

## Identification of Issues for Research on Corporate Management Strategies and Personnel Treatment Systems

### Summary

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#### Objective of the research

While economic globalization has intensified competition in recent years, Japanese companies are expanding their operation overseas and dynamically restructuring their corporate organization, which have also impacted their personnel treatment systems in various ways. Specifically, in pursuit of short-term performance, they are now giving a greater emphasis on a more flexible form of employment of part-time workers, dispatched workers, and limited-term contract workers, which can be adjusted in accordance with the business climate. Moreover, the Japanese-style employment practices are also changing, as the result of disclosure of personnel appraisals to the appraised employees, individualized employment relations, human resources utilized regardless of sex or age, diversified decision-makings on working conditions, and development of multi-track career formation. Comprehensively analyzing the Japanese companies' significantly changing management strategies and personnel treatment systems and raising issues related to today's Japanese corporate management and labor in a medium-term research project is a task that the Japan Institute for Labour Policy and Training must undertake. In this report, we identified the issues related to the above research topics, prior to a survey (to be conducted in 2004 or after), and summarized the results.

## **Outline of the research results**

### **1. Objective and issues of the research**

While globalization of the Japanese economy has intensified competition in recent years, Japanese companies are expanding their operation overseas and dynamically restructuring their corporate organization, which have also impacted their personnel treatment systems in various ways. To cope with these changes, Japanese companies are forced to change their existing management styles. In pursuit of short-term performance, they now put a greater emphasis on a more flexible form of employment of part-time workers, dispatched workers, and fixed-term contract workers, which can be adjusted in accordance with the business climate. Moreover, under these changes in the environment, the Japanese-style employment practices are also changing, as the results of disclosure of personnel appraisals to the appraised employees, individualized employment relations, human resource management regardless of sex or age, diversified decisions on working conditions, and development of multi-track career formation.

To comprehensively analyze the Japanese companies' significantly changing corporate strategies and personnel treatment systems and to raise issues related to their future corporate management and labor, we set down "research on comprehensive analysis of corporate management strategies and personnel treatment systems" as a research topic in our medium-term project. This year, we reviewed existing research prior to next year's survey and identified the issues mainly centered on the topics of "changes in Japanese-style human resource management (HRM)," "progress in performance-based personnel management," and "employment of non-regular workers." The results are shown below.

### **2. Chapter I: Values and goals in human resource management (HRM)**

<Relation between strategies and HRM> The high-cost structure of long-term employment and of evaluation and treatment reflecting workers' skills increase is significantly changing Japan's human resource management (HRM). Corporate managers and shareholders hope to change today's HRM, which is separated from corporate management in an almost "extraterritorial" arrangement, in ways that human resources will effectively improve companies' performance in terms of corporate management and strategy. In other words, they look to HRM that will contribute to corporate management and will efficiently utilize human resources as management resources. In this connection, some argue that "strategy and HRM should be linked," but it is difficult for implementers of strategies and vision to translate them into

tangible management goals and to link them with human resources contribution without limiting them to specific industries or workplaces. Therefore, from the standpoint of research, there is a limit to discussing the connection between management strategies and HRM. It would be more effective if strategic human resource management is viewed as a mechanism not only for achieving immediate strategic goals, but also for maintaining, enhancing and reinforcing companies' competitiveness over the long term.

<Deliverables of human resource management> Strategic human resource management forms the basic capabilities of companies to lay down new strategies and to maintain competitiveness over the long term. It contributes to corporate management, supporting companies in strengthening their organizational capabilities without depending on specific strategies. A representative and essential element of organizational capabilities is the ability to bring about change, which also pertains to the flexibility of human resource management systems and the flexibility of people's competencies and behavior itself, and the ability for an organization to change. In this respect, human resources management can make a significant contribution. Furthermore, with regard to human resource management, four types of values and goals (deliverables), separated by the two axes of "individuals' viewpoint and management's viewpoint" and "long-term goals and short-term goals," must be provided to the stakeholders simultaneously and while maintaining a balance.

<Future direction of research> The four important values and goals (deliverables) in human resource management can be described as (1) "Increase contribution to achievement of strategies" (management's viewpoint, short-term goal), (2) "Acquire and enhance capabilities to lay down strategies" (management's viewpoint, long-term goal), (3) "Provide evaluation and treatment based on fairness and disclosure of information" (individuals' viewpoint, short-term goal), and (4) "Assist in development as a person through one's career" (individual's viewpoint, long-term goal). In next year's research, it will be possible to study what values and goals in human resource management are provided to companies and workers. For instance, it will be possible to examine how new human resource management methods that are based on the management's viewpoint, such as performance-based personnel management and early selection, are affecting workers, and how they are reflected on a firm's performance over the long run.

Table 1: Four important goals in future human resource management

	Short-term goals	Long-term goals
Management's viewpoint	Increase contribution to achievement of strategies	Acquire and enhance capabilities to lay down strategies
Individuals' viewpoint	Provide evaluation and treatment based on fairness and disclosure of information	Assist in the development as a person through one's career

### 3. Chapter II: Performance-based personnel management and its impact

<Concepts of “ability,” “performance,” and “results”> There are a variety of arguments over these concepts. From the point of view of human resource management of Japanese companies, however, it is necessary to distinguish between (1) systems such as the ability-based grading system that are based on evaluation of one's ability to perform work and (2) systems based on evaluation of the performance (results) of short-term work (merit-based HRM: MBH). By removing the concept of “ability” from the concept of “performance,” the effect of MBH becomes observable. It is generally believed in Japan that MBH is well advanced in the U.S., but on a closer inspection of human resource management systems in the U.S., one finds there is a gap between common belief and reality as the emphasis is not necessarily limited to performance (results), and other factors such as ability to perform and competencies are also evaluated. Nevertheless, as human resource management of white-collar workers became increasingly performance-based in the U.S. from the 1980s, it may be possible that an exaggerated form of such human resource management was introduced to Japan from the 1990s.

<MBH in Japanese companies> In Japan, performance-based personnel management apparently began with the introduction of MBH by Fujitsu Ltd. in 1992. MBH in the form of reflection of individuals' performance on pay, wage differences among employees of the same age, and introduction of a yearly contract system spread among Japanese companies starting in the 1990s. However, while the weight of such factors as age, years of service, and educational background in the decision on basic pay is decreasing, many companies still lay emphasis on “ability to perform work.” Therefore, the emphasis in human resource management is not only on short-term results, but on both “ability” and “performance.” The yearly contract system, which probably form the core of MBH, rapidly spread among managerial people at first, and was eventually expanded to non-managerial employees as wages could be linked to

short-term results. On employees' response to introduction of performance-based personnel management, there has been a mention of (1) uncertainty about the fairness of the evaluation system, (2) uncertainty about the congruity of the particular nature of one's work to a performance-based system, and (3) concern about its effect on one's living as wages become variable. In addition, as performance-based personnel management will individualize decisions on working conditions, labor unions are moving to take countermeasures.

<Challenges in future research> As seen in changes in Fujitsu's MBH, Japanese companies in recent years are revising their MBH. While an emphasis solely on results without regard to the process was considered the "strength" or "weapon" of MBH, it has now been reviewed in the actual implementation of the system so as to "moderate the performance-based personnel management" by underscoring the process and introducing the concept of competence. Kohn (1993), citing existing empirical research, pointed to the problems related to performance-based pay as (1) it cannot be checked whether remuneration has a positive effect on the performance of the organization as a whole; (2) limits to financial incentives; (3) de-emphasis on the process; and (4) avoidance of setting ambitious goals and risk. There is a need to study whether performance-based systems maximize contribution made by corporate employees and as the result contribute to improving the performance of companies. Furthermore, as there is little empirical study done on the effect of performance-based personnel management on workers' morale and productivity and on the life security function that past human resource management provided, there is a need to conduct a survey on these topics.

#### **4. Chapter III: Formation of part-time workers as a core labor force**

<Part-time workers as a core labor force> While employment patterns become increasingly diverse, a rise in part-time workers, who make up the second largest group in the work force after regular full-time employees, goes on unabatedly. As a result, management of part-time workers is now an important area in human resource management. We examined the emergence of part-time workers as a core labor force both qualitatively and quantitatively. In terms of quantity, part-time workers are becoming a core labor force because a wide variety of work could be entrusted to them and because companies took the initiative in employing them. At the same time, heterogeneous groups of part-timers, such as housewives, students, and job-hopping part-times, are being employed in combination. In terms of quality, the nature of

work entrusted to them and their ability to perform the work is approaching that of full-time employees. This trend can be evidenced by the fact that part-time workers are entrusted with higher levels of work in a variety of industries and workplaces and their ability to perform such work is being enhanced, and this tendency is being reinforced as their length of service is extended. As companies are very much eager to promote this qualitative improvement in part-time workers, the trend is expected to continue.

<Human resource management of part-time workers> Human resource management of part-time workers becomes an important issue for corporate performance as they come to form a core labor force. One of the questions is how to go about the formation of a core labor force. In terms of quantity, companies are not rapidly replacing full-time employees with part-timers. Rather, both types of workers maintain a complementary relation, and as a result, few problems have occurred between the two groups. In this respect, the formation of a core labor force is expected to continue to be promoted. In terms of quality, the formation of part-time workers as a core labor force is being promoted by giving greater rights to individual part-time workers and by integrating them into small groups at the workplace. This, however, has not necessarily improved the vocational attitude of part-time workers, and it also has a risk of negatively affecting the vocational attitude of full-time workers. The combination of quantitative and qualitative formation of part-time workers as a core labor force varies widely from workplace to workplace, and the optimum mix is still not clear. Another question is incentives, which is mainly related to the qualitative aspect. While some companies are introducing a system of individualized wage management that is relative to improvement in individual part-time workers' ability, such an effort aims to promote the formation of a core labor force by creating wage gaps among part-time workers. The important question of wage gaps between part-time workers and full-time employees remains unanswered. For further formation of part-time workers as the core labor force, there is no choice but to increase equality between the treatment of full-time and part-time employees. Integration of the remuneration system is one way to do this, but such a scheme is not spreading. Setting appropriate employment categories in accordance with individual workers' job description and careers and in response to diversified working styles is also essential. Promoting mobility between different employment categories should also be effective in realizing equal treatment.

<Issues for future research> Firstly, will formation of part-time workers as a core labor force continue to be promoted in the future, and for what reasons will quantitative and qualitative formation be combined? Secondly, to what extent should existing wage systems change to promote such formation, and how far should equal treatment with full-time employees be promoted in that process? Thirdly, to what extent will part-time workers respond to companies' design for such formation? And fourthly, problems that may arise from promoting such formation need to be identified to find what kind of measures companies could adopt to avoid such problems. In this light, the trends related to full-time employees, who will be affected by the formation of part-timers as a core labor force at the workplace, will also need to be examined. By studying the above issues, it should be possible to further elucidate human resource management of part-time workers.

#### **5. Chapter IV: HRM reform and governance reform**

<Two types of corporate system reform> If macroeconomic system reform can be summed up as “regulatory reform,” microeconomic corporate system reform can be boiled down into “building competitiveness.” Building or rebuilding competitiveness became an urgent issue for the Japanese corporate system, and two types of corporate system reform, namely, the reform of the existing Japanese-style HRM (human resource management) and the corporate governance reform that gave greater importance on stockholders were advanced during the 1990s.

<Pursuit for flexibility> To build competitiveness, a corporate system must be established that will respond flexibly to changes in the external environment. “Flexibility” is also essential to HRM reform. There are three concepts of flexibility: (1) “quantitative flexibility,” (2) “pecuniary flexibility,” and (3) “functional flexibility” (Atkinson 1987, Morishima 1995). Quantitative flexibility means expansion of fixed-term and temporary employment, and expansion of employment adjustment as well as acceleration of its immediate implementation. Pecuniary flexibility pertains to introduction of performance-based wages, and functional flexibility relates to the ability of employees and the organization as a whole to respond to changes in the market and technology. A company's competitiveness is based on (3) functional flexibility. On the other hand, (1) quantitative flexibility and (2) pecuniary flexibility are what actually drive HRM reform and the reason governance reform is necessitated. Identifying the conditions for realizing both flexibility of (1) and (2) and of (3) or ensuring that each type of flexibility complements each other forms the basis for true

HRM reform. Functional flexibility was actually realized in the Japanese-style HRM in the form of long-term employment and wages based on ability. An increase in the costs and a decline in performance under such a system led to governance reform reinforcing discipline and incentives for the performance of corporate managers. As a result, managers in turn had to strengthen discipline and incentives for the performance of employees, which led to HRM reform. Therefore, governance reform and HRM reform are consistent with each other with respect to their emphasis on performance. The question is whether or not such reform will actually build companies' competitiveness.

<Gradual change of Japanese companies> The actual performance-based HRM is restrained both in terms of incentives and discipline. In Japanese companies, performance-based HRM is introduced not to deny continued employment, but on the assumption of continued employment. In other words, it is introduced on the assumption that achievement of individual employees' jobs will result in recovery of a company's performance, which will make continued employment possible. In Japanese companies, the intention is to establish performance-based HRM within the employment system of in-house labor market. "Career within the boundary of a company" is a basic assumption. Therefore, in reality, wages based on ability continue to form the basis of pay, while the appended element of seniority is reduced or abolished to be replaced by performance-based pay. The actual HRM reform remains a "gradual change." Performance-based wages are introduced as discipline and incentives for exertion of ability, and in addition to that, quantitative flexibility and pecuniary flexibility are sought in the form of non-regular employment and introduction of performance-based pay.

<Autonomous governance and "sharing of a sense of crisis"> It is said that governance of Japanese companies is less influenced by the pressures of the stockholders or capital control, but more by "autonomous governance." Observation of "successful" "blue-chip" companies in Japan showed that the governance of such companies was not controlled by the stockholders as the case is in the U.S. (Niihara, 2003). At these companies, the management and employees "share a sense of crisis" and make it a common goal to build competitiveness based on such a sense of crisis. If, however, the workings of such autonomous governance were to malfunction for one reason or another, it would be difficult to bring about an "autonomous" recovery. In this respect, there is a need for a mechanism that will replace autonomous governance,

and such a mechanism is governance through the pressures of stockholders and the pressures of debt. For a company to instill a sense of crisis and maintain a high level of discipline among its employees, there must be trust in the management. In the existing Japanese-style management, employees were provided with security in both employment and wages. This was evident in the form of continuation of employment and wages based on ability. This obviously meant that employees were not in a position to express their opinions to the management. This security, however, is being removed. In particular, performance-based wages will subject individual employees to the risk of variable wages, and the responsibility to deal with such risk is left to individual employees. If so, there is a need for a mechanism that allows employees to express their views regarding this risk. It can be expected that employees will be allowed to speak their views on various aspects of HRM, including placement of employees, results of performance evaluation, and opportunities for development of new skills. Such a mechanism will constitute governance reform for employees. For these changes to existing rules to result in building up companies' competitiveness, the conditions of efficiency as intended by the management and the conditions of the likelihood of acceptance by employees must also be met.

<U.S. companies> There are two issues related to governance. The first is the question of how, as ownership and management is separated, stockholders should exercise governance when the management's discipline weakens. The other is the question of how to manage a company from the long-term viewpoint as opposed to short-term expectations of shareholders. Generally, the first question is considered an issue related to governance. As governance in the sense of the first question is well established in U.S. companies, however, governance in the sense of the second question is a more pertinent issue. If there were to be a complete performance-based system, it would only be found in the so-called "professional firms" in the U.S. In "professional firms," ownership and management are unified as they are nonpublic companies, and problems related to governance do not arise. In this regard, governance reform that would place greater importance on stockholders and that which is modeled on U.S. companies does not have a significant meaning. In "professional firms," individual employees who cannot improve on his performance are laid off. This is indeed based on the rule of quantitative flexibility and pecuniary flexibility. For the individual employees, this flexibility is a risk. At the same time, a professional employment system is established as a device to disperse or absorb this risk. In other words, professional qualifications such as the academic qualifications of MBA guarantee

employment and mobility within the field of expertise. Such an employment system has been conceptualized as “boundaryless career” (Arthur and Rousseau, 1996). This, however, does not mean that there are absolutely no boundaries. For instance, IT engineers at Silicon Valley, financial experts at Wall Street, and media experts in Hollywood operate within the boundary of their “regional communities.” In such communities, there is a network of people who share professional education, career, and values, and this device provides a medium for information on jobs and absorbs the risk associated with quantitative and pecuniary flexibility. The organization of functional flexibility that transcends corporate boundaries forms a system of competitive advantage. There is also a widely held view that Japan is at a competitive disadvantage in this respect.

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