

### **III. Salary Management**

#### **(JAPAN)**

## 1. Salary Determination Factors

- The main salary determination factors are seniority and the number of years the employee has been working at the company.

Many Japanese companies have systems in place for periodic salary increases. Base pay is increased periodically based on years of service and seniority. Also, in determining wages, increase in salary is linked to the promotion system, with job promotion resulting in seniority and included in periodic salary increases. (However, job promotion itself is not based entirely on the seniority system.) Salary increase based on seniority is general labor practices, and not a “system.” However, the idea of seniority is deeply embedded in the consciousness of workers in Japan.

Japanese companies rarely evaluate academic degrees such as doctorate. That is, while it cannot be said that there is no difference in salary between white-collar and blue-collar workers, or based on educational background, this difference is remarkably smaller than it is in other capitalist nations.

Generally, even if someone is an executive or occupies a position of upper management at a Japanese company, that person’s base pay is based on the same standard as the base salaries of the people who work under that person. Therefore, a distinguishing feature among Japanese companies is that the salary range of company executives is lower standard compared to that for companies in the US and Europe.

### **Basic Concept in Deterring Salaries**

#### **-Pay system Based on Seniority**

The distinguishing feature of the Japanese pay system is that many companies employ a “seniority-based system,” whereby salaries are increased in nearly direct proportion to age and the years of service. While in the strict sense salary increase is based on seniority, this is not to say that salaries are increased based on age and the years of service regardless of a person’s job and skills. But even if employees are of the same age and started working at the company at the same time, differences do occur between them if there have been differences in their promotion and job performance.

Generally, many companies adopt base pay based on age and job skill as follows

### **Age-based salary**

Under the premise that a person's job skill improves with age, a person's base pay increases by one (1) rank every working year within the company.

### **Skill-based salary**

Judging job proficiency level from the appraisal results, an employee receives rank points and increased salary based on promotion in skill rank or in accordance to proficiency level in this same rank.

### **[Points for consideration]**

Although the notion of skill-based salary is primarily different from that of seniority, since the tendency to evaluate potential skills, it also tends to apply to seniority factors.

### **[For reference]**

#### **<Starting Salary>**

The starting salary is the amount paid by a company to a new hired graduate.

#### **[Distinguishing features of starting salary]**

- The conditions of supply and demand on the job market have a direct influence on decisions regarding starting salary.
- There is not a big difference in starting salaries based on such factors as industry, scale of company, educational background or geographical area.

Companies decide starting salaries based on the balance of supply and demand on the job market and the standard salaries of employees are determined through negotiation, taking into consideration the standard pays to new graduates.

Since decisions regarding starting salary are influenced by the overall balance of supply and demand on the job market, which goes beyond the situation in some companies, as a general rule the starting salary for people hired at the same company has nothing to do with what university someone is graduated from, what department a person belonged to in the university, grades at the university, affiliations or job type. There are no big differences based on educational background and almost none among people of the same age based on the attended university or high school. For example, the average starting salary in all industries in fiscal 2000 (monthly salary) for male university graduates was 195,100 yen, while that figure was 154,000 yen for male high school graduates. The salary for male high school graduates in their fourth year working at the company would be very close to the starting salary for a male university graduate. (Ministry of Health, Labor and Welfare: Basic Statistical Survey on Salary Structure in Fiscal 2001)

### **-Wage Differentials**

The longer a person works at a company the greater wage differentials that follow his/her personnel appraisal will be. Considering the pay of company employees on an individual basis, while they receive the same amount for their starting salary, it increases throughout the years they work within the company, and the difference in the promotion level according to skill rank system is caused by their appraisal results, which are reflected in pay, so that the difference in their salaries grows.

The general tendency is for employees to continuously receive similar salary increases for the first several years of work. Then, when they have reached the age for rank promotion for their job skills, their skill rank is determined based on the appraisal by their immediate senior and the results of rank promotion examinations.

#### **[For reference]**

“Skill rank system” is a mechanism for the systematic classification of job achievement skills, the standardization of the grading of all employees together, and the comprehensive integrated organization of personnel throughout the company.

### **-Salary Increase**

Salary increases generally take place once a year, with employees receiving a raise in their base pay based on the system of salaries in each company. This is called “periodic salary increase.”

Increases in employee salaries normally consist of the portion of periodic salary increase with its rising salary table according to seniority and the portion of substantial pay increase (base up) for the actual standard of the pay table. The amounts of these pay increases are basically determined by some factors like performance at the company and the increase rate in consumer prices. For deciding the amounts there are the customs (spring pay offensive) assumed every spring by labor unions to set a standard of pay increase demand focusing on large enterprises. Since companies in the same industry or in the same type of business decide pay increase amounts around the same time through the spring pay offensive, while differences do occur between industries and business types, a “public market” has been formed in the same industry and the same type of business so that there are few occurrences of large differences in salary increase amounts.

### **-Minimum Wage**

Based on the Minimum Wage Act, the minimum wage is determined by municipalities and the employer is legally compelled to abide by that minimum wage. (In 2001 the weighted average for prefectures was 5,168 yen for daily wages, and 633 yen for hourly wages.)

Concretely, the regional minimum wage in prefectures is determined by the Minister of Health, Labor, and Welfare, the directors of the labor standards bureaus in prefectures, based on studies and deliberation by the Minimum Wage Council. (There are some employees to whom this does not apply.) An employment agreement which calls for a wage amount below the minimum line is invalid, and an employer who has concluded such agreement will ultimately be penalized.

### **[Trends during recent years]**

#### **<Wage System Based on Performance Achievement>**

In recent years there has been an increase in the number of Japanese companies that are considering the adoption of a “pay system based on performance achievement,” represented by the annual salary system. The main reason for this is, because of the raise in the percentage of the middle-aged and elderly brackets among the overall employee population at individual companies, the increase in the cost of wages has laid heavily upon corporate management in companies with pay systems that are deeply based on seniority.

Companies are mainly adopting the idea of “job-based salary,” focusing on people occupying managerial positions or higher, and there is an increasing number of companies which are putting a stop to their practice of periodic salary raises based on seniority, and introducing systems in which bonuses are influenced by the appraisal results. In this case, many companies have adopted or are considering the adoption of the management by objectives as well as an arrangement for feeding back the appraisal results to employees.

While there has been an increase in the number of companies that have begun to adopt a form of payment that puts less emphasis on seniority, others tend to be faced with problems such as the difficulty in fairly evaluating “results” and obtaining employee’s understanding. A major theme for the future will most likely be the extent to which companies will be adopting pay systems based on results at the exclusion of seniority, in addition to the measures to improve the short-term management by objectives for key positions.

## 2. Pay System

### Basic Pay System

- At Japanese companies, this system is generally made up of “base pay,” “allowance” which is influenced by personal factors, and “periodic bonuses.”

In addition to seniority-based wages, distinguishing pay features in Japan include periodic bonuses and allowances. Generally, employees receive their pay monthly; usually, bonuses are given during summer and winter.

Monthly salaries include pays within the prescribed sphere and pays outside the prescribed sphere. The former consists of base pay and allowances (family allowance, etc.), the latter is paid against work performed outside of the prescribed sphere (overtime work, work on days off, midnight work, etc.). Base pay, which is the core of this pay system, used to generally be age-based salary, increased in accordance to age and years of service. But, in order to raise the levels of functionality and desire to work among employees, there is the necessity from companies to reflect the difference in the skills and performance of employees in their pays, so that starting in the mid-1960s more and more companies have switched from age-based to job-based salary system. Job-based salary is a form of pay where the base pay is determined by skill rank, defined by the systematic classification and organization of job achievement skills in a company. Rank promotion means that an employee's rank raises according to the skill rank system. Since the standard for years of service within a company is determined based on appraisal by one's senior, even if employees have the same number of years of service, differences arise in base pay because of the different speed in which employees are promoted in rank. However, on the practical level this is often based on age.

### **-Bonuses**

A bonus is the surplus in profit paid to the employees based on business performance at the company. However, bonuses in Japanese companies have the nature of compensative salary paid in addition to one's monthly salary as “subsistence wage”. The amounts of these bonuses are normally determined through negotiation between labor and management. Bonuses are generally paid twice a year, in summer and winter, and it is possible to adopt the sliding scale of the amounts and conditions of these bonuses in connection with performance at the company. However, once an agreement regarding bonuses has been concluded between labor and management, the company must pay these bonuses even if it is in the red. The bonus amount is generally calculated by multiplying the calculated basic amount (base pay) by the coefficient determined by the situation at the company (e.g., this is often calculated as x number of months' worth of the calculated basic amount), and adding the rate of attendance at the company during the period to which the bonus is applied and the evaluation coefficient (based on the results of the personnel appraisal).

**[Points for consideration]**

A bonus is only paid to people who are in the registered roll the day the bonuses are paid and the day that the standard was determined (requirement to be in the registered roll at the day of payment). For example, the period in which the summer bonus is to be paid, between October of the previous year and March, even if an employee should retire after April 1, if it is before the day that the standard was determined, then that employee might not receive a summer bonus.

**[Trends during recent years]**

**<Wage System Linked to Job Performance>**

While there is hardly any difference in monthly salaries at Japanese companies, there is a big difference in bonuses based on the results of personnel appraisal.

Amidst the trend for “pays based on performance achievement” during recent years, a considerable portion is distinguished as performance salary mainly for people occupying positions of management and workers performing specialized jobs. More and more companies adopt a system for determining bonus amounts based on the evaluation of the degree by which objectives were achieved. This trend has been spreading also to overall pay, as represented by the “system of annual salary.”

### 3. Incentive System

#### Main Pecuniary Incentive Systems

- It is a custom at Japanese companies to periodically pay a uniform bonus to employees. This bonus has more to do with the livelihood of the employees than it does with incentive.

The main incentive system in Japanese companies is that by which a uniform bonus is generally paid to employees. Although the bonus amount is somewhat affected by such factors as the company's business performance, it is looked upon mostly as a subsistence pay for the employees. Also, there are some companies that have adopted systems of official commendation for individuals or organizations that have made a special contribution to the company.

#### **-Bonus System**

As previously mentioned, bonuses are incorporated into the basic pay system at most Japanese companies. That is to say, most Japanese companies pay bonuses equivalent to several months' salary twice a year, in summer and winter.

This bonus ratio is of a much higher standard than in other countries, and it is proportionate to around one half of an employee's annual income. Almost all Japanese companies pay bonuses, even if they are in the red. This is not because a bonus is linked to the business performance of the company, but because practices result from the deep-rooted concept that bonus is a deferred payment against wages, and the fact that it is an important factor in the livelihood of the employees. However, unlike monthly salaries, 10% to 20% of the bonus amount is assessed based on the employee's evaluation during the period in which it is applied, and even if employees receive the same wage, the amounts of their bonuses are generally different.

A company can be flexible about its payment of bonuses. During times of economic depression cutting bonuses can be an important means of avoiding employment adjustment.

#### **-System of Official Commendation**

There is a system by which companies officially commend and give pecuniary incentive to employees, evaluating the level of contribution by individuals or organizations that have contributed to the expansion of the company, with the commendation and pecuniary incentive being granted by the company president.

**[Trends during recent years]**

**<Introduction of Stock Options>**

During recent years the idea of distributing the achievements of the company among the employees has been spreading, mostly among venture businesses. Some companies have established incentive systems based on appraisal results and stock options.

**<Greater differentials in bonuses>**

Although bonuses formerly reflected appraisal results as a basic logic for calculating them, the differentials in bonuses received among employees of the same rank were very small, even when the employee had a high ratio of base pay (which was influenced by service years, including skill-based salary and age-based salary). During recent years there has been a trend for “bonus based on results” incorporated into the logic for calculating them, particularly regarding bonuses for people occupying management positions. So, the appraisal results and job performance of such people are greatly reflected in their bonuses, meaning that there are some companies that have curtailed the seniority factor. The aim is to guarantee employees a salary for their livelihood through their monthly pays, and to reward people who have achieved good results with a bonus.

## 4. Appraisal System

- Appraisal results are used to determine such matters as employee skill development, employee stationing and rank promotion.
- Appraisal is determined by judging overall “skills,” “enthusiasm” and “achievement,” and the appraisal results are used as data for the development and selection of human resources.

Through the appraisal system, companies can observe the everyday job performance of employees, and evaluate such aspects as job achievement, how well an employee demonstrates his/her skills, and job attitude.

Generally, Japanese companies use these appraisal results as data for developing skills among employees, including “human resources development,” organizing jobs, stationing, rotation, salary increases, rank promotion and “selection” for bonuses.

Each company determines of its own accord the standards and concrete procedures of its appraisal system. However, the following factors are the most common standards for appraisal: the higher a person’s position, more severe becomes the standards for evaluating that person’s performance, with a high standard being applied to the evaluation of the younger age bracket.

### [Important factors for appraisal]

<b>Skill evaluation:</b>	Knowledge and skills required for job performance, which are obtained through job experience and training
<b>Enthusiasm evaluation:</b>	Job posture and attitude
<b>Achievement evaluation:</b>	Degree of job achievement by which an employee has contributed to the company during a specified period

Appraisals are generally conducted periodically, with an annual skill evaluation being reflected in salary increases and rank promotion. Achievement evaluation and enthusiasm evaluation are reflected in the bonus decisions made twice a year (during summer and winter). The primary evaluator is generally the line manager (direct senior), who possesses the authority to appraise employees.

The consideration for appraisal consists of “absolute evaluation” and “relative evaluation”. The former is considered from the viewpoint of “development,” to determine the level of achievement against appraisal standards that have been set in advance. The latter is considered from the viewpoint of “selection”. The primary evaluator generally conducts an absolute evaluation, while the secondary evaluation is performed by the head of the division, generally from the point of view of relative evaluation based on logic in selection.

## **Main Appraisal Systems**

### **[Skill rank system]**

As a general rule, many large Japanese companies periodically hire new university graduates, and have a skill rank system in effect for evaluating the job achievement skills of employees, standards of certain job skills and ranking them according to job skill level. There are few evaluation factors limited to job contents, and the focus of the evaluation is placed on such factors as a wide range of experience, skills and knowledge, including potential skills as the requirements for skill evaluation.

### **-Rank Promotion and Title promotion**

A rise in rank is called “rank promotion.” A rise in position is called “title promotion.”

In actual practice, rank promotion at the upper levels is generally accompanied by title promotion to positions like chief clerk or section manager. There are cases in which one job rank is applied to one position, and there are cases in which multiple job ranks are applied to a certain managerial position.

For rank promotion candidates, in addition to appraisal results covering the past 1 to 3 years of that person’s job, rank promotion is also decided through interview. And depending on the situation, some companies conduct this appraisal through written examinations in the form of essays.

## ~~ Coffee Break~~

### Topic 5: Feedback of Appraisal Results

In the past, evaluators were reluctant to feedback appraisal (evaluation) results to people who had been appraised. In recent years, however, due to an increased awareness for fairness, clarity and understanding for appraisal, and for purposes of human resources development, more and more companies are feeding these results back to the people in question and holding interviews with them, in an effort to effectively apply the results to the improvement of employee's skills.

#### [Trends during recent years]

##### <Shortage of Management Positions>

When the skill rank system was first introduced in Japan, there were many companies that correlated ranks with management positions. However, with the deceleration of expansion and growth of companies that went through the oil crisis in the 1970s and the increase in the density of middle-aged and elderly brackets, companies have become unable to prepare a number of high-ranking people who could fill for management positions. In order to eliminate the shortage of posts, there are an extremely great number of companies that have instituted a "system of setting retirement age for management position" and a "system of professionals by course".

##### <Management By Objectives (MBO)>

There is an increased awareness for clarity and understanding of management by objectives. An increasing number of companies are introducing MBO so that seniors and subordinates can establish objectives and review achievements of objectives together based on appraisal. Particularly, through joint-use of MBO, companies that are reducing seniority factors and examining treatment "based on results" are introducing personnel systems and increasing understanding for evaluation.

##### <Versatile Evaluation/360-degree Evaluation>

There is an introduction of a versatile type of evaluation, the evaluation of colleagues and subordinates who regularly work with the person being appraised, in addition to appraisal by the person's senior. However, since it is difficult to evaluate people, many companies use evaluation by colleagues and subordinates who are not developed as evaluators as reference information for the primary appraiser, in order to apply this evaluation from the standpoint of human resources development.