

# Personnel Management: Recruiting, Paying, Managing And Firing in Japan

By Thomas J. Nevins

## The lifetime employment myth

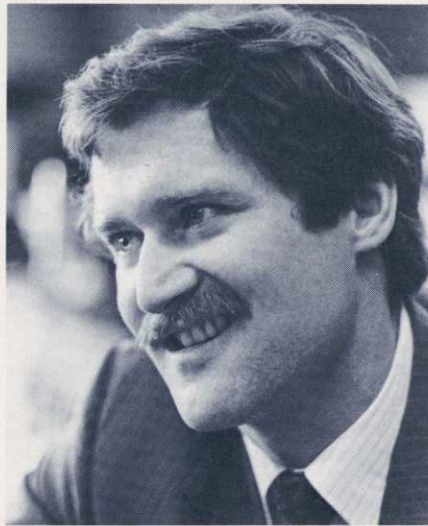
I could spend several hours talking about the differences between Japan and other countries in labor relations and personnel practices, but it may be instructive here simply to note some points which may highlight the differences.

People talk a lot about "lifetime employment." This is actually only experienced by about 20% of the workforce—those employed in large firms with over 1,000 employees. In smaller firms and industry at large there is considerable turnover, mid-career hiring, and the typical Western pattern of hiring a man to do a job. It is only in the largest firms where recruiting is almost exclusively restricted to the hiring of new school graduates all joining the firm together on April 1.

It is true that in the largest firms a man will rarely change jobs until age 45 to 55, when his firm may be interested in having him work in a subsidiary or other affiliate. This is the point where *kata-tataki*, or shoulder tapping, begins and when the company is not generally too concerned if anyone other than the very top high-performing senior managers leave.

It should be understood, however, that the hesitancy to leave one's firm is more a product of the closed labor market than evidence of blind loyalty to one's employer. In other words since there is little or no mid-career hiring in large firms, it is virtually impossible for an employee to get an equally good job in another large firm. And it is these large firms that pay not only higher cash wages but considerably better benefits and remuneration in terms of pension and life-long income.

Lifetime employment is not a complete myth. It does exist. The point is that it exists primarily in only the largest firms with over 1,000 employees. Yet older employees in firms of all sizes begin to get squeezed out depending upon ability after



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age 45 or 50. In fact in Japan it is "first-hired, first-fired"—employees with the most seniority are generally the first to go. The result is that unlike in the United States and European countries, there is virtually no unemployment among youth or up to employees in their 30s. Rather the highest unemployment rates are those for employees over 45, which is exactly the opposite in these other countries.

Yet despite the "lifetime employment" at Japan's largest companies, an open labor market characterizes small firms. Recruiting and career paths are less systematic and bureaucratized. We also see, in smaller firms, that the stereotyped enterprise union model breaks down and does not apply to the vast majority of Japanese employees. Union organization rates rapidly decrease as firm size decreases, and labor relations may not be nearly as smooth at a small firm which does have a union. Unlike the enterprise union model, in these small firms dues are sometimes paid directly to an upper-body industry or a trade union with direct affiliation to the upper-body organization, rather than the enterprise union.

## Wage negotiations

Also, no discussion of unions would be complete without some mention of the important role played by the *shunto* or spring wage offensive. There is nothing more responsible for controlling collective action and wage-push inflation and keeping industrial relations smooth with a predictable outcome and with low-to-moderate settlement figures generally benefiting management than this *shunto* factor. *Shunto* was started in 1955 with eight industrial upper-body unions getting together and coordinating their efforts. These unions were concerned not with a uniform wage demand but rather with the timing of negotiations and with carrying out a mutually helpful exchange of information and data. By 1960 about 4 million organized employees were involved. By 1970 this had increased to 8.5 million and today some 75% of organized labor formally take an active part in *shunto*. But the *shunto* settlements, generally made clear by the end of April and early May, influence settlements throughout industry and also among the non-union 70% of employees in the private sector.

Various surveys of *shunto* wage settlements are published in newspapers, and employees throughout Japan are content and satisfied as long as they get a settlement figure which comes close to the *shunto* figure. The *shunto* wage leaders on the union side, however, have traditionally been rather reasonable, moderate unions, including steel, automobile, ship building, and electric machinery workers affiliated with the IMF-JC. Especially since steel has been a recession industry in recent years and had a settlement just over 3% in 1983, the result has been that last year's *shunto* wage increase was only about 4.4%, with total overall annual wages increasing by only about 3.8%. Over the last five years in Japan annual income has only increased by an average of about 6.6%.



After some 25 years of the *shunto* experience, very few employees and unions think in terms of winning a high wage increase. This tends to limit serious collective bargaining and strike action at the vast majority of Japanese work sites, with almost no wage and benefit-related collective bargaining contracts exceeding one year. Settlements are really made through national consensus rather than through hard-nose collective bargaining, labor disputes and strike action.

For these reasons, in my opinion the existence of *shunto* has tended to weaken the Japanese trade union movement. In a very real sense *shunto* serves as an effective tool of national incomes policy. It seems ironic that the concept was originated by a union leader.

## Regular vs. contract workers

On the subject of unions, in a good, reasonable, and moderate enterprise union there is generally a union shop with all employees from elite college graduates down to blue-collar rank-and-file belonging to the same union until they reach *kanrishoku* or managerial status somewhere between ages 35 and 43. There will be some blue- and white-collar employees who will always be members of the union.

Note, however, that unlike in most other countries, blue-collar factory workers are almost always on monthly salaries rather than paid by the day or hour. One of the unique features of Japanese labor relations, however, is the important role

of the "temporary" employee on a contract, who may in fact be working shoulder to shoulder with "regular" employees for many years. At the time of employment, though, *shokutaku*, or temporary employees, were placed on contract and it is the presence of a term contract which distinguishes between those employees who have "lifetime" job security and those who do not. According to a 1978 study by Hitachi Sogo Keikaku Kenkyusho, as many as 18% of white-collar employees and 47% of blue-collar personnel were non-regular employees on contract in the late 1970s.

These contract employees are almost never members of the union and management and union practitioners from outside Japan often find it difficult to understand why there is no attempt on the part of the union members already in the firm to organize the temporary contract employees working at much lower wages. Apparently the regular union member employees in Japanese firms are aware that their privileged position is maintained through the presence of these contract employees, for in fact when the economy turns sour, it is the contract employees who are the first to be let go and they go without the payment of retirement benefits.

## Points to watch

There are any number of other points which those familiar with industrial relations in other countries will find interesting. For example, unlike in the United

States there is no exclusive bargaining agent under Japanese trade union law and in theory an employer must bargain in good faith with a trade union which could consist of even two employees. There is also no legal provision for a union-committed unfair labor practice. The Labor Relations Commission and judicial process do not strictly interpret maintenance of peace obligation language (during the term of the collective agreement) and so once labor relations break down, things can indeed get rather messy.

Since the overwhelming percentage of dues are paid to the enterprise union rather than an upper-body trade or industry-wide union, strike chests are limited and upper-body unions do not have rich strike funds to support a prolonged strike at a given company. The result is that there are rarely prolonged strikes where employees walk out. On the contrary, the strike is really a walk-in or a work-in in which it is legal and appropriate for employees to withhold a certain proportion of their working services and otherwise to harass and embarrass the employer within the employer's premises. Thus what would be considered sabotage by the laws of other nations is only considered, in Japan, to be legitimate collective action, since judges rule that if employees are allowed to withhold 100% of their work (in the "walk-out" context as we know it) certainly it is acceptable for them to withhold only a portion of their work.

Other differences peculiar to Japanese labor relations include an overall lack of union-imposed seniority and work rules. Thus workers' pay and security is irrelevant to job function. This makes for easy plant and job restructuring and allows Japanese industry to rapidly adapt to technological innovation or automation.

At least in large firms, since superiors are securely locked into their jobs by lifetime employment and promotional patterns which largely reflect seniority, bosses tend not to feel threatened by sharp subordinates and therefore do not hesitate to train and participate in their career development.

Probably due to lack of space and comparatively expensive real estate rents, as much as for any other reason, the compartmentalized office is rare in Japan with all employees, from rank-and-file level all the way up to members of the board of directors (who are usually internal directors rather than outside appointed direc-



Photo: Asahi Shimbun

Demonstrators demanding better labor conditions during the 1983 *Shunto*





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tors as in other countries) working together in an open office space environment. This probably has much to do with improving communications and eliminating the need for detailed job descriptions and written memos. Face-to-face verbal communication becomes much easier and cross-functional cooperation in any project more efficient and effective without the presence of walls and imposed barriers.

Many outside observers are surprised at how late the Japanese work or the great number of offices that remain lit with people bustling about until 8 or even 9 at night. Keep in mind, however, that unlike in most other countries, until a young elite college graduate manager reaches that *kanrishoku* level, he is paid overtime, and the household budget counts on an overtime check each month of some 10 to 15% even in the case of young managers who would normally be treated as exempt staff in other countries.

## Approaches to compensation

Given this background on labor relations in Japan, what are the ramifications for compensation within the foreign-capitalized firm? Many foreign-capitalized firms will come into Japan and begin their businesses with a compensation package structured similarly to the one at home. Here in Japan, however, rather than dividing annual income by 12, the practice is to divide by 17 or 18 allowing for the payment of five or six months of bonus. Obviously this is not bonus in the sense it is understood outside of Japan but is a deferred wage approach which also gives the employer some discretionary flexibility should business be unusually bad. Monthly compensation will also generally include housing, family, meal, and some job or work-related allowances.

All these allowances represent income which, like the bonus, is not considered to be pensionable. Since the Japanese pension is generally a lump-sum retirement

benefit representing one or more months' salary for each year of service in the firm, it is important to look at both the lump-sum retirement benefit payment coefficient scale as well as the structure of the compensation package. In other words, if a foreign firm adopts a liberal lump-sum scale with a high-quality benefit payout yet has a 100% weight of basic salary due to non-payment of bonus and allowances, that firm is obviously in trouble when it comes to its pension liability and its ability to maintain a healthy position in this market in view of high long-term fixed costs.

When it comes to the relationship between compensation structure and long-term costs, obviously it is essential to have a competitive but fair and reasonable weight of non-pensionable income in order to control pension liabilities. In assisting TMT clients, I have developed a gradually accelerating second-salary component of non-pensionable income which increases as salary increases. This is therefore one element of the compensation package which should vary between employees who have different rank and status in the organization.

Contrary to popular belief, there is ample room to pay by performance using a traditional Japanese compensation package. Most companies, for example, provide for a 40% range on the summer and winter bonus (the five or six months of bonus mentioned earlier). This would mean that in a firm paying six months' bonus on average, the worst performer would make only 4.8 months while the top man could make as much as 7.2 months. Furthermore, appraisal procedures and the Japanese salary table provide for acceleration in ranks and grades at varying speeds depending upon performance.

The fact is that the traditional salary table is not generally used in small Japanese firms (nor is it applicable to small foreign firms). Instead a foreign-capitalized firm in Japan would do well to look at a salary-table approach to compensation which allows the employer to flexibly pay by performance, yet with methods

and systems which the Japanese employees view as acceptable and legitimate.

Commissions paid to salespeople are another device whereby compensation can be performance-based. Although such commission sales are often limited to group incentives in the largest Japanese firms, a wide range of innovative approaches to commission sales exists in smaller firms in Japan. I know one company that will allow employees to take a choice of three progressively higher basic salaries or even to work with no basic salary and with the highest of four differing commission schedules. Surprisingly employees often opt for lower basic salaries and higher commission rates. My experience has shown me that although commissions may not be necessary to get employees hustling in the very largest firms where the closed labor market may impose loyalty and necessitates high performance, commissions seem to be a helpful tool to increase sales volume and ensure corporate success in Japan in the open labor market of foreign capitalized firms.

## Retirement benefits

Firms which are new to the Japanese market are usually well advised to structure their compensation so that they pay five or six months' bonus. Many may also want to introduce the concept of a non-pensionable second-salary component, or job/qualification allowance, which is rapidly gaining popularity in Japan in view of the rapid aging of the workforce and the realization on the part of even the strongest and largest firms that they will be plowed over in 15 or 20 years by their retirement benefit liability unless it is drastically cut back.

Rank is another important consideration in many foreign-capitalized firms' compensation structures. However, I firmly believe that with the exception of members of the board of directors, who are handled differently under the tax laws, all employees from top executives down to rank-and-file should basically be on the same compensation package. I once had a client firm which initially paid five or six months' bonus to its managers but then decided to pay them on an annual-income basis dividing by 12. This immediately lined the managers' pockets with far superior lump-sum retirement pension benefits and when the rank-and-file employees realized this, they organized a union.

Another reason for putting everyone on basically the same compensation schedule is that it buys credibility for managers who have to force through rationalizations. Benefit cuts are only going to be credible with rank-and-file employees (often union members) if the managers are equally affected by any adverse impact that may result from the adjustment.



## Disciplinary action

It is possible to get around lifetime employment, and more importantly to get employees performing better by eliciting desired behavior from them, if the company has strategically written rules of employment which provide detailed grounds for disciplinary measures and graduated mechanisms to take action against employees, including verbal and written warning, pay freeze, suspension of attendance, demotion, salary cut, nominated resignation, and, finally, disciplinary discharge. In evaluating whether or not the employer is entitled to take such action against an employee, a court of law will look to the actual language in the rules of employment. Thus a large part of our business is to get companies set up right or straightened out in this important area.

If "firing someone" indicates immediate discharge, we are talking about termination for just cause or disciplinary discharge in the Japanese context. This requires the prior approval of the Labor Standards Office and is not easy to get. Article 20 of the Labor Standards Law, however, provides for 30 days' notice or 30 days' pay even in cases where there is no just cause. Due to judicial precedents, the interpretation of liberal judges, and based on the legal theories they have developed, it is difficult to fire if the employee challenges and litigates. Poor performance can be thoroughly documented however, and with the proper personnel regulation language and consistent implementation in the company, employees will generally come to expect that it is legitimate and natural for the employer to take action against them when they are consistently below standard or when they have violated company rules.

Under these circumstances although the individual is in reality fired, he is generally allowed to resign. Many firms have been successful in getting employees to resign because they showed the employees that failure to resign would mean continued salary freezes, demotion, or significant pay cuts, which in turn would reduce the basic salary of pensionable income and significantly erode the lump-sum retirement benefit. Before that happens it is quite easy to get an employee to retire with the higher lump-sum retirement benefit figure.

Make no mistake about it. Firings, or forced resignations, are common and routine in many firms, especially in small Japanese firms where there is no expectation of lifetime employment and where everyone realizes that the company cannot afford to carry anyone who is not a satisfactory performer.

Designated discharge of certain employees is not impossible, and this avoids the problem that the best employees tend

to leave in a non-designated voluntary retirement program when a retirement premium is added to the normal involuntary retirement benefit scale in the rules of employment. Staff reduction exercises are legally made easier when they are accompanied by strategic corporate reorganizations or the spinning off and closing down of certain unprofitable divisions. This is especially true if you have a union and if these employees have already had experience with a staff reduction. Prior consultation is, of course, important, and an employer should also thoroughly analyze his workforce and determine a retirement benefit premium which will have the maximum appeal to the least desirable employee groups, encouraging them if at all possible to accept the benefit and retire. The idea is to try and reduce the maximum number of staff and cut down payroll costs as much as possible at the lowest extra retirement premium cost to the firm.

Staff reductions should always be a last resort however, and before carrying out a staff reduction I would encourage all companies to have their rules of employment, compensation, and benefits thoroughly reviewed. There is probably lots of room for rationalization and cost savings, and it becomes easier to force these changes through when management can argue that the adjustments are being made in good faith in lieu of a staff reduction and in order for management to be in a position to continue to guarantee job security.

## There are ways...

Whether there is a labor union or not it is important to move very carefully and strategically in the sensitive area of rationalizing or reducing benefits because of profit deterioration or as part of a merger. By assisting the client with data and briefs explaining the necessity for change and educating the Japanese employees as to local practice and why their benefits are high or out of line, etc., TMT has often been able to smoothly orchestrate these adjustments and to avoid litigation and claims of adverse impact. *Jizen kyogi*, or prior consultation, is the buzz word and above all else it is important to take enough time and have enough meetings.

When there is no trade union it still takes time but only the rules of employment (legally required when a firm is hiring more than 10 regular employees) need be changed and the employer is legally free to do this. Note, however, that the majority representative of the employees must place his comments, whether in favor or in opposition, on a signed statement of opinion, or *ikensho*, and the employer must submit this *ikensho* along with the rules of employment to the Labor Standards Office. Employee objections are merely sympathetically read,

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however. Management may go on and execute its plan.

Since the collective bargaining contract has legal precedence over the rules of employment, when there is a labor union it is necessary to deal with the union in a collective bargaining context about the desired changes or adjustments. After a couple of months of good-faith negotiation, however, the employer will be able to claim that an impasse has been reached and can then go about effecting and implementing the changes in terms of an adjustment in the rules of employment rather than the collective bargaining agreement.

Things may take a bit longer in a unionized setting but, nonetheless, if proper procedures are followed with a good educational campaign and full documentation, there is no reason why a company cannot trim off excess fat and get down to competitive fighting weight. This is especially true if corporate sales have been falling off, profits are shrinking, or it can be documented that the compensation structure or benefits are out of line with local practice, thus jeopardizing a responsible employer's ability to provide job security to his employees in the long term.

I discourage foreign companies from hastily funding their lump-sum retirement benefits before assuring themselves that they have personnel policies and benefits that they can live with and maintain in the future. I have found that there is a lot of leverage to cut and snip when a company can neutralize this adverse impact by arguing that for the first time the lump-sum will be funded and not just a benefit on paper. ●

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