

**Compensation System in Japan, United  
States and European Countries**

**Chen Yuping**

**Institute for International Labor Studies  
Ministry of Labor and Social Security, P.R.China**

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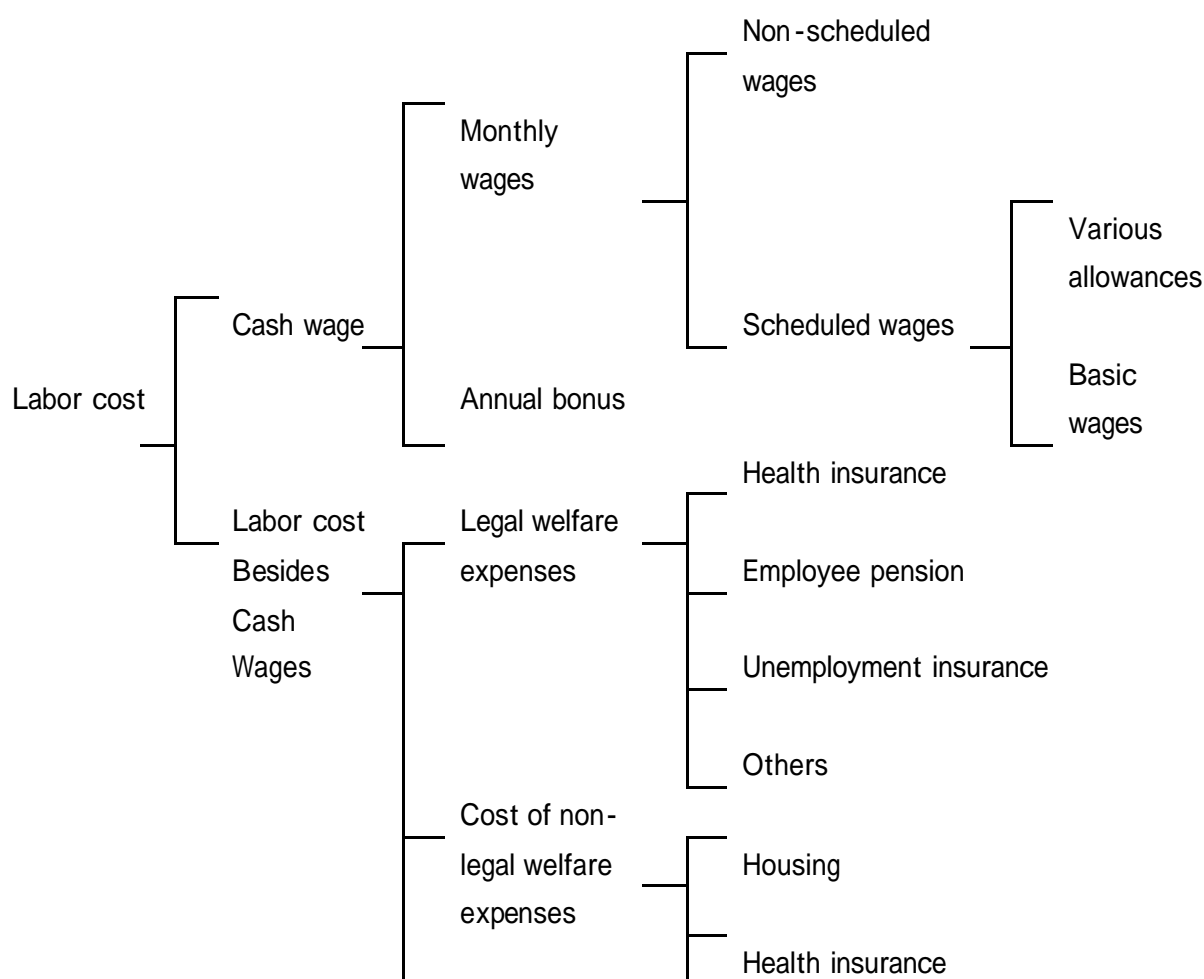
With the development of market economy, in China the problem for compensation system becomes an important issue that have to be dealt with. While a great progress has been achieved in recent years, for instance, collective bargaining system has been introduced initially, we are still facing many challenges. Major tasks include setting up a sound payment distribution mechanism, which is full of motivation. The purpose of this report is to analyze the compensation system in Japan and other developed countries, and then absorb useful experiences.

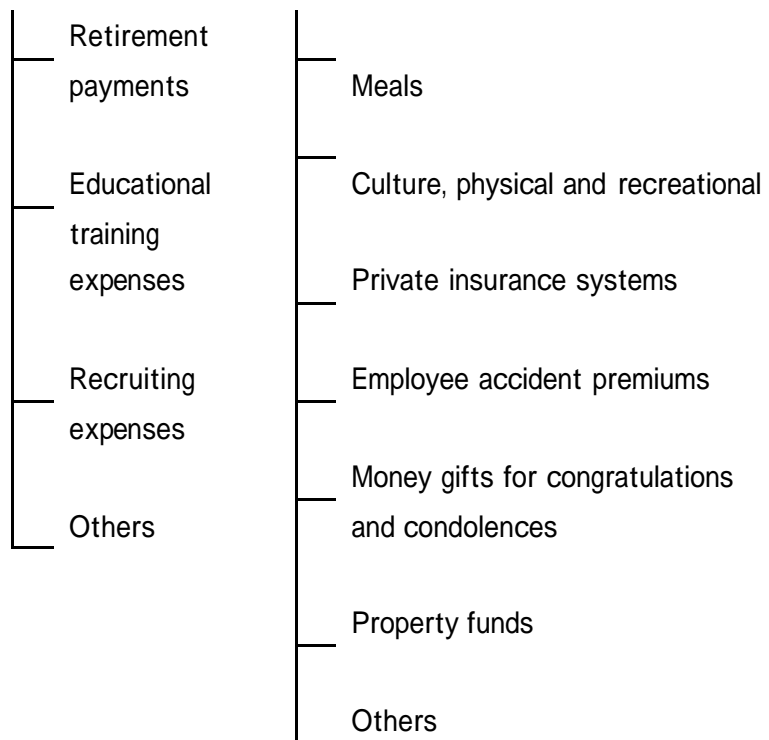
## 1. Composition of compensation

### ( 1 ) Compensation structure in Japan

Compensation structure refers to a series of payment items that composes the total compensation paid to an employee. Normally, compensation consists of wages, bonus, legal welfare and non-legal welfare as shown in figure 1.

Figure 1 . **Composition of labor costs**





Source: Yoko Sano, Human Resource Management in Japan, 1995, p 116. Takashi Araki, Labor and Employment Law in Japan, 2002, p 73.

### **A. Monthly wages**

Generally, cash wages can be divided into monthly wages and bonuses. Monthly wages are divided into scheduled wages (i.e. basic wage and various allowances) and non-scheduled wages (such as overtime or rest-day work allowances). Scheduled wages are further divided into basic wages and various allowance. Various allowances regularly paid include job-related allowance (allowances for taking special posts, special skills, perfect attendance or good performance) and other allowances which are paid according to employee's personal circumstances such as family allowances, housing allowances and commuting allowances.

The main feature of the Japanese payment 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 years of service regardless of a person's job and skills.

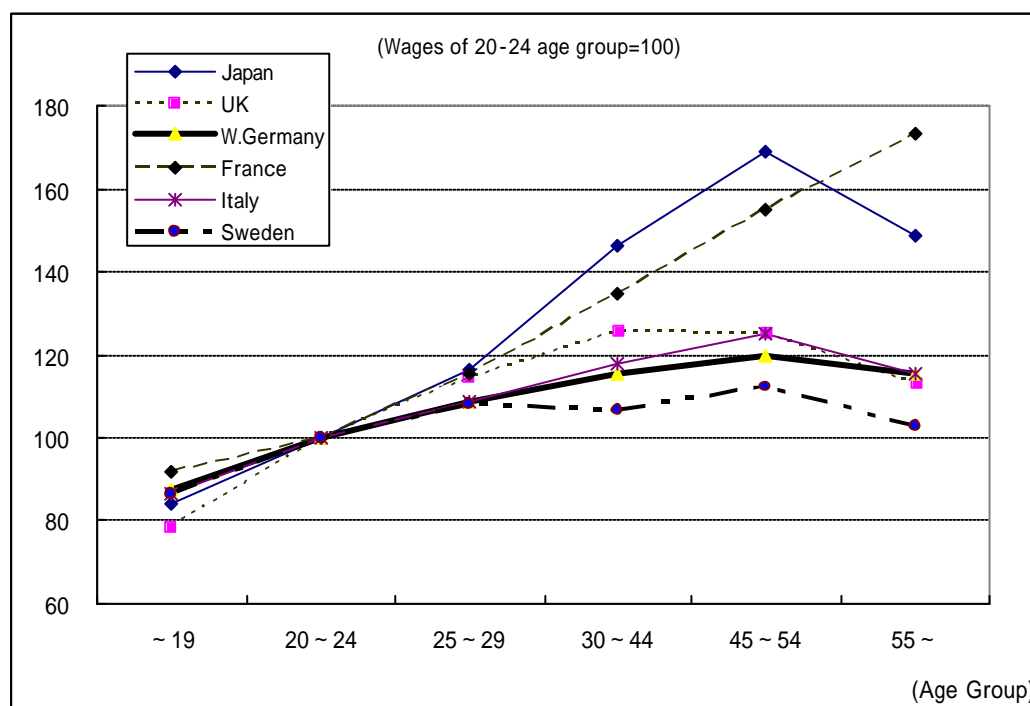
Currently, basic wages normally consist of two types of wages: age and seniority-based wages that are increased in accordance with workers' age or length of service, and skill-based wages determined under the "skill-based grade system".

The "skill-based grade system" is a grading and wage system based on the level of skill

and competence development. This wage system has been adopted in many Japanese companies to attempt to coordinate lifetime employment practices with the need to remunerate workers in accordance with their performance and skills. Under this plan, there are a certain number of grades (e.g. A-G), which are further divided into subgrades (A1-A5, B1-B5, etc.). A high school graduate may start at A1, and a university graduate at B1. Although one can be promoted to a higher subgrade after certain years of service in a particular subgrade, a worker whose performance is excellent will be promoted in a shorter period and may sometimes skip subgrades. In order to move to a higher grade, workers must fulfill certain prerequisites, undergo evaluation, and complete the required training. Promotion to higher grades or subgrades is decided on the basis of job-performance evaluations conducted by the employer as well as the worker's length of service.

Since length of service is one of the most important factors affecting wages, a Japanese worker's wage profile has a steep curve. Although such a wage profile is not uncommon for white-collar workers in other countries, it is unique that the wage profile for Japanese blue-collar workers also has a similar pattern. Please refer to figure 2.

Figure2. International comparison of wage differences by age group  
(Male production workers, manufacturing industries)



Source: Figure is calculated based on the information from Japan Ministry of Health, Labor and Welfare, and EU, Structure of Earnings Statistics 1995

## B. Bonuses

Bonuses, which are typically paid twice a year ( in June and December ) , are one of the most important features of the Japanese wage practice. They amount to more than 20% of the annual wages of an average Japanese worker. Just like wages, the amount of the bonus at unionized companies is determined by the annual collective bargaining agreements. The decisive factor in the collective bargaining to determine the amount of bonuses is the company's economic performance. Almost all Japanese companies pay bonuses, and certain portion of the bonus is assessed in accordance with the employee's evaluation during the period in which it is applied, and even employees receive the same wage, the amount of their bonuses are generally different.

### **C. Welfare**

According to the Results of Welfare Expense Survey in 2002, conducted by Japan Business Federation, when a company employs someone, besides salary and bonus, it pays about 17% of them as additional personnel expenses. The benefit cost (the average in all industries) per employee in 2001 is 95,883 yen, 2.9% increase from the previous year. The amount of the benefit cost that is stipulated in laws was 68,482 yen, showing 4.7% increase from the previous year, while the amount of the benefit cost that is not mandatory was 27,401 yen.

A company's welfare expenses consist of "legal welfare" and "non-legal welfare". Legal welfare mainly includes health insurance, employee pension insurance, nursing care insurance, unemployment insurance and workman's compensation insurance for job-related accidents. In 2001, health insurance premiums are 32.8%, and employee's pension insurance premiums are 52.7%, so that those two compose about 85.5% of the compulsory benefit costs that organizations are paying out for employees. Labor insurance premium occupies 11.8%, broken down as 8.2% for unemployment insurance and 3.6% for employee's compensation insurance.

In recent years, the mandatory benefit cost has shown more increasing tendencies than the actual increase in the annual salaries. The total annual salary in this survey – the average amount including bonuses, and allowance – was 562,098 yen, 2.1% increase from the previous year, while the mandatory benefit cost shows 4.7% increase. The ratio of the mandatory benefit cost to the total amount of the annual salaries became 12.2% (11.9% for the previous year).

Non-legal welfare includes support for housing, medical insurance, gifts of family celebration and condolence, mutual aid and so on. The non-mandatory benefit cost per employee for a month is 27,401 yen in 2001, 1.4% decrease from the previous year. This decrease seems to reflect employers' efforts to review their benefit systems. The ratio of

this benefit cost to the amount of the annual salary became 4.9%, the lowest since the start of the survey. While the non-mandatory benefit cost shows a decreasing tendency in recent years, employers have been struggling to review their system to reallocate the limited amount of the benefit cost.

## ( 2 ) Compensation structure in other developed countries

In terms of compensation structure in other developed countries, from table 1, we found that even the percentage for each item of labor cost in those countries is different, for instance, the statutory welfare cost in France and Germany is higher than that in other countries, the items of the whole composition are similar, which means they all include such items as cash wages, non-wage costs, statutory welfare costs and so on.

Some foreign investment companies in Japan, for example, in Nippon Polaroid ( US ), besides salary and bonus, the company provides all legal welfare programs including health insurance, pension plan, employment insurance, accident compensation insurance and nursing care insurance. Polaroid is a member of a health insurance association and also has contracts with private services such as resort houses and exercise clubs that provide cultural, education or recreational facilities at reasonable prices.

In Sun Microsystems, Inc.( US ), in addition to salary and bonus, company also provides employees with social insurance allowance, benefits and some voluntary social benefits. Social insurance allowance includes health insurance( nursing care insurance ), pension insurance. Benefits compose of medical examination, by which a medical examination for employees is performed once a year; group term insurance; compensation scheme for industrial accidents not required by law; group long-term disability insurance, and so on. Other kinds of benefits such as annual leave with pay, summer holidays, club activities, sports club, rest houses, etc. are also available.

Table 1. Comparison of labor cost components by cost items ( manufacturing industries )

		1985	1988	1991	1995	1998
Japan	Total	100	100	100	100	100
	Cash wages	84.3	83.7	83.0	82.3	81.2
	Non-wage costs	15.7	16.3	17.0	17.7	18.8
	Statutory welfare costs	7.6	7.9	8.5	8.9	9.5
	Voluntary social benefits	3.1	2.8	3.1	3.1	2.9
	Retirement allowance	4.0	4.3	4.1	4.9	5.5
	Others	1.0	1.3	1.4	0.9	0.7

United States	Total	100	100	100	100	100
	Cash wages	82.6	80.7	71.8	71.6	81.9
	Non-wage costs	17.4	19.4	28.2	28.4	18.1
	Statutory welfare costs	6.6	8.5	9.1	8.5	7.8
	Voluntary social benefits	5.7	10.6	16.1	15.8	
	Retirement allowance	4.9	--	2.9	4.0	10.2
	Others	--	0.3	0.1	0.1	
United Kingdom	Total	100	100	100	100	100
	Cash wages	82.3	81.6	86.0	85.1	83.8
	Non-wage costs	17.7	18.4	14.0	15.0	16.2
	Statutory welfare costs	8.9	9.4	7.3	7.5	8.5
	Voluntary social benefits	6.0	6.3	4.2	4.7	5.0
	Retirement allowance					0.0
	Others	2.7	2.7	2.5	2.9	2.8
France	Total	100	100	100	100	100
	Cash wages	70.0	69.9	69.0	68.1	65.2
	Non-wage costs	30.0	30.1	31.0	32.0	35.0
	Statutory welfare costs	19.0	18.9	19.2	21.8	21.8
	Voluntary social benefits	2.8	3.1	4.5	7.0	7.4
	Retirement allowance	3.7	3.7	4.0		1.8
	Others	4.5	4.4	3.5	3.3	4.2
Germany	Total	100	100	100	100	100
	Cash wages	78.5	78.2	77.0	78.8	73.8
	Non-wage costs	21.5	21.9	23.0	21.6	26.3
	Statutory welfare costs	16.2	16.1	16.5	15.3	15.9
	Voluntary social benefits	0.2	0.2	0.1	3.1	0.6
	Retirement allowance	3.2	3.4	4.2	3.1	0.6
	Others	2.0	2.2	2.2	3.2	2.2

Source: Japanese Working Life Profile, 2003 – Labor Statistics, p 57.

Eurostat, Labor Cost 1992. Japan: Ministry of Health, Labor and Welfare, General survey on Wages and Working Hours System. United States: Bureau of Labor Statistics 2000: trial calculation, Department of Labor.

Notes: (1) In the U.K., Germany, and France, this includes allowances paid in kind. However, in Japan, allowances paid in kind are included under others.

(2) Includes pension and savings, e tc.

(3) Training costs, taxes, subsidies, etc.

(4) Derived from March surveys by an index based on 1980.

(5) Germany figures for 1988 and earlier are for former West Germany.

## 2. The amount of compensation for technical staff and middle level

## managers

### (1) The amount of compensation for technical staff and middle level managers in Japan

In Japan, employees of the same company like, for example, white-collar and blue-collar worker, are managed under the same system of human resource management, regardless of job type. In other words, the characteristic of the Japanese wage profile is the phenomenon called “the white-collarization of blue-collar workers”. The phenomenon of the white-collar workers’ wage rising with age is observable not only in Japan, but in Europe and the United States as well. While the situation for blue-collar workers are different. In other nations, the wages of blue-collar workers rise a little with age, and these wage increases are invisible after age 30. In Japan, However, even though the wage profile for blue-collar workers does not rise as sharply as that of white-collar workers, the two curves are similarly shaped, indicating that wages increase as worker’s age.

Therefore there are not evident wage differences based on educational background among white-collar and blue-collar employees. 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.<sup>1</sup>

Table 2. Wage indices by education and age

	Graduates of university ( Male )		Graduates of junior colleges ( Male )		Graduates of senior high schools ( Male )	
	Wages ( thousand yen )		Wages ( thousand yen )		Wage ( thousand yen )	
	1975	2001	1975	2001	1975	2001
Total	169.9 177	404.4 186	178.2 196	306.8 155	133.0 145	313.8 159
20-24	95.8 100.0	217.1 100.0	90.7 100	198.1 100	92.4 100	196.8 100
25-29	121.4 127	257.5 119	115.8 128	239.0 121	115.0 125	236.8 120
35-39	203.1	405.6	171.8	338.6	157.8	311.1

<sup>1</sup> Ministry of Health, Labor and Welfare: Basic Survey on Wage Structure in Fiscal 2001.



	212	187	189	171	171	158
45-49	267.4	516.8	234.8	415.5	178.4	373.2
	279	238	259	210	193	190
50-54	285.3	569.8	252.3	441.9	190.6	392.8
	298	262	278	223	206	200

Source: Ministry of Health, Labor and Welfare, Basic Survey on Wage Structure, 2001. Japan

From table 2 we found that by reading rows, which reflect educational background for same age span, the statistics show little difference. By contrast, when reading columns, which reflect the different age groups of same educational background, we see evident gap. It indicates that age is important than educational background in the respect of wage level determination. The other conclusion drawn from table 2 is that the older the employees become, the bigger the wage gap between them caused by educational background. For example, for employees who are in their 45-49, wage differences are more evident than that in their young age. It is also true in terms of company scale, which means bigger enterprises bring higher level of wage. Please refer to table 3.

Table 3. Trends in enterprises wages differentials by enterprise size ( industry total )  
( 1,000 or more = 100 )

	1980(Male)		1990(Male)		1997(Male)		2001(Male)	
	Contractual Cash earnings	Scheduled Cash earnings	Contractual Cash earnings	Scheduled Cash earnings	Contractual Cash earnings	Scheduled Cash earnings	Contractual Cash earnings	Scheduled Cash earnings
1,000 or more	100	100	100	100	100	100	100	100
100-999	83.5	86.3	82.6	84.6	83.0	83.8	82.0	82.8
10-99	76.4	81.2	75.0	79.3	75.4	77.9	73.0	75.2

Source: Ministry of Health, Labor and Welfare, Basic Survey on Wage Structure.

Note: (1) For 1996 and earlier, differential of scheduled cash earnings as of June for each year.

(2) From 1980 and thereafter, results are for private enterprises.

Compare with education background, class of position is more important in wage level determination. From table 4 it can be seen that for each class, from director to non-position, the actual earnings differential is between 20%-30%, and the amount of actual earnings of director is about two times higher than that of non-position.

Table 4. Wage differentials by class of position ( 1000 yen )

		1980	1990	2000	2001
<b>Director</b>					
Contractual cash earnings	Actual earnings differential	401.1 100	575.6 100	638.0 100	636.3 100
Annual special cash earnings	Actual earnings differential	2,153.0 100	3,051.1 100	2,872.7 100	2,843.9 100
<b>Section chief</b>					
Contractual cash earnings	Actual earnings differential	320.6 79.9	463.8 80.6	521.1 81.7	526.2 82.7
Annual special cash earnings	Actual earnings differential	1,644.2 76.4	2,433.2 79.7	2,308.4 80.4	2,349.5 82.6
<b>Chief clerk</b>					
Contractual cash earnings	Actual earnings differential	271.8 67.8	390.2 67.8	435.8 68.3	436.6 68.6
Annual special cash earnings	Actual earnings differential	1,185.9 55.1	1,710.6 56.1	1,733.8 60.3	1,729.9 60.8
<b>Non position</b>					
Contractual cash earnings	Actual earnings differential	182.1 45.4	268.2 46.6	315.0 49.3	318.7 50.1
Annual special cash earnings	Actual earnings differential	609.3 28.3	919.1 30.1	1,013.9 35.2	1,024.6 36.0

Source: Ministry of Health, Labor and Welfare, Basic Survey on Wage Structure.

Note: Enterprises surveyed have 100 employees or more. Differentials were calculated on the basis of director = 100.

From the above analysis it can be seen that in Japan the wage gap between middle level managers and blue-collar workers is higher than that between technical staff and blue-collar workers. As the table shows that a chief clerk's wage, which is nearest to non-position, is about 20% higher than that of non-position.

## ( 2 ) The amount of compensation for technical staff and middle level managers in other developed countries

The statistics in table 5 and 6 indicate that in other developed countries the salary system has their own features. One of the characteristic is that the salary gap between production employees and management and office employees is evident. Usually, salary of management and office employees is at least 40 or 50 percent higher than that of production employees. The biggest difference, such as in Italy, is 159 points for man in

55 or more years old group. The second characteristic is that age affects more in wage determination to management and office employees than to production employees. Sweden can be seen as a typical model in this regard. In Sweden, for production employees, the wage difference between employees of 20-24 years old and employees of 45-54 years old is only about 12 points, but for management and office employees the wage difference between employees of 20-24 years old and employees of 45-54 years old is 63.6 points. The third characteristic is that for both production and management and office employees, the length of service does not affect more on wage level determination. In this regard, the extreme example is France. In France, for production employees, the biggest differential is 50.1 points for an employee who work for one year and the employee who work for 20 years or more. However, the biggest differential for management and office employees is 31 points.

Table 5. Wage indices by age group ( manufacturing industry, production worker )

Production employee

Country	Sex	Total	19 or less years old	20-24 years old	30-44 years old	45-54 years old	55 or more years old
Japan --1997	Man	140.8	83.9	100.0	146.4	168.8	148.6
	Woman	98.7	89.6	100.0	100.5	98.8	94.3
United kingdom -1995	Man	118.5	78.8	100.0	125.7	125.2	113.2
	Woman	104.9	87.8	100.0	109.4	106.5	95.9
Germany --1995	Man	114.4	87.3	100.0	115.8	119.8	115.5
	Woman	103.3	89.5	100.0	103.9	104.0	101.7
France --1994	Man	131.9	91.5	100.0	134.7	155.0	173.2
	Woman	114.9	102.3	100.0	115.0	126.3	137.0
Italy --1995	Man	114.3	86.5	100.0	117.9	125.4	115.6
	Woman	108.2	94.7	100.0	111.6	116.9	126.5
Sweden --1995	Man	106.3	86.4	100.0	106.6	112.1	102.6
	Woman	110.5	--	100.0	117.0	110.1	104.1

Management and an office employee

Country	Sex	Total	19 or less years old	20-24 years old	30-44 years old	45-54 years old	55 or more years old
Japan --1997	Man	177.6	77.3	100.0	107.6	218.0	206.9
	Woman	117.7	86.2	100.0	128.4	135.3	133.0
United kingdom -1995	Man	156.7	67.3	100.0	164.1	178.9	154.2
	Woman	122.6	75.2	100.0	137.4	118.6	112.6
Germany --1995	Man	176.9	86.0	100.0	171.8	195.6	199.2
	Woman	133.6	83.2	100.0	142.5	145.3	141.8
France --1994	Man	192.1	71.1	100.0	185.7	233.3	265.0
	Woman	141.2	83.0	100.0	143.3	163.5	207.1
Italy --1995	Man	182.2	93.4	100.0	176.4	223.5	274.3
	Woman	125.0	96.5	100.0	130.3	156.0	168.0
Sweden --1995	Man	149.5	--	100.0	151.5	163.6	146.1
	Woman	123.6	--	100.0	129.8	130.1	110.8

Source: The Japan Institute of Labor, Comparative Labor Statistics-Japan and Other Major Countries 2000, p 118.

Japan: Ministry of Labor "Basic Survey on Wage Structure"

Others: EU "Structure of Earnings Statistics 1995"

Note: Wages of Japan are monthly contractual cash earnings. EU each country is the monthly total income of money.

Table 6. Wage indices by the length of service ( manufacturing industry, production worker )

Production employee

Country	Sex	0-1 years ( 0-2years )	2-4 years ( 3-4 years )	5-9 years	10-19 years	20 years or more
Japan --1997	Man	100.0	106.5	117.0	137.8	172.0
	Woman	100.0	105.3	110.1	115.4	138.6
United kingdom -1995	Man	100.0	107.7	112.9	118.0	119.6
	Woman	100.0	106.7	110.8	112.8	105.0
Germany --1995	Man	100.0	105.8	111.7	119.8	123.9
	Woman	100.0	103.6	109.9	114.5	116.3
France --1994	Man	100.0	116.1	122.9	133.5	150.1
	Woman	100.0	104.9	108.9	119.2	123.1
Italy --1995	Man	100.0	104.2	110.1	117.1	122.7
	Woman	100.0	102.9	103.7	111.1	118.5
Sweden --1995	Man	100.0	111.6	110.6	109.5	112.4
	Woman	100.0	106.4	115.1	105.9	109.7

Management and an office employee

Country	Sex	0-1 years ( 0-2years )	2-4 years ( 3-4 years )	5-9 years	10-19 years	20 years or more
Japan --1997	Man	100.0	105.8	116.9	146.4	194.2
	Woman	100.0	106.2	114.5	131.4	162.6
United kingdom -1995	Man	100.0	107.0	112.0	113.5	101.9
	Woman	100.0	97.8	101.9	100.9	115.1
Germany --1995	Man	100.0	105.9	111.3	119.2	126.9
	Woman	100.0	104.2	110.7	123.9	131.5
France --1994	Man	100.0	110.8	124.9	126.1	131.0
	Woman	100.0	114.4	119.8	115.9	121.7
Italy --1995	Man	100.0	105.7	110.1	118.2	133.6
	Woman	100.0	106.0	112.0	121.4	128.6
Sweden --1995	Man	100.0	110.0	112.3	127.5	112.9
	Woman	100.0	97.6	96.5	103.1	97.0

Source: The Japan Institute of Labor, Comparative Labor Statistics-Japan and Other Major Countries 2000, p 119.  
Japan: Ministry of Labor "Basic Survey on Wage Structure"

Others: EU "Structure of Earnings Statistics 1995"

Note: ( ) is Japan. Wages of Japan are monthly contractual cash earnings. EU each country is the monthly total income of money.

### **3. The mechanism for compensation standards determination**

#### **( 1 ) The mechanism for compensation standards determination in Japan**

In Japanese companies the amounts of pay increases are determined by collective bargaining, in which some factors, like performance of the company and the increase rate of consumer prices will be taken into consideration. Since companies in the same industry or in the same type of business decide pay increase amounts around the same time through collective bargaining, 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. For companies without trade unions, the wage negotiation results from the industries and business types similar to them will be their benchmark. According to the statistics from the Ministry of Health, Labor and Welfare, the wage hike rate for this year’s spring labor negotiations is 1.63%. The data was compiled by 189 companies listed on section 1 of either the Tokyo or the Osaka Stock Exchange, with paid-in capital of two billion yen or more, with 1000 or more employees, and with labor unions.<sup>2</sup>

Once the wage increase rate has been set up, the following task is to distribute it among employees. Salary increases generally take place once a year, which is called “periodic salary increase”. As mentioned above, in Japan technical staff and blue-collar workers are managed under the same system of human resource management. Currently, their basic wages normally consist of two types of wages: age and seniority-based wages that are increased in accordance with worker’s age or length of service; and skill-based wages determined under the “skill-based grade system”. Basically, employees in the same company 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 according to the appraisal by their immediate senior and the results of rank promotion examinations.

The amount of bonuses is also determined through negotiation between labor and employers. Bonuses are paid twice a year, in summer and winter. It is possible to adopt the sliding scale of the amounts and conditions of these bonuses in connection with performance at the company. The amount of bonus 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  $\times$  number of month of the calculated basic amount ) , and adding the rate of attendance at the company during the

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<sup>2</sup> [www.jil.go.jp/emm/vol.50](http://www.jil.go.jp/emm/vol.50)

period to which the bonus is applied and the evaluation coefficient ( according to the results of the personnel appraisal).

As for the mechanism of compensation standards determination for middle level managers, usually they are not covered by collective bargaining, so the rate of salary increase for them is not determined by negotiation between managers and labor. However the result of the collective bargaining in their companies could be a benchmark. The rate of salary increase for them is little bit higher than the result of collective bargaining, sometimes in the same level. We can also find some characteristics from the survey conducted by the Japan Institute of Labor in 2002, which covers large manufacturing companies with employees between 5000–20000 and trading/physical distribution companies with employees between 1500-10000.

With the heightening of competition due to globalization and predictions of the further aging of Japanese society, companies have become concerned about the burden imposed by the high salaries paid to the growing ranks of middle-aged and older employees. To create a better balance between those employees' salaries and their productivity, and to further motivate workers, many companies began to adopt a salary system based on annual performance for managers. In some companies the broadband-type of salary on job evaluation ( broadband-type job-based pay ) has been adopted for the basic pay for managers ( compensation is determined based on job title ) . For each job, job points are determined on job value + degree of responsibility. A grade is therefore determined. Unlike the employees who are not in management positions, there is no concept of periodic salary increases for managers because of the introduction of the job-based pay system. In some companies, a division chief or a person in an equivalent receives an annual salary based on job performance assessment (basic annual salary + annual salary based on job performance). A department chief or a person in an equivalent position receives a salary based only on performance. A Section chief or a person in an equivalent position receives basic salary ( 40% ) and salary based on job performance ( 60% )<sup>3</sup>.

Therefore we may say that in Japan at present, basically, pay system for non-position employees is based on age + skill rank system. For middle level managers, new mechanism has been introduced initially, which means that job-based pay ( based on roles ) and function-based pay ( based on function the company expects employees to fulfill ) are added. ( e.g., roles of a department chief are managing staff, making sales plans, and improving business performance. ) . In other words the mechanism of salary

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<sup>3</sup> The Japan Institute of Labor, Reference guide to Japan Human Resource Management-Manufacturing, p 7.

determination for middle level managers is changing gradually, while the portion of seniority declines the portion of performance-based increases.

## **(2) The mechanism for compensation standards determination in foreign-affiliated companies**

The principles of salary system in Hewlett-packard Japan Ltd., ( US ), expressed below, are typical for many companies in other developed countries. They are:

- Market Driven:  
Salary is determined by market valuation of the job.
- Pay for Performance:  
Individuals who achieved higher performance will be paid more than others.
- Fairness:  
Treat everyone fairly as much as possible. Therefore, the system is disclosed as much as possible.<sup>4</sup>

These principles summarized the ideas that are currently prevalent in many foreign-affiliated companies. A set of management methods and procedures, such as job design, market survey, and assessment system are supportive in achieving the above mentioned goals.

### **A. Job design**

In other developed countries, job-based wage system is widely adopted in many companies. Under this system, every employee belongs to a specific job level according to his/her position and salary is determined within the respective salary range based on individual evaluation.

In United States, blue-collar workers usually receive hourly wages and are paid by week. The actual wages paid are determined based on the job performance and skills within the job-based wage range. Companies must pay overtime allowance of 50% over their normal pay for the time exceeded 40 hours per week. For white-collar workers to which the system of annual salary applies basically has the same concept of "job-based salary". The range of the annual salary amount for the worker engaged in the job is determined based on the evaluation by each workplace. A worker's annual achievement objective is decided through discussion with the worker's senior, and that worker is evaluated based on the degree by which the objective has been achieved.

In regarding to job design, actual methods can be different from company to company.

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<sup>4</sup> The Japan Institute of Labor, The Personnel Management Cases of Foreign-affiliated Companies, 2, p9.



For example, having already applied a job grading system, American Express International, Inc. ( Japan ) changed it to a broadband system called the “Job Band System”, in which the previously-existing 12 job grades, with the manager class at the highest, have been merged into three bands, please refer to figure 3.

Figure 3. Job band system in American Express International, Inc. ( Japan )

Non-managerial positions	Grades 1 to 5 => 1 band
Supervisors	Grades 6 to 8 => 2 band
Managers	Grades 9 to 12 => 3 band

Source: The Japan Institute of Labor, the Personnel Management Cases of Foreign-affiliated Companies, 4, 2002, p 5.

Getronics Japan, Ltd. ( Netherlands ) introduced the “job family system”, which is a globally-common position grading system used by Getronics. Job family is referred to a group of jobs that are the same or similar in terms of the nature of the work involved. There are 5 job families, each of which is stratified into 4 or 5 levels. This arrangement makes it possible to rate individuals based on globally-common criteria and company implements various personnel management schemes according to this system. Figure 4 tabulates the jobs defined under the job family system with respect to the salary level at 8 grades. The job grading system is a pay-grading system applied on the basis of these 8 salary grades.

Figure 4. Relationship between pay-grade and job family

Pay-grade ( New job grade )	Job Family				
	Support	Technical service	Business development	Technology consulting	Professional
8					PR5
7					PR4
6			BD3B	TC4	PR3
5		TS4	BD3A	TC3	PR2
4	SU4	TS3	BD2B	TC2B	PR1
3	SU3	TS2	BD2A	TC2A	
2	SU2	TS1	BD1	TC1	
1	SU1				

Source: The Japan Institute of Labor, the Personnel Management Cases of Foreign-affiliated Companies, 1, 2002, p 4.

The salary is decided according to the salary range set for each grade within the job

grading system. The characteristics of the company's salary system are: to treat employees based on their accomplishments and contributions; to launch a performance-linked bonus that reflect the company's performance, the division's performance and the individual's performance.

Getronics Japan, Ltd. applies two salary systems on the base of job family ratings. The company introduced the annual salary system, together with the discretionary work system, which is applicable to BD2A, BD2B, BD3A, BD3B, TC2A, TC2B, TC3, TC4, PR1, PR2, and PR3. The other system, pay for work system, is applicable to SU1, SU2, SU3, SU4, TS1, TS2, TS3, TS4, BD1, and TC1.

Figure 5. Breakdown of annual salary



Source: The Japan Institute of Labor, the Personnel Management Cases of Foreign-affiliated Companies, 1, 2002, p 8.

As shown in figure 5, in Getronics Japan, Ltd., the performance-based annual salary ( performance-based bonus ) varies with the company's performance, the division's performance and the individual's performance. Higher job grades are subject to more variables and the annual salary is substantially dependent on the performance-based bonus. The fixed bonus is paid regardless of performance: a certain number of month's pay is given commonly at each job grade( minimum guarantee ). It also can be seen from the figure that the ratio of performance-based bonus increases with grade and the ratio of fixed bonus is higher in lower grades. Specifically, the performance-based bonus for the fiscal year is decided based on the performance in the previous year, and is paid biannually, in summer and winter.

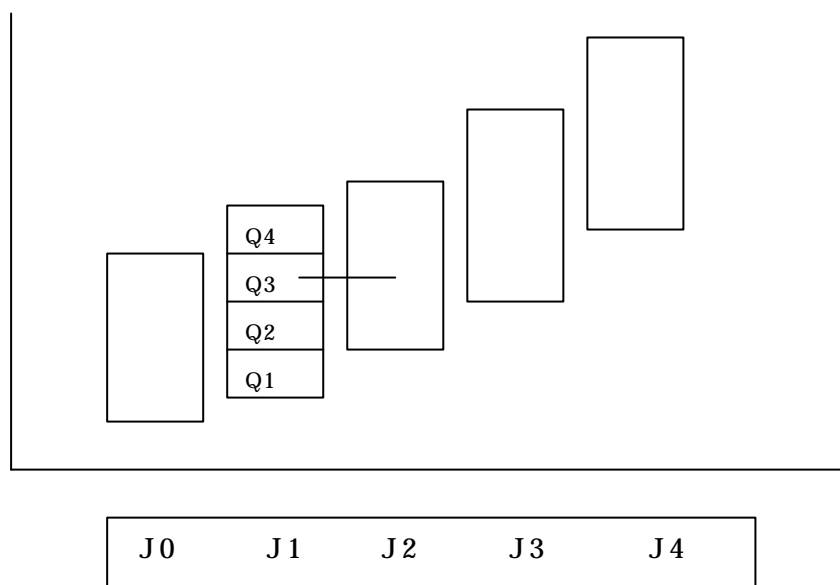
In terms of measures for deciding the bonus payable to the employees subject to pay for work, the company decides the number of months pay as the annual bonus for those in job grade 4 or lower, based on spring-time negotiations with the labor union. The performance-based portion is reflected in the year-end bonus.

Global Knowledge Network Japan, Ltd. ( US ) sets its salary level in accordance with job rank system. The rank starts at J0( rank of recent school graduates ), and goes up to J1, J2, J3 and J4. Each rank is divided into quarters and the amount of pay may vary widely within the same rank.

Employees know about the quarter to which they belong. They are ranked Q1 to Q4 depending on the results concerning the achievement of the contribution target, and their promotion and pay rise are decided based on the rank. For example, the evaluation might be the same for two employees, but an employee in the first quarter will get a 5% pay rise whereas an employee in the second quarter will get a 4% pay rise. Employees in

the third quarter or above are encouraged to move onto the next rank because the amount of pay rise is limited.

Figure 6. Salary rank system in Global Knowledge Network Japan, Ltd.



Source: The Japan Institute of Labor, the Personnel Management Cases of Foreign-affiliated Companies, 2, 2002, p 3.

## B. Marketing survey

In some industries, such as IT industry, the competition for acquiring human resource is fierce. As the pay range and the remuneration level need to be competitive in comparison to rival companies, some companies design their salary systems by marketing survey. For instance, Global Knowledge Network Japan, Ltd. ( US ) participates in a salary survey conducted by a consulting firm, and reviews it once every few years. The starting salary in the company is also determined in such manner that it matches the general market value according to the age and position identified by a salary survey. The other example is that SAP Japan, Co., Ltd. ( Germany ) decided to sustain the salary at a level that ranks between the top 10 to top 25 in the industry, based on salary survey conducted by a number of consulting firms.

In GE Yokogawa Medical System, Inc. ( US ) , base wages are determined in accordance with the grade of job of each employee. One central figure is set for each grade of job and salaries range between 75% and 125% of this amount. Employees in the same position of job are treated equally in the salary system, regardless of age or the number of years of employment. This central figure is called the base wage policy line and shows a salary level that the company should pay in each band of job. The base wage policy line is a

market standard of salary calculated on the basis of various research on salaries, representing the current salary range existing at GEYMS and its external competitiveness.

### **C. Evaluation system**

In other developed countries, there are some kinds of evaluation system that currently used. They are Management by Objective ( MBO ), Management by Result ( MBR ) and Management by Behaviors, Process and Results. Most companies use MBO system to conduct performance appraisal. In American Express International, Inc. ( Japan ), the objective achievement evaluation is conducted at the end of every business year, in which the degree of achievement by each employee is measured against his/her own goal that has been set at the beginning of the year in such a manner that it should match the three categories of "what to do for employees", "what to do for customers" and "what to do for shareholders". The percentages allocated to these three categories differ depending on the job or position, they are generally 25:25:50. The evaluation process takes a two-tier form in which the direct supervisor of an employee first conducts the evaluation and subsequently a more senior supervisor further scrutinizes the evaluation results and gives an approval. Prior to such evaluations by their supervisors, each employee is required to submit his/her self-evaluation. It is an established practice that, after final evaluation results are determined, the employee and his/her supervisor have a meeting to discuss the grounds for such evaluation or the gap between that and his/her self-evaluation, and a development plan etc.

In some companies, for instance, in Global Knowledge Network Japan, Ltd., ( US ) evaluation linked to the salary system is based on management by result ( MBR ). It is not on management by objective, ( MBO ) as they believe that results are subject to evaluation rather than the process. MBR involves the evaluation of two areas: the business performance during the year ( i.e. business target ), and the contribution made towards building the organization ( i.e. contribution target ). The evaluation is performed by the manager and the employee on a one-to-one basis and the evaluation results must be signed by the evaluated employee, which means the results must be acceptable to the evaluated employee as well.

In Nihon Ericsson company ( Sweden ), performance evaluation is conducted on the basis of three elements, i.e., "behaviors", "process" and "results". "Behaviors" refer to attitudes towards work, including strict punctuality in keeping promises and appointed times, prompt transfer of all messages taken from customers. "Process" refers to a process taken by an employee until a result is attained. As it is known that the

existence of an adequate “process” is essential for an employee to continuously show good performance, Nihon Ericsson has made the observation of a “process” one of the significant points in performance appraisal. “Results” means sales and/or profits, customer satisfaction, final quantitative and qualitative results attained, such as completion of a project etc.

#### **D. Measures to ensure fairly evaluation**

In order to gain fair evaluation results, two main methods have been adopted in many companies. The first one is to offer training courses to managers. For example, in Nihon Ericsson (Sweden), recognizing that appraisal skills on the part of managers are important, the company had all its managers go through a special training program focused on appraisal issues when it introduced the new personnel system, and they also plan to offer such programs on a regular basis. The other measure is to conduct 360-Degree Survey. As a tool for employees to learn “how people see me in the workplace” and improve and develop themselves, a “360-Degree Survey” is conducted once a year in many companies, although its results do not directly affect their evaluations.

In General Electric International Inc.(US), an employee is evaluated by 8 to 15 people in three different relationship categories, i.e., supervisors, colleagues and customers, that the employee chooses himself/herself under the advice of his/her supervisor, who are asked to answer 5 to 60 questions on the web. Customers as referred to here are not necessarily restricted to external people and may also be employees in other department. As the 360-degree survey is first and foremost a tool designed for the purpose of giving feedback to employees, no one else can access its results. Employees are encouraged to prepare an “Action Plan” in response to the results of the 360-degree survey and submit it to the respondents of the survey in return.

In Nippon Becton Dickinson Company, Ltd., 360-degree feedback is conducted by more than 6 members, direct supervisor, subordinates and peers. It is not a process for others to evaluate an individual. The findings are used to improve performance in the following year.

In Johnson & Johnson(US) , each employee is subject to a 360-degree survey in which his/her supervisor, workers working under him/her and his/her colleagues answer a questionnaire. Survey results thus obtained are fed back to the employee so that he /she can identify room for improvement to become an ideal employee, draw up an improvement plan and achieve growth on his/her own.

### **E. Methods of salary and bonus distribution**

Job design, marketing survey and performance evaluation system provide a foundation for payment distribution. Just like the different job design and performance evaluation systems adopted in many companies, the salary distribution system in many companies are also different in terms of implementing methods even they are all performance-based system.

The pay structure in Nihon Ericsson (Sweden) is composed of base pay and variable pay. The amount of base pay is reviewed every year on the basis of performance appraisal results with reference to the market standards of salaries. Company determines a pay range by first classifying all the work positions existing in the company into 11 job categories and subsequently combining the job category with the 6 role grades. Variable pay can be divided into two portions, namely, a guaranteed portion and a variable portion. Unless there are any problems with the number of working days or some other work-related circumstances, employees can receive the guaranteed portion for sure. On the other hand, the variable portion is determined on the basis of annual performance evaluation: in principle, the higher the role grade, the larger the amount of pay variation will be. See table 7.

Table 7. Variable pay guideline

	Maximum months	Minimum months
Grade 4	6	2
Grade 3	5	3
Grade 2	4.5	3.5
Grade 1	4.25	3.75

Source: The Japan Institute of Labor, the Personnel Management Cases of Foreign-affiliated Companies, 1, 2002, p 24.

The pay structure for employees with the role grade of 5 or higher (senior manager level or higher) is not based on the combination of a base pay and a variable pay. Instead of a variable pay, they are paid a short-term-incentive. The STI is an incentive program commonly applied to all Ericsson group companies worldwide and its recipients are given separate notice regarding their compensations.

Sun's (Sun Microsystems, Inc) wage system consists of base salary, allowances, seasonal bonus and performance-based bonus. The base salary in each job rank may go down to 80% or go up to 120%. For ordinary employees, performance-based bonus is calculated by multiplying the basic salary by a certain type of coefficient, which is determined on the basis of company's performance and the individual's performance.

The coefficient accounting for the company's performance is set at 0 if no more than 80% of the target of sales, profits, etc. has been achieved and at 2 if at least 140% of such target has been achieved. The coefficient accounting for the individual's performance is set between 0 and 22% depending on the extent to which the job target has been accomplished. In other words, if the company achieves at least 140% of the target and the individual's performance earns the highest rating, assuming that an employee's basic salary is 5 million yen, the employee will be paid a performance-based bonus of 2.2 million yen.

5 million yen  $\times$  2 ( company's performance )  $\times$  22% ( individual's performance ) = 2.2 million yen.

On the other hand, if the company can not fulfill 80% of the target, or if the individual's performance rating is 0, he/she will not be paid bonus.

For management-level employees when account for their performance-based bonus, the individual's performance is set at between 0 and 24%, which is 2 percent higher than that of ordinary employees.

In some companies, such as Nippon Polaroid (US), pay system is a more demanding one for senior managers because of two reasons. One reason is that the heavier the responsibility becomes, the greater the change in the compensation according to business performance becomes. The other reason is that there are no upper or lower limits for performance-based portion in the compensation for directors and managers. The system is strongly linked to business performance for senior managers since division manager and above are on annual salary system, indicating that a large portion of their compensation is based on performance. Section managers and below receive monthly salaries, performance-based compensation, bonus and allowance. A maximum of 25% compensation is linked to business performance. Bonus for section managers and below also varies according to business performance and differences may be about four times of the total monthly salary at the maximum. Factors such as the level of difficulty in achieving the objective are considered for evaluation of salaries, but bonuses are based solely on actual achievement.

#### **4. Compensation system comparison between Japan and other developed countries**

Through payment system studies we find that there are some differences between Japan and other countries. The main differences are as follow:

##### **( 1 ) Bonus**



Bonuses, which are typically paid twice a year ( in June and December ) , are one of the characteristics of Japanese payment practice. They amount to more than 20% of the annual wages of an average Japanese worker. In some industries such as banking and insurance, the total amount of yearly bonus even is around 5-6 monthly salary. From table 8, it can be seen that the amount of bonus in Japan is about 18 times higher than that in UK and 2 times higher than that in Germany and France. Perhaps because bonuses in Japan is part of compensative salary paid in addition to one's monthly salary.

Table 8. The amount of bonus in some developed countries ( percentages )

	UK ( 1992 )	Germany ( 1992 )	France ( 1992 )	Japan ( 1991 )
Bonuses	1.09	7.91	9.68	19.00

Source: Japan: Ministry of Labor, General Survey on Wages and Working Hours System and Basic Survey of Wage Structure.

EC: Eurostat, Labor Cost Survey; USA: US Chamber Research Center, Employee Benefits.

## **( 2 ) Incentive system**

The main method of incentive in Japanese companies is uniform bonus which paid to all employees. In other developed countries, such as United States, many companies have adopted incentive system, and there are some kinds of measures. Bonus are paid based on achievement and mainly paid to managers and white-collar employees. Please refer to table 9.

Table 9. Example of pecuniary incentive program in United States

Type	Main targets	Target period	Amount	Achievement	Expected effect
Profit sharing	All employees	1 year	Depending on profit	Increasing profit ratio	Retaining employees,
Stock option	Upper management	3 years	Depending on stock prices	Increasing profit ratio	long-term motivation, recognition by company
Commission	Sales	1 year	Around 35%-65% of base pay	Increasing sales	Luring applicants, retaining employees,
Annual incentive	People occupying positions or higher	1 year	Around 10%-50% of base pay	Successful MBO	short-term motivation
Milestone incentives	Engineers	0.5-2 years	Around 10%-40% of base pay	Achieving development objectives	
Award	Given Immediately for short-term contributions by an employee ( This is a small amount of around \$100. Gifts other than cash are also given. )				Recognition and praise for results achieved by an employee

Source: The Japan Institute of Labor, Guide to Human Resource Management, Comparative HRM Between Japan and United States, p45

### (3) Employee share ownership schemes

The employee share ownership schemes, which include variable forms, such as stock option and so on, as one of the additional resource of income, are widely used in the United States. From 1980 to 1990, it began to be introduced in many European countries in such measure as financial participation. Financial participation is participation of employees in profits and enterprise results. It is a form of remuneration additional to an employee's wage or salary. It is usually seen in two main forms: profit-sharing or employee share ownership. In Japan now some foreign investment firms have introduced the share holder system. For example, in Nihon Ericsson Japan ( Sweden ), the top 20% of key contributors among employees of Ericsson group companies worldwide are granted Ericsson stocks free of charge under the stock option

system. In GE Yokogawa Medical System, Inc. (US), about 5% of the highest performing employees are assigned GE stock. This privilege used to be offered to employees in management position only, but the system has been utilized as a means to increase the degree of job achievement of employees in recent years and beneficiaries have therefore been selected regardless of whether they are in management or clerical position. Table 10 shows the current situation in this regard in Europe.

Table 10. Business units with financial participation schemes in European countries %

Country	Percentage
Austria	9
Belgium	29
Denmark	21
Finland	30
France	41
Germany	20
Greece	23
Ireland	34
Italy	15
Netherlands	45
Portugal	5
Spain	19
Sweden	26
United Kingdom	45

Source: Employee Share Ownership and Profit-Sharing in the European Union, Luxembourg: Office for official publications of the European Communities, 2001, p31

Compare to the statistics from European countries, share ownership system in Japan is not as prevalent as that in Europe. According to the 1999 General Survey of Wages and Working Hours System by the former Ministry of Labor, in Japan 4% of companies with 1000 or more employees have introduced stock options, allowing workers the choice of purchasing stock in their companies at a price fixed in advance. According to the survey, it can be expected that the introduction of this system will continue in the future, focused on large-scale enterprises.<sup>5</sup> Actually in Japan now, some newly founded firms,

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<sup>5</sup> The Japan Institute of Labor, the Labor Situation in Japan 2002/2003, p 38.

which have special technology and are targeted at new investment, are introducing the stock option system. There are also such so many firms in Japan.

## **5. Experiences from Japan and other developed countries**

Above all we have examined the compensation system in Japan and other developed countries, and maybe some conclusions can be drawn from the research as follow:

### **(1) Compensation system should be suitable to the circumstance of a country**

In the process of study we found that with Japanese characteristic, seniority-based wage system is a very successful practice and has been playing a very important role in the development of Japan's economy. When explained the phenomenon Mr. Haruhiko Hori wrote: Under this system, "by staying at one firm, workers acquired skill with their employer's proprietary technology. Employers, in return, used promotions to reward employees for their skill development. Additionally, the tendency of the cost of living to increase as employees aged further justified linking wages to seniority. Thus, promotions following skill improvement and increases in cost of living were connected to longer years of service, and the seniority-based wage system was established to raise wages with advancing age and years of service."<sup>6</sup> Therefore, both employers and employees benefit from the system and it might be the reason for the success of this system because it fits the situation in Japan. Furthermore the experience in Japan indicates that for a country, a good compensation system is a system that suits the situation of the country as each country has its own social background such as different history, culture and so on. From this point of view we may say that the new compensation system satisfied with the demands of market economy, which is expected to be established in the process of economic reform in China, should reflect its own characteristics. In other words, we should absorb experiences from other countries in accordance with the specific circumstance in China.

### **(2) Compensation system should be adjusted according to the changing situation**

Compensation system should be founded in accordance with the circumstance of a country; on the other hand, it also should be changed with changing situation. Due to the changing condition there are going to be some adjustments, by which some new measures will be introduced and some obsolete practices and regulations have to be abolished or replaced with alternative methods. For instance in Japan the portion of

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<sup>6</sup> The Japan Institute of Labor, the Labor Situation in Japan 2002/2003, p 31.

allowance and welfare in salary has decreased in recent years because company's burden of legal welfare expenses and retirement allowance is expected to increase, so they have to make an effort to curtail the non-legal welfare expenses as much as possible. In addition, there is a growing trend of abolishing personal allowances that are not related to job, such as allowance for family and allowance for housing. The other example is that some major banks, such as Bank of Tokyo-Mitsubishi, The Resona Bank Group and Mizuho Financial Group plan to cut the pension benefits they provide to employees retired by 7-20%, 48% and 40% respectively.<sup>7</sup> The Analysis of the Labor Economy 2003, shows that more than 70% of the companies plan to change their wage system, and more than 30% of the companies have increased the weighting of achievements and performance as wage determination factors.<sup>8</sup> The experiences from Japan told us that adjustment of payment system based on the changes in the field of social and economy is necessary, or the development of economy will be hampered.

### **(3) Evaluation system is essential for the implementing of performance-based wage system**

As discussed above, many companies intend to expand the portion of performance-based in their wage system, but the main problem for them is that while employees approve the introduction of a performance-based wage system and wage differences based on evaluation, they feel some concern as to whether such evaluations would be fair. According to the information from Ministry of Health, Labor and Welfare, there is a risk that depending on how objectives are set and implemented, the performance-based wage system may have a negative impact on employees' desire to work and human resources development. For this system to function effectively, it is important to gain the agreement of employees by setting proper objectives, maintaining transparency and fairness.<sup>9</sup> The analysis from Japanese government introduced the current situation in Japan, it also might be a challenge for us because we also plan to adopt performance-based wage system in China. Therefore it is important to pay attention to and enhance research work on this issue.

### **(4) Incentive mechanism should be combined with enterprise's culture**

In China, before economic reform, the major problem in terms of payment system in enterprises is that there were no effective incentive measures. Under this system wage

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<sup>7</sup> The Japan Institute of Labor, The JIL Labor Flash/vol. 38, E-mail Journal, 03,17,2003.

<sup>8</sup> Ministry of Health, Labor and Welfare, Summary of the Analysis of the Labor Economy 2003, p22.

<sup>9</sup> Ministry of Health, Labor and Welfare, Summary of the Analysis of the Labor Economy 2003, p23.

standards for all employees were set and regulated by government, so employees were paid same amount of wages regardless of contributions to their enterprises. This situation has changed gradually with the development of economic reform and the introduction of experiences from other countries in regard of payment system. While motivation system has been adopted in some enterprises, the importance of enterprise's culture should also be emphasized. The enterprise's culture refers to the loyalty and the feeling of identification to the companies employees serve for. For employees, in most cases, their satisfactions can't be fulfilled only by the amount of wages or salaries. What they desire, except for economic rewards, should include the feeling of success from career development. Therefore one of the important tasks for companies is to provide their employees with harmonious working environment, as well as payment system that is full of motivation to keep labor force stable.

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