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## GENERAL SURVEY

### Average New Business Start-up Creates 4.2 Jobs

A recently released survey found that new business start-ups create an average of 4.2 jobs. The survey also found that people who started new businesses were highly satisfied both in terms of the sense of fulfillment they found in the work and their sense of involvement, even if they worked longer hours for less pay.

The National Life Finance Corporation targeted companies that had been established within the year, including some which had not yet officially begun operations. The survey, conducted in August 2002, involved firms which had borrowed from the Corporation from April to September 2001. The results were released on January 9, with usable replies from 1,195 firms.

In terms of business type, 27.4 percent of the respondents were engaged in services to individual consumers, followed by retail businesses (18.6%), food and drinking establishments (15.4%), and business-to-business services (12.1%). Slightly less than one-fourth of the firms surveyed, 23.3 percent, hired between five and nine employees, followed by two (22.5%), one (only the owner, at 16.1%), and three employees (13.4%).

Of the business owners, males made up a dominant 86 percent with females accounting for the remaining 14

percent, though the proportion of the latter has been increasing by one percentage point annually over the past few years. No particular age group stood out: those in their 20s accounted for 13.4 percent, those in their 30s for 35.4 percent, those in their 40s for 28.3 percent, and those in their 50s for 19.1 percent. In terms of previous job, 93 percent of all male business owners were formally regular employees; females with the same background accounted for a mere 56.2 percent, whereas 16.9 percent of female entrepreneurs were part-time or *arubaito* (side job) workers, and 10 percent full-time housewives. On the other hand, 78 percent of those who were regular employees before opening up their own businesses worked in firms with less than 300 employees, and 45 percent were employed in firms with less than 20 employees. The vast majority originally worked for small or mid-sized companies, in particular the former.

The main reasons given for launching new business start-ups were that the preparations to do so were complete (14.9%), and because the person was not satisfied with the directions and contents of the work he/she was doing at the previous firm (14.4%). This was followed by concern about the future of the previous company (10.9%) and bankruptcy or labor cuts being carried out at the previous firm (9.2%). In short, concern about and dissatisfaction with the workplace, company policy on restructuring measures, and other negative factors served

directly to encourage business start-ups.

The average number of employees at these new firms was 4.2 workers when the business began, and 5.5 workers at the time of the survey; thus it increased, if only slightly, between the two periods. Even so, more than half, 50.7 percent, of the firms surveyed answered that their business operations had been in the red, and more than half of the new entrepreneurs who were regular employees reported that their income had fallen and that they worked longer hours than when they were employed as a regular employee. Thus, starting a new business did not necessarily improved the person's working conditions.

Despite the above, when asked to compare themselves with employed workers in the same age bracket, as many as 85.6 percent of the business owners believed they found more satisfaction in their work, and 80 percent answered that they thought their new lifestyles better suited them.

#### LABOR-MANAGEMENT RELATIONS

##### Revised Commercial Code Introduces U.S.-style Corporate Governance

In April, a revised Commercial Code came into effect, under which firms can now adopt American-style corporate governance by transferring power from auditing officers to directors from outside the companies. A majority of large firms are expected to maintain the current audit system, but Sony Corporation, Hitachi Ltd., Toshiba Corporation, Mitsubishi Electric Corporation, and other large electronic manufacturers — where the proportion of foreign shareholders is relatively high —

have decided to adopt the U.S. style of corporate management, shifting to the new structure after their plans are approved at general shareholder meetings in June.

The "Company with Committees" system (*Inkaitou Setchi Kaisha*)\*, modeled on corporate governance in the U.S., will explicitly separate management supervision and executive duties, which until now have been criticized as enjoying a cozy relationship. Directors will be in charge of the former, while corporate executive officers will be responsible for the latter. Three committees will be established within the Board of Directors: (1) a Nomination Committee responsible for appointing candidates for directors; (2) a Compensation Committee to determine compensation for corporate executive officers; and (3) a Auditing Committee responsible for auditing management. This will decentralize power in the corporation. At the same time, because more than half the board members in each committee are directors from outside the company, it is expected that business operations will become more transparent. In addition, the substantial transfer of power from the Board of Directors — which under the new system will concentrate on supervising management — will enable corporate executive officers to expedite decision-making and to carry out a wide range of operations. The post of auditing officer will be abolished under the new system.

Sony will adopt a unique system of corporate governance which not only observes the rules mentioned above, but also sets standards for separating the post of chairperson of the Board of Directors and CEO. (The revised Commercial Code in Japan and laws in the U.S. allow these posts to be combined.) On the other hand, Hitachi, together with 18 group and related companies listed on stock markets, will also establish a "Company

#### Statistical Aspect

##### Recent Labor Economy Indices

	February 2003	March 2003	Change from previous year (March)
Labor force	6,542 (10 thousand)	6,649 (10 thousand)	-27 (10 thousand)
Employed <sup>(1)</sup>	6,193	6,266	-31
Employees <sup>(1)</sup>	5,262	5,296	4
Unemployed <sup>(1)</sup>	349	384	5
Unemployment rate <sup>(1)</sup>	5.2%	5.4%	0.1
Active opening rate <sup>(1)</sup>	0.61	0.60	0.08
Total hours worked <sup>(2)</sup>	150.6 (hours)	150.6 (hours)*	0.1 (%)
Monthly cash earnings <sup>(2)</sup>	280.7 (¥ thousand)	298.7 (¥ thousand)*	-1.1 (%)

Notes: <sup>(1)</sup> Seasonally-adjusted figures.

<sup>(2)</sup> Figures refer to establishments employing five or more people.

\*Preliminary figures.

US\$1=¥118 (May 1, 2003)

Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Rodoryoku Chosa* (Labour Force Survey); Ministry of Health, Labour and Welfare, *Shokugyo Antei Gyomu Tokei* (Report on Employment Service), *Maitsuki Kinro Tokei* (Monthly Labour Survey).

with Committees” system in an attempt to strengthen its management by creating a closely united group and expand its supervisory function over individual group companies. In addition to these giant electronic manufacturers, Orix Corporation, a financial services company, also plans to adopt the new system of corporate governance.

While some large firms have decided or are planning to undertake such policies, many other firms appear to support the present corporate system. Nevertheless, some say that the new option may have a certain impact on traditional intra-corporate labor-management relations, which have been stabilized on the assumption that top executives are chosen from inside the company.

**Note:** \*The “Company with Committees” system (*Iinkaitou Setchi Kaisha*) is a new form of corporate governance — known as “U.S.-style” corporate governance — resulting from the revision of the Commercial Code in April 2003. Large firms capitalized at either ¥500 million or more, or ¥20 billion or more of total deficits are now permitted to adopt such a system. Currently, some 10,000 large firms are eligible.

### Rengo Moves toward Organizing Community Unions

Rengo (Japanese Trade Union Confederation) has finally begun the procedures to formally approve the admission of Zenkoku Community Union Association (Zenkoku Union) into its ranks at its Central Committee meeting scheduled for June 26. The issue had been pending for several months.

Community Unions are a new type of labor union open to part-time workers, dispatched workers, employees of small and mid-sized companies with no company unions, workers in managerial posts, foreign workers, and others who have not been eligible for membership in traditional company labor unions. An increasing number of such community unions have been emerging as the number of non-regular workers has increased in recent years.

Zenkoku Union, comprised of eight community unions with a total membership of 3,000, was set up by a nationwide network consisting of 66 community unions with a membership of some 15,000. The unions within Zenkoku Union favored joining Rengo, and applied for admission in November 2002. However, some unions affiliated with Rengo were opposed, and finding agreement has been difficult. The main objections were that (1) Zenkoku Union’s presence would conflict with Rengo-affiliated unions that are actively trying to organize part-time workers; (2) there are activists within Zenkoku Union who were critical of Rengo at the time it was formed in 1989; and that (3) workers who belong to an individual-based labor union have a tendency to withdraw once their problems have been solved.

Nevertheless, Rengo has set a target for the number of non-regular workers it will organize, and published

guidelines to this effect in February. These guidelines state that everyone will benefit from unionizing non-regular workers, on the grounds that it protects the rights of the workers in question, that it strengthens the negotiating power of labor unions, that it makes it easier for management to familiarize employees with company policies, which in turn leads to increased productivity and stability of corporate management and, accordingly, that it is beneficial to workers belonging to the existing company unions.

Rengo conducted a number of meetings with Zenkoku Union to affirm that (1) it will comply with Rengo’s bylaws and platforms, and participate in Rengo activities; that (2) it will call for community unions newly affiliated with Zenkoku Union to henceforth comply with Rengo’s rules; and that (3) it will adjust claims in advance when Zenkoku Union and Rengo affiliates may compete against each other when unionizing particular workers. Agreement on these three points provided Rengo with the go-ahead to accept Zenkoku Union into their ranks.

Part-time workers currently number some 10 million, about one-fifth of all employees. However, the number of part-time workers who are unionized is a mere 293,000, or less than three percent, according to Ministry of Health, Labour and Welfare surveys. It will be interesting to see how the labor unions handle the unionization of such workers in the future.

**Note:** \*Rengo-affiliated unions are typically classified into industry unions and regional branch unions. Individual company unions can belong to Rengo via one of these intermediate unions, and individual workers can join Rengo through an affiliated regional union. Thus, this was the first time for labor unions consisting of individual workers (in particular, non-regular workers) to directly affiliate with Rengo.

In general there are three ways that part-time and other non-regular workers can join a labor union: (1) join a community union (although Zenkoku Union is to be an affiliate of Rengo, other community unions remain independent); (2) join a regional branch labor union affiliated with a national center; and (3) join the existing union of the company where the worker works. The latter is rather exceptional in that, apart from some companies with a large number of part-time workers, many company unions are not open to, or are negative about, accepting such workers. Under these circumstances, Rengo has clearly laid down policies for company unions to follow, within its guidelines, concerning unionizing part-time and other non-regular workers. Company unions should take the initiative in unionizing part-time workers; company unions should attempt to unionize part-time workers whose employment patterns are close to those of regular employees; and company union executive boards should enter into dialogue with part-time and other non-regular workers so as to understand their needs, and attitudes towards union activities. At the same time, Rengo is seeking to establish an effective and comprehensive system defin-

ing the roles of industry unions and regional unions. Thus, industry unions should provide indirect support for company unions via, for example, dispatching organizers to company unions, and regional unions should attempt to unionize workers at small businesses in local industries which are difficult to cover, and to encourage individual workers to join labor unions.

### Spring Labor-Management Wage Talks Reach a Turning Point

With the economy stuck in the midst of a protracted slump and deflation, the spring wage negotiations (*shunto*) have been difficult ordeals for labor unions for the past several years as they have been forced to choose between maintenance of employment levels and pay hikes. Since 1999 in particular, employers had been conscious of the application of the new International Accounting Standards adopted in 2001, and have linked everything to the idea of “total labor costs,” including corporate pensions, retirement benefit funds, and other costs involved in the welfare of employees.

At the same time, employers have tried to avoid treating labor costs as something fixed, emphasizing their view that achievements should not be reflected in basic wage nor pay increases, but in lump-sum allowances. Many labor unions have given up their demand for basic pay hikes due to the deflationary state of the economy. Unions also seem to be trying to depart from their traditional strategy of concentrating on wage increases in the spring wage offensive; some industry unions have switched their negotiation methods from an emphasis on a biannual, rather than an annual basis.

With the majority of company unions obliged to defer their demands for basic pay hikes, the primary focus of this year’s wage talks was the continuation of regular pay hikes and an increase in the amount of lump-sum bonus payments. In mid-March, only the union at Nissan Motor Co. out of all the major automotive unions demanded an average basic monthly wage hike of ¥1,000. They received a satisfactory answer: the full amount plus a bonus equal to 5.8 times the monthly basic wage. The union at Toyota Motor Co. — whose profits the previous fiscal year are estimated to have hit a record high — refrained from calling for a basic wage increase, but received a favorable answer from the company: a pay raise and bonus (five times the monthly basic wage), together with an extra lump-sum payment of ¥550,000. In the electronic industry, on the other hand, the wage negotiation situation was somewhat different. Last year, immediately after the spring wage talks were concluded, management at major electronic companies proposed postponing for six to 12 months the agreed-upon regular pay raises, together with a cut in the overtime premium rate. They claimed the proposals were emergency steps due to the deterioration of business performance, and the unions gave in to these proposals.

(See the June 2002 issue of the *Japan Labor Bulletin*.) In the same fashion, management at this year’s negotiation table took the initiative by proposing a reconsideration of regular pay raises. The negotiations concluded with the employers saving the face of Denki Rengo (Japanese Electrical Electronic and Information Union), as far as the *shunto* wage talks were concerned. Management offered more than the bottom line the unions had set — maintenance of an automatic pay raise and lump-sum bonuses equal to four times or more the basic monthly wage. On the other hand, Toshiba Corp. had launched a new wage determination system in April, whereby only employees younger than 35 were eligible for regular pay hikes, while some electric power companies and their unions had been discussing a reconsideration of regular pay hikes before the *shunto* began. Thus, the general trend is for labor and management to go outside the bounds set by the *shunto* to settle issues such as revision of seniority wage systems, reducing the *shunto* to little more than a façade.

Following the agreements reached between labor and management at large firms, small and medium-sized firms started their wage talks in mid-April. It appears that the pace as a whole was slower than in usual years due to the difficult economic environment, and that the diversification of business performances among firms was reflected in the size of bonus payments.

Last year Rengo (Japanese Trade Union Confederation) jettisoned its policy of establishing uniform criteria for demanding basic pay hikes, which its affiliated unions used as guidelines. Its new emphasis henceforth has been on systems and policies involving reduction in working hours and work-sharing, extending the mandatory retirement age, measures regarding re-employment for workers who leave companies due to mandatory retirement, and other matters affecting workers as a whole. During last year’s *shunto*, Rengo tackled the issue of improving labor conditions for part-time workers. This year, Rengo considered this question to be a top priority, along with, for the sake of workers in its affiliated unions, the maintenance of regular pay hikes and the elimination of non-payment for overtime. In their negotiations this year, unions representing workers in the distribution and retail sectors which employs many part-time union members called for improving working conditions. Some unions have already succeeded in obtaining pay hikes for part-time workers.

With the number of non-regular workers increasing, and “total labor cost” management becoming widely accepted by enterprises, it appears that labor and management at many firms will start discussing revision of wage setting systems for regular employees. In line with this, the spring wage offensive, which has hitherto placed top priority on the maintenance and improvement of labor conditions for regular employees, is becoming simply negotiations, held in spring, focusing on equal treatment for part-time and other non-regular workers.

## PUBLIC POLICY

### Number of Labor-related Lawsuits Hits Record High 2,321

The number of labor-related civil suits brought before district courts nationwide in 2002 reached a record high, according to Supreme Court statistics.

The annual number of new labor lawsuits filed with district courts was around 1,500 in the mid-1990s, but began to increase in 1996, and in recent years has exceeded 2,000. Recently published preliminary figures for 2002 show an increase of 202 compared to the previous year, reaching a record high 2,321.

Cases demanding payment of wages and other allowances totalled 995, accounting for 42.9 percent, followed by 445 cases concerning payment of retirement allowances (19.2%), 361 cases concerning dismissals other than punitive dismissals (15.6%), 109 cases concerning punitive dismissals (4.7%), and 411 cases (17.7%) concerning other issues (see Table 1). This indicates that cases concerning wages, retirement allowances and other money-involved issues accounted for more than 60 percent of all the lawsuits.

Compared to the pattern 10 years earlier, the number of lawsuits concerning wages and allowances increased by 75.2 percent from 568 cases marked in 1993, thus

constituting a large part (77.6%) of the increase in the number of labor-related lawsuits as a whole. The Supreme Court commented that the number of lawsuits involving unpaid overtime has increased in recent years. (Regarding unpaid overtime, see the February and April 2003 issues of the *Japan Labor Bulletin*.)

At the same time, in tandem with the growing number of companies — particularly large ones — that are shedding their workforce via restructuring measures, the number of lawsuits concerning dismissals has risen. Such lawsuits, in fact, have exceeded 300 since 2000. Other cases involve deteriorating working conditions. In 1999 and 2000, there were no suits involving changes in work rules or collective agreements, but there were four such cases in 2001, and 12 in 2002.

On average, it took 12 months for cases to be settled — either through court ruling or out-of-court settlement — in 2002, the shortest amount of time since the data was first collected in 1983. While many cases concerning wages, retirement allowances and dismissals came to an end within one year, proceedings on suits concerning discrimination in the workplaces tended to be prolonged (see Table 2).

The number of disputes relating to labor shedding is increasing, while the number of suits protesting failure to pay overtime and changes to working conditions brought by workers still employed is also on the rise. All this is a stern reflection of the protracted sluggishness of

## Statistical Aspect

**Table 1. Number of New Labor-related Lawsuits by Nature of Case (District Courts)**

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Number of new lawsuits	1,307	1,507	1,552	1,525	1,656	1,793	1,802	2,063	2,119	2,321
Wages and allowances	568	665	655	695	711	716	763	826	859	995
Retirement allowances	251	325	379	333	402	474	412	484	454	445
Dismissals	210	256	237	230	227	274	269	323	346	361
Punitive dismissals	84	73	61	88	89	81	106	112	117	109
Others	194	188	220	179	227	248	252	318	343	411

**Note:** Figures for 2002 are estimates.

**Source:** Administrative Affairs Bureau, Supreme Court.

**Table 2. Average Duration of Labor-related Civil Cases That Have Been Settled (District Courts)**

(months)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Average duration of settled labor-related civil cases	14.9	15.0	14.0	15.6	15.4	13.0	14.5	13.6	13.5	12.0

**Note:** Same as in Table 1.

**Source:** Same as in Table 1.

# Changes in the Spring Wage Offensive and the Future of the Wage Determination System in Japanese Firms

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## 1. Significance of the 2003 *Shunto* Wage Negotiations

The 2003 spring wage offensive (*shunto*) was said to represent a significant turning point as, for the first time, labor unions did not demand basic pay increases. The traditional *shunto* negotiations, which started in 1955, begin with requests by labor unions for a basic pay raise aimed at maintaining and improving the living conditions of their members, and for regular pay hikes reflecting the increased level of skill gained by the workers themselves. Based on these requests, management and labor negotiate over working conditions. “Xx percent increase in wages including a regular pay raise” has been the standard expression used by labor unions when demanding pay increases during the *shunto* wage talks.

The amount of the basic pay raise has normally paralleled the increase in consumer prices. During periods of inflation it was reasonable for labor unions to bargain for increases in wages — basic pay hikes — to maintain and improve living conditions.

Since 1999, however, the Japanese economy has been afflicted by seriously persisting deflation. Year-on-year changes in the consumer price index have been in negative territory for the past four years: -0.3 percent in 1999, -0.7 percent in 2000, -0.7 percent in 2001, and -0.9 percent in 2002, and the trend is expected to continue this year. Despite this persistent fall in consumer prices over the years, labor unions have continued to call for “basic pay raises to improve the living conditions” of their members. However, management’s position — that it may be appropriate to lower basic pay, i.e. decrease wage levels, since consumer prices have fallen — has been stronger, and the result has been no basic pay hikes, in practice. Despite this, Rengo (Japanese Trade Union Confederation) continued to call for basic pay raises through the 2002 negotiations. This year, however, the confederation dropped the demand for a uniform basic pay raise. In this sense the spring wage negotiations reached a “significant turning point.”

The 2003 spring wage negotiations began at the large firms in early February and most agreements were reached on March 12, the date that company unions affiliated with the IMF-JC (International Metalworkers’ Federation – Japan Council, Kinzoku-Rokyo) had demanded answers from management. According to results collected by Rengo as of April 4, 404 company

unions adopting the “average wage increase method” (whereby unions demand an increase in the average wage per union member) received answers from management that the average monthly wage increase would be ¥5,204. This amount is the sum of the basic and regular annual pay hikes, so that an accurate breakdown of the two components is not possible.



Wage negotiations between labor and management have been complicated in recent years, and Rengo therefore published the results of the negotiations, not just according to the average wage increase method, but also the individual wage increase methods “A” and “B.” Under method “A,” labor and management bargain over the amount of a basic pay raise for a specific type of worker (for example, a 35-year-old blue-collar worker with 17 years of service). Twenty-one unions (with a combined membership of approximately 137,000) received answers from management, offering a monthly increase of ¥357. On the other hand, method “B” focuses on how much wages should be increased this fiscal year compared to the previous fiscal year for, again, certain types of workers (e.g., a 35-year-old blue collar worker with 17 years of service, or a 30-year-old white collar worker with 12 years of service). Twenty-nine unions (with a combined membership of approximately 77,000) using this method for a standard 35-year-old worker received replies from management, as did 19 unions (with a combined membership of approximately 51,000) adopting the same method for a standard 30-year-old worker. These negotiations saw agreements with monthly increases of ¥4,598 and ¥6,933, respectively. Rengo’s compilation also includes the negotiation results of 199 unions (with a combined membership of approximately 702,000) which agreed on regular monthly pay raises of ¥5,798 on average, an increase of 1.81 percent over the previous fiscal year.

The diversification of wage negotiation methods described above is attributed to recent revisions in wage systems. Since the mid-1990s, quite a few Japanese

firms have adopted a new wage system which emphasizes the performance of individual employees. This pay system is generally called a performance-based wage system, though the systems actually adopted vary slightly among individual firms. The following section will discuss the changes in wage systems in Japanese firms.

## 2. Changes in Wage Systems: Four Periods

### 2.1 Wage System Based on Securing a Livelihood (1945 to early '50s)

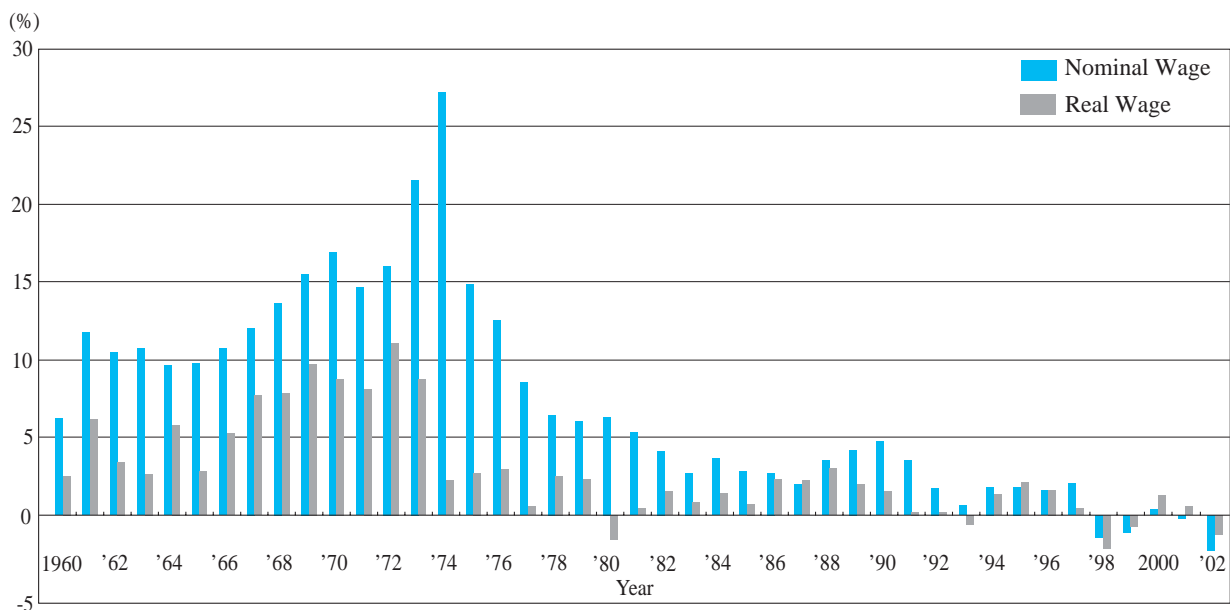
The wage system in Japanese firms has undergone four major periods since the end of World War II. The first period falls between 1945, the year of defeat, to the early 1950s. While the country was putting itself on its feet amidst the confusion of the postwar period, a wage system was created for the purpose of securing a livelihood for the people. Under this so-called “electrical industry style” wage system, evolved by industry unions in the electrical sector and adopted with the agreement of employers, the basic wage consisted of three components: payments for security of livelihood, years of service and ability. Of these, the payments for livelihood security accounted for the largest proportion, 67 percent, whereas those linked to ability and jobs accounted for a mere 20 percent combined. The system was applied to all employees regardless of whether they were blue-collar or white-collar, which meant that a kind of evaluation of blue-collar workers was also conducted, and their wage levels changed accordingly.

### 2.2 Wage Systems Differentiating Workers by Educational Level and Seniority (early 1950s to late '60s)

Once the chaotic postwar conditions came to an end and the Japanese economy was set on the path of steady recovery, people began to look for a wage system which placed priority on the nature of the job and ability of the employee rather than on security of livelihood. This was the beginning of the second period. In the early 1950s, a progressively larger number of firms began to adopt a wage scheme whereby beginning salaries were determined in accordance with the educational level of the individual worker, and regular pay raises were added on an annual basis. Regular wage increases were not uniform among all workers, and there were differences among both white-collar and blue-collar workers depending on their work evaluation. However, differences based on yearly evaluation were not so great. In the late-1950s, there was a movement among some large firms to introduce the wage determination system, linked to the type of job, adopted by U.S. companies. However, this system did not become common since it did not agree with the general view of the labor situation in Japanese firms, which placed priority on a close rapport among workers.

It was in the early 1970s that the second period came to an end. By the latter half of the 1960s, certain serious problems had arisen in a wage system in which regular pay increments had been added every year to beginning salaries. One major problem was the increase in the

Figure 1. Year-on-Year Changes in Nominal and Real Wages



Source: Counselor's Office of Industrial Relations, Director-General for Policy Planning and Evaluation, Ministry of Health, Labour and Welfare.

number of workers with higher education. In 1970, the proportion of males who went on to university reached nearly 30 percent of all males in that age group; thus in order to line up better workers, companies were obliged to seek university graduates as their new employees. And employers were beginning to feel that it was not sufficient to handle employees simply in accordance with their educational levels. Another serious problem was the intensifying contradiction that senior workers with longer tenure were paid more than young, but able, workers. Wages are not simply a reward for labor, but should also incorporate expectations of individual employees. As shown in Figure 1, because nominal wages had increased by nearly 20 percent every year in the 1960s, employees shifted their interest from regular pay raises, the amount of which varied according to job performance (an increase of 2% or so on average), to the amount of basic pay increases, which were determined simply by the effort and performance of the unions during the spring wage negotiations. For wages to serve as an incentive for higher achievement in the workplace, it was necessary to implement a new wage system.

### **2.3 Wages Linked to Ability and Qualifications (early 1970s to mid-'90s)**

In line with this, a new wage system which evaluated workers based on their ability and qualifications was widely adopted. Employees were divided into several ranks according to how well they executed their duties, and wages were handled in accordance with those ranks, which contained a range of wage rates. Starting ranks, applied to new employees, were predetermined according to educational level, but priority was placed on years of experience, rather than educational level, when it came to promotions. Thus the wage setting system during this period was less influenced by educational level than in the previous period. In many cases, the basic wage consisted of three components related to age, length of service and vocational ability; the wage linked to age and length of service was automatically increased annually, whereas the part linked to a worker's ability varied depending on the evaluation he/she received. This system still retained the nature of a seniority wage system, but substantially reflected the desire of management to turn wages into an incentive. Hence, many Japanese firms adopted the wage system linked to a worker's ability and qualifications. At one time, more than 90 percent of large firms with 5,000 or more employees did so, and the trend continued until the mid-1990s.

### **2.4 Wages with Stronger Emphasis on Performance (mid-1990s to present)**

The Japanese economy plunged into a serious recession in 1992 after having enjoyed a "bubble boom" around 1990. Between 1992 and 2002, the GDP slipped

into negative figures (in 1998 and 2001), and the unemployment rate soared substantially from 2.2 percent in 1992 to 5.4 percent in 2002. With sales lagging, many Japanese firms have made efforts to survive by cutting labor costs and undertaking other cost reduction measures.

The wage system based on an employee's ability and qualifications was not, from the start, designed to allow adjusting wage levels downwards, on the theory that once an employee acquired ability, he/she would not lose it. In the intervening years, the majority of Japanese firms had taken measures to maintain the jobs of as many of their regular employees as possible, but they were beginning to realize that it would be impossible to maintain both wage levels and employment while business was in such a slump. In line with this, these firms started to revise their wage setting system to make it possible to lower wage levels. Their aim was to make total labor costs more flexible by introducing a wage mechanism which enabled flexible adjustment of wage levels both upwards and downwards depending on the ability and performance of the individual employee, and also on the business performance of the firm.

Labor unions have shown understanding of the flexible wage system, and an increasing number of firms are adopting such systems whereby wage levels are closely bound to performance. Even so, some firms have not completely abolished the system linked to an employee's ability and qualification, but reserve the basic idea of linking ability evaluations and wage levels in a new system. In this sense, the fourth period can be described more accurately as a revision of the system used during the third period.

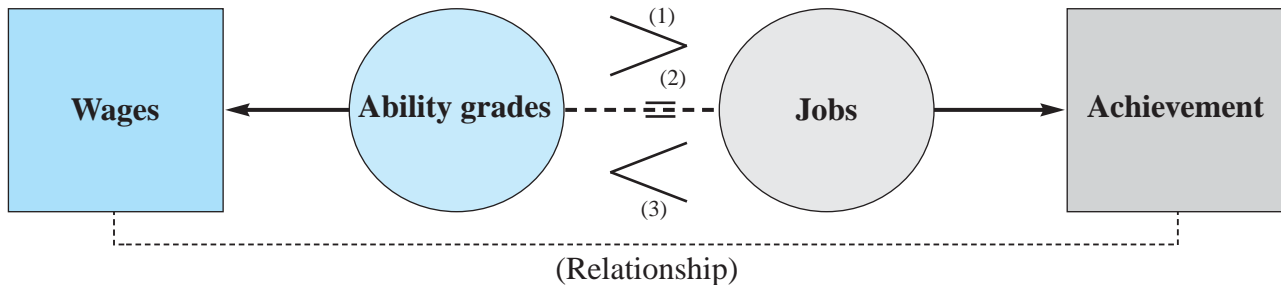
## **3. Problems with Relying on an Employee's Ability and Qualifications**

To understand the new wage system adopted since the mid-1990s it is necessary to be aware of the problems inherent in the previous system based on ability and qualification. Many problems arose because the linkage between wage levels and actual job performance was somewhat loose in that system. Between the 1970s and early 1990s, that loose linkage actually served as an advantage in promoting better functioning of the wage determination system, as will be clear from looking at Figure 2.

The wage system based on an employee's ability and qualifications functioned well in that wages and achievement were closely linked between a worker's ability, in the abstract, and that worker's actual jobs. In these cases, wage levels are determined according to the rank one receives for ability, while achievement is the result of the tasks performed. The problem here, though, is the relationship between an ability ranking and the actual job. When a particular job is assigned to a particular employee at an appropriate ability ranking [case (2)



**Figure 2. Relationship between Wages, Jobs and Achievement under the Ability- and Qualification-Based Wage System**



- (1) Situation in which an employee is overpaid because he/she is assigned jobs that require an ability ranking lower than theirs  
 (2) Situation in which an employee is appropriately paid because he/she engages in jobs agreeing with his/her ability ranking  
 (3) Situation in which an employee is underpaid because he/she engages in jobs demanding an ability ranking higher than theirs

in Figure 2], the wages paid to the employee and his/her business performance are securely related. However, if the relationship between a job and ability ranking becomes distorted, there is an immediate impact on the relationship between wages and achievements.

If a worker with a low ability ranking is assigned a job that falls above his/her rank [case (3) in Figure 2], he/she will be paid wages less than the value of the job. It stands to reason that such a situation is more than acceptable to management. At the same time, this situation is beneficial to the employee if his/her contract is long term and the firm is expected to continue growing. Carrying out an assignment that is above one's ability provides the employee with a good opportunity to develop his/her abilities, which in turn increases his/her promotion prospects. In fact, for about 20 years, beginning in the early 1970s, this mechanism did function well in many Japanese firms.

What, then, happens if the value of a duty is lower than the ability ranking of the worker assigned to it [case (1) in Figure 2]? Employers will find this situation unacceptable because they will be paying high wages for low results. On the other hand, the employee benefits by being given a low ranking assignment while receiving high wages, but misses an opportunity to engage in a job of higher value, which in turn is an impediment to developing his/her abilities. Since the bursting of the bubble economy, Japanese firms have, one might say, been trapped in this state of imbalance between wages and performance. While an increasing number of employees are now highly qualified, their employers are, due to the decline in demand, unable to offer enough tasks requiring such high qualifications. Consequently, firms maintain an increasing number of employees who are paid more than their achievement justifies. It is often said that certain factors which at one time brought success may be the source of failure if the circumstances change — and the wage system based on

the ability and qualifications of individual workers is a very good example.

#### 4. Wage Systems Recently Adopted

##### 4.1 Purpose of Revising the Wage System

A special feature of a new wage system which appeared in the mid-1990s is a closer relationship between an employee's achievement and his/her wage level. The purpose is (1) to enhance the motivation of able employees by effecting wage differences among employees more quickly and on a larger scale than before; and (2) to curb total labor costs by incorporating a wage setting mechanism which allows wage levels to drop. Under the previous wage system which, as under the new system, was linked to the abilities and qualifications of employees, the speed of promotion to higher ranks varied among employees as their tenure lengthened to, say, 10 to 15 years, and the wage differences gradually widened. The introduction of the new wage system allows employers to distinguish among employees by permitting earlier promotions, and better pay to higher quality workers.

There are two theories behind changing the personnel management system to focus on treating employees with different abilities differently. First, differentiating between employees early on would provide better workers with more incentive, resulting in a strengthening of the company's business competitiveness. Even among employees, some seem to favor such distinctions in promotion.

In February and March 1998, Rengo-RIALS (the Research Institute for Advancement of Living Standards) conducted a survey<sup>(1)</sup> that targeted white-collar union members. The results indicate that the most popular reasons for desiring a revision to the human resource management system was, "Now that the negative aspects of the seniority wage system have become so evident, I would like the wage system to be thorough-

ly ability- or achievement-centered” (35.8%), and “Since individual employees have such different abilities, I would like the personnel management system to reflect this difference” (33%). Since the survey allowed multiple answers, it is likely that many respondents chose both these two responses. Even so, at least one-third of the employees surveyed wanted a wage system which treated employees with different abilities differently.

Another theory behind the reform of the wage system is associated with reducing total labor costs. With business performance mired at low levels, companies are slashing personnel overhead costs as a powerful way to reduce overall costs. Companies are also trying to curb expenses spent on existing employees as a whole by cutting the overall number of employees by reducing the number of new people hired and by not replacing retiring employees, and also by encouraging early retirement with favorable allowances. A review of the wage determination system is imperative to single out better quality employees for better treatment and at the same time to check the increase in total labor costs. More specifically, their strategy seems to provide able workers with additional payments at the expense of cutting the wages of those who demonstrate poor “performance.”

#### 4.2 Problems with the Evaluation System

A personnel management system which allows different treatment for employees with different abilities seems to be favored not only by companies but also by the employees themselves. Nevertheless, one should bear in mind that this assumes that the reason for different treatment must be transparent before employees will accept the new system. Offering different wages without explicit reason may encourage some employees, but at the same time will demoralize others, a state of affairs that may in the end undermine the business competence of the company. Justification for the differentiation is provided by personnel evaluations which are normally carried out more than once at each workplace. The method of differentiation — wages and bonus payments, or promotion to a higher position and raise in job ranking — is based on the results of personnel evaluations made by managers on the front line.

In recent years, various new evaluation methods have been adopted, and companies have attempted to maintain objectivity. Concerning personnel evaluation sheets, for example, evaluation items are listed in careful detail, and the final evaluations take into consideration multiple factors. The basic policy is to accumulate points rather than reduce them, which means that the system positively assesses the attitudes of workers who try to undertake something new. An MBO (management by objectives) system is adopted that allows an employee’s achievements to be evaluated by comparing plans made at the beginning of each fiscal term with the results actually

gained by the end of that term<sup>(2)</sup>. However, the system will not work as well as expected if managers are incapable of applying the system appropriately and making correct assessments. In this sense, developing the evaluation skills of managers is another big task.

Umezaki, Nakajima and Matsushige monitored the scale of changes in wage levels before and after adoption of wage setting systems at firms which had linked wages to business performances<sup>(3)</sup>. Their results showed that wage differentials narrowed after adoption of the new system, meaning the revision had the exact opposite outcome than expected.

Matsushige, et al. argued that this contradictory result was possibly due to the reluctance of managers to make substantial differentiations among their subordinates. Since the new system creates a strong link between wage levels and business achievement, managers can easily learn, when assessing an employee’s performance, approximately how much he/she will be paid. Managers will hesitate to give him/her a bad mark which will result in a drop in his/her wages. Under the previous wage setting system, manager evaluations were linked to wage levels only through various intermediary factors, so they apparently were able to evaluate their subordinates fairly freely. It will take several more years to determine if this is a temporary phenomenon following revision of the wage system, or whether it will continue for a relatively long period.

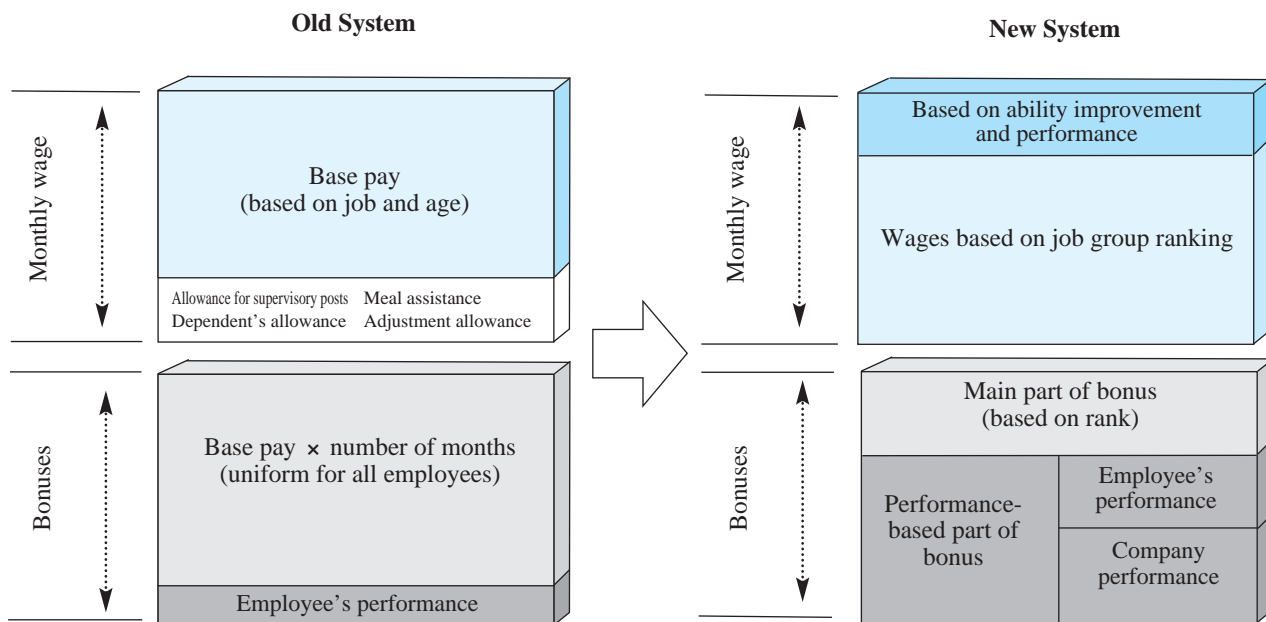
#### 4.3 New Wage System at Canon Inc.

Since the mid-1990s when it introduced new wage determination systems, Canon Inc. has attracted much attention. In 2001, the company revised its wage system for managers, and the following year revised the system for ordinary employees, i.e., members of the company labor union. Figure 3 compares the previous and new systems.

Three aspects of the monthly wage settings have been altered: (1) the basic payment, which previously consisted of age- and ability-related components, is now determined in accordance with ranks based on the nature of the jobs (job categories); (2) the portion of wages determined by development of ability and achievement in performance of duties is now transparent; and (3) extra allowances for certain managerial posts, dependent allowances, and other allowances have been abolished and are now incorporated in the new monthly wage profile.

Previously wages were based on the ability- and qualification-based system. Introduced in 1969, it was becoming apparent that the system was defective to a certain extent, with long-time employees not being assigned to jobs that would justify their wage levels. A new set of job ranking was therefore launched which corresponded to the previous ability- and qualification-based wage system, and monthly wage bands were

Figure 3. Basic Wage and Bonus Concept for Non-managerial Employees at Canon



Source: Canon Inc.

established for each job rank, as shown in Figure 4. This alteration made it possible to stop wages from rising above a certain level in each job rank, no matter how long employees stayed with the company. To receive higher wages, it is now necessary for employees to engage in jobs associated with the higher ranks.

Again, under the previous system, part of the regular pay hike was automatically applied to all employees, regardless of the results of a personnel evaluation. However, with the new system, unless an employee receives an evaluation exceeding the average, he/she will not be eligible for a regular pay raise. Even so, Canon's new wage system still bears the nature of a regular wage increase. The previous achievement evaluation system had a scale of five, and allowed for pay raises even if the employee in question received the lowest mark. However, the new system now requires at least an average mark for an increase in payments. This change was not accurately understood by the mass media in Japan, which distorted it in their reporting, saying that Canon had abolished the regular wage increase scheme.

The third aspect of the revision of monthly wage payments — abolition of various allowances — reflects management philosophy on the revised wage system. Generally speaking, a range of allowances linked to the individual's rank and number of dependents have made up a certain proportion of wages in Japanese firms. The 2002 *General Survey on Working Conditions* published by the Ministry of Health, Labour and Welfare shows that such allowances accounted for 14.6 percent of the average monthly salary in companies with 30 or more

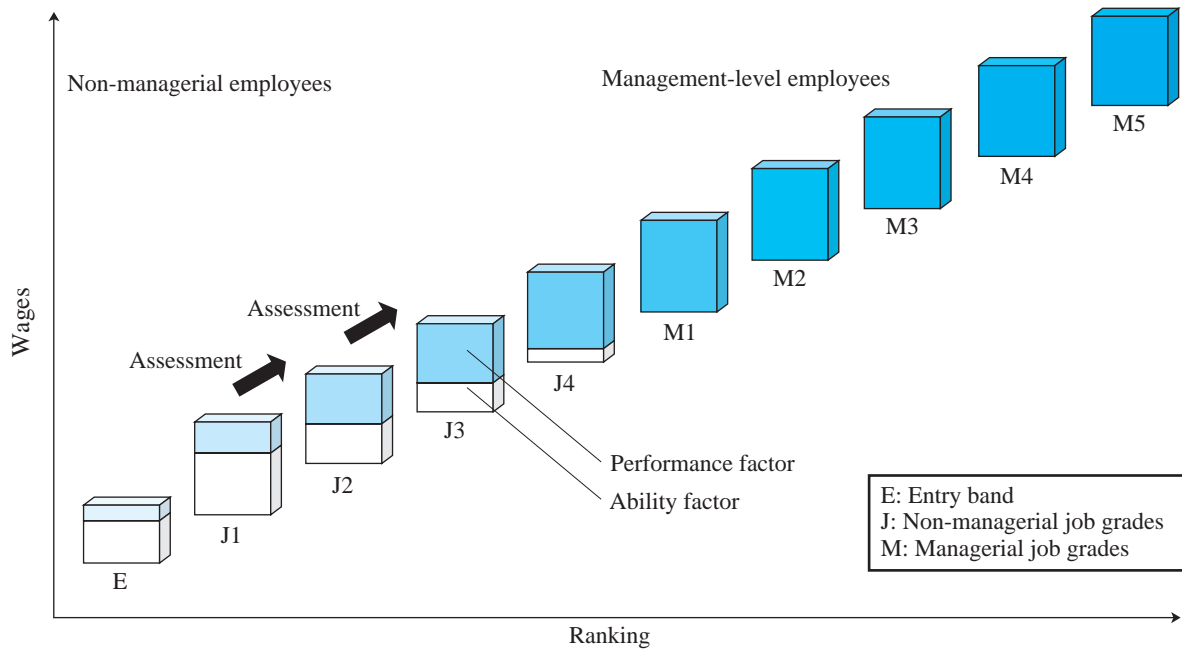
employees. In the case of Canon, the portion of wages not directly related to the job performances of the employees themselves, such as the number of dependent family members, has now been incorporated into the job-rank-based wage setting mechanism, so that the basic portion of monthly wages is now determined not by the characteristics of individual employees, but by the level and nature of the jobs assigned to them.

Figure 3 shows the revisions of the bonus payment system. Under the previous system, virtually the entire bonus was calculated as a fixed multiplier of the individual's basic monthly salary. Now, however, bonuses are divided into a basic portion determined in connection with job rank, and a portion that is subject to the performance of both the company and the employee. When the new wage system was introduced, the bonus was equivalent to about six times the monthly job-rank-based wage — the basic portion accounted for about four months' wages, and the portion linked to the company and individual's performance for about two months.

#### 4.4 Future Wage Systems in Japan

I have so far discussed how wage systems in Japanese firms are changing. Many are seeking a transition from a system based on an employee's ability to execute jobs to one based on the nature of those jobs. Progress towards the transition, however, is not very rapid. The main reason behind this sluggishness is concern that a complete shift to a new system based on the nature of jobs might deprive firms in certain areas where

Figure 4. Ranking System and Wage Range at Canon



Source: Same as in Figure 3.

Japan has had an edge over other countries — good teamwork, information sharing within a workplace, smooth passing on of skills from superiors to the younger generation, and so on. It seems it will take a little more time to define the nature of the new wage system which is to replace the current ability- and qualification-based wage determination system.

**Notes:**

(1) The survey targeted 2,300 employees, 2,000 of whom were members of a Rengo-affiliated union working for private firms and were engaged in clerical, sales and technical jobs. The remaining 300 were department heads (*kacho*) or higher ranking managers in private firms listed on the First Section of the Tokyo Stock Exchange. The number of respondents totalled 1,192; 144 in managerial posts and 1,048 ranked as section chief (*kakaricho*). The rate of usable returns was 51.8 percent. Questions referred to in this article were whether or not they favored a revision of their personnel management system, and if so, why. Seventeen choices were provided for wanting a revision, from which respondents could choose as many as applied to them. Incidentally, those who answered that they did not favor any revision composed 13 percent of the respon-

dents as a whole.  
 (2) According to the results of the 2002 *Survey on Employment Management*, firms with an MBO system accounted for 50 percent of all the firms surveyed (28% in the 1996 survey, and 43.5% in the 1999 survey); those with a “multifaceted” evaluation system for 26 percent (32.2% in the 1996 survey, and 41.8% in the 1999 survey); and those with a self-evaluation system for 32.1 percent (22.2% in the 1996 survey, and 29.2% in the 1999 survey). By company size, the larger firms were more likely to have an MBO system and a self-evaluation system. In particular, a higher proportion of large firms — 85 percent of firms with 5,000 or more employees, and 74.9 percent of those with 1,000 to 4,000 employees — had adopted an MBO system.  
 (3) Umezaki, Osamu, Nakajima, Tetsuo and Matsushige, Toshikazu. “The Impact of the Introduction of Performance-based Wage Systems as Observed in Wage Levels and Assessments of Employees — An Analysis of Corporate Microdata,” *Discussion Paper in Economics and Business, 01-11*, Graduate School of Economics and Osaka School of International Public Policy, Osaka University, 2002.

**OPINIONS REQUESTED**

The editor invites readers to send their views and comments on the contents of *JLB* via e-mail to [akuwa@jil.go.jp](mailto:akuwa@jil.go.jp) or via fax to +81-3-5991-5710.

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