
Introduction

Future of the Performance-based Pay System in Japan

Since the second half of the 1990s, Japanese companies have adopted and operated the “*Seikashugi* (performance-based pay system).” Changes from the Japanese traditional pay system based mainly on the service years and age to the performance-based pay system have resulted in various confusions among companies and employees in Japan. Two opposite opinions have been applied to the case that the performance-based pay system introduced does not work well in Japan in a sense that productivity does not improve or that many complaints arise from employees. One opinion is that the introduction of the performance-based pay system is essentially wrong because the system is not fitted at all to Japanese culture or Japanese company management. Another opinion is that the failures of the introduction in many Japanese companies are attributable to their inadequate operations of the introduced performance-based pay systems. Considering these two completely different opinions, we can say that the Japanese society has not yet finalized the evaluation of the performance-based pay system adopted by many companies in Japan.

What analysts have to do in this circumstance is, we think, to analyze the significance of introducing the performance-based pay system as objectively as possible. Based on such concept, the current issue collects five papers analyzing the performance-based pay system at this time that 10 years have passed since the introduction of the system. More specifically, this issue discusses the significance of the performance-based pay system introduced, what changes in economic environment existed behind the introduction of the system and how workers have understood and reacted to the system.

From the perspectives of the standard personnel economics, Masahiro Abe has taken up and analyzed the question of why Japanese companies have introduced performance-based treatment and reward systems. According to a theory on the optimum reward system available in the personnel economics, a work performance ability system is likely to create moral hazard problems. Abe also discusses issues in actual performance-based pay systems. Neither the

work performance ability system nor the actual performance-based pay system is a complete system in the sense that neither system is the first best reward system.

It has been often pointed that reduction in labor management costs is a main reason why Japanese companies have tackled the reform of personnel system and introduced performance-based pay systems since the 1990s. Abe, however, pays a close attention to technical innovation and corporate governance. According to his opinion, changes in corporate management environment caused by technical innovation and corporate governance changes, and the aging of employees, have increased the number of the companies that try to adopt the performance-based pay system. Whether the work performance grade or the role grade is applied, there are few companies which apply personnel assessment only by the objective performance index in the Japanese performance-based pay system. In relation to this, there is also the criticism that the performance-based pay system does not work well since the performance index are not sufficiently prepared. However, the subjective index are still effective. The fact that workers become aware of the performance-based pay system having been introduced have played a role of an incentive for such workers.

Kohei Daido has analyzed performance-based wage systems using contract theory. His thesis is characterized by the models that consider the effect of wages on working mentality from behavioral economics viewpoint. Firstly, he identifies how wage gaps are enlarged in the case that workers have social preferences dependent not only on the agent's own remuneration but also on the remuneration of others. Secondly, he introduces the economics model that analyzes the "crowding-out effects" of motivation that show how the incentives given to workers in order to enhance their motivation have resulted in lowering it to the contrary. Thirdly, considering the psychological effect resulting from the delegation of responsibilities, he introduces the recent paper that analyzes the effectiveness of the performance-based pay system. This is because the issue of delegation of responsibilities has been taken up as one of the requirements for the performance-based pay system to function. The introduction of workers' psychological traits in the contract theory has allowed

him to explain various issues related to performance-based wage systems.

Through case researches, Mitsuo Ishida has clarified how the wage reforms in Japan have changed since the 1980s. He summarizes the recent wage reforms as follows: (1) The wage system has been diversified; (2) The diversification is a result of the accelerated involvement of wage system management in the business model of individual companies; (3) In parallel to diversification, the core of the wage system has been substantially reformed from the system of the 1980s.

Regarding the diversification of the wage system, there are two very different examples, namely Company B, a distribution and retail company, which has adopted a performance-based system, and Company F, a steel maker, which has maintained the system emphasizing seniority-based treatment. The wage system reform has been initiated by management reform, followed by job management reform and then by personnel reform. In other words, the reform of business model has inevitably resulted in a change in wage system, meaning the diversification of business models has led to the diversification of wage systems. Concerning the core systems in the diversification of wage systems, Ishida thinks that with the concept of “role,” employee grade, base pay and personnel evaluation will be based mainly on the “role grade” system, “role pay” and “competence evaluation and performance evaluation,” respectively.

Shingo Tatsumichi and Motohiro Morishima have analyzed the actual status of introduced *Seikashugi* (performance-based pay system) from an employee perspective in terms of the following: (1) Worker’s perspective of *Seikashugi* itself; (2) The effect of the wage differential, created by *Seikashugi*, on working mentality, and (3) The effect of introduced *Seikashugi* on the commitment and satisfaction level of workers. Based on the analysis of workers’ perspectives of *Seikashugi*, they have clarified the following three points: (1) Many workers favor the concept of emphasizing business results, work experience and ability over using the seniority system as a wage distribution principle; (2) As for assessments of *Seikashugi* in one’s company, many workers praised it by saying, “This system elicits personal motivation,” or “This system facilitates fair treatment of personnel,” and “This system improves a company’s overall business performance.” Nevertheless, workers have doubts regarding the

general question, “Is the *Seikashugi* system in my company working successfully?” Finally, (3) Many workers believe there are problems with *Seikashugi* in terms of assessment methods and application, and as a result many workers become dissatisfied with the system in its early stages.

As a result of the analysis of wage differential, the following two points have been identified: (1) An increase in the wage differential leads to a decrease in the satisfaction regarding the assessment of wages and bonuses; (2) On the other hand, in companies with sufficient personnel measures for ensuring a satisfaction, an increase in the wage differential does not lead to a decrease in the satisfaction regarding the assessment of wages and bonuses. In short, in terms of the wage differential fairness, perceptions of employees in companies that seek to make them more receptive to the wage differential differs from those in companies that do not.

According to the results of their analysis, the introduction of performance-based pay system have had unprecedentedly substantial impact on workers, while workers’ lifestyles and mental status are becoming increasingly unstable. Considering these points, Tatsumichi and Morishima have concluded that further investigations are necessary regarding stable labor-management relationships and workers’ lifestyles believed to be maintained by traditional Japanese employment practices.

Have employees really and accurately understood the contents of the reformed wage system? Hisakazu Matsushige has tackled this question from statistical viewpoints, combining human resources data on employees from a specific company with the results of a questionnaire completed by the same employees. As a result, it has been verified that the knowledge of workers concerning the human resources policies and wage structures is not necessarily sufficient, and especially, that the overall image employees have of their salaries is substantially different from the reality. Furthermore, it has been verified that the competency of employees has a positive correlation with the accurate comprehension of human resources policies, though this competency does not necessarily share a strong correlation with their knowledge of wage structures.

According to Matsushige’s opinion, in situations where employee knowledge regarding human resources policies is insufficient and employee

awareness of their actual status is inaccurate, changes in these policies will not bring about the desired results. It can be argued that in order to change working mentality, it is necessary to upgrade the level of their knowledge regarding human resources policies.

We hope that you will read these five papers to deepen your understanding concerning the present status of and background behind the reform of wage systems in Japan and how workers understand and react to that reform.

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