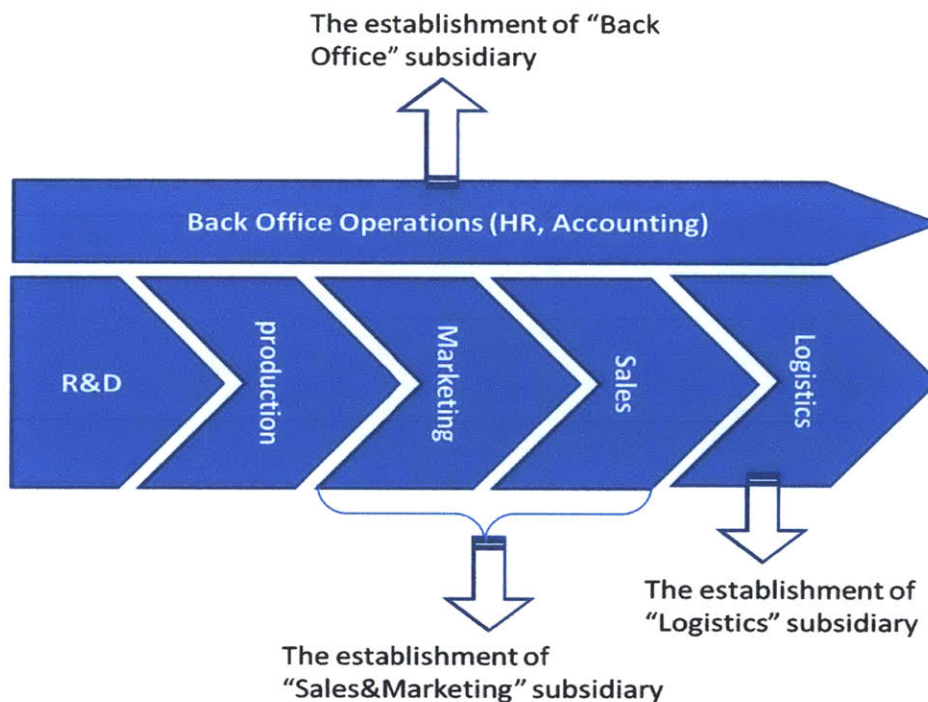


Fig. 3-17 Functional divisions that have been spun off

Why does spinning off functional divisions and creating new subsidiaries lead to a reduction of labor costs? One reason is that a specialty firm, such as a back-office company, can more easily accumulate workers with special skills and then provide better services throughout the company (or, perhaps, even sell their special services to outside

firms). Companies can also sell their subsidiaries and revert to outsourcing which may be cheaper.

From an HR perspective, however, creating subsidiaries also means that companies can reduce labor costs. New subsidiaries have different work policies and regulations, different salaries, allowances, and compensations. In addition, employees in the new subsidiary are not always members of the firm's labor union. It is my assumption, that salaries in subsidiaries are relatively lower than in the parent company. Also, when companies create functional subsidiaries, they try to adjust salaries in the subsidiary to match external standards such as those outsourcing companies. For traditional companies, this means that the salary levels go down.

Side effects

From the perspective of the potential abilities-based ranking system, creating subsidiaries means that more abilities-based ranking systems will now exist in a firm where in the past only one such system existed. This situation demands a more complicated HR management system. It also means that transferring to jobs between companies becomes more difficult. Therefore, employees' careers are more likely to be limited to one company and employees will not obtain the broad experience and additional skills as they did when only one HR management system was in place.

3.3 SUMMARY

In summary, I wish to point out that traditional Japanese HR management is facing many challenges. Since the 1990s, Japanese companies have revised the potential

abilities-based ranking system. However, they have not abolished this system and have tried to maintain it by reducing the costs associated with the system. Also, inside the potential abilities-based ranking system, the length of working period has still played an important role.

Recently, there has been a movement among companies to abandon their potential abilities-based ranking system and replace it with one of two possible substitutes: the “pay for jobs” system, or the “pay for accountabilities” system, both of which are prevalent in the United States.

Pay for jobs system (job-based ranking system)

This system is the most popular globally, but is not popular in Japan. However, some American-based Japanese companies introduced this system some time ago. Some Japanese companies are also introducing the pay-for-jobs system. In this system, the trapezoid area is consistent with the triangle area. For companies that had used the potential abilities-based ranking system, changing to the pay-for-jobs system will bring about major changes.

Pay-for-accountabilities system (accountabilities-based ranking system)

This system is less drastic compared to the pay for jobs system. Rank is decided based on the importance and breadth of each job in comparison to other jobs in the company. In this system, trapezoid area is also consistent with the triangle area.

Kusuda (2004, 2010) recently recommended a hybrid type of system in which at lower-levels in the company would maintain the potential abilities-based ranking system so employees can acquire skills, knowledge, and experience; then, at managerial and higher levels, the pay for accountabilities system would be introduced.

Figure 3-1 shows that Kusuda's recommendations are consistent with the data. Ishida (2009) predicts that in the near future Japanese companies will change their ranking system from the potential abilities-based ranking system to pay for accountabilities system.

CHAPTER FOUR

Case Study: Kirin Holding Company

I have worked at Kirin Holding Company (Kirin) since 1995. Kirin is primarily engaged in the manufacture of beer, non-alcoholic beverages, and food products. Kirin's food and beverage business ranks number one among Asia-Oceania companies in terms of sales; in terms of beer products, it ranks second in Japan and tenth in the world. The company also has a pharmaceutical subsidiary, where I worked in HR for about three years before attending the MIT Sloan Fellows program. Kirin ventured into the pharmaceutical business more than 20 years ago by exploiting its strong biotechnological expertise.

In this chapter, I introduce the HR management system in Kirin. I then show Kirin is now facing the same challenges as other large Japanese companies are facing that I outlined in the previous chapter. In addition, I show that seniority is still an important factor in the potential abilities-based ranking system in Kirin. Finally, I outline the future perspective of the HR management system in Kirin.

4.1 EMPLOYEE GRADE SYSTEM

Kirin introduced a potential abilities ranking system in the late 1970s. Consulting support was provided by Kusuda (see Figure 2-1 in Chapter 2). Kirin has maintained this potential abilities ranking system for over 30 years. The companies now has a hybrid HR management system comprised partially of a potential abilities-based ranking system and

a pay for accountabilities system at the manager level (i.e., exempt employees). The potential abilities-based ranking system is for the non-manager level (i.e., non-exempt employees). Other rules apply to directors (board members) and operating officers. This new system began in 2006 at the manager level and, in 2007, at the non-manager level. Before the change, all employees were managed only by the potential abilities-based ranking system. However, as described in Chapter 3, a mismatch between grades and jobs caused problems. Kirin decided to add a pay for accountabilities system, together with the potential abilities-based ranking system. In Kirin's grade system, there are 11 grades: 4 at the manager level, and 7 at the non-manager level (see Figure 4-1).

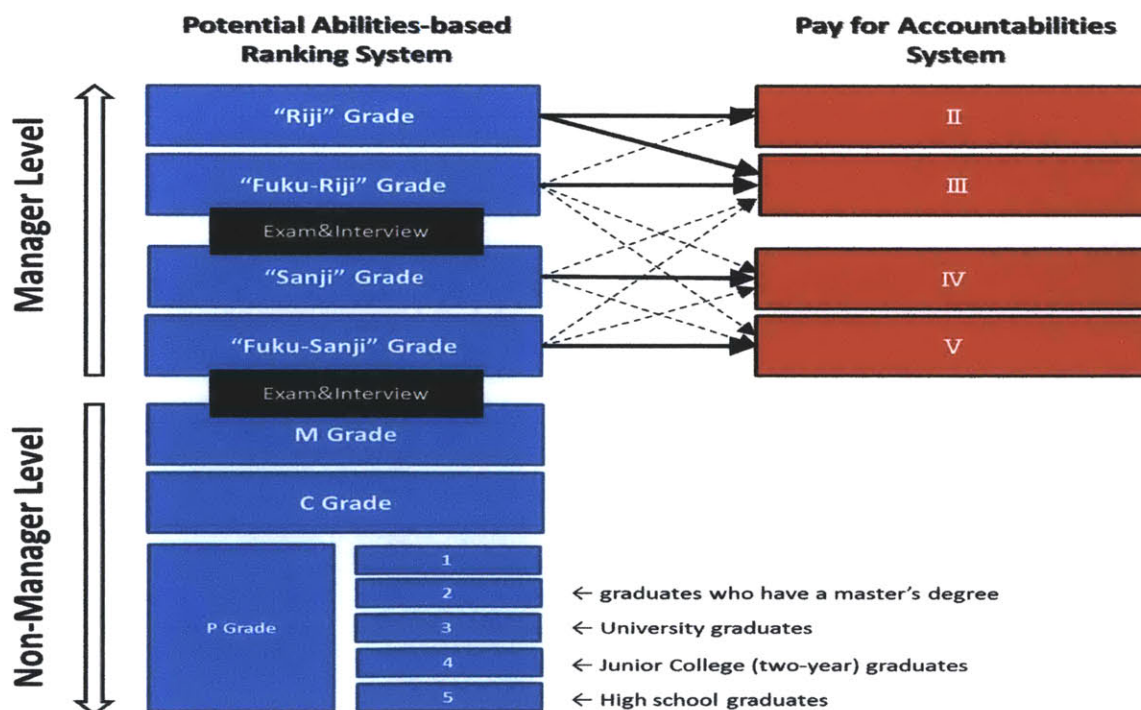


Fig. 4-1 Kirin employee grade system

Source: Handbook for managers (2008), p.22

At the manager level, the potential abilities-based ranking system operates. But, each manager is also assigned to a specific “accountabilities grade.” Thus, each manager has a “potential abilities grade” and an “accountabilities grade.” This creates a number of different combinations. For example, employees at *Fuku-Sanji* grade in the potential abilities-based ranking system are most likely to have V Grade in the pay for accountabilities system (see the solid line in Figure 4-1). But it is also possible to have IV Grade or III Grade (see the broken lines in Figure 4-1).

Upon employment with Kirin, new graduates from high schools are given a P5 Grade in the potential abilities-ranking system; new graduates from junior (two-year) college are P4 Grade; university graduates are P3 Grade; and new graduates with a master’s degree are P2 Grade. There are no exceptions to this rule. Furthermore, each will be promoted according to his/her abilities, skills, knowledge, and experience. For example, employees who are assigned to P3 Grade will be promoted to P2 Grade based on an evaluation of their abilities, skills, knowledge, and experience, as well as accumulated performance evaluations conducted on an annual basis.

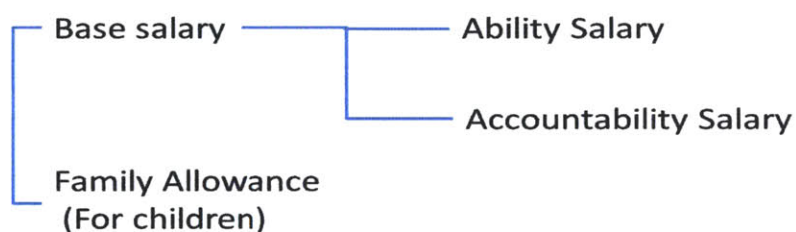
There are two rigid hurdles in this system for every employee ready for promotion. The first occurs at the time an employee is ready for promotion from M Grade to *Fuku-Sanji* Grade. At this time, an examination takes place to determine whether an employee is qualified to become a manager. After careful screening, employees who pass the examination must be interviewed by an executive officer and by HR senior manager. The other hurdle occurs when an employee is ready for promotion from *Sanji* Grade to *Fuku-Riji* Grade. In this case, an examination also takes place to judge whether an employee is qualified to become a top management member. After careful screening,

employees who pass this examination must sit for an interview with board members and the HR director or the HR operating officer.

4.2 SALARY SYSTEM

Kirin's salary system is divided into two systems: one for managers, the other for non-managers (see Figure 4-2).

Monthly Payment for Managers



Monthly Payment for Non-Managers

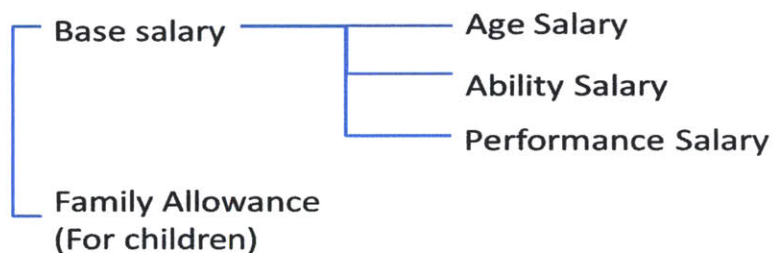


Fig. 4-2 Kirin salary system

Source: Handbook for managers (2008), p.28 and Salary regulation in Kirin

At the manager level, the base salary is composed of “ability salary” and “accountability salary.” Ability salary is a fixed payment based on one’s grade in the potential abilities-based ranking system. An accountabilities salary is paid based on the

grade in the pay for accountabilities system. This is also influenced by one's evaluation in last year's performance review.

At the non-manager level, the base salary is composed of three parts: "age salary," "ability salary," and "performance salary." Age salary is based on the employee's age (see Figure 2-4 in Chapter 2). Ability salary is based the employee's grade in the potential abilities-based ranking system. These two payments increase with age and an accumulation of years in a grade. Performance salary is influenced by one's evaluation in last year's performance review.

Both at the manager level and the non-manager level there is family allowance for those who have dependent children.

4.3 ACTIONS AFTER THE RECESSION

In Chapter 3, I introduced various actions taken by Japanese HR management since the bubble economy burst in 1990. Those same actions can be seen in microcosm in Kirin.

- At the non-manager level, Kirin decreased regular pay raises when it revised the system in 2007. This was achieved by reducing the increase of age salary each year and ability salary within a grade. In addition, it reduced the number of grades from nine to seven. At the manager level, it also reduced the number of grades from 5 to 4 when it revised the system in 2006.
- Kirin introduced a position retirement system in the early 1990s, followed by an early retirement system in the late 1990s. The position retirement age is set at 57. If

employees retire using the early retirement and the position retirement systems, they receive an additional retirement allowance. As I show later in this chapter, almost all employees at the manager level retire at the age of 57 except for those who have been promoted to higher managerial levels such as directors or operating officers.

- Kirin dramatically reduced the number of new hires, especially in the late 1990s and early 2000s. It also stopped hiring new graduates from junior college in the late 1990s. Jobs for these employees were shifted to non-regular employees. For example, in the payroll processing center in Kirin, half of the employees are non-regular employees.
- Kirin continues to spin off functional divisions and create functional subsidiaries. For example, a back office company named Kirin Business Expert Company was established in 2001. A merchandising company was created in 2001, and a sales and marketing company named Kirin Marketing Company was launched in 2012.

4.4 RELATIONSHIP BETWEEN GRADE SYSTEM, BASE SALARY, AND SENIORITY

As described in Chapter 2, the potential abilities-based ranking system was developed as a replacement to the seniority system. However, most Japanese companies continue management by seniority as shown in Chapter 3 (see in Figure 3-2 in Chapter 3). Is this true of Kirin?

In this section, I examine this by using data from 2008 and 2011. For convenience, data are limited to employees graduating from universities.

Figure 4-3 shows the number of Kirin employees for two work years, 2008 and 2011. The total number of employees was 2020 in 2008 and 1630 in 2011. The reason for

sharp decrease was that Kirin created a new pharmaceutical company and employees of this company now fall under another HR management system.

The post retirement system and the early retirement system seem to be working well. The number of employees over the age of 57 (more than 35 years of employment) was two in 2008 and one in 2011, thus, almost all managerial employees retired through the early retirement system. This helped maintain the potential abilities-based ranking system as discussed in Chapter 3.

Length of Work Period	2008	2011
38	0	0
37	0	0
36	2	1
35	0	0
34	10	10
33	21	29
32	26	21
31	28	26
30	37	21
29	27	31
28	35	32
27	26	27
26	33	29
25	35	45
24	36	57
23	34	73
22	46	87
21	64	78
20	77	99
19	93	108
18	82	69
17	106	64
16	121	45
15	77	40
14	86	26
13	64	27
12	61	32
11	47	22
10	46	27
9	63	22
8	46	25
7	43	42
6	39	35
5	49	61
4	70	66
3	71	56
2	106	69
1	110	66
0	103	62
Total	2020	1630

Fig. 4-3 Number of employees, based on length of employment

Figure 4-4 and 4-5 shows the number of Kirin employees in each rank of the potential abilities-based ranking system and the pay for accountabilities system in 2008 and 2011, respectively.

Potential Abilities-based Ranking System			Pay for Accountabilities System		
Grade	Number	Percent	Grade	Numver	Percent
Riji	79	3.9%	II	41	2.0%
			III	37	1.8%
			IV	1	0.0%
			V	0	0.0%
				2	0.1%
Fuku-Riji	246	12.2%	III	101	5.0%
			IV	137	6.8%
			V	6	0.3%
				0	0.0%
Sanji	344	17.0%	III	2	0.1%
			IV	178	8.8%
			V	164	8.1%
				0	0.0%
Fuku-Sanji	232	11.5%	III	0	0.0%
			IV	5	0.2%
			V	227	11.2%
M	337	16.7%	Total	901	44.6%
C	233	11.5%			
P1	168	8.3%			
P2	198	9.8%			
P3	183	9.1%			
P4	0	0.0%			
P5	0	0.0%			
Total	2020	100%			

<Total>		
II	43	4.8%
III	140	15.5%
IV	321	35.6%
V	397	44.1%
Total	901	100.0%

Fig. 4-4 Kirin ranking system, 2008

Potential Abilities-based Ranking System			Pay for Accountabilities System		
Grade	Number	Percent	Grade	Numver	Percent
Riji	69	4.2%	II	37	2.3%
			III	32	2.0%
			IV	0	0.0%
			V	0	0.0%
Fuku-Riji	266	16.3%	II	2	0.1%
			III	108	6.6%
			IV	150	9.2%
			V	6	0.4%
Sanji	341	20.9%	II	0	0.0%
			III	1	0.1%
			IV	134	8.2%
			V	206	12.6%
Fuku-Sanji	186	11.4%	II	0	0.0%
			III	0	0.0%
			IV	1	0.1%
			V	185	11.3%
M	179	11.0%	Total	862	52.9%
C	141	8.7%			
P1	189	11.6%			
P2	137	8.4%			
P3	122	7.5%			
P4	0	0.0%			
P5	0	0.0%			
Total	1630	100.0%			

<Total>		
II	39	4.5%
III	141	16.4%
IV	285	33.1%
V	397	46.1%
Total	862	100.0%

Fig. 4-5 Kirin ranking system, 2011

These data show several trends:

- Among employees graduating from universities, about half are managers (44.6% in 2008, 52.9% in 2011). I assume that this situation resulted from the length of the working period (seniority) in the potential abilities-based ranking system. But this

distribution was not consistent with hierarchical structure of the company.

- Among managers, about half were V Grade in the pay for accountabilities system (44.1% in 2008, 46.1% in 2011). Kirin was therefore caught between the upward pressure to promote employees to managers and the downward pressure to reduce positions. This situation created what some Japanese call “playing managers,” a label I will discuss in Chapter 5.
- The number of employees promoted from M Grade to *Fuku-Sanji* Grade (manager) was 58 (17.0%) in 2008 and 37 (18.8%) in 2011. The number of employees that were promoted from *Sanji* Grade to *Fuku-Riji* Grade was 32 (10.1%) in 2008 and 35 (10.8%) in 2011. From these numbers, it seems that the HR department sets a fixed promotion rate. That is to say, if there are many employees in the lower grade, the higher grade will increase in the near future.

Finally, what is the relationship between length of employment (or seniority) and salary and grade in Kirin? Figure 4-6 shows the relationship between average grade and work period for 2008, and Figure 4-7 shows the relationship between average monthly salary and work period in 2008. Figures 4-8 and 4-9 show the same relationship for 2011.

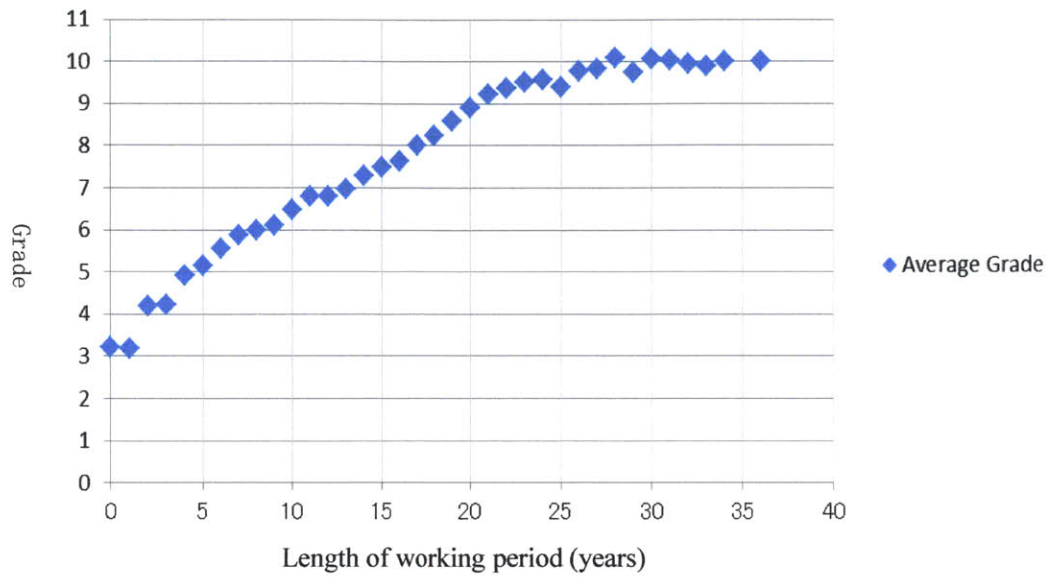


Fig. 4-6 Average grade (2008)



Fig. 4-7 Average monthly salary (2008, in US\$)

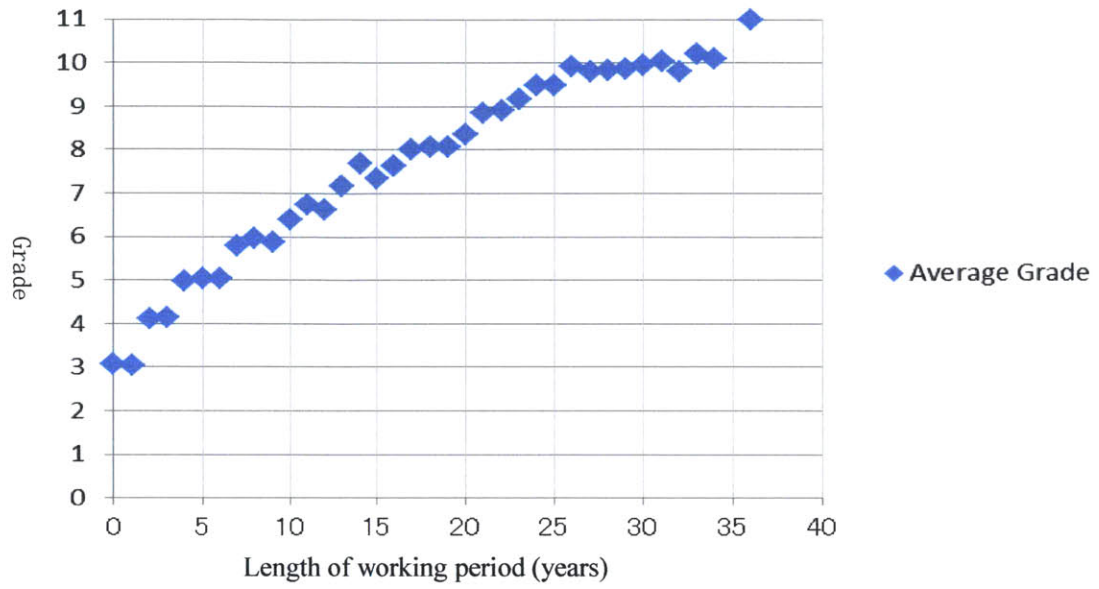


Fig. 4-8 Average grade (2011)

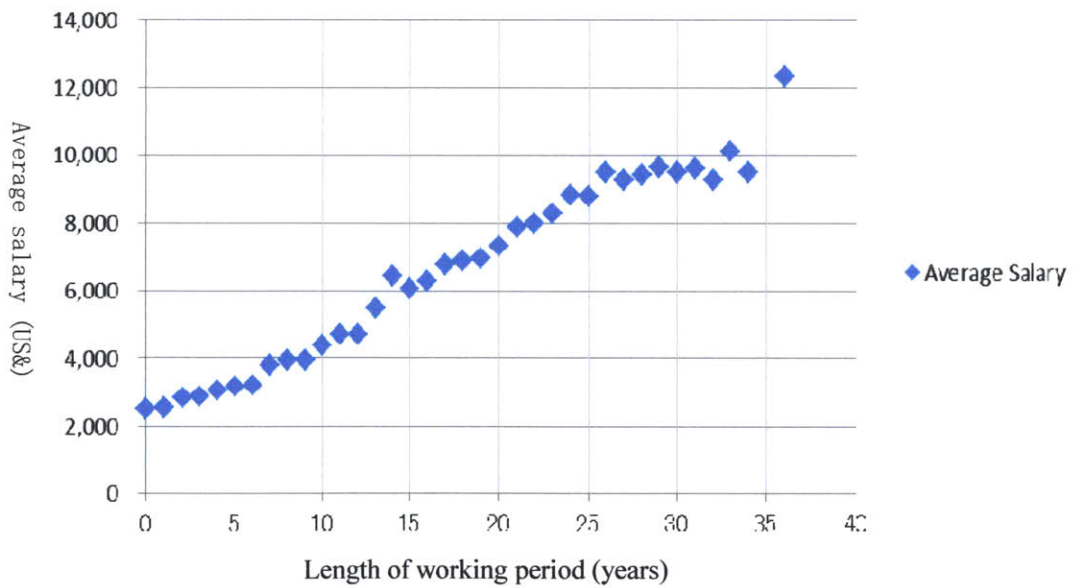


Fig. 4-9 Average monthly salary (2011, in US\$)

Figure 4-10 shows the standard deviation for grade and Figure 4-11 shows the standard deviation for monthly salary in 2008. Figures 4-12 and 4-13 show the same standard deviation for 2011.

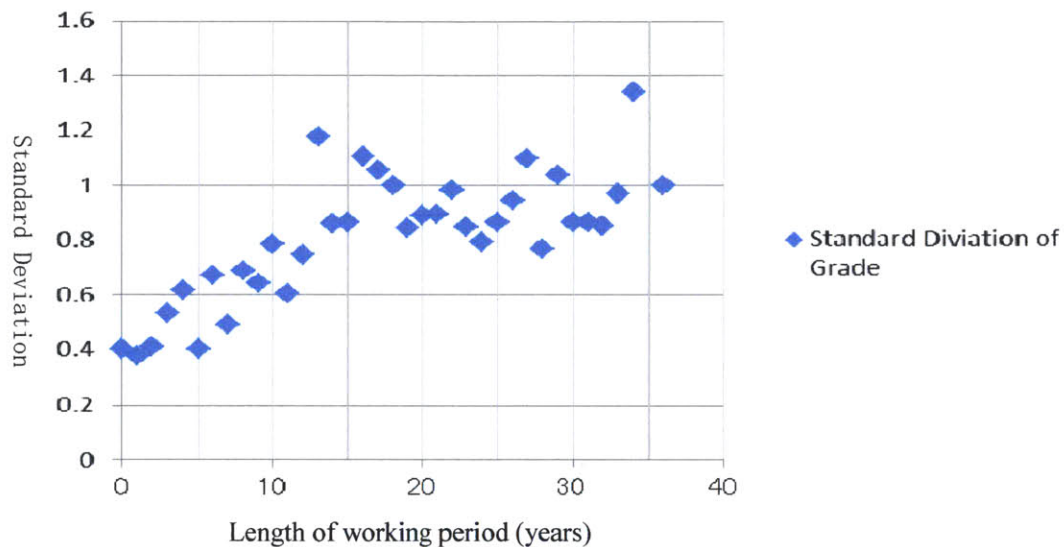


Figure 4-10: Standard deviation for grade (2008)

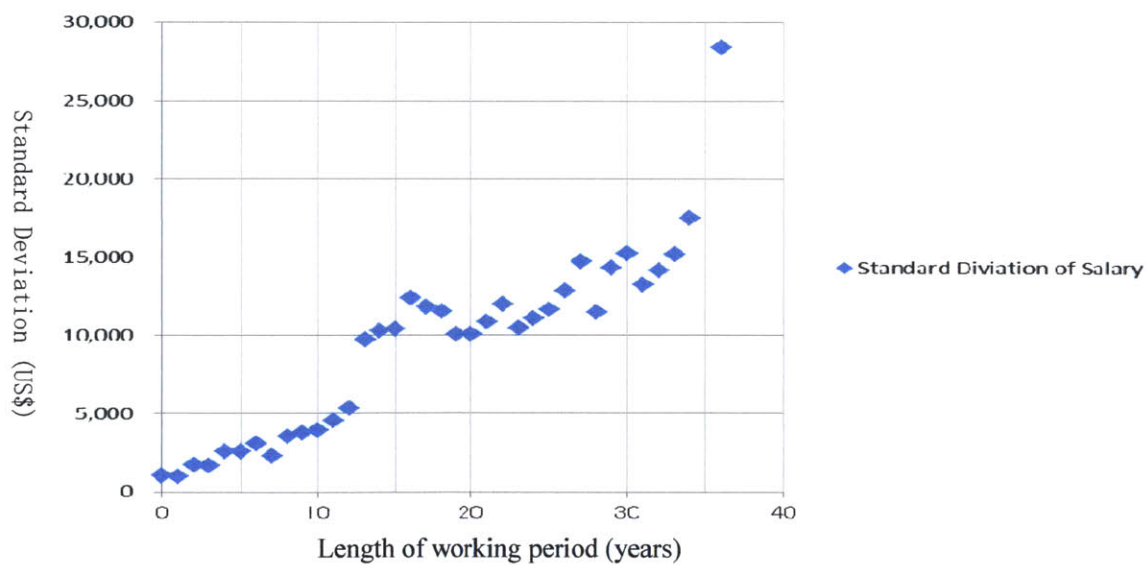


Fig. 4-11 Standard deviation for monthly salary (2008, in US\$)

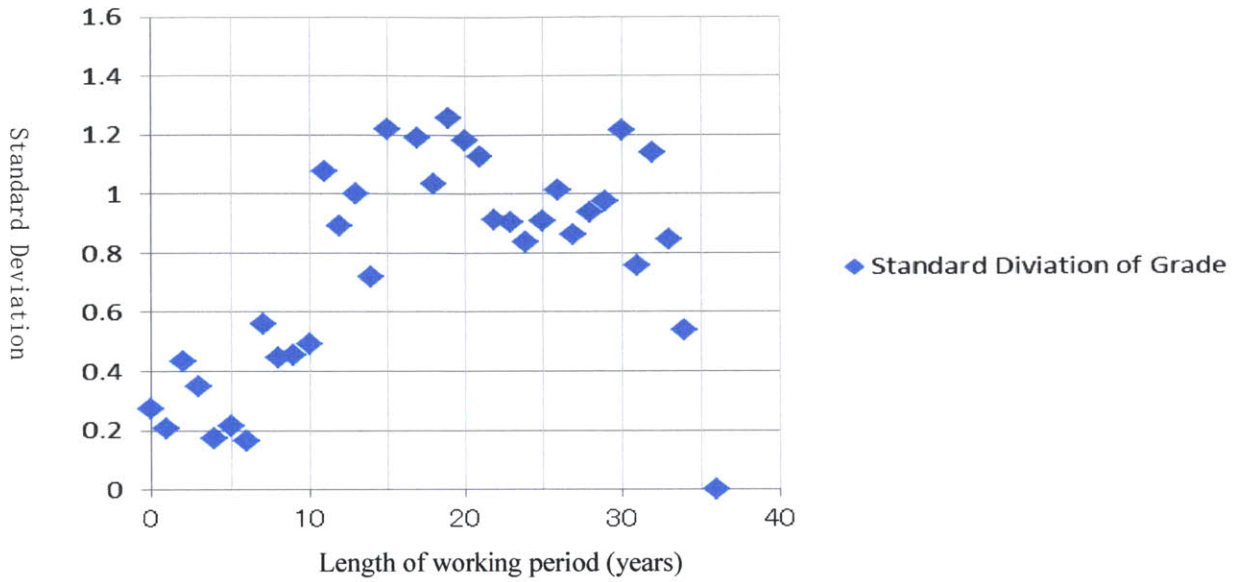


Figure 4-12: Standard deviation for grade (2011)

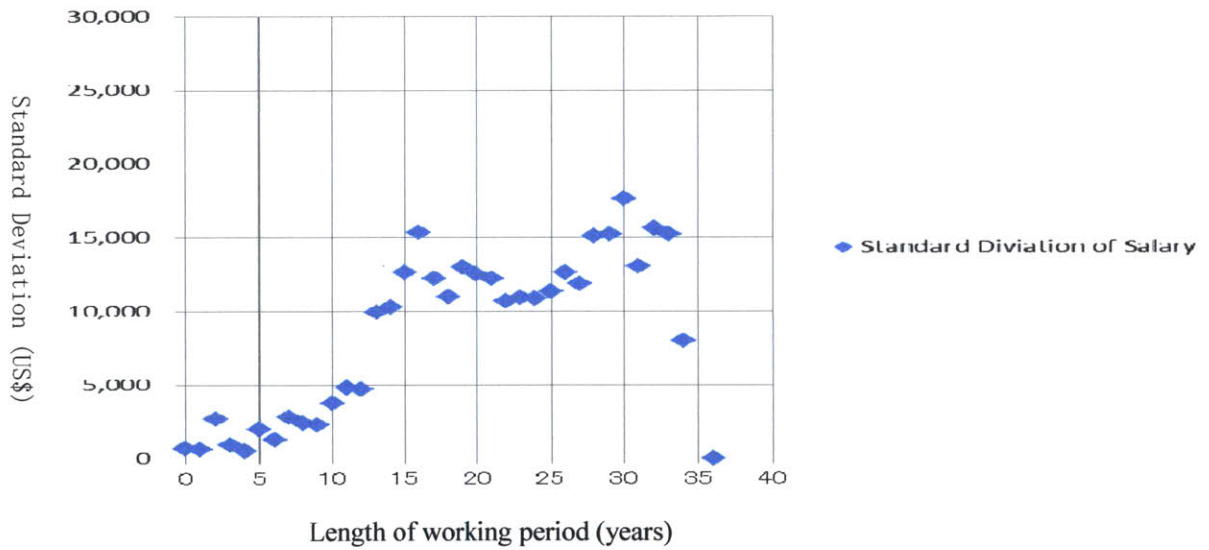


Fig. 4-13 Standard deviation for monthly salary (2011, in US\$)

From these eight figures from Figure 4-6 to Figure 4-13, the following can be observed:

- The shape of each graph is almost the same for 2008 and 2011.
- The relationships between average grade, average monthly salary, and the length of work time are strong.
- Between Years 0 and 25 (ages 22 to 47), both average grade and average monthly salary increase in a straight linear fashion and then level off. This means that promotion to *Fuku-Riji* Grade is a major hurdle. The fastest promotion to *Fuku-Riji* Grade is set at about the age of 45.
- Nevertheless, the standard deviation gradually increases year by year, until Years 13 to 15 (ages 35 to 37) when it goes up dramatically. This means that the late promotion (screening) system is conducted gradually among *dokis*. The end occurs when they are promoted to manager (*Fuku-Sanji* Grade). The fastest promotion to *Fuku-Sanji* Grade is about 35.

4.5 SUMMARY

In this chapter, I examined the actual data of Kirin in 2008 and 2011. According to the data, Kirin's HR management seems to be based on seniority. This implies that the HR department of Kirin strictly controls promotions among *dokis*. On the other hand, the standard deviation of both grade and salary increase in the early stages of the *dokis* working careers. This implies that screening and competition among *dokis* also comes earlier in their careers.

CHAPTER FIVE

Changes and Challenges for Japanese HR Systems

5.1 CHANGES

I have examined the characteristics of traditional Japanese HR management systems and the changes that have occurred in recent years. My conclusions are summarized as follows.

1. In the 1970s, the seniority system was supposedly replaced by the potential abilities-based ranking system. This has since functioned as the core of Japanese HR management system.
2. The potential abilities-based ranking system fit well with the employment situation that existed in the 1970s. It was a popular system not only for Japanese companies but also for Japanese labor unions. For Japanese companies, the potential abilities-based ranking system was attractive because it meant flexibility in the jobs that were assigned to each employee, and made it easier for companies to transfer employees—especially compared to pay-for-job systems. This system also relied on the steady growth for companies and promotions for employees.

For labor unions, the system meant there was little or no discrimination based on education, age, or sex, and no difference between white-collar and blue-collar workers. All employees were evaluated by the same measures based on their abilities to perform

their specified job. In addition, energetic efforts were made by Kyu Kusuda to support and encourage this system. As noted, he spread his idea by leveraging (1) consultations with individual companies, (2) consultations with business associations, (3) seminars, (4) institutional activities, and (5) publication of books.

3. During the 1970s, Japanese companies also introduced the hiring system for new graduates. This system and late promotion system encouraged competition among *dokis* and apparently contributed to their motivation and cooperation. The HR department monitored this competition among *dokis* as another way to screen for good managerial candidates.

4. Yet, even in Japanese companies that had introduced the potential abilities-based ranking system, management by the length of working period (i.e., seniority) has continued to be an important factor in deciding grades and salaries.

5. When the economic bubble burst in the early 1990s, Japanese companies began to take various measures to adjust their HR management systems. Japanese companies had to deal with cost pressures. The mismatch between reduced number of posts because of a flattened corporate structure and number of people on waiting list for positions became a problem. Therefore, various programs have been introduced since the 1990s. These programs were intended to reduce labor costs while maintaining the potential abilities-based ranking system.

6. The potential abilities-based ranking system remains the major HR system in use in

Japanese companies (about 75-85 % in 2000, about 60-70% in 2009). And, as I have shown, this preserves the seniority system.

7. However, the programs that have been introduced since the 1990s to reduce labor costs have had related problems. Japanese companies are trying to solve these problems in the following ways:

(1) Companies are now strengthening their screening process to identify the most capable employees. The gap between the regular bonus for good and bad employees has grown larger. This encourages more competition among *dokis*.

(2) Diversification of the workforce is perhaps changing the management style of Japanese companies. I believe the corporate culture implicitly shared by long-term regular employees is growing weaker.

(3) Companies have also spun off some functions to independent subsidiaries. These subsidiaries have a different HR management system from that of the parent company.

8. Some companies are changing their ranking system from the potential abilities-based ranking system to a pay for accountabilities or pay for job system. Some observers, including Kusuda, predict that the pay for accountabilities system will soon become more popular in Japan.

9. In my opinion, the Japanese HR management is in transition. Japanese companies are searching for a balance between the traditional Japanese HR management system and the

system found in the US. Globalization intensifies this search for balance. But, given the strength of Japanese labor laws, the transition will surely be slow and perhaps never complete.

5.2 CHALLENGES

My research has identified the following future challenges for the Japanese Human Resources management system:

1. Managing Company Values

Japanese companies are becoming more divided. Inside each company, there is a greater variety of employees in the workforce, such as regular employees, part-time workers, contract workers, and outsourced workers—all of whom must work together cooperatively.

Companies can no longer expect the same level of loyalty to the company as existed some years ago. What will allow employees to “connect” to the company and to each other? This, I believe, rests on the employees’ perception of company values. Until recently, Japanese employees entered a company feeling like they were a valued member of a community. Most willingly spent their lives in that one community. No special effort was needed to create this mood of cooperation and loyalty. Today, it is hard to find the same cooperative mood. Companies must work as they never have before to create a binding force – values - that bring together and unite employees.

2. Solving the “playing manager” problem

It appears that most Japanese companies today have too many “playing managers.” This is a label used in Japan to describe employees who are promoted to a managerial level – thanks to the potential abilities-based ranking system – but then cannot be promoted to a higher level because the number of higher posts is severely limited. They are called managers but they have no subordinates reporting to them. What worries many companies is that “playing managers” are being paid too much for what they do. Companies are also worried that there is little to motivate “playing managers” since they have little chance of further promotions in the firm. Without considerable economic growth, there seem to be no obvious solution to this problem. Given current conditions, it may take many years of restricted hiring and the eventual retirement of “playing managers” before the situation is resolved.

3. Improving the evaluation system and screening process

As shown in Figure 5-1, labor costs in Japanese companies amount to more than 70% these days. Screen and evaluation of employees is then a critical problem and improvements must be made. In many companies, efforts are underway to develop new fair and transparent evaluation process.

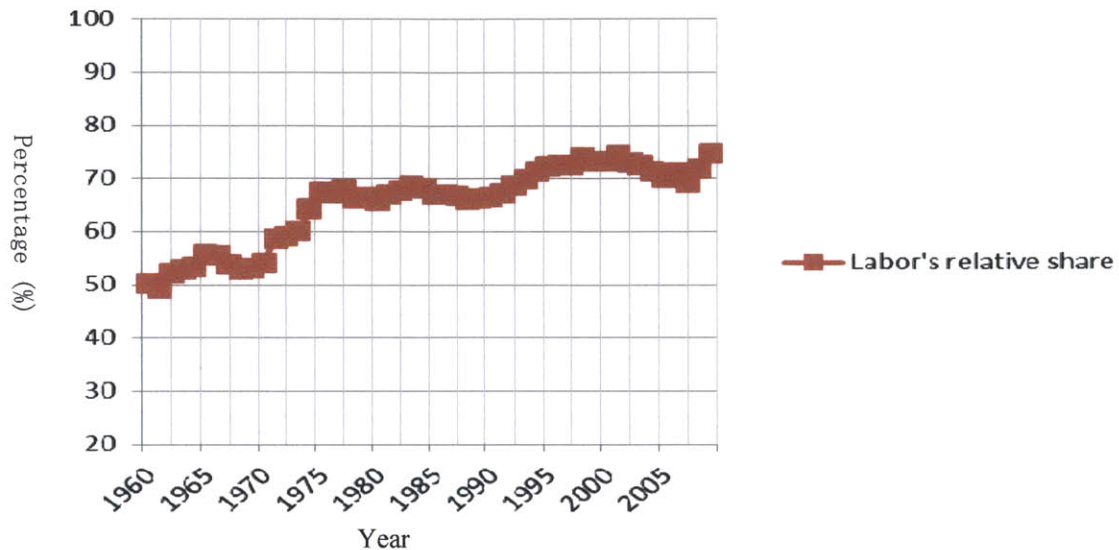


Fig. 5-1 Labor's relative share of costs in Japanese companies

Source: White paper on the labour economy (Minister of Health, Labour and Welfare), p.302

4. Changes in the Roles of HR Departments and Labor Unions

In theory, spinoffs increase the importance of HR departments and labor unions. But, as Jacoby (2005) states, central HR departments have become less powerful in Japanese firms because of spinoffs. The headquarters HR department transfers part of its authority to the HR department in each subsidiary. These HR departments manage employees in each subsidiary in different ways.

Labor unions face the same situation. The headquarters-level HR department and associated labor union need to find ways to coordinate across headquarters and the subsidiaries.

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