

ARJAN B. KEIZER

# The Changing Logic of Japanese Employment Practices

A Firm-Level Analysis of Four Industries



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**A Firm-Level Analysis of Four Industries**

De veranderende logica van  
Japanse werkgelegenheidsinstitutes

Een analyse op ondernemingsniveau van vier industrieën

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by

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Summary

Nederlandse Samenvatting [Dutch summary]

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## List of important Japanese terms

<i>arubaito</i>	casual jobs for a limited number of hours a week
<i>buchō</i>	general manager (see appendix one, table A.10 for a list of hierarchical titles)
<i>haiten</i>	reassignment of workers
<i>honninkyū</i>	person-related wage
<i>ippanshoku</i>	general, auxiliary employment track
<i>jusen</i>	housing loan corporations for real estate lending
<i>kachō</i>	department manager, section manager
<i>kaizen</i>	improvements in the production process
<i>kanban</i>	system for horizontal coordination
<i>keiretsu</i> (vertical)	supplier networks headed by a final assembler
<i>kigyō kumiai</i>	enterprise unionism
<i>kihonkyū</i>	basic wage
<i>mokuyō kanri seido</i>	management-by-objectives
<i>nenkō jōretsu</i>	seniority wage system
<i>nenpōsei</i>	annual wage system
<i>nōryōkyū</i>	ability-related wage
<i>pāto</i>	part-time (broad and strict definition)
<i>satei</i>	personal assessment
<i>seikashugi</i>	performance-principle
<i>seishain</i>	regular employee
<i>senmonshoku</i>	specialist employment track
<i>shigotokyū</i>	job-related wage
<i>shōkaku</i>	promotion to a higher horizontal rank
<i>shokunō shikaku seido</i>	ability qualification system, qualification grading system
<i>shōshin</i>	promotion to a higher vertical rank
<i>shukkō</i>	temporary transfer employee
<i>shūshin koyō</i>	lifetime employment
<i>shūshoku</i>	job-hunting
<i>shokutaku</i>	specialist or re-hired employees on fixed-term contracts
<i>sōgōshoku</i>	career employment track
<i>taishokukin</i>	lump-sum payment at mandatory retirement
<i>tantōshoku</i>	general, auxiliary employment track
<i>teikishōkyū</i>	automatic annual salary increase
<i>tenseki</i>	definite transfer employee
<i>(kōnai) ukeoi</i>	‘internal contractor’
<i>zokujinkyū</i>	person-related wage





Ironically, the causes of the crisis are now often attributed to the very institutions hailed as keys to the Japanese economic juggernaut in the late 1980s (Whittaker and Kurosawa, 1998, 761).

# 1. Reconsidering the Debate on Japanese Employment Practices

## Introduction and framework

*From success to failure, the debate on Japanese employment practices. The economic malaise of the 'lost decade'. Introduction to the research. The logic of Japanese employment practices. Research methodology and method. Chapter overview. Concluding remarks. References.*

### **From success to failure, the debate on Japanese employment practices**

Since the 'burst of the bubble' late 1989, the Japanese economy has known a reversal of fortune among the most dramatic in modern history. Most striking has not been the initial reversal but the subsequent lack of economic recovery. As a manifestation of this change of fortune, this period of stagnation has become known as the 'lost decade', in retrospect a rather conservative qualification of its length. All major economic indicators testify of this reversal. Real GDP growth rate in the 1990s was less than 1 per cent on average, unemployment rose from 2.1 per cent in 1990 to 5.3 per cent in 2003.<sup>1</sup> The loss in asset value was unprecedented as both

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<sup>1</sup> Internationally, this is not an extraordinary percentage. However, it is extremely high for Japanese standards as Japan's unemployment has been limited to one or two per cent during most of the post-war period. Moreover, as the next chapter will show, employment security has been a

land and stock prices fell to the levels of about twenty years ago.<sup>2</sup> The weak economic performance is particularly striking when compared to that of the decades before the bubble burst, when the Japanese economy knew a long period of high economic growth.<sup>3</sup> Even though growth decreased after the first oil crisis in 1974, the Japanese economy kept outperforming those of most other nations and with an impressive spurt of growth in the late 1980s, Japan was seen to threaten the US position as the world's leading economy.

The change from success to failure has been mirrored in the perception of the Japanese economic institutions. From the late 1970s, the Japanese economic success came to be seen as more than a temporary phenomenon and as a direct consequence of a specific Japanese 'model'.<sup>4</sup> This belief in the economic efficiency of the Japanese practices started with foreign observers who praised the Japanese system of industrial organisation for its overall efficiency (e.g. Dore, 1973; Vogel, 1979). In later years, specific characteristics of Japan's economy were singled out as sources for its competitive strength. Examples include the organisation of production (that became known in the West as lean production), the extensive and close cooperation with suppliers (just-in-time delivery, *keiretsu* networks), the typical employment practices (lifetime employment) and the guiding role and support by the government.<sup>5</sup> However, the positive perception changed when the economy proved incapable to return to its (former) path of economic growth during the 1990s. The same institutions that were previously considered instrumental in the Japanese success have become subject to substantial criticism in a debate about the revitalisation of the Japanese economy. Important topics include cross-shareholding

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major objective of the government and the high unemployment percentages can be seen to entail a failure of its policies.

<sup>2</sup> The index number for the average land prices in the six major cities declined from 100 in 1990 to 30.4 in 2002 and the Nikkei 225 index fell from its year-end high of 38,916 in 1989 to 8,579 in 2002. In this respect, it needs to be stated that the composition of the Nikkei 225 index was changed in April 2000. Ito (2003) estimates that under its old composition the Nikkei would have been about 4,000 points higher in 2002.

<sup>3</sup> In the 1950s and 1960s, GDP grew between six and twelve per cent and in the 1970s and 1980s, growth remained between three and five per cent with several upward exceptions. The Japanese economy doubled in size every seven years between 1950 and 1973 (Blomström, Gangnes, and La Croix, 2001).

<sup>4</sup> It is ironic that, by then, the very high economic growth before the first oil crisis was already beyond reach. We can thus conclude that the positive perception lagged economic performance by a substantial number of years.

<sup>5</sup> See Aoki and Dore (1994) for a collection of articles on the predominantly positive contribution of the various institutions and practices to the Japanese economy. Included examples are the incentive system (Koike), training productivity and quality control (Sako), networks (Asanuma), research and development (Westney; Okimoto and Nishi), human resource management (Itoh), the main bank system (Hoshi) and interlocking shareholding and corporate governance (Sheard).

practices, the close co-operation with suppliers and relational banking. Moreover, the criticism has also extended to the typical Japanese employment practices like lifetime employment and seniority-based wages.<sup>6</sup>

For many years, its employment practices were considered as one of the cornerstones of Japan's economic success. As with many of the Japanese institutions, this positive evaluation culminated in the 1980s and early 1990s when several analyses pointed out how the employment practices contributed to the success of Japanese firms (e.g. Aoki, 1988, 1990; Koike, 1995, 1997). However, the lack of economic growth and various structural developments, like the ageing of the population and the increasing importance of the service sector, have led to a reversal of perception. The critical acclaim of a few years ago has made way for a renewed discussion on the efficiency of Japanese employment practices and the need for adjustment. This is reflected in a large number of articles on (the need for) changing employment practices (e.g. Ornatowski, 1998; Hirakubo, 1999; Holzhausen, 2000; Watanabe, 2003) and the reconsideration of employment practices by Japanese firms, industry-, and government organisations. Nevertheless, little agreement exists on the degree and direction of change and this has led to a lively debate on reform between those who focus on either the advantages or disadvantages of 'traditional' employment practices and propose either continuation or change of existing practices.<sup>7</sup>

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<sup>6</sup> The Economist's survey of Japan, entitled 'What ails Japan?', in 2002 provides an interesting example. In its usual subtle manner, the Economist discusses the need for change among, for instance, the banks ('chronically weak and...burdened by duff loans'), the firms ('few...outside the plain that extends from Tokyo to Osaka are internationally competitive'), politicians ('they pumped money...into companies that were so inefficient that they should have been allowed to go bust'; the existence of 'corruption and conservatism'), and the tradition of consensus ('that has led to the cossetting of rotten businesses and incompetent public-sector corporations...and reinforces a lack of individualism'). Eight years earlier, the Economist had already spoken about the 'built-in obsolescence' (July 9<sup>th</sup>, 1994, 18) of Japanese working practices and institutions. Although most commentators will not share the phrasing or the extent of the Economist's criticism, a rather general consensus exists that many of Japan's institutions were suited for a developmental economy but have outlived their usefulness. Blomström, M., Corbett, J., Hayashi, F. and Kashyap, A. (2003) provide a more nuanced overview of the 'Structural Impediments to Growth in Japan'. This edited volume includes discussions of financial sector profitability (Fukao), the deteriorating fiscal situation and the ageing population (Dekle), the distribution sector (Flath), labour (Ono and Rebeck) and corporate groups (Yafeh).

<sup>7</sup> Holzhausen (2000) labels these groups as 'apologists' and 'critics'. He admits that such a dichotomous presentation of the debate is a simplification but values its explanatory usage as it clearly distinguishes the pros and cons of the Japanese employment practices. Apologists stress how the employment system has historically shown a remarkable flexibility to adapt to changing circumstances and plead for modification of existing practices. They point out that the current practices around the core institution of permanent employment enable employees to acquire firm-specific skills that generate higher labour productivity. Critics, on the other hand, challenge the importance of firm-specific skills and plead for fundamental changes. They stress that the firm-

However, as this study will show, we should not take this discussion on change at face value. The debate on change has basically been around ever since the typical character of Japanese employment practices was first described by Abegglen (1958). Many analyses in the past have explicitly expressed the expectation that substantial changes were imminent (e.g. Abegglen, 1973; OECD, 1973).<sup>8</sup> Even the predominantly positive evaluations since the 1970s did not end this and, in retrospect, the analyses on the 1980s and early 1990s can probably be considered an exception in their relative silence on the issue of change. However, actual changes have fallen short of expectations and, until the 1990s, change remained limited to, what we can consider, the periphery of Japanese employment practices. We must therefore wonder if the current situation differs from before and will lead to substantial changes in Japanese employment. At the same time, we cannot deny that some of the current challenges, both cyclical and structural, are unprecedented. They will not cause an overnight dismantling of Japanese employment practices but can be expected to have a substantial impact.

With these considerations in mind, this research takes its position within the debate on changing Japanese employment practices by studying the likeness, character and consequences of changing Japanese employment practices. An important question is whether the current changes will impact the core of Japanese employment practices or, once more, remain limited to their periphery. In addition, the apparent contradiction between past success and current failure raises important questions. How can it be that institutions that were (perceived as) successful a few years ago have suddenly lost their value? Have circumstances really changed that

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specific character of skills does not enable employees to react to discontinuities. Moreover, as lifetime employment leaves employees without an outside option, it rewards obedience and discourages innovative, creative thinking and the weak external labour market (a direct consequence of the strong internal labour markets) hampers the adaptations to the changes in the economy.

<sup>8</sup> Abegglen (1958) predicted that the employment practices would change with the growing internalisation and prosperity of Japan. Moreover, the predominantly positive evaluation of Japanese employment practices in later years did not really change this expectation. Abegglen (1973, 20-1) states that '[i]t is evident that the early years of the 1970s mark a broad-ranging transition period for Japan and its economy' and that '[t]hese issues suggest very great changes indeed in Japan over the next several years'. The OECD report 'Manpower Policy in Japan' (1973) calls '[t]he timing of its examination...opportune for revealing critical problems for the future of Japanese manpower policy'. Dirks (1997) also provides an interesting illustration when he lists the following signs of changing employment practices: (1) widespread, personnel-related cost reduction measures, (2) an increase of more precarious employment forms such as a rise in the number of part-timers, (3) an increase in employment flexibility, and (4) a more results-oriented, profitability-based work organisation and resultant incentive schemes. After listing these, and when the informed reader will have nodded in recognition, Dirks mentions that this list of changes comes from a paper written in the early 1980s.

much and fast? Has economic success maybe obscured problems for a long time? Or, and this would be particularly interesting for economic theory, have past analyses been partial and overestimated success? These and similar question will guide this research and enable us to formulate a well-founded answer to both the issue of change and the paradox between past success and current failure.

The remainder of this chapter discusses the structure, research questions and major theoretical perspectives of this study. It subsequently discusses the meaning of the word 'logic' in the title, a concept that characterises both the employment practices themselves and the theories used to analyse these practices. The chapter then continues with a section on research methodology and method before it ends with an overview of the remaining chapters. However, before the description of the research commences, the next section provides the necessary background by sketching the important factors behind the 'burst of the bubble' and the 'lost decade' that followed. This will provide a first but important indication how employment practices can be related to Japan's economic malaise.

### **The economic malaise of the 'lost decade'**

It is undeniable that the lack of economic recovery during the 'lost decade' has been instrumental in the recent renewal of the debate on Japanese employment practices. Many critics see these practices as one of the major structural problems of the Japanese economy. However, it would be an oversimplification to relate the economic malaise directly to Japanese employment practices as its causes are various. It is very well possible that the weak economy has merely rekindled old beliefs on Japanese employment practices and we must therefore examine if these practices truly add to the lack of economic recovery or if they merely take the blame. This section takes a first step towards answering this question by discussing the various causes that have been provided in explaining the burst of the bubble and the subsequent economic malaise. In discussing these causes, the main debate is between those who favour macro-economic and those who favour structural explanations.<sup>9</sup> As a matter of fact, the by now accepted view predominantly stresses the importance of macro-economic factors.<sup>10</sup> This section will discuss these factors as both a background to this study on the need for changing employment practices.

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<sup>9</sup> As we will see in the next chapter, these two positions also determine the political debate on employment practices. In recent years, the government and the employer organisation Nippon Keidanren have stressed structural problems and the need for reform ('*Risutora*') while Rengo, the national organisation of labour unions, has stressed lack of demand as the main cause of weak economic performance and denied the need for major structural adjustments.

<sup>10</sup> Weinstein (2001) explicitly discusses to what extent the current recession reflects structural rather than macro-economic (cyclical) factors. He describes the common tendency to look for structural interpretations of business cycles. 'Losing one's job...is often a tragedy for workers



A discussion of the economic malaise can probably best start with the burst of the economic bubble at the end of 1989.<sup>11</sup> In the second half of the 1980s, the Japanese authorities implemented an expansionary monetary policy to halt the further appreciation of the yen after the 1985 Plaza Accord. At the same time, they also continued the financial liberalisation in response to foreign pressures for increased market access. The combination of these policies is nowadays seen as the key cause of the asset price inflation that led to the bubble (Fukao, 2003). The figures are insightful. Between 1985 and 1989, the Nikkei 225 stock index more than tripled in value and in another year, average land prices had achieved a similar rise. When the bank of Japan finally raised the interest rate to cool the economy, it turned out to be too late. The economic downfall was just as impressive as its initial rise. The Nikkei 225 plummeted within one year from 38,916 to 23,984. The decline in land prices followed two years later. All major groups in the economy – banks, firms and households – suffered from this decrease in asset value and the ‘burst of the bubble’ thus initiated a long period of meagre economic growth.

In particular, the position of Japanese banks has been weak and many see the banking crisis as the main cause for the economic stagnation in the 1990s (Kanaya and Woo, 2000). Important explanations for this weakness include insufficient regulatory supervision (Hoshi and Kashyap, 1999; Honda, 2003; Ito, 2003), forbearance (Kanaya and Woo, 2000), and the bankruptcy of the old system of community banking (Nishimura and Kawamoto, 2003). The impact of weak supervision originates from before the bubble burst, when deregulation strengthened the ability of large firms to borrow directly from the market. This put a downward pressure on banks’ interest rate margins and, in the absence of a proper regulatory

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and their families...How can such pain be caused by something so trivial as misreading information about monetary aggregates?’ (Weinstein, 2001, 29). Not surprisingly, he continues by stressing the importance of macro-economic causes. However, as the discussion of the problems in the banking sector will show, the distinction between cyclical and structural causes is not always easy to draw. Weinstein, for instance, acknowledges that the mountain of bad debts held by Japanese banks is a structural problem but decides to regard the banking crisis as macro-economic since it can be considered a rather natural consequence of the preceding bubble.

<sup>11</sup> We will thus not discuss the factors that have contributed to the exceptional economic growth during the preceding decades. Blomström, Gangnes, and La Croix (2001) present a good overview of these factors, which they describe as part of a nowadays ‘well-established view’. They list, as important factors, the very high domestic savings rate, macro-economic policies that restrained inflation, a well-developed financial sector and capital controls that insulated the domestic capital market. In addition, they refer to the importance of the good primary and secondary schooling and the contribution of the government’s industrial policies. Finally, we have already discussed the contribution of practices like specific production management and inter-firm relations in the form of *keiretsu* (Aoki and Dore, 1994).

framework for supervision, heightened risk taking by banks.<sup>12</sup> The consequences of this behaviour became clear when the bubble burst and banks were confronted with an erosion of their capital and a sharp decline in the quality of their outstanding loans.<sup>13</sup> Ito (2003) therefore concludes that supervision should have been enhanced when deregulation allowed more competition in the 1980s. However, it would take a long time and several crises and bankruptcies before the authorities took substantial steps to confront the arisen situation; out of the false hope that the economy would soon recover, because they feared a public panic, and because they expected strong banks to rescue those troubled as had been custom under the ‘traditional’ convoy system. Kanaya and Woo (2000) speak in this respect about regulatory forbearance. In the meantime, the effectiveness of the main bank system suffered because the banks, preoccupied with their own state of affairs, were no longer able to perform their monitoring role. Moreover, fears for a loss of reputation made banks hesitant to allow their borrowers to default and the banks thus also exercised forbearance.<sup>14</sup> The situation was aggravated by the lack of economic recovery, the subsequent lack of business opportunities, and additional bad debts. As a consequence, additional bad loans outweighed those written off by the banks (Hoshi, 2002; Fukao, 2003). The authorities tried to strengthen the banking sector by supplying funds (Fukao, 2003; Nishimura and Kawamoto, 2003) and improving the regulatory framework in the late 1990s. Important initiatives were the big bang reforms in 1996 (Honda, 2003) and the establishment of the Financial Supervisory Agency (FSA) in 1998 to supervise the financial system (Kanaya and Woo, 2000). However, the authorities are blamed for not doing so earlier (Saxonhouse and Stern, 2003; Ito, 2003).<sup>15</sup>

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<sup>12</sup> Many banks reacted by expanding the riskier segments of their portfolios and increased lending to consumers, the real estate sector, and small- and medium-sized enterprises. A persistent focus on market share contributed to a neglect of credit standards.

<sup>13</sup> The first signs of serious failure were the problems concerning the *jusen* companies (housing loan corporations) that became apparent as early as 1992. Because these *jusen* companies focused almost exclusively on real estate lending, they were extremely hard hit by the collapse of real estate prices. Eventually, these companies were dismantled in 1996, the parent and creditor banks bearing the majority of the costs. Other failures in the banking sector included the liquidation of several insolvent credit co-operatives in the middle 1990s and the bankruptcy of several large and well-known financial institutions in 1997.

<sup>14</sup> Banks took several actions to assist in the survival of troubled firms like reducing interest rates, extending the maturity of loans, capitalising unpaid interest, and opening new credit lines for defaulting borrowers. Banks even used ‘related companies’ for cleaning up their balance sheets, something made possible by a loophole in regulations that was only closed at the end of 1998.

<sup>15</sup> Saxonhouse and Stern (2003) state how during most of the decade no political support existed for the use of public money to bail out Japan’s banks. ‘When problems spread to larger banks from the *jusen*, again the regulators and politicians did not take early, pre-emptive action. There was no legal structure to close insolvent banks, or inject capital into weak banks. It was only after the crisis of November 1997 – in which two securities firms and one large bank failed – that the government prepared funds for capital injection’ (Ito, 2003, 287). Funds finally became

Just like the banks, firms also suffered from the decrease in asset value. Firms had acquired their assets by borrowing against the collateral of those assets and when prices plummeted, many balance sheets turned red. This forced them to mend their balances and refrain from investments. Koo (2001) mentions how the corporate sector turned from a net taker to a net supplier of funds and the resulting weakness of the economy made asset prices fall even further, thus aggravating the problem of weak balance sheets. 'The result has been a vicious cycle brought about by the so-called "fallacy of composition", that is, everybody is doing the right thing from their individual perspective, but the combined result of their efforts has been the opposite of their aggregate goal' (Koo, 2001, 16). Koo refers to this kind of recession as a 'balance sheet recession'.<sup>16</sup> An alternative explanation for the difficult financial position of corporations stresses lack of supply by the weakened Japanese banks, which were forced to reduce their outstanding loans, thus causing a credit crunch for private investors (Fukao, 2003).<sup>17</sup> It is likely that the relevance of these two explanations differs between different periods of time (the tightening of supply was particularly relevant after the Bank of International Settlements' requirement became effective in 1997) and between different potential borrowers. However, both subscribe to the low investment demand by Japanese corporations as an important cause for the lack of economic growth.

In comparison to the financial and corporate sector, the direct impact of the 'burst of the bubble' on individual households has been relatively modest but the loss in value of land prices and stocks they suffered also contributed to the diminished demand.<sup>18</sup> In addition, general uncertainty about the future, and employment stability in particular, has reduced consumer confidence and further

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available in 1998 and 1999 but banks were reluctant to apply for these funds because they did not want to draw attention (see Ito, 2003).

<sup>16</sup> This explains why the economy has been insensitive to low interest rates. However, on a positive note, Koo (2001) expected that the balance sheets would be restored to pre-bubble levels within 2 or 3 years.

<sup>17</sup> Important was the rule of the Bank of International Settlements (BIS) that internationally operating banks must maintain 8 per cent of self-capital. When it decided to sign an agreement with the BIS in the 1980s, the Japanese government did not expect any problems because Japanese stock prices kept rising and could be included among capital for 45 per cent of their value. However, when the 8 per cent requirement came into effect in 1997, the situation had changed almost completely. Gao (2001) describes how within one month Japanese city banks cut loans by 15 trillion yen and Yamaichi Securities Company and Hokkaido Bank declared bankruptcy.

<sup>18</sup> 'According to one estimate, by late 1990, the collapse of the bubble had resulted in a loss of 270 trillion yen, and 22.6 per cent of this loss, or about 61 trillion yen, belonged to individual investors. This loss led to lessened availability of consumer credit and reduced consumption of luxury merchandise' (Gao, 2001, 244).

slowed down consumer demand, thus contributing to the continuation of the economic stagnation.

As a matter of fact, the Japanese government has taken several attempts to restore economic growth. Most striking have been the many fiscal stimulus packages and expansionary monetary policies.<sup>19</sup> The effectiveness of the packages is strongly debated<sup>20</sup> but it is clear that they have not been as substantial as has been suggested because, in many cases, it included previously announced spending.<sup>21</sup> The major successful exception was the 1995 stimulus package that actually contributed to a short period of economic recovery until 1997 when growth was undercut by various other policies, including a raise in the consumption tax.<sup>22</sup> In spite of the actions taken, many believed that the gravity of the problems had only increased at the beginning of this century. '[I]n several ways, the situation in 2002 is worse than it was in 1992. The interest rate has been lowered to zero, but the inflation rate remains negative...The debt-GDP ratio became the highest among the G7 nations as the result of several fiscal stimulus packages...Banks are still under growing burdens of non-performing loans' (Ito, 2003, 288).

So far, this section has mainly focused on macro-economic and ignored structural causes. This focus is understandable since, as Koo (2001, 15) points out, 'it is difficult to blame [structural problems] entirely for the poor performance of the Japanese economy in the 1990s. This is because most structural problems date back for decades and so cannot explain why an economy...suddenly lost its forward momentum from the 1990s onwards.' It is therefore irrefutable that macro-economic factors have been a major cause of the economic malaise. In accordance, Passet (2003) stresses how employment practices have mainly been on the receiving end of

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<sup>19</sup> Blomström, Gangnes, and La Croix (2001) mention how five fiscal packages were enacted between 1992 and 1995 to counter the business cycle. These packages totalled 65 trillion yen, more than ten per cent of Japan's GDP.

<sup>20</sup> Ihori, Nakazato, and Kawade (2003) claim that '[n]either government spending nor tax cuts did much to stimulate the economy' (Saxonhouse & Stern, 2003, 270) while Kuttner and Posen (2001) stress that fiscal policy was effective when it was used and Koo (2001) explicitly states that fiscal policies have actually compensated for the lack of consumer and investment demand and kept the Japanese economy from collapsing. According to Gao, the appreciation of the yen in the middle of the 1990s undermined the effectiveness of the fiscal stimulation policies. 'As the result of the yen's appreciation, half of the 65 trillion yen spent by the Japanese government was watered down' (Gao, 2001, 245).

<sup>21</sup> '[A]mong the expansionary fiscal policies adopted since 1992 by the 12 largest OECD economies, 21 were larger than that of Japan for any single year' (Gao, 2001, 245; in reference to Posen, 1998).

<sup>22</sup> Other factors that hampered the impact of the fiscal stimulus package include a raise in social securities contribution, the repeal of the special tax cut of the preceding two years, the 'big bang' policy for the banking sector, and the impact of the Asian currency crisis (Ito, 2003; Gao, 2001, 245-6).

the economic malaise as firms struggled with the lack of growth and were sometimes forced to take rather drastic measures. He therefore concludes that ‘although the crisis was generated by upheavals in the banking and finance system – and not in the employment system...it is the employment system that must shoulder the consequences’ (Passet, 2003, 210).

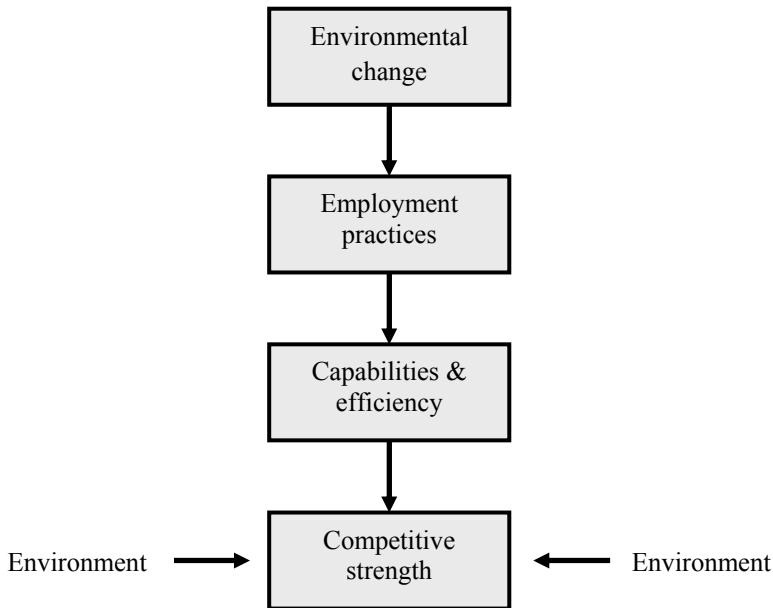
However, as mentioned, analyses have also extended beyond the macro-economic to point out structural causes behind the economic decline. The lack of economic growth has opened the eyes to various long term developments that hamper the efficiency of some typical Japanese institutions.<sup>23</sup> This also holds for the Japanese employment practices. Structural developments like the ageing of the population, the decrease in economic growth, the change in technologies, the efficiency of firm-specific skills, and the shift from manufacturing to service industries, are likely to affect the efficiency of the Japanese employment practices. Adaptations in employment practices will therefore be a necessity and can be expected to continue beyond the economic malaise. Whether this will lead to substantial changes in the core employment practices remains to be seen but the current period certainly stands out as one of reconsideration and redefinition.

### **Introduction to the research**

This research thus focuses on changing employment practices, more specifically the economic need for and consequences of changing employment practices. It discusses the impact of the various environmental changes and adaptations in employment practices on the economic performance of the Japanese firm. The basic structure of the research is depicted in figure 1.1.

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<sup>23</sup> A major example is provided by the banking sector, where Nishimura & Kawamoto (2003) have pointed out the bankruptcy of the system of community banking and Hoshi (2002) the failure of the so-called ‘convoy system’. Under community banking, banks develop a long-term relation with their client-firms. The proceeds of the relation are shared between the bank and the firm in various subtle ways. ‘The convoy system is usually defined as a wide set of financial regulations in Japan that discourage competition within the financial sector’ (Hoshi, 2002, 157). One major aspect of this system is the pressure on healthy banks to assist or merge banks that have got into trouble.



**Figure 1.1 Changing employment practices and their consequences<sup>24</sup>**

Environmental changes are expected to inspire adaptations in employment practices, which are expected to have an impact on the performance of Japanese firms. Focus is on the operational efficiency and the capabilities that are enhanced by Japanese employment practices. However, efficiency and capabilities only provide competitive strength when there is a good ‘fit’ with the environment.<sup>25,26</sup>

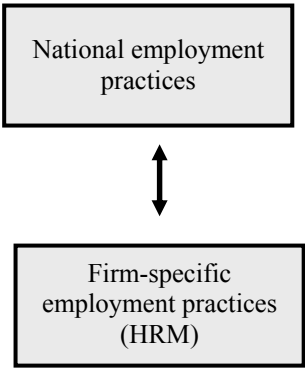
As a matter of fact, this overview obscures one important aspect of the research because it ignores the dialectics between national employment practices and the actions of individual firms. National employment practices are not simply an outside institution to the firm but are constituted by the firms’ own behaviour. To an important extent, they can be considered as the aggregate of the individual firms’

<sup>24</sup> This framework has been loosely inspired by Davis and North’s theory of institutional change (Davis & North, 1971) and several articles by Williamson about the position of transaction cost economics (Williamson 1993, 1998). However, the framework has been adjusted to fit the present study on employment practices.

<sup>25</sup> Environmental fit actually suggests an equilibrium perspective not in line with the dynamic approach of this study. I have therefore opted for the discussion of ‘environmental fit’, a state of relative fit in an essentially dynamic world.

<sup>26</sup> The figure presents the causality rather than the process of change. The actual motivation for change will usually come from diminished competitive strength but, since this can be reduced to environmental change, (feedback) effects from ‘competitive strength’ to ‘employment practices’ are not included in the figure.

strategies for human resource management. At the same time, these national practices function as an institution that determines the strategies an individual firm can implement because they ‘assume the guise of an impersonal and objective reality’ (Scott, 1995, 34).<sup>27</sup> Until recently, Japan knew a relative equilibrium between national practices and firms’ strategies but firms are likely to change their perspective on established practices in response to the changing circumstances. The resulting tension is central to this study. Accordingly, figure 1.2 divides the box of “employment practices” from figure 1.1, to distinguish national from firm-specific employment practices and illustrate the dialectics between national and firm-specific employment practices.<sup>28</sup>



**Figure 1.2 The dialectics of institutional change in employment practices**

<sup>27</sup> Sjöstrand makes an insightful distinction between the micro and macro level of human interactions and exchanges. ‘Micro level situations refer to people’s first-hand evidence of particular others and particular environments, while the macro level refers to (indirect) indicators, descriptions of or from generalized or unknown others, and/or formal (legal, physical) structures’ (Sjöstrand, 1995, 37). Institutions, which exist at the macro-level are to be confirmed by the activities of the individuals at the micro-level. However, in the case of changed circumstances, the firm can decide to initiate change.

<sup>28</sup> This research uses the terms ‘employment practices’ and ‘human resource management’ (HRM) mutually exchangeable. However, the tendency exists to use ‘HRM’ in discussing the strategies of individual firms as ‘employment practices’ basically concern employment practices that are nationally embedded. However, the terminology of employment practices is also used at the firm-level as the practices manifest themselves at this level. A third concept, ‘employment governance’, is used to refer to the general necessity to manage employment.

Overall, the research addresses the following major questions.

1. How and to what extent do changed circumstances inspire adaptations in employment practices?
2. How do changed circumstances and adaptations in employment practices influence the competitive strength of Japanese firms?

These questions are a testimony of the research's dual interest and approach. The first question (related to the top half of figure 1.1) points to the issue of institutional change, the second question (the bottom half of figure 1.1) to its economic outcomes. The firm holds a central position between these issues since it experiences the impact of both the embedded employment practices and the economic consequences of changing circumstances. In accordance with this double perspective, the study uses both theories of institutional change and theories of the firm. While theories of institutional change analyse the incremental and path-dependent character of change, theories of the firm discuss issues of efficiency, capabilities, and competitive strength. A special position is taken in by so-called 'evolutionary theories of the firm' because their characteristics make them particularly well-suited for the present study. These theories tend to show a strong institutional awareness, focus explicitly on issues of change, and acknowledge firm heterogeneity. These characteristics coincide with the focus of the present study on change in national employment practices through the actions of individual firms. Acknowledging dynamics enables to study the changes in practices and evade a simple dichotomy between old and new employment practices. It is also because the importance of dynamics that this study speaks about 'Japanese employment practices' rather than the more common 'Japanese employment system'. This difference may appear insignificant but the presentation as a system tends to underestimate the dynamic flexibility among the various practices. Finally, acknowledging firm heterogeneity enables the study of the reaction of individual firms, which will not unambiguously interpret the changing circumstances but develop their own answers, dependent upon their specific circumstances.<sup>29</sup>

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<sup>29</sup> As shown by Holzhausen's (2000) distinction between apologists and critics, the debate on changing employment practices easily becomes one between proponents and critics. By presenting a rather static presentation of Japanese employment practices (*in extremis* existing of lifetime employment and seniority wages), the variety and dynamics of individual firm behaviour is often oppressed. In this respect, there is a major difference between titles like 'The end of Japanese-style human resource management' (Ornatowski, 1998) and titles like 'Japanese employment practices in transition' (Holzhausen, 2000). We obviously have a clear preference for the latter type as it implies continuity in the process of change.



### **The logic of Japanese employment practices<sup>30</sup>**

Although its broad meaning as ‘a way of thinking or explaining something’ (Oxford English Dictionary) is part of the concept’s appeal, we need to discuss the term ‘logic’ in the title more elaborately given its central position within this research. Mostly, it refers to the institutional and economic logic that characterises the employment practices. However, the concept also acquires a second meaning as it proves instrumental in the application of the various theories of the firm.

An obvious starting point for this discussion is the ‘institutional logic’ as it was defined by Friedland and Alford (1991). They describe how institutional orders have ‘a central logic – a set of material practices and symbolic constructions – which constitutes its organizing principles and which is available to organizations and individuals to elaborate’ (Friedland and Alford, 1991, 248). Friedland and Alford’s logic refers to the major institutional orders like capitalism and religion but the statement also holds for other institutions as this logic is a direct consequence of the way institutions function as long-term customs that structure and enable social behaviour through orderly and predictable relations. A mutually dependent set of institutions creates its own set of rules, its own logic, through the specific form in which it structures human behaviour; hence, the reference to the central role of ‘organising principles’ in the above quotation. The existence of this institutional logic is also crucial for the current study since we acknowledge how the existing order and mutual dependence between Japanese employment practices determine the possibilities for change.

However, the logic of Japanese employment practices as discussed in this study also differs from this concept of institutional logic because it is economic as well as institutional.<sup>31</sup> The logic refers to the economic consequences of the various employment practices and their interdependencies. Chapter four will discuss this logic in detail. The study thus largely abstracts from other (social) issues like the exploitation of certain groups of employees and the important role of gender in the

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<sup>30</sup> I like to thank the participants of a seminar at the East-Asia Institute of Duisburg University on November 28, 2003. In particular through the reaction of some more sociologically trained participants, it became clear to me that the ‘traditional’ economic logic I used to analyse the case-studies was not the only fruitful perspective and actually obscured some potentially very interesting and far-reaching developments. This proved to be the starting point for developing the logic concept as central to the discussion of changing Japanese employment practices.

<sup>31</sup> This sole economic focus has as an important consequence that the perspective it provides is not necessarily shared by the social agents involved. It is likely that Friedland and Alford (1991) refer to some general and well-balanced institutional logic as it is perceived by the social agents. It is also likely that they propose some kind of participant-observer method rather than a theoretical outside perspective, like offered by the theories of the firm, as the means to study this institutional logic.

Japanese labour market.<sup>32</sup> However, in spite of the limitations this implies, the importance of this economic perspective for the overall institutional logic can hardly be overestimated. As the next chapter will show, arguments of economic efficiency are fundamental in the perception of economic institutions like Japanese employment practices and lack of functional efficiency is generally considered as a major source of institutional change (Seo and Douglas Creed, 2002).

The overall economic perspective brings us to the second meaning that ‘logic’ holds in this study. The third chapter will show how we can also distinguish the economic logic as provided by the different theories of the firm. It argues that none of the theories of the firm has proven capable to satisfactorily capture the various economic facets of the firm. However, they all do provide important insights in the economic implications of the firm and its organisation. In other words, the different theories of the firm can be said to offer their perspective on ‘the logic of the firm’, on the characteristics, relations and contingencies that determine the firm’s performance. This second interpretation of logic is inspired by Heidegger’s (1973, 1993) study on the original meaning of ‘*logos*’ (λογος) as it can be found in the works of Plato and Aristotle. Heidegger states how *logos* originally translated as ‘discourse’, that which enables us to discuss something.<sup>33</sup> In other words, the *logos* shows us, makes visible, what we talk about.<sup>34</sup> According to Heidegger, it is this character of showing that enables *logos* to take the meaning of synthesis, ‘letting something be seen in its togetherness with something’ (Heidegger, 1973, 56).<sup>35</sup> Heidegger thus concludes that *logos* signifies ‘making something visible’, ‘bringing it into the open’, ‘letting it be seen’.

This coincides with the remarks on the logic of the theories of the firm. The different theories of the firm all stress certain important economic characteristics of the firm and bring into the open the importance of, for instance, asset specificity or

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<sup>32</sup> One could, for instance, also focus on social issues like the exclusion of female employees from the employment track for career employees or other exclusionary practices that characterise the dual labour market of regular and non-regular (atypical) employees (see chapter five). As a matter of fact, these issues are dependent upon the economic perspective as they often have important implications for the economic efficiency of employment practices.

<sup>33</sup> ‘λογος as ‘discourse’ means rather the same as δηλοῦν: to make manifest what one is “talking about” in one’s discourse’ (Heidegger, 1973, 56).

<sup>34</sup> ‘In discourse (...), so far as it is genuine, what is said [...] is drawn from what the talk is about, so that discursive communication, in what it says [...], makes manifest what it is talking about, and thus makes this accessible to the other party’ (Ibid.).

<sup>35</sup> Heidegger relates this to another concept of truth than the traditional focus on ‘correspondence’ between theory and facts. Truth now refers to the way the entities we discuss are ‘taken out of their hiddenness’ (Heidegger, 1973, 56). However, it is clear that this issue extends beyond the discussion of this study on Japanese employment practices. Fortunately, this interpretation of logic can also be defended by the choice for a pluralist perspective as it is discussed in the next section on research methodology and method.

rare, valuable and non-imitable resources. Moreover, it also holds for the logic of Japanese employment practices as the organising principles of these employment practices are brought into the open. As a matter of fact, we have to acknowledge that the distinction between the two forms of logic – that of employment practices and that of the theories of the firm – is hard to make. The various theories (those of the firm but also various others, both institutional and economical) bring out the institutional and economic logic of Japanese employment practices. In other words, without these theoretical perspectives, the institutional and economic logic of Japanese employment practices would not be known; at least not in their current form. The distinction between these two types of logic is therefore impossible on an empirical level and should be considered an analytical construct for explanatory purposes. In this sense, theory and empirics are dialectically related through the concept of ‘logic’.

### **Research methodology and method**

The methodology of this research can be summarised as pluralist and institutional. The institutional methodology is in accordance with the institutional awareness and the use of theories of institutional change. In addition, the pluralist, or even eclectic, approach already became apparent in the discussion of the different theories of the firm and the various logics they provide. This methodology is supported by a choice for the case-study method as the main means for the collection of empirical data.

Since this study is institutional, its methodology is likewise and thus extends beyond the orthodox preferences in economics like the search for equilibria, comparatively static theories, methodological individualism, *homo economicus*, and market selection of the fittest. The methodological basis of economic institutionalism has been analysed by Wilber and Harrison (1978) as holistic, systematic, and evolutionary. In accordance, Wilber and Harrison stress so-called ‘pattern models’ as the common explanatory mode of institutional theories. Pattern models can be considered as a ‘systematic form of storytelling’, an institutional theorist focuses on some system that he considers a unified whole to look for recurrent themes in order ‘to construct a model which emphasizes the interconnectedness or unity of the system’ (Wilber and Harrison, 1978, 75). This is exactly what this research aspires to in the development of various logics of Japanese employment practices and the previous section is therefore a good example of how the research follows this institutional methodology.

A second major characteristic of this study is the choice for pluralism. Theoretical pluralism states that our understanding can be enhanced if we use

several perspectives instead of one.<sup>36</sup> However, Groenewegen and Vromen (1996) make one important qualification, the different theories cannot contradict each other as this would create a situation in which ‘anything goes’. Fortunately, apparently conflicting theories might be reconciled. Groenewegen and Vromen, for instance, raise the possibility that the variables these ‘conflicting’ theories discuss can be co-determinants for the issue in question and thus require a further analysis of the conditions under which the different variables are dominant. Moreover, apparently conflicting theories can also cover different aspects of certain phenomena. In an interesting twist of events, this appears to turn theoretical pluralism into monism because the theories do not appear to be irreconcilable after all. However, in spite of the usefulness of these recommendations, we could defend a stronger form of theoretical pluralism. If we acknowledge that all discursive attempts create their own discourse for analysis, their own framework and concepts, and that all facts thus are theory-laden, we cannot be surprised that different theories reach different and sometimes contradictory conclusions.<sup>37</sup> Moreover, given the specificity of discourse, it will be difficult to compare theories and assess clear issues of contradiction. Perspectives will sometimes be incomparable precisely because of their specific definition of initial conditions and phenomena. We should therefore practice restraint in the dismissal of theories.<sup>38</sup> Once again, if we accept our analyses to be incomplete and coloured, we also should accept that they can be contradictory. It will always be difficult to accept contradictory statements about the same phenomenon as true and choices need to be made but, unless there are truly conflicting paradigms, we should reserve these choices to specific empirical situations.<sup>39</sup>

A final issue concerns the method for data collection. Besides the use of publicly available statistics on the Japanese labour market and Japanese employment practices, the case-study method has been the main instrument in the collection of empirical data. Given the topic of our study, this choice is rather self-evident as the case-study method can be considered the preferred strategy ‘when “how” and “why” questions are being posed, when the investigator has little control over events, and

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<sup>36</sup> It is opposed to theoretical monism, ‘the doctrine that there exists one and only one true theory for any set of phenomena’ (Groenewegen and Vromen, 1996, 370). Theoretical monists can only accept the existence of different theories addressing the same phenomena as a temporary state that needs to be overcome eventually.

<sup>37</sup> ‘Discourse’ is used here in its common meaning and thus not necessarily related to Heidegger’s discussion of logic. However, it is striking that the definitions are commensurable.

<sup>38</sup> The example provided by Groenewegen and Vromen (1996), transaction cost economics versus a power approach, actually seems to confirm this problem of ‘incomparable’ perspectives.

<sup>39</sup> Of course, we will still have good reasons to reject theories; for instance, when they are inconsistent or in clear contradiction with our overall understanding.

when the focus is on a contemporary phenomenon with some real-life context' (Yin, 1994, 1). All these conditions are fulfilled in the current research. Moreover, Yin (1994) also points out some strong similarities with the institutional methodology; in particular the preference for pattern models. He states how the case-study method is particularly suitable for the study of 'complex social phenomena' and retains 'the holistic and meaningful character of real-life events'.

Crucial in the case-study method is the objective of analytical rather than statistical generalisation. Yin speaks about a logic of replication. 'Each case must be carefully selected so that it either (a) predicts similar results (a *literal replication*) or (b) produces contrasting results but for predictable reasons (a *theoretical replication*)' (Ibid., 46). Such replication requires a theoretical framework as a point of reference to which the outcome of the case studies can be compared. As mentioned before, this study takes theories of institutional change and theories of the firm, together with past analyses of Japanese employment practices, to develop its theoretical framework. However, the interviews not only served an explanatory objective but were also partly explorative. The existing literature and statistics on changing employment practices discuss some important tendencies in Japanese employment practices but it was important to acquire precise knowledge on the actual adaptations that were made by specific firms in their specific circumstances. In order to achieve variety, we addressed large Japanese firms in a number of different industries and, in the end, decided to discuss cases from four industries – automobile, electronics, construction and retailing – that show substantial differences. The case-studies have been made anonymous as a number of firms made this a condition for their participation.<sup>40</sup>

A list of case-study interview questions developed to guide the interviews (see appendices two and three). It provided an overview of possible discussion topics and questions but, given the open character of the interviews, actual questions also depended on the course of the interview. Nevertheless, the more important issues, like the different employment contracts, the criteria for evaluation, and the issue of lifetime employment, were discussed in all interviews. Most interviews were held in Japanese, a few in English. For this purpose, the interview questions were translated in Japanese (see appendix four). During most interviews a Japanese assistant was present, both to assist in case of misunderstandings and to discuss the outcomes afterwards. After the interview, the interviewees were also asked to fill in a questionnaire with additional questions (see appendices five and six). Finally, both

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<sup>40</sup> Most firms actually did not pose this condition. A number of firms is so well-known that it is an illusion that any description of their activities could be anonymous. However, it seemed best to be consistent in this respect. Nevertheless, in case of some of the best-known firms, the identity might actually be rather obvious.

the questionnaire and the interpretation of the interviews outcomes have been substantiated by a broad study of the literature. Moreover, because the interviews took place during a five-month period, it was possible to test formulated hypotheses during subsequent interviews.

### **Chapter overview**

The remaining chapters of this study can be classified into three major groups, namely a theoretical, empirical and interpretative part.

The next three chapters are predominantly theoretical. The first of these, entitled ‘The Dialectics of Change’, will confirm the institutional character of Japanese employment practices by discussing their social embeddedness. It particularly discusses the traditionally wide support for the practice of lifetime employment by the government, employers and employees, and Japanese case law. Moreover, in spite of some minor developments to the contrary, this support has remained strong. The chapter then continues by presenting various theories of institutional change, which show how contradictions between functional efficiency and legitimacy are a crucial if not sufficient condition for institutional change. Finally, it also stresses the important role of the firm as the major party responsible for change in the case of employment practices and the appropriate level of analysis.

In accordance with the crucial role of the firm in initiating change, the subsequent chapter ‘Theories of the Firm’ introduces the contractual, capability and evolutionary perspectives as three major strands of theories of the firm. It also discusses three explicit examples of the different perspectives, namely transaction cost economics, the resource-based view and the dynamic capabilities approach. Together, these theories provide three different types of logic that enable us to study the impact of (changing) employment practices on firm performance. The core of this framework will consist of the so-called ‘evolutionary perspective’, as represented by the dynamic capabilities approach, because of its similarities with theories on institutional change and its treatment of dynamics and firm heterogeneity. However, the use of these theories for an empirical analysis is not self-evident and the chapter takes two important steps to make the theories operational. First, it shows important differences in their treatment of knowledge, dynamics, governance and specificity. Secondly, the chapter discusses the explicit problems that exist in making transaction cost economics and the capabilities perspective operational. Finally, it discusses the concept of logic as a means to overcome these operational difficulties and to combine the different perspectives.

The final theoretical chapter, ‘Productivity and Flexibility’, discusses the conventional logic of Japanese employment practices. As a matter of fact, this logic

is twofold. The first logic is an ‘adjustment logic’ that enables firms to adjust the input of labour while upholding the practice of lifetime employment. Secondly, there is a ‘productive logic’ that explains the contribution of employment practices to the competitive strength of the Japanese firm. In discussing this second logic, the theories of the firm are instrumental. Focus will be, in particular, on the importance of firm-specific and so-called ‘contextual’ and ‘intellectual’ skills and the way the employment practices enable the development of these skills. Together, the two types of logic can be interpreted as the core of Japanese employment practices and the benchmark against which we can evaluate change. Finally, the chapter discusses various contingencies for competitive success.

The next five chapters present the empirical findings of the research. The first of these, entitled ‘Statistics of Change’, is based on existing literature and statistics. It opens with a discussion of the employment adjustments firms have implemented in answer to the difficult economic circumstances of the ‘lost decade’. These adjustments can be safely considered ‘traditional’ as the adjustment logic discussed in the previous chapter prevails. As a consequence, layoffs remain rare and the practice of lifetime employment strongly supported. The chapter then lists the environmental changes that are expected to lead to adaptations in employment practices. To put the current developments into perspective, the chapter also reflects on the historical developments in Japanese employment practices. Finally, the chapter introduces some of the possible, likely, and actual adaptations in Japanese employment practices as inspired by the environmental changes.

The subsequent four chapters subscribe the need to study heterogeneous firms in their specific circumstances by discussing individual firms in four different industries. As mentioned, these industries concern automobiles, electronics, construction and retail. These chapters have a similar structure. They first present the industry’s character and circumstances by successively discussing its historical development, past analyses and evaluations, the economic situation, and the past employment practices. The chapters then switch to the discussion of the firms in that particular industry. Just like the chapters, these discussions follow a similar pattern. The discussion of each firm consists of an introduction and discussions of its major strategies, its economic situation and, as its major part, the practices in human resource management and their changes. After all cases are discussed in this manner, the chapters conclude with some concluding remarks and an overview of the firms studied and their changing employment practices.

The final chapters interpret the empirical findings by generalising to the industry- and national level. Chapter ten, ‘Industry-Specific Employment Practices’, discusses

the industry-specific adaptations in employment practices. Two types of logic are instrumental in this discussion. Firstly, the conventional productive logic and its contingencies for success as discussed in chapter four. Secondly, an alternative logic based on the increasing involvement of non-regular employees as it can be found in particularly the retail industry. Together, these two types of logic will prove central in the analysis of inter-industry differences in employment practices. The next chapter, entitled ‘Changes in Japanese Employment Practices’, returns to the national level and discusses several general tendencies, like the trend towards performance-based pay (*seikashugi*) and the possible diversification of employment types. Focus is on the possibilities for and likelihood of these adaptations and their consequences for human resource management. Finally, the chapter also discusses the likelihood of a new constellation of Japanese employment practices. The last chapter, entitled ‘Conclusions’, returns to the intentions and questions of this introductory chapter. It discusses the impact of changed circumstances and adaptations in employment practices on the Japanese firm. Although definite answers are unlikely, both because of the never ending processes of institutional change and the many other determinants of firm performance, the study enables us to formulate a weighed judgement on the paradox of success and failure of Japanese employment practices. In addition, the chapter also takes another look at the theories that guide this study.

### **Concluding remarks**

This chapter has introduced the reversal of Japan’s economic fortunes and the subsequent debate on Japanese employment practices. It has also discussed how and to what extent the debate on employment practices can be related to the economic malaise of the ‘lost decade’. Although macro-economic factors were shown to be essential, analyses have also included structural factors and the employment practices were seen as a possible and major area of change. The chapter subsequently discussed the study’s structure and major questions, the concept of logic and the research methodology and method. Finally, it provided an overview of the remaining chapters. Concerning these chapters, a final remark is in place. Theoretical and empirical issues have been separated in different chapters but these chapters are the result of a dialectic process in which the theoretical issues have inspired the empirical study and vice versa. As a consequence, the discussion of the different theories has eventually been specified to those issues that proved relevant to the empirical chapters. However, in spite of these dependencies and the important synergies we believe to exist, the chapters have been composed as independent identities as much as possible and can be read as such. Readers mainly interested in the theoretical issues or in the Japanese employment practices and the changes



therein can thus focus on the chapters specific to their interest. The only exception is possible chapter four, which can be considered the bridge from theoretical to empirical issues and whose concepts are explicitly referred to in the empirical chapters.

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# **PART I**

## **THEORY**

The process of institutional change is a dialectical interplay between forces of continuation and forces of change. The following chapters discuss the constituents of this process in the case of Japanese employment practices. They successively discuss (1) the dialectics of change in employment practices with the firm as the agent of change, (2) the theories of the firm that enable us to analyse the impact of employment practices on firm performance, and (3) the contribution of employment practices to the performance of Japanese firms. Together, these chapters provide the theoretical framework that enables us to analyse both the room and need for the adaptation of the existing employment practices and the consequences these adaptations are likely to hold for the performance of Japanese firms.



[V]arious factors such as case law restricting dismissals, social norms concerning employment security, and the state's employment policy centered on maintaining employment security, have made the long-term employment practice the core feature of Japanese employment relations. Japan's occupational training and education practices assume long-term employment. Collective labour relations...have adapted to the Japan's internal labor market...Since an employment system is comprised of such intertwined and interdependent institutions, the current long-term employment system will not be modified easily (Araki, 2002, 21-2).

## **2. The Dialectics of Change**

### **The embeddedness of employment practices**

*Introduction. The genesis of employment practices, employers' and employees' support. Judicial support. Government support, the strategy of total employment. Remaining societal support. Implications for Change. Contradictions as the source of institutional change. The firm as the actor of change. Concluding remarks. References.*

#### **Introduction**

The previous chapter has presented conflicting insights concerning the issue of change in Japanese employment practices. On the one hand, there is a strong expectation of change as the lack of economic growth has opened the eyes to various long-term environmental changes likely to diminish the efficiency of Japanese employment practices. Examples include the ageing of the population, the substantial decrease in growth of sales, and the diminishing importance of the manufacturing sector. The discussion on the impact of these, and other, changes is

left for chapter five but, in anticipation of this analysis, we can already acknowledge the expectation of substantial adaptations in employment practices. On the other hand, we have also seen that, in spite of a long-term expectation of change, existing practices have proven rather resistant and actual changes have been limited to the periphery. This chapter elaborates on this tension by discussing the dialectics of Japanese employment practices, a dialectics constituted by the poles of ‘embeddedness’ and ‘functional efficiency’.

This chapter first discusses how the Japanese employment practices are strongly embedded in Japan’s society. This holds in particular for the core practice known as lifetime employment, defined as ‘the practice whereby a worker is hired immediately after school and is expected to stay with the same firm until retirement’, while ‘[t]he firm, in return, is expected to retain him until the age of mandatory retirement (typically 55 to 60) regardless of business conditions’ (Odagiri, 1994, 48).<sup>41</sup> Since the 1970s, lifetime employment has usually been presented as one of the three pillars of the Japanese employment system – together with seniority wages and enterprise unionism – but it can easily be considered as the defining characteristic of the (human resource) management at Japanese firms (Matanle, 2003).<sup>42</sup> While it can be said to originate from post-war agreements on job security between employers and labour unions, the practice of lifetime employment became widely supported during the subsequent decades of high economic growth as one of the major cornerstones of this growth. The practice became widely implemented and aspired to

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<sup>41</sup> Its recognition can be traced back to Abegglen (1958), who spoke of ‘lifetime commitment’, a concept that became ‘lifetime employment’ (*shūshin koyō*) in the Japanese translation of Abegglen’s book and the concept has been used ever since, both in and outside Japan (Matanle, 2003). In later years, the concept of ‘lifetime employment’ has often been replaced by ‘long-term employment’ as a better description of the actual practices. As a matter of fact, both descriptions have their advantages and disadvantages. ‘Lifetime employment’ can be said to be incorrect given the existence of mandatory retirement. In a similar vein, ‘long-term employment’ can be said to ignore the strong social implications that the practice holds. I will use the concepts interchangeable with a preference for ‘lifetime employment’ as the direct translation of the common Japanese concept ‘*shūshin koyō*’. See, for instance, Gordon (1985, 395–401) for a discussion on the appropriateness of ‘lifetime employment’.

<sup>42</sup> First defined by Abegglen (1973), these ‘pillars’ have long been considered to embody the unique character of the Japanese employment system. The second pillar of seniority wages (*nenkō jōreitsu*) simply means that wages and promotions are dependent upon seniority. This practice will actually be a major topic in the later chapters on change as the criteria for remuneration and promotion constitute one of the major areas – if not the major area – of change. The third pillar, enterprise unionism (*kigyō kumiai*), ‘implies that all the employees of the firm, including both blue-collar and white-collar workers but excluding those in managerial positions above a certain rank, are presented by a single union’ (Odagiri, 1994, 49). I will not further discuss this pillar as it remains an accepted though somewhat caving practice that does not play a major role in the debate on change.

and, as this chapter will show, came to be seen as the self-obvious and inextricable element of Japanese employment governance.<sup>43</sup>

This strong embeddedness has important implications for the possibilities of change. It gives the practices a legitimacy that extends beyond mere functional considerations and they therefore tend to resist change. However, changing circumstances can increase the tension between legitimacy and functional considerations, thus initiating institutional change. As was discussed in the introductory chapter, a major role is reserved for the firm as it feels the demands for both efficiency and legitimacy. This awareness sets the stage for the subsequent chapters, which will take the perspective of the firm in discussing the impact of environmental changes and the need for changing employment practices in maintaining functional efficiency.

The structure of this chapter is as follows. It first discusses the embeddedness of particularly the core practice of lifetime employment by listing the support from, respectively, employers, employees, the judiciary and the government. The next section then focuses on the functional, social and cognitive implications of this embeddedness. Finally, the chapter emphasises contradictions between legitimacy and functionality as the major source for change and the firm as the major player in initiating these changes.

### **The genesis of employment practices, employers' and employees' support**

In spite of various 'predecessors', the practices of lifetime employment and seniority wages were only established in the post-war years, during a period of conflict with harsh confrontations between labour and management (Gordon, 1985).<sup>44</sup> At first the

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<sup>43</sup> As mentioned, 'lifetime employment' can be considered the core practice of (human resource) management in Japan. However, by itself, it tends to stereotype the employment practices and hide important differences and disparities. Odagiri (1994), for instance, points out how lifetime employment (just like the other pillars) is mainly relevant among big firms, how it only applies to a minority of the employees (the so-called 'regular workers'), how it is a rather recent phenomenon, and how separation rates in Japan are low but comparable to certain groups of employees in other countries. This last phenomenon has been observed by Koike (1988), who characterises the Japanese internal labour market as 'the white-collarization of blue-collar workers'. This refers to the fact that, for white-collar workers, a form of lifetime employment and seniority wages exist in European countries and the US. In Japan, on the other hand, it also exists for blue-collar workers. In addition, Odagiri also describes how Japanese firms can adjust the input of labour under the condition of lifetime employment, something that will be discussed as 'adjustment logic' in chapter four.

<sup>44</sup> Examples of pre-war 'predecessors' of the practice of lifetime employment and supportive developments include the system of *hōkōnin* at the Mitsui House during the late Edo period and its later adaptation after the Meiji Restoration (Chimoto, 1986; 1989), the establishment of long-term employment for skilled manufacturers in the 1920s (Hazama, 1997), the ideology of 'managerial familism' (Ibid.), and the wartime establishment of seniority wages and lifetime



unions gained the upper hand and achieved far-reaching concessions on both so-called 'living wages' (a continuation of wartime promises) and job security.<sup>45</sup> However, not before long the balance of power shifted towards the employers' side. The allied powers changed their initial support to the unions because of their political involvement and the harsh deflationary policies of the Dodge line forced the firms to take a hard stance.<sup>46</sup> Moderate employees were motivated to establish alternative and less radical unions. These developments eventually led to the emergence of a 'management version of Japanese labour relations' in the early 1950s (Gordon, 1985).

Both wages and job security were important issues in these struggles between unions and management. Unions demanded 'objective' criteria like age and family size for the determination of wages to reflect the needs of workers. The unions achieved some early successes but, after the reversal of the power balance, firms regained much flexibility in the determination of wages.<sup>47</sup> In the end, both 'objective' and 'performance' criteria found their way into the wage calculations.<sup>48</sup> A similar struggle took place concerning the issue of job security. These struggles also had a major impact during the subsequent decades as 'the two sides thrashed

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employment through strict regulation (Miura, 2000). See Matanle (2003) for an elaborate discussion of these practices.

<sup>45</sup> In the immediate post-war period, the allied powers encouraged labour unions as one of the most important democratic reforms. The so-called 'three (fundamental) labour laws', namely the Trade Union Law (12/45), the Labour Relations Adjustment Law (9/46) and the Labour Standards Law (4/47), were enacted.

<sup>46</sup> The Dodge Line was a series of economic measures, named after and under the supervision of the US Envoy Joseph Dodge, to reduce inflation by slashing government expenditures and balancing the budget. The direct economic consequences were very severe but they did slow inflation and paved the way to economic recovery. See, for instance, Gordon (1985) and Gao (2001) for a more elaborate discussion.

<sup>47</sup> However this battle was not won easily and the early 1950s were characterised by many and intense confrontations. Moreover, management was less successful when it came to the determination of bonuses. Concerning bonuses, there were similar disputes about need or efficiency as the basis for determination. Nikkeiren (The Japan Federation of Employers' Association) argued that bonuses were essentially different from wages but, in the end, bonuses stayed an issue of collective bargaining and companies were often not capable to reduce the standard levels. Gordon believes 'that managers gave way on the bonus issue in order to concentrate all efforts on the concurrent disputes over raising the wage base and granting regular raises...For unions, a healthy bonus softened the pain of defeat; for the company, this was a less expensive battle to lose' (Gordon, 1985, 381).

<sup>48</sup> 'By the early 1950s, well over 90 per cent of major Japanese firms used factors such as ability ratings, job classification, attendance, or supervisor evaluations, *in addition to* the...livelihood factors of age and family size, in setting the base wage and giving out raises. Most often a part of the yearly pay raise would be "automatic" or objective, linked directly to age and seniority, and the remainder would depend upon an evaluation that took ability, attendance, and performance into account' (Gordon, 1985, 380).

out a set of rules concerning job security which has been critical to Japanese industrial policy and labor relations ever since' (Gordon, 1985, 390). We thus see how industrial relations settled in the middle of the 1950s in a balance between management and unions that became typical for the post-war decades. The settlement reflected the balance of power as developed through several stages. 'What finally emerged by the end of the first postwar decade was an amalgam; the Japanese wage system discovered by Abegglen...is a management revision built out of three distinct prior incarnations of Japanese wage practice: a prewar vision dominated by management, a wartime government version, and an early postwar labor version' (Ibid., 383).

Since then, the practices were further confirmed and developed, supported by the pre-war ideology of 'managerial familism' (*keieikazokushugi*) as a confirmation of the special relationship between a firm and its employees (Hazama, 1997). Adversarial relations gave way to a more co-operative attitude as both employers and employees supported the resulting practices, albeit for different reasons. Seniority could achieve a central role in the determination of wages since unions considered it a proxy for need while employers saw it as a proxy for ability. The practice of lifetime employment also offered mutual benefits to both unions and management as it allowed managers to recoup their investments in training while unions could attract support by achieving job security.<sup>49</sup> Gordon eventually concludes that the 'combination of expectations, ideology, and rhetoric from both sides conspired to create the myth of the permanent job, past and present' (Ibid., 396). Moreover, the continued and cumulative support since then has strengthened the normative implications. In particular, the practice of lifetime employment became self-enforcing as the practice to recruit management among the existing employees strengthens management's commitment to maintain employment and improve working conditions (Shirai, 2000).<sup>50</sup>

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<sup>49</sup> A major occurrence was the establishment of the Japan Productivity Centre in 1955 by business circles to promote productivity increases and joint consultation. Sodomei, the national federation of moderate unions, agreed to participate in the so-called 'Productivity Increase Movement' under the condition that its opinions would be fully respected. Together Sodomei and the Japan Productivity Centre subscribed to the following three principles: (1) productivity increases shall be used to enhance employment security, (2) labour-management cooperation shall be promoted in search for measures to increase productivity, and (3) the fruits of increased productivity will be shared fairly among management workers and customers.

<sup>50</sup> This tendency has been strengthened by an insider-oriented type of corporate governance (Sheard, 1998). Characterised by close inter-firm relations through mutual shareholdings in *keiretsu* networks and supervision by main banks, Japanese firms have been rather invulnerable for unfriendly take-overs and this has provided them with the freedom to implement labour-oriented policies (Sheard, 1994).

### Judicial support

The settlement between employers and employees has been supported by the jurisprudence in labour law. As a matter of fact, Japan knows a very limited legislative restriction on dismissals with, for instance, no statute that requires just cause for dismissals.<sup>51</sup> However, firms' freedom to dismiss employees has been strongly limited by the development of case law that has been labelled the 'abuse of the right to dismiss' theory and requires just cause for dismissal. This case law was developed by courts, which recognised the importance to protect workers from arbitrary dismissals as seniority wages made a change of employment very costly and turned to the general clause of the civil code that prohibits the abuse of rights to curtail firms' right to dismissal (Araki, 2002). The decisions of lower courts were eventually confirmed by the Supreme Court in 1975, which thus established the need to demonstrate just cause.

As criteria for just dismissal the courts accepted the practices as they were agreed upon by employers and employees in response to the recession caused by the oil crises in the 1970s. Any adjustment dismissal was considered an abuse of rights unless it met the following four requirements.

'First, there must be business necessity to resort to reduction of personnel...Second, the employer is obligated to take various measures to avoid adjustment dismissals...Third, the selection of those workers to be dismissed must be made on an objective and reasonable basis. Lastly, management is required to explain...to the labor union or worker group if no union exists, and consult with them concerning the dismissals in good faith' (Araki, 2002, 26).

In case a dismissal turned out to be abusive, employers had to pay the wages lost during the period of dismissal and reinstate the worker.

Interestingly, the restrictions also extend to non-regular employees.<sup>52</sup> During the long period of economic growth, many fixed-term contracts were renewed repeatedly and these relations became rather indistinguishable from those of regular employees. In accordance, the courts decided that a refusal to renew would be considered similar to a dismissal when contracts had been renewed at least five times and there was an expectation of continued employment. A later court

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<sup>51</sup> The Labour Standards Law (LSL) only prohibits dismissals during periods of absence through work-related injuries and childbirth. In addition, laws against discriminatory treatment prohibit discriminatory dismissal. However, besides these restrictions there are no statutes that restrict the dismissal of employees.

<sup>52</sup> This is somewhat surprising as non-regular forms of employment have been ascribed an important role as a buffer to protect the long-term employment for core employees. This is part of the 'adjustment logic' as discussed in chapter four.

decision even considered the reasonable expectation of continued employment as sufficient to treat a refusal of renewal as dismissal. So, although their protection will always be second-rate to that of regular employees and they continue to function as a buffer in the case of major economic difficulties, employees with fixed-term contracts can not be dismissed easily.

### **Government support, the strategy of total employment**

The Japanese state has also contributed strongly to the establishment of lifetime employment as the social norm because employment security has been an explicit policy objective. This is clearly shown by the actions the government initiated after the first oil crisis. Ohtake (2001) describes how the government took various initiatives explicitly directed at the prevention of unemployment. Most important were the subsidies that enabled struggling firms to retain or transfer their workers. Overall, it is estimated that in 1975 and 1976, 60 billion yen of subsidies saved 600,000 workers from unemployment (Araki, 2002). These policies were later continued through the 'Act for Employment Adjustment for Specified Depressed Industries' of 1978, which was aimed at assisting workers from depressed industries in finding new employment. It provided extended payments of unemployment insurance, vocational training, and other services necessary for re-employment. The Act was revised in 1983 and merged with the similar Act for Employment Assistance for Specified Depressed Regions to put an even stronger emphasis on preventing unemployment (Sekiguchi and Horiuchi, 1985). These measures were extended and revised in recent years and were included in the employment measures taken in the late 1990s.

Moreover, the support runs much deeper as we can actually conclude that the government has grown dependent on the practice of lifetime employment. Gao (2001) describes how its economic policies in the post-war period made it impossible for the state to build elaborate social welfare programmes.<sup>53</sup> Instead, it capitalised on the settlement between employers and employees and privatised the

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<sup>53</sup> Gao (2001) describes how the Japanese government has pursued a deflationary fiscal policy. Initially, it was forced to do so by the Dodge Plan in 1948 but the government decided to continue this policy to control inflation and encourage capital accumulation. 'To counter the recession created by the Dodge plan, the Japanese state began to practise an expansionary monetary policy, providing private corporations with bank credit. To make this policy work, the deflationary fiscal policy, which was forced upon the Japanese state by the Dodge plan, became useful in controlling inflation' (Gao, 2001, 121). The combination of expansionary monetary and deflationary fiscal policies became the policy mix that the Japanese government used for most of the post-war period. It was successful but also meant that the Japanese government did not have the means to develop a big public sector or build government-sponsored social welfare programmes.

social welfare function by encouraging private corporations to maintain job security and the distribution of income. In return, the state offered various forms of support to both big and small- and medium-sized firms, described by Gao (2001) as its ‘total employment strategy’. This strategy had three cornerstones: a favourite treatment of oligopolies that enabled large firms to institutionalise permanent employment, the acceptance of cartels by medium- and small-sized firms, and strict regulation to protect the domestic sector. Through these forms of support and protection, the government created the conditions that enabled firms to perform the welfare function that is usually considered a government responsibility.<sup>54</sup>

This strategy had important merits because it provided political stability and enabled firms to take full advantage of the many opportunities offered by the growing economy. However, the strategy also had its costs as the economy had to allow for many inefficient sectors.<sup>55</sup> For a long time, the advantages appeared to outweigh the costs but from the 1970s several developments came to hinder the total employment strategy. Because of international pressure, Japan continued deregulation and privatisation and the government slowly lost its ability to protect its inefficient domestic industries. Moreover, the economy could no longer profit from the high growth and many sunrise industries that created important gains in productivity during the previous period. The situation further worsened when the high yen after 1985 made firms move production offshore. The consequences of these developments have been clearly visible because, although Japan continued its total employment strategy, unemployment figures rose sharply to over five per cent during the early years of this century. However, alternatives are hard to come by and all major parties – the government, labour unions and even Nippon Keidanren – continue to stress the importance of employment stability. Gao sees no other possibility than to strengthen the government’s role in unemployment programmes but its capability to do so is severely hampered by the already huge budget deficit and a quickly ageing population that will draw heavily on the government’s future finances.

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<sup>54</sup> This analysis shows strong similarities with Aoki’s (1988) discussion of ‘bureaupluralism’ as a description of how the Japanese polity not only supported big business but also divided the fruits of the economic growth among various social groups like farmers, small shopkeepers, and business owners.

<sup>55</sup> Other sources confirm this analysis. The Economist states that ‘[i]n a society where work is all, especially for men, and welfare benefits limited, the politicians were desperate to avoid unemployment. They therefore used some industries, notably construction, to soak up labour laid off by other industries’ (Economist, 2002, 5).

### Remaining societal support

The previous sections have shown how Japanese employment practices have grown strongly embedded during the post-war period. Moreover, if we limit our discussion to the core practice of lifetime employment, support has remained strong in spite of the difficult economic circumstances.<sup>56</sup> The recent support from all the major parties in industrial relations can be considered predominantly traditional with only some tentative adjustments. This is probably best illustrated by the tripartite agreement from December 2002 between the government and employers' and employees' representatives. It lists the following three major points.

'(1) Employers will make even greater efforts than before to maintain and secure employment. Labor will be flexible concerning working conditions when maintaining employment is at stake. The government will make the labor insurance system more efficient and more priority-oriented and offer more support to enterprises' efforts to ensure job security. (2) The government will support motivated job-seekers, actively coordinating to establish a reemployment promotion scheme, create new jobs and reform the employment insurance system. (3) Regulatory reform needed to change the labor market will be promoted and labor laws will be reviewed, to encourage diversification of employment types' (Japan Business Federation, 2003b, 13).

This agreement shows a continued focus on the maintenance of existing employment but also stresses the importance of labour market reforms that will allow (individual) job seekers to find new employment. As we will see, this duality between 'old' and 'new' proposals also characterises the positions of all parties separately.

The major representative organisation for employers, Nippon Keidanren (Japanese Business Federation), was formed in May 2002 through a merger of the Keidanren (Japan Federation of Economic Organisations) and the Nikkeiren (Japan Federation of Employers' Associations).<sup>57</sup> It has proposed several structural adjustments, like the promotion of employment diversity<sup>58</sup> and the introduction of

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<sup>56</sup> See chapter five for a more elaborate discussion of the continued support for lifetime employment by both employers and employees.

<sup>57</sup> At the same time, Nikkeiren's Committee for the Study of Labour Issues was reorganised as Nippon Keidanren's Committee on Management and Labour Policy. This committee yearly publishes a position paper about its basic policies on management and human resources. The first paper, entitled "Diversity Generating Dynamism and Creativity," was published in 2003 and forms an important constituent for this section's discussion (Japanese Business Federation, 2003b).

<sup>58</sup> Under diversity management, firms use differences in employee characteristics (gender, age, religion, nationality, values, etc.) and ideas (including those concerning working) to increase

new forms of human resource management, to increase labour cost efficiency; necessary since wages in Japan are among the highest in the world (Japan Business Federation, 2003b). Proposals include an appropriate combination of employment types (regular and non-regular employees) and new remuneration systems that are 'result-oriented' and 'based on individual performance and contributions'. In spite of possibly far-reaching consequences, these initiatives can be considered consistent with the practice of lifetime employment. Admittedly, the promotion of employment diversity is likely to result in a smaller percentage of employees with lifetime employment but the practice itself is not under real discussion. The continued support for lifetime employment is also confirmed by Nippon Keidanren's perspective on training, as they continue to stress the crucial role of firms in the provision of training. The major exception concerns the proposal to institute a social safety net to relieve public anxiety over business failures and unemployment. This initiative, considered essential for a recovery of domestic demand, is a clear adjustment to the past policy of total employment.

A social safety net is also a major proposal by Rengo (the Japanese Trade Union Confederation), the most important national organisation of labour unions in Japan (Rengo 2002, 2003). In the case of Rengo, the need for a safety net is particularly felt because it believes that the economic malaise is caused by a lack of demand rather than structural causes. The introduction of an adequate safety net for unemployed persons is seen as crucial for boosting demand through the removal of job insecurity and fears about the future. In addition, Rengo also strongly defends the existing employment security as a minimum condition to reduce these fears and opposes the structural reforms as proposed by both employers and the government because they only work to squeeze demand further. They also criticise the short-term focus of many firms, as it will hurt the training of employees and the mutual trust between firms and their employees, and the diversification of employment forms, as they only favour employers who exploit these differences to maximise cost reductions. In summary, Rengo's support of lifetime employment remains strong.<sup>59</sup>

Maybe not surprising given its huge budget deficit, the government remains somewhat silent on the issue of a social safety net. However, their policies do show

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flexibility. Nippon Keidanren sees this as an important contribution to the cultivation of a creative culture that is required for constant innovation. At the same time, it is felt that this may lead to personal growth and satisfaction for workers. The major means towards employment diversity remains the employment portfolio as it was proposed by Nikkeiren (Nikkeiren, 1995; Japan Business Federation, 2003a). See chapter five for a discussion of this proposal.

<sup>59</sup> In addition, Rengo also proposes several other, rather far-reaching, changes like the removal of the distinction between regular and non-regular employees and the introduction of work-sharing as a solution to some of the major anomalies of Japanese employment practices. However, it acknowledges that these proposals will be difficult to introduce in the Japanese setting.

a similar dual perspective. As an answer to the soaring unemployment since the economic recession of 1997, the government has implemented a series of employment packages. It is beyond the scope of this section to discuss all these measures in detail but Ohtake (2001) and the Japan Business Federation (2003b) give an overview of the different policies. Ohtake concludes that these policies are both ‘traditional’ in their support for maintaining employment and the absorption of unemployed by public works and ‘new’ in their inclusion of subsidies for job creation.<sup>60</sup> Araki provides a similar assessment and describes the current employment policies ‘as a diversification of policies in accordance with the diversification of the work force or a partial adjustment of the employment policy that has, in the past, been too skewed towards employment maintenance of regular workers’ (Araki, 2002, 32).

Finally, judiciary support has largely been maintained. However, since 2000 several district courts have changed their interpretation of the requirements for just dismissal. These courts stated that the ‘so-called “four requirements” are nothing but “four factors” to analyze abusiveness. Therefore, according to their interpretation, if one of the four “factors” (for example, consultation with a union) is not met, such an economic dismissal can be held legal and valid by taking all other factors surrounding the dismissals into consideration’ (Araki, 2002, 26). This change in interpretation subsequently led to a heated discussion on the conditions for just dismissal as other district courts upheld the traditional interpretation of the four requirements. It is therefore hard to predict the outcome of these developments.

Overall, we can conclude that the different parties display a continued support for the core practice of lifetime employment. Moreover, we can expect this support to continue in the near future as there appear no real alternatives. The major innovation from past policies is the shared support between employers and employees for the improvement of the safety net. This subscribes to the apparent bankruptcy of the total employment strategy but, for obvious reasons, the government remains rather quiet on this issue. Nevertheless, it has introduced certain policies that be considered a change from past policies as they focus on the re-employment of unemployed workers. At the same time, the allocation of the government’s budget still runs along traditional lines and is largely directed towards the maintenance of employment.

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<sup>60</sup> To what extent these policies have been effective is not the issue as this section only focuses on the existence of continued support for lifetime employment. See Ohtake (2001) for an analysis of the success of recent policies.



### Implications for change

The wide societal support is a persuasive manifestation of the embeddedness of, specifically, the lifetime employment practice. When practices are deeply embedded, they can not easily be replaced as alternatives have to overcome the 'embedded functionality' and legitimacy of the existing practices.

'Embedded functionality' implies that existing practices tend to be strongly dependent upon one another. Because the different practices depend upon and presuppose one another, changes in specific practices can often have negative consequences. The so-called 'rational choice theories', with Douglas North as their main representative, have particularly discussed this issue and its implications for change (North, 1990, 1993). North describes how the entrepreneur compares the gains and costs of either working within the existing institutional framework or spending resources in an attempt to change that framework. Any attempt towards change will usually be costly as the existing practices resist change. '[E]conomies of scope, the complementarities, and the network externalities that arise from a given institutional matrix of formal rules, informal constraints, and enforcement characteristics will typically bias costs and benefits in favor of choices consistent with the existing framework' (North, 1993, 37-38). The eventual process of institutional change will therefore be incremental and path dependent. Change tends to take place at the margins as this limits the consequences for the overall institutional logic.<sup>61</sup>

However, institutions tend to be more than functional solutions. It is well-documented (e.g. DiMaggio and Powell, 1991a; Friedland and Alford, 1991) that new organisational forms, once they are institutionalised, become normative and achieve a legitimacy that is not directly related to their functional efficiency. DiMaggio and Powell (1991b) show how organisations gain legitimacy by becoming isomorphic with their institutional environment as conformity to legitimate practices can offer several rewards like reputation and better access to resources.<sup>62</sup> This importance of legitimacy can provide another brake on processes of institutional change as firms may suffer in legitimacy when they abolish accepted

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<sup>61</sup> North (1993) also introduces the issue of politics by stating how change also depends on the number of agents that tend to lose from the new constellation. Those who will lose from new practices will oppose their introduction. This issue already shone through in the past sections on the support for employment practices by the representative groups like Nippon Keidanren and Rengo.

<sup>62</sup> In this respect, it is interesting to point out that most nations have a certain form of labour that is predominant – like lifetime employment in Japan – while it is widely acknowledged that different employment practices for different situations would increase (functional) efficiency (Seo and Douglas Creed, 2002).

practices.<sup>63</sup> The actual sources for legitimacy can be various as shown by Scott's (1995) discussion of three dimensions of legitimacy in terms of a regulative, normative and cognitive pillar. The regulative dimension coincides with the basic understanding of institutions as constraining and regularising behaviour through legal and quasi-legal requirements. As defined by the regulative pillar, institutions are seen as functional structures that define the rules of the game for rational actors and this perception is therefore highly similar to that of authors like North. Secondly, the normative dimension points out how certain values and norms can constitute the legitimacy of institutions by defining the appropriateness of certain activities. Scott refers to March's (1981) discussion of the 'logic of appropriateness' as an insightful confirmation of the normative character of institutions. An important addition is that this normative dimension often becomes internalised and thus becomes more than an outside constraint of behaviour. Finally, the cognitive dimension refers to the fact that existing practices also become the categories and frames that define the considerations of social agents. Compliance occurs because the existing practices are taken for granted or other types of behaviour are inconceivable.

The issues of functional efficiency and legitimacy indeed prove fundamental in the case of Japanese employment practices. The relevance of embedded functionality is well-illustrated by the more common reference to the 'Japanese employment system'.<sup>64</sup> An important example concerns the way lifetime employment has made issues like training and welfare predominantly a firm responsibility. Without alternative institutions, the abolition or disappearance of lifetime employment would therefore lead to serious shortcomings in the training of employees or consumer confidence. More examples will be listed in chapter four, which discusses the logic of employment practices and thus the dependencies among employment practices and between employment and other practices.

The remainder of this chapter focuses on the issue of legitimacy. The strong embeddedness of employment practices and their direct implications for people's daily lives makes the issue of legitimacy particularly relevant. Since Scott's distinction between three pillars is analytical rather than empirical, it is difficult to

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<sup>63</sup> The opposite development takes place when a certain practice spreads and persists because of comparable social rather than functional considerations. In this respect, DiMaggio and Powell's discussion of institutional isomorphism, defined as 'a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions' (DiMaggio and Powell, 1991b, 66), cannot remain unmentioned. They distinguish three types of isomorphism, coercive, mimetic and normative, that explain how a certain practice can spread through society for other than mere functional considerations.

<sup>64</sup> It is also because of 'embedded functionality' that a discussion on the embeddedness of the lifetime employment practice extends to many of the other employment practices that can be considered strongly dependent.

distinguish the various constituents of legitimacy but all ‘pillars’ can be considered present in the case of employment practices. If we limit our discussion once more to the core practice of lifetime employment, the regulative dimension is clearly present in the case law concerning just dismissal. Moreover, it is equally clear that the legitimacy extends beyond mere regulation and also has a strong normative character. Compliance with the practices has, for instance, been crucial in recruiting first-class employees. College graduates consider job security and a firm’s reputation as the two most important criteria for selecting an employer (Usui and Colignon, 1996).<sup>65</sup> Another manifestation is the media’s reactions to proposed employment adjustments in the middle of the 1990s. ‘The media and the public responded with intense discussions, especially on the “fairness” of dismissing longtime workers by paying extra retirement benefits but without helping them find new jobs’ (Usui and Colignon, 1996, 568). As a consequence of these vehement reactions, several companies withdrew their plans for dismissals. Finally, the cognitive dimension is difficult to substantiate but appears equally relevant as firms have supported these practices, grown used to their existence and, in spite of the previous remarks about discussions in the media, often accept them as ‘natural’.<sup>66</sup>

We thus see that embeddedness has important implications for change as lifetime employment has achieved a regulatory, normative and even cognitive status. Major changes therefore appear unlikely and we can agree with past conclusions that describe the possibility for change as ‘a constrained choice imposed by strong employment security’ (Morishima, 1995, 636) or speak about an organising logic that is ‘pro-employment’ (Usui and Colignon, 1996, 560). However, although the practice of lifetime employment itself remains strongly embedded, its implications or complementary practices may change.

### **Contradictions as the source of institutional change**

In spite of the strong embeddedness and its implications for the functionality and legitimacy of employment practices, change is likely to take place when

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<sup>65</sup> In this respect, it is important to remember that under lifetime employment workers do not so much look for a specific job (*shūshoku*) as for a career (*shūsha*). Particularly in the heydays of the Japanese success, it was simply impossible for major employers to ignore accepted practices like lifetime employment (Broadbent, 2003).

<sup>66</sup> The apparent contradiction between the cognitive status of lifetime employment and media reports on firms trying to adjust employment can, besides by the heterogeneity of firms, be explained by the different interpretations about the precise meaning of lifetime employment. Chapter four discusses the ‘adjustment logic’ that enables firms to adjust their labour input while maintaining lifetime employment for core employees. However, certain of the included strategies for employment adjustment are sometimes interpreted as a break of the promise of lifetime employment.

contradictions develop between legitimacy and functional efficiency. A good example of a theory that analyses this process is the dialectical perspective on institutional change as presented by Seo and Douglas Creed (2002). They discuss how legitimacy tends to undermine functional efficiency.<sup>67</sup> '[I]nstitutional rules, which tend to be categorical and general, are apt to conflict with the logic of efficiency, because technical activities require diverse and customized solutions' (Seo and Douglas Creed, 2002, 226). To an important extent, the differences between efficiency and legitimacy can be accommodated through 'selective decoupling of formal activities in the technical core' but this policy reaches its limits if changing circumstances further diminish the efficiency of institutions. The discussion on actual changes is left for later chapters but this process can be said to be taking place in Japan as environmental developments change the efficiency of the existing employment practices and heighten the tension between efficiency and legitimacy.

A similar analysis is provided by Bush and Tool (2001) in their discussion of 'the evolutionary principles of neo-institutional analysis'. Central in neo-institutional analyses, as described by Bush and Tool, is the distinction between two modes of evaluation, instrumental and ceremonial (Bush, 1987). Valuation is instrumental when actions are valued for their consequences in technical terms, their success in achieving certain technical goals. Effectiveness and efficiency are relevant criteria. Ceremonial valuation, on the other hand, refers to the valuation of actions for their 'coherence with received doctrines of custom and practice, and their capacity to direct behavior in such a way as not to upset existing patterns of privilege, power, and status prevailing within the community' (Bush and Tool, 2001, 205). Actions that fulfil these criteria are considered 'ceremonially adequate'. Lifetime employment itself provides a good example as this economic practice is 'ceremonially justified' through the ideology of 'managerial familism'. At the same time, a increasing distinction between instrumental and ceremonial values can be an important source of institutional change.

The central role of these contradictions between respectively functional efficiency and legitimacy (Seo and Douglas Creed) and instrumental and ceremonial valuation (Bush and Tool) hints at several tendencies in the processes of institutional change. First and foremost, as efficiency is essentially an economic criterion, both perspectives stress the importance of economic forces as a source of change. The

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<sup>67</sup> Seo and Douglas Creed also discuss three other sources of institutional contradictions: (1) adaptation that undermines adaptability, (2) intra-institutional conformity that creates inter-institutional incompatibilities and (3) isomorphism that conflicts with divergent interests. However, we will limit the discussion to the contradiction between legitimacy and functional efficiency because this is particularly relevant in the case of changing employment practices.

remainder of this study will therefore focus almost exclusively on the supposedly diminished efficiency of Japanese employment practices as the force of change. A second regularity concerns the potential outcomes of processes of institutional change. In accordance with rational choice theories, though not necessary for similar reasons, institutional change can be expected to be path dependent.<sup>68</sup> '[A]gents are likely to adopt a frame or set of frames available in the broader, heterogeneous institutional context – a frame that is sufficiently incompatible with the existing institutional arrangements to generate a fundamental departure from the past while also sufficiently resonant with some existing societal systems of belief to mobilize substantial support and resources from other participants' (Seo and Douglas Creed, 2002, 236). Bush and Tool formulate several principles, like the principle of ceremonial encapsulation and the principle of minimal dislocation, which also explain the path-dependent character of change.<sup>69</sup> Finally, the perspectives also point to the importance of alternatives. The interpretation of institutions and their legitimacy is not set in stone and one could even say that change is as legitimate as the alternative it offers. The degree at which the alternative fits with the existing practices will determine its acceptance.

### **The firm as the actor of change**

By themselves, these contradictions are not sufficient for institutional change. In the dialectical perspective of Seo and Douglas Creed institutional change is considered as the outcome of the dynamic processes between institutional contradictions and 'human praxis', defined as 'agency embedded in a totality of multiple levels of interpenetrating, incompatible institutional arrangements (contradictions)' (Seo and Douglas Creed, 2002, 222). The inclusion of praxis incorporates the role of agents in institutional theory and solves 'the theoretical paradox of embedded agency' by acknowledging that agents are both institutionally conditioned and possess a certain freedom to change the same institutions by which they are conditioned.<sup>70</sup> The

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<sup>68</sup> However, one major possible exception exists concerning the slow character of institutional change. A major characteristic of (a set of) institutions is the adaptability or non-adaptability, the extent to which change takes place gradually. In the case of non-adaptability, changes are likely to be few because of institutional inertia but in the case they do occur they cause revolutionary change and possible institutional crisis.

<sup>69</sup> The principle of ceremonial encapsulation states that instrumental actions will be accepted to the extent that they can be incorporated without disrupting the existing pattern of ceremonial values. The highly related principle of minimal dislocation states that the degree to which technological innovation can be introduced depends on the extent to which it minimises the dislocation of the existing behavioural patterns.

<sup>70</sup> In comparison, Bush and Tool (2001) focus almost exclusively on the institutional changes themselves – their sources, their form – and explain very little about the social agents that are

dialectical concept of praxis is the necessary mediating force between contradictions and institutional change and is the manifestation of 'the partially autonomous social actor in a contradictory social world and the active exploiter of social contradictions' (Ibid., 230).

The importance of praxis points out the necessity to focus on the party responsible for change. In the case of Japanese employment practices, no matter how embedded they are, this is the individual firm. Other parties like the government and judiciary can also initiate change but, in the end, it is the human resource management at individual firms that constitutes a nation's employment practices. Moreover, the firm also feels the need for both functionality and legitimacy. It is thus crucial to study the changing Japanese employment practices from the perspective of the firm. In a situation of change, firms will adjust their employment strategies in search for a better fit with the changing circumstances. Moreover, the concept of praxis also illustrates the importance of firm heterogeneity as firms' reactions will differ; not just because of entrepreneurial discretion in an uncertain environment but also because firms differ in both their economic and 'embedded' circumstances. Crucial factors that may determine a firm's reaction include, for instance, the economic necessity for change, the competitive environment (highly regulated or open markets, international or mainly national competition) and the character of the firm (innovative or traditional, institutionally embedded or relative outsider).<sup>71,72,73</sup>

This study therefore focuses on individual firms and this has consequences for both the theoretical and empirical part of the research. The first chapter already explained the preference for, in particular, evolutionary theories of the firm as they capture both firm heterogeneity and the evolutionary character of change. A similar focus has been central in the empirical part of this study and the empirical chapters

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responsible for the actual changes. However, this is no insurmountable problem since the two frameworks appear highly compatible.

<sup>71</sup> These possibilities will be further explored in the empirical chapters.

<sup>72</sup> Moreover, the outcome of the interaction between these issues is not self-evident. We would expect that only firms in severe economic difficulties would be willing to risk their legitimacy but as some of the case-studies (e.g. firms A in retail and electronics) will show, economic success can actually be positively related to change. When firms have the confidence, resources and the trust of their employees, the acceptance of change within the organisation can be higher. We therefore might hypothesise that relatively successful firms in stumbling industries or economies are in the best circumstances to implement change. However, this is not further investigated in the present study.

<sup>73</sup> A rare example of an analysis that incorporates the position of individual firms in the process of changing national employment practices is Ahmadjian and Robinson (2001). They discuss how firms with high legitimacy and visibility are less likely to implement a downsizing strategy.

will discuss the changed employment practices at specific firms before later chapters interpret the implications of these changes at the industry- and national level.

### **Concluding remarks**

This chapter has shown how their historical development and embeddedness provide the Japanese employment practices with a legitimacy that makes them relatively resistant to change. This holds in particular for the practice of lifetime employment but extends to other practices as the different practices tend to be functionally embedded. However, the chapter has also shown that change is possible in case of an increasing tension between legitimacy and functional efficiency. As mentioned, the firm will take a central position in this discussion as it feels the need for both legitimacy and efficiency. While this chapter has shown the importance of legitimacy, the next two chapters will discuss the importance of efficiency by discussing, respectively, theories of the firm and the impact of employment practices on the performance of the Japanese firm. Even when the core practice of lifetime employment remains strongly supported, related but distinct practices can prove susceptible to change. Moreover, the meaning and implications of lifetime employment can also be subject to change. Possible changes are, for instance, a decrease in the number of employees that ‘qualify’ for lifetime employment or in the quality of the employment that is being offered. Moreover, this chapter has already discussed the problems for the government’s total employment strategy and this will unmistakably weaken the trust employees place in the possibilities for lifetime employment.

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[F]irms are input combiners, bundles of contracts, cognitive entities, knowledge-accumulating entities, strategizing entities, political entities, information-processing entities, etc...To focus on only one aspect may pay off as a short-term research strategy; in the longer run, we surely want to consider all those aspects that have a bearing on economic organization (Foss, 1997a, 21).

### 3. Theories of the Firm

#### The analysis of employment practices

*Introduction. Various perspectives on the firm. Similarities and differences. Operational issues transaction cost economics. Operational issues capabilities perspective. The logic of the firm. Concluding remarks. References.*

#### Introduction

The previous chapters have pointed out the crucial position of the firm as the main initiator of change in employment practices. This chapter complies with this observation by presenting the various theories of the firm as they have been developed in recent decades. As these theories all aim to explain ‘the existence, boundaries, organization and competitive advantage of the firm’ (Foss, 1997a, abstract), they offer an excellent opportunity to study the impact of (changing) employment practices on the performance of Japanese firms.<sup>74</sup> This holds, in

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<sup>74</sup> In another publication, Foss speaks about ‘the body of theory that addresses the existence, the boundaries and the internal organization of the firm’ (Foss, 2000, xv). These two definitions are highly comparable but suggest a different inspiration from the capabilities perspective and transaction cost economics in their respective focus on ‘competitive advantage’ and ‘internal organisation’. Another but comparable definition is provided by Conner, who states in reference to Holmstrom and Tirole’s (1989, 65) definition that ‘a theory of the firm must address two central questions: (a) why firms exist (their purpose), and (b) what determines their scale and scope’ (Conner, 1991, 123).

particular, for the evolutionary theories of the firm as they focus explicitly on issues of dynamics. Moreover, in their attention for path-dependence, these theories also show a strong institutional awareness and acknowledge firm heterogeneity. This chapter discusses these characteristics elaborately. However, the alternative approaches known as the contractual and capabilities perspective also offer important insights in the management of employment and are included. Finally, the chapter also discusses the dynamic capabilities approach, the resource-based view and transaction cost economics as major examples of the different perspectives.

However, in spite of their promise, the use of these theories is not self-evident, but hampered by potential operational problems. This chapter therefore takes two preparatory steps to enable a successful analysis of employment practices. First, it analyses the assumptions and characteristics of the different approaches by comparing these among one another. Topics of comparison are the treatment of knowledge, dynamics, governance and specificity. Secondly, the chapter discusses the explicit operational problems in the application of both transaction cost economics and the capabilities perspective. As they can be considered a subgroup of the capabilities perspective, this discussion also has implications for the evolutionary theories of the firm. Finally, the chapter discusses the concept of logic as a means to overcome these operational difficulties and to align the different perspectives and theories in a pluralist perspective.

### **Various perspectives on the firm**

The three major strands as they can be distinguished within the modern theory of the firm are the contractual, capabilities and evolutionary perspective. As a matter of fact, the evolutionary perspective, in particular when it takes the firm as *explanans*, can be considered rather similar to and is often included within the capabilities perspective. However, given the importance of change in the current study and the differences in the treatment of dynamics, the evolutionary perspective is discussed separately.

The contractual perspective – also known as ‘organisational economics’, ‘the modern economics of organisation’ and ‘new institutional economics’ – is ‘characterized by the heuristic of reducing literally all aspects of economic organization to the alignment of incentives’ (Foss, 1997a, abstract). It comprises a broad group of theories, such as transaction cost economics (Williamson, 1985), the incomplete contract approach (Hart, 1995), principal-agent theory (Jensen and Meckling, 1976), and the nexus of contracts approach (Alchian and Demsetz,

1972).<sup>75</sup> Among these, the transaction cost approach by Oliver Williamson appears the best candidate for the present study. Firstly, it can be considered as most influential; not only within this approach but among all modern theories of the firm. Foss (1997a, 7) describes Williamson as '[t]he present flagbearer of the field' and Groenewegen and Vromen (1996, 365) state that it can 'be considered the new orthodoxy'. Moreover, compared to its alternatives within the contractual perspective transaction cost economics probably offers the most concise description of the firm, is relatively operational, and shows a good awareness of the institutional environment.

Transaction cost economics explains the existence of organisations by the need to economise on transaction costs. This is achieved by assigning different transactions to their right governance structures, defined as frameworks for exchange that vary between markets (market governance) and organisations (unified governance) and include all kinds of intermediary forms. Three factors are considered crucial in determining the height of transaction costs, two are behavioural and one concerns the transaction.<sup>76</sup> The first assumption is that human agents have bounded rationality, which means that behaviour is '*intendedly* rational, but only limitedly so' (Simon, 1961, xxiv; as quoted by Williamson, 1985, 30). The second assumption is that agents show opportunism, 'self-interest seeking with guile' (Williamson, 1985, 30).<sup>77</sup> The third dimension, asset specificity, refers to substantial investments in assets that are specific to a certain exchange relation. Such investments lose part of their value when they are re-applied for another use and are therefore said to be specific to a particular relation. According to Williamson,

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<sup>75</sup> Williamson makes a further distinction within this perspective between the governance and measurement branch. 'The measurement branch of transaction cost economics is concerned with performance or attribute ambiguities that are associated with the supply of a good or service' (Williamson, 1985, 29). The classical example would be Alchian and Demsetz's (1972) analysis of the implications of teamwork. The governance branch, with Williamson as its main representative, analyses the transaction costs that arise because an owner of specific assets might try to renegotiate the division of rents by threatening to withdraw from a transaction and the governance structures to economise on these transaction costs.

<sup>76</sup> In addition to these factors, the uncertainty and frequency of the transaction also determine the height of transaction costs. However, as these assumptions are rather clear and distinct and do not change the explanatory logic of transaction cost economics, they are not included in this discussion.

<sup>77</sup> A more elaborate description of opportunism is as follows. 'By opportunism I mean self-interest seeking with guile. This includes but is scarcely limited to more blatant forms, such as lying, stealing, and cheating. Opportunism more often involves subtle forms of deceit...More generally, opportunism refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse' (Williamson, 1985, 47).

the simultaneous presence of these three factors requires private governance.<sup>78</sup> As organisational governance usually implies employment, this framework also applies to the employment relation. Firm-specific skills have to be embedded in a protective governance structure. However, the governance of employment also comes at a cost as the high-powered incentives of market governance are replaced by the low-powered incentives associated with organisational governance.<sup>79</sup>

In addition, Williamson (1996a, 1996b) acknowledges that governance does not operate in isolation. He, for instance, introduces the institutional environment as a 'shift parameter' since changes in the institutional environment usually require a reconfiguration of governance structures. However, such changes are not the main interest of transaction cost economics as it focuses on the best governance given a certain institutional environment. A similar analysis holds for the various 'feedback effects' that Williamson distinguishes (e.g. organisational attempts to influence the environment and the fact that organisations have 'a life of their own') as actual discussion of these effects is almost non-existent. Williamson considers this limitation acceptable given the secondary nature of these effects.

The second perspective, the capabilities approach, is a colourful group of theories that focus on the resources, routines, capabilities and competencies which distinguish one firm from another.<sup>80</sup> To facilitate the discussion, we will use 'capabilities' as a generic term for all four concepts.<sup>81</sup> These theories share the idea that firms compete on the basis of different capabilities, an idea that can be traced

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<sup>78</sup> This is very much governance of incentives. Like Foss (1997a) points out, literary all aspects are reduced to the alignment of incentives. Governance does not exist to coordinate activities (produce) but to protect oneself against opportunism.

<sup>79</sup> It is therefore that Williamson considers private governance as a second-best solution, only to be chosen when the combined ramifications of bounded rationality, opportunism and asset specificity make market transactions impossible.

<sup>80</sup> As a matter of fact, several of these theories (e.g. Prahalad and Hamel, 1990; Stalk *et al.*, 1992) make extensive use of Japanese companies as examples of exemplary behaviour.

<sup>81</sup> The variety of names has led to criticism that the capabilities perspective is ill-defined. Foss refers to 'the plethora of names that are now placed on strategic knowledge assets, such as routines, competencies, capabilities, dynamic capabilities, etc., and the lack of agreement about how these concepts relate' (Foss, 1997a, 16). Loasby (1998, 163) considers the concept of capabilities 'not welldefined' and Winter (1987, 170) speaks about the necessity 'to confront the difficulties that arise from the complexity and diversity of the phenomena denoted by such terms as knowledge, competence, skill, and so forth'. However, among all confusion, there seems to exist a dormant majority consensus, which becomes apparent if we focus on the transformation process that takes place within the firm. Irrespective the precise terminology, the definitions show important difference between means (usually termed 'resources'), governance ('routines'), and outcomes ('capabilities' and 'competencies'). The concept of capabilities is most comprehensive because it can refer to inputs, governance, and outcomes. This explains why these approaches are often summarised under the heading of the capabilities perspective.

back to Penrose (1959) who first characterized firms as a bundle of resources. These capabilities tend to be sticky, they cannot be copied easily, and have to be accumulated over time. This idea, already implicitly present in Penrose's analysis, received an important boost from Polanyi's concept of tacit knowledge to refer to the fact that 'we can know more than we can tell' (Polanyi, 1983, 4). Knowledge cannot always be easily articulated in words or other symbols but can often only be acquired by a long-lasting process of 'learning by doing'.<sup>82</sup> This not only holds for individuals but even more so for organisations, where many activities are based on teamwork and difficult to take out of the organisation. Consequently, a person or organisation cannot change capabilities at random.<sup>83</sup> The existing capabilities influence both the strategies a firm can and the strategies it cannot pursue and they can therefore be the ground for long-lasting differences in performance. However, the same inertia that enables long-term success also makes change a difficult and slow process and Schumpeterian creative destruction can be interpreted as destroying the existing capabilities that are no longer of use after innovations have taken place.

All these characteristics become visible if we discuss one of the major representatives of the capabilities perspective, the resource-based view (RBV) as developed by Jay Barney. Barney (1991, 102) defines as firm resources those attributes 'that do enable a firm to conceive of and implement strategies that improve its efficiency and effectiveness'. Not surprisingly, resources are subsequently considered a possible source of sustained competitive advantage. Sustainability does not refer to a certain period of calendar time but implies that a

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<sup>82</sup> It is important to note that the two forms of knowledge, the tacit and explicit, are not found separately in reality. Knowledge is a combination of tacit and explicit elements. Tacit knowledge can often be partly codified but never completely and even codification of objective knowledge is never complete. The continuous relation between both forms of knowledge is also shown by the different processes of conversion between tacit and explicit knowledge that have been distinguished by Nonaka and Takeuchi (1995). Several authors have suggested ways to analyse this tacit character – or more specific, the lack of transferability – of capabilities. Winter (1987), for instance, lists a number of dichotomies or continua to analyse the transferability of assets. A position near the left is an indicator that the knowledge may be difficult to transfer, a position near the right is indicative of ease of transfer. The dichotomies are: (1) tacit vs. articulable, (2) non-teachable vs. teachable, (3) non-articulated vs. articulated, (4) not-observable in use vs. observable in use, (5) complex vs. simple, and (6) an element of a system vs. independent.

<sup>83</sup> A common distinction is that between 'knowing that' and 'knowing how'. "Knowing that" is knowledge of facts and relationships, the primary subject matter of formal education and the news... "Knowing how", by contrast, is the ability to perform the appropriate actions to achieve a desired result. It includes skill both in performance and in recognising when and where this skill should be applied' (Loasby, 1998, 165). As one can imagine, capabilities are predominantly 'knowing how'.

competitive advantage continues after others have failed in duplicating this advantage. It can thus be considered an equilibrium definition. In order to be a source of sustainable competitive advantage, a resource must fulfil four conditions, '(a) it must be valuable, in the sense that it exploit [*sic*] opportunities and/or neutralizes threats in a firm's environment, (b) it must be rare among a firm's current and potential competition, (c) it must be imperfectly imitable, and (d) there cannot be strategically equivalent substitutes for this resource that are valuable but neither rare or imperfectly imitable' (Barney, 1991, 105-6).

The first condition actually is a repetition of the earlier definition of resources as attributes that improve the firm's efficiency and effectiveness.<sup>84</sup> However, this is now explicitly linked to the environment and the use of so-called 'environmental models' (e.g. Porter, 1980). It thus becomes clear that the resources are a given for the resource-based view and we apparently need other (environmental) models to determine which attributes are valuable and qualify as resources. The second condition, rarity, can also not be made explicit easily and Barney acknowledges the difficulties in determining how rare a resource must be in order to be a source for competitive advantage. He eventually reaches the rather unsatisfactory platitude that resources can be a source of competitive advantage if they are rare enough to prevent perfect competition. Fortunately, the other two conditions appear more clear-cut. Barney lists three explanations why resources can be imperfectly imitable: '(a) the ability of a firm to obtain a resource is dependent upon unique historical conditions, (b) the link between the resources possessed by a firm and a firm's sustained competitive advantage is causally ambiguous, or (c) the resource generating a firm's advantage is socially complex' (Barney, 1991, 107). All these factors make it difficult for competitors to copy a firm's resources. Finally, the condition of non-substitutability requires the absence of resources that are comparable or enable similar strategies. Particularly, this second form of substitutability complicates matters because it is likely to produce a grey area of partial substitutability.

This example of the resource-based view shows how the rather general insights that define the capabilities approach can be developed into a concise theoretical framework. Moreover, it also shows how properties as 'valuable' and 'rare' are difficult to make explicit. At the same time, we need to acknowledge that the resource-based view with its focus on equilibrium is a rather exceptional

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<sup>84</sup> The discussion actually seems rather careless. First of all, there seems no difference between 'resources' and 'valuable resources'. '[R]esources are valuable when they enable a firm to conceive of or implement strategies that improve its efficiency and effectiveness' (Barney, 1991, 106). But was this not the condition for attributes to be qualified as resources? Resources do, literally, by definition contribute to the firm's competitive strength.

exponent of the capabilities perspective. The important question how capabilities are developed remains in the dark and it is here that the evolutionary theories differ.

Crucial in the evolutionary perspective is the presence of the three evolutionary concepts of variety, heredity, and selection (Foss, 1997b). A discussion of these concepts shows the similarities to the capabilities perspective. Variety comes from the firms' different pools of 'capabilities', heredity is caused by the tacit, team-embodied character of 'capabilities' that makes them hard to copy, and finally, selection follows when the market favours the firms with the best 'capabilities'. It is therefore not surprising that evolutionary theories have sometimes been included in the capabilities perspective (Foss, 1997a).<sup>85</sup> However, important differences also exist. A first major difference concerns the focus on dynamics within the evolutionary perspective. While many theories in the capabilities perspective, like the resource-based view, focus almost exclusively on the characteristics of the capabilities themselves, the evolutionary perspective stresses their development. 'Briefly, one may see the evolutionary approach as having developed the dynamic aspects of Penrose's theory (her view of the process of firm growth as a continuous and cumulative "unfolding" process), while the resource-based approach has been more pertinent to the analysis of the resources themselves' (Foss, Knudsen, and Montgomery, 1995, 9). So, even though the differences tend to be gradual, the treatment of dynamics is an important line of division.

Another major difference used to be the theories' domain. With Penrose (1959) as a major exception, the evolutionary perspective has long focussed on the industry level.<sup>86</sup> It is likely that it is in particular the central importance of selection that has contributed to this tendency. It is at the industry level that heterogeneous firms are selected and the (more) successful firms are separated from the unsuccessful. If we focus on the firm level and the management perspective, selection is only a theoretically distant reality that cannot be analysed.<sup>87</sup> However, recently there has been an important change in this respect. Foss (1997b) describes

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<sup>85</sup> However, this classification is not unambiguous. As a matter of fact, Foss (1997b) presents the capabilities approach as an example of evolutionary theories.

<sup>86</sup> The evolutionary perspective is still very much associated with the evolutionary theory of economic change by Nelson and Winter (1982). Just as in the neo-classical theory of the firm, they model industries instead of individual firms.

<sup>87</sup> As a rather natural consequence, firm-level theories focus more on intentions and rationality and less on selection. These perspectives are obviously not inconsistent (intentionality does not exclude selection and vice versa) but the focus is usually different. This difference in perspective also shines through in the following ascertainment by Montgomery. 'I came to see that strategists are diehard optimists: the kind of people that can be depended on to see the glass half full, not half empty. In contrast, the population ecologists and evolutionary theorists appeared rather sober (if not somber)' (Montgomery, 1995, 251).



how so-called ‘ontogenetic’ theories, which take the firm rather than the industry as *explanans*, have been developed.<sup>88</sup> Interesting is that Nelson and Winter, highly responsible for the surge in evolutionary economics and its industry perspective, have both increasingly focused on the firm. This makes us return in the direction of the capabilities perspective as will become clear in the discussion of the dynamic capabilities approach developed by David Teece, Gary Pisano, and Amy Shuen. This is a major example of an ontogenetic evolutionary theory of the firm and shows that the differences between the capabilities and evolutionary perspective are gradual.

Teece, Pisano and Shuen (1997) explicitly position themselves in regard to the resource-based view. They acknowledge how this perspective emphasizes firm-specific assets as the fundamental determinants of firm performance but state that it ‘does not attempt to explain the nature of the isolating mechanisms that enable entrepreneurial rents and competitive advantage to be sustained’ (Teece *et al.*, 1997, 510). To confront this deficiency they focus on dynamic capabilities, defined ‘as the firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments’ (Ibid., 516). The dynamic capabilities approach thus introduces a specific type of capabilities that enable the firm to adapt to its changing environment. This illustrates the dynamic focus of the evolutionary perspective.

Their approach to identify the foundations for (dynamic) capabilities is reminiscent of the resource-based view. In order to be strategic, capabilities need to be ‘honed to a user need’ (valuable), unique (rare and without close substitutes), and difficult to replicate (imperfectly imitable). It is the next step that makes the difference because Teece, Pisano, and Shuen identify the factors that are behind a firm’s competences and dynamic capabilities. They organise these factors in three categories: processes, positions, and paths. The processes can be further divided into processes of coordination and integration (static concepts), learning (a dynamic concept), and reconfiguration (a transformational concept). Positions refers to the firm’s specific assets which can, for instance, be technological, financial, reputational, structural, or institutional. Finally, paths are an expression of the fact that a firm’s past investments and routines determine its opportunities because if ‘too many parameters are changed simultaneously, the ability of firms to conduct meaningful natural quasi experiments is attenuated’ (Ibid., 523).

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<sup>88</sup> We can distinguish theories that focus on industries (so-called ‘phylogenetic’ theories) and theories that focus on individual firms (so-called ‘ontogenetic’ theories). See Hodgson (1994) for a discussion of this and other taxonomies among evolutionary approaches.

This discussion of the dynamic capabilities perspective shows some of the important similarities and differences with the resource-based view. Issues of value and rarity are made less explicit by Teece, Pisano and Shuen but are likely to suffer from similar difficulties as in the resource-based view.<sup>89</sup> On the other hand, an important difference exists in the explicit focus on organisational processes within the dynamic capabilities approach. Teece, Pisano and Shuen are therefore able to analyse the factors behind the development of a firm's dynamic capabilities and this can be considered a major addition the resource-based view's focus on the characteristics of capabilities. It is dynamics that has taken central stage. This is also instrumental in the recognition of core rigidities because in a changing environment competencies can actually become a liability (e.g. Leonard-Barton, 1995). This possibility is not considered in the equilibrium perspective of the resource-based view.

### **Similarities and differences**

The discussion of the capabilities and evolutionary perspective already pointed out some important similarities and differences. This section builds on this knowledge by a critical comparison of the three perspectives to achieve a better understanding of their assumptions and characteristics. The areas of comparison are the treatment of knowledge, dynamics, governance, and specificity. The differences between transaction cost economics and the theories of the other perspectives are particularly striking.<sup>90</sup> The subsequent sections then discuss how the characteristics thus determined have an important impact on the operational possibilities of these theories and perspectives.

The treatment of knowledge appears similar as all theories consider rationality as bounded. However, its implications differ substantially. In the case of transaction cost economics, it is insightful to look at the assumption of opportunism as it is precisely the combination of opportunism and bounded rationality that is essential within transaction cost economics. 'I agree that opportunism is of no account in the face of unbounded rationality. But I also insist that bounded rationality notwithstanding, contracting would be ubiquitous in the face of nonopportunism – that is, if simple self-interestseeking is assumed' (Williamson, 1985, 66). It thus appears that without opportunism communication and coordination would be unproblematic. Williamson assumes one truth, one objective perspective on the

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<sup>89</sup> The section on the operational issues of the capabilities perspective provides a more elaborate discussion of this issue.

<sup>90</sup> As the theories in the contractual perspective show substantial differences in spite of their shared focus on incentives, we will limit the comparison to the specific example of transaction costs economics.

world, and only cheating, a consciously false presentation of the truth, can explain disagreement. It is therefore that bounded rationality and opportunism almost coincide within transaction cost economics.

This dependence on opportunism in transaction cost economics becomes clear if we look at the work of several authors who claim that the assumption of opportunism is not necessary to explain the existence and boundaries of firms (e.g. Conner, 1991; Kogut and Zander, 1992, 1996; Conner and Prahalad, 1996). Interestingly enough, Conner and Prahalad use a definition of bounded rationality provided by Williamson but reach different conclusions because ‘cognitive limitations imply that no two individuals possess identical stocks of knowledge’ (Conner and Prahalad, 1996, 482).<sup>91</sup> Consequently, the existence of firms no longer requires the assumption of opportunism because this can now be explained by a firm’s capabilities to exchange and develop knowledge.<sup>92</sup> Conner and Prahalad describe how the organisational mode – with as extreme cases, the organisation and the market – influences the available knowledge in two ways. ‘These are (1) how the parties existing knowledge is blended and used, and (2) how new learning or developments occurring during the course of the work are taken into account. We call these, respectively, the “knowledge-substitution” and “flexibility” effects of organizational mode’ (Conner and Prahalad, 1996, 478). According to this view, transaction cost considerations are of secondary importance in the make-or-buy decision for a certain product as the decision is mainly dependent on the current knowledge of the firm and the expected outcome of investments in innovation.<sup>93</sup>

We can conclude that for Williamson, knowledge is bounded in the sense that we do not know what has not yet happened or what has not been told to us. It is essentially a combination of uncertainty about the future and asymmetrical

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<sup>91</sup> As a matter of fact, Williamson’s interpretation of bounded rationality seems closer to Simon’s (1961), who also focuses on the limits of the human ability to process existing (objective) information.

<sup>92</sup> The importance of opportunism seems dependent upon the focus on transactions rather than production. Transaction cost economics focuses on transactions – and thus situations of exchange and negotiation – and it is therefore no surprise that it stresses the importance of opportunism. However, if we focus on productivity and acknowledge that (productive) knowledge is dispersed among different persons who might reach different conclusions, opportunism is no longer needed to explain the advantages firms can hold over the market.

<sup>93</sup> Foss (1996) claims that writers like Conner and Prahalad (1996) do not give a sufficient reason for the existence of the firm. He states that their analyses do not presuppose common ownership as ‘co-specialization and the presence of higher order organizing principles are not sufficient to explain the existence of the specific constellation of property rights that characterizes the firm’ (Foss, 1996, 473). However, Foss’ criticism focuses explicitly on the structure of ownership, which concerns the division of rent rather than the knowledge of production. The focus is therefore different. One explains competitive strength (productive), the other explains the division of rents (transactional).

information. Both types of uncertainty create chances for opportunism and require the presence of protective governance structures. However, the knowledge itself is objective. The capabilities and evolutionary perspectives, on the other hand, show a different perception of knowledge. As has become clear from the earlier discussion, the tacit, team-embodied and heterogeneous character of knowledge is central to these approaches. Knowledge is thus bounded by the person possessing this knowledge, the knowledge is subjective.<sup>94</sup> This was already clear in Penrose (1959) who presents a subjectivist disequilibrium theory of the firm.<sup>95</sup>

A second topic of comparison concerns the issue of dynamics. We have already seen that the distinction it creates runs along unexpected lines since its treatment can be considered the major dividing line between the evolutionary and capabilities perspective. Foss, for instance, criticises the resource-based view because ‘it actually tells us very little of direct value for understanding the more dynamic and managerial aspects of competitive advantage’ (Foss, 1998, 136). However, since this issue has already been discussed, this section is limited to the discussion of dynamics within transaction cost economics. Williamson suggests that transaction cost economics has a good eye for dynamics. ‘Transaction cost economics concurs with Friedrich Hayek (...) and Chester Barnard (...) that adaptation is the central problem of economic organization...The upshot is that transaction cost economics is very much an intertemporal, adaptive managerial exercise’ (Williamson, 1998, 32-3). However, the treatment of dynamics remains limited to adaptation within the different forms of governance. It concerns adaptation through governance instead of adaptation of governance and we can therefore qualify transaction cost economics as a comparative, static analysis. Governance at two different moments in time or between two different governance structures can be compared but the actual process of change cannot be analysed.

As the theory’s *explanans*, governance is clearly of central focus in transaction cost economics. Given bounded rationality, opportunism, and asset specificity, the most efficient governance structure can be determined and different forms of governance can be compared in terms of transaction cost efficiency. A good example is Dyer (1996) who compares ‘supplier governance’ between US and Japanese automobile

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<sup>94</sup> Because of the importance of knowledge, Foss actually groups these approaches under the heading of ‘knowledge-based approaches to the theory of the firm’ (Foss, 1996, 470).

<sup>95</sup> Another insightful example is by Denzau and North (1994) who introduced the concept of ‘mental maps’. Every individual has a specific mental map and cooperation will succeed if these maps are rather similar but will fail if the maps are ‘not compatible’.

manufacturers.<sup>96</sup> This is not to say that such analyses are without problems. The theory is, for instance, ambiguous on the relation between the governance of particular transactions and the existence of firms and the question which group of transactions will eventually be combined within a single firm. Another major problem concerns the neglect of technology and production. Overall, the focus on transactions provides a very small basis to the existence of firms and this explains that Winter (1982, 75) concluded that ‘the firms of the contractual perspectives “are held together *only* by the thin glue of transaction cost minimization”’ (Foss, 1997b, 92).<sup>97</sup>

The situation is rather different for the other perspectives. Just as in the case of dynamics, we find important diversity as capabilities can refer to both resources and the capacity to deploy resources by use of organisational processes. We have, for instance, seen how the resource-based view predominantly focuses on the characteristics of resources and remains silent on issues of development and governance. The dynamic capabilities approach, on the other hand, does treat the issue of governance by naming organisational processes as the most important source for a firm’s competitive advantage. However, a major difference exists between claims about the importance of organisational processes and analysis that state what these organisational processes should look like.<sup>98</sup> However, one specific form of governance has actually received elaborate attention within the capabilities and evolutionary perspective, the development of capabilities. Most striking example in the present context is the work of Nonaka and Takeuchi (1995), which focuses solely on the development of new knowledge and capabilities in Japanese

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<sup>96</sup> The possibility of ‘real-world’ comparative analyses like Dyer (1996) actually presents us with an interesting paradox. According to transaction cost economics arguments, the most efficient form of governance will eventually win out. However, comparisons like Dyer’s show that such definite outcomes are highly unlikely as different forms of governance exist next to one another even if they concern similar transactions.

<sup>97</sup> Foss (1997a) discusses the consequences of this confined focus on transaction costs because it might miss-present important phenomena and also closes off certain alternative explanations. ‘One is the possibility that knowledge about how to produce is imperfect – or, if you prefer, dispersed, bounded, sticky and idiosyncratic. The second is the possibility that knowledge about how to link together one person’s (or firm’s) productive knowledge with that of another is imperfect’ (Foss, 1997a, 9).

<sup>98</sup> This possibly leads us to the limits of general theorising. We have to acknowledge that the treatment of dynamics is also not without difficulties within the evolutionary perspective. Nooteboom (2002, 3) observes how ‘whereas saying dynamics is easy, doing economics is hard’ and Montgomery (1995, 263-4) states the following. ‘The distinction between static and dynamic routines is an important one from both a scholarly and practical perspective. Nonetheless, in its present state, the argument has a “happily ever-after” quality, as dynamic capabilities are the “push-back” firms need against mortality.’ See the section on the operational issues of the capabilities perspective for a further discussion of this issue.

firms. Another interesting example is provided by Doz (1996) who distinguishes five processes in the management of competencies: development, diffusion, integration, leverage, and renewal.<sup>99</sup>

A final issue is the treatment of specificity. Asset specificity is crucial within transaction cost economics, firm-specific (tacit) knowledge is an important ingredient of the evolutionary and capabilities perspective. These concepts are strongly related in the sense that both concern a dependence on either transaction partners (asset specificity) or the carriers of tacit skills (employees). However, in spite of strong similarities they do not coincide. First of all, asset specificity is described as ‘conscious investments in dependency’ and it is solely this dependence that is analysed. The reason for accepting asset specificity, the possibility of more efficient production, remains outside the analysis as it is merely assumed that higher asset specificity will lead to better productivity or, specifically, that firms will not accept higher asset specificity unless it leads to higher productivity. This contrasts with the explicit focus on issues of production within the capabilities and evolutionary perspectives. Secondly, the asset specificity of transaction cost economics has no explicit knowledge component. Knowledge is not tacit but the dependency merely concerns sunk costs as a result of past investments (as indicated by the term ‘asset specificity’). This leads us back to the beginning of this section and the treatment of knowledge can probably be considered the most fundamental difference between transaction cost economics and the other two theories.

### **Operational issues transaction cost economics**

In discussing the operational possibilities of transaction cost economics we should focus on two of its central concepts, bounded rationality and opportunism. As a matter of fact, these concepts are not defined consistently. On several occasions, they are presented as realistic descriptions of human behaviour. ‘Transaction cost economics characterizes human nature as we know it by reference to bounded rationality and opportunism’ (Williamson, 1985, 44). Moreover, Williamson explicitly rejects the widely held opinion in economics that the realism of assumptions is unimportant and agrees with Coase that ‘[m]odern institutional

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<sup>99</sup> The contents of most of these processes will be clear; except maybe for integration and leverage. Competence integration concerns ‘the ability to integrate specific elements of know-how, rooted in skills, technical systems and specific assets into wider value-creating competencies’ (Doz, 1996, 167). It is the combination (aggregation) of different elements of competencies that often creates competitive advantages. Competence leverage concerns the dilemma between ‘efficiency learning and the exploitation of mastered competencies in the existing business domain of the firm [and]...effectiveness learning by stretching competencies to explore business domain extensions’ (Ibid., 169).

economics should study man as he is' (Coase, 1984, 231; quoted in Williamson, 1985, 44). Finally, the inclusion of the institutional environment and various feedback effects subscribes the intention towards even greater realism.

However, in most cases the assumptions of opportunism and bounded rationality seem instrumental rather than realistic. Williamson defends the assumption of opportunism as follows. 'If candid reference to opportunism alerts us to avoidable dangers, which the more benign reference to frailties of motive would not, then there are real hazards in the more benevolent construction' (Williamson, 1998, 31). The expectation of opportunism might be unfounded but its potentiality requires protective governance. As the treatment of opportunism is binary there are only two possibilities, (the chance of) opportunism or no (chance of) opportunism, and we better assume the worst. In this sense, Williamson can be considered as the Machiavelli of economic organising, albeit with less severe consequences. This ambivalence concerning the status of opportunism is confirmed by Groenewegen and Vromen (1996, 376), who observe that '[s]peaking of the specific case of Japan, [Williamson] seems to suggest that opportunistic behavior depends on the institutional environment, but in general he treats opportunism as an independent variable. In his opinion it is an assumption that facilitates a profound understanding of organization(s).' A similar analysis holds for the assumption of bounded rationality. Williamson (1985, 46) speaks about 'the realities of bounded rationality' but the analysis points to a more instrumental importance of bounded rationality. This shows, in particular, in the use of bounded rationality but the absence of the concept of 'satisficing'. Groenewegen and Vromen (1997, 46) therefore express the suspicion 'that the degree to which Williamson takes the rationality of individuals to be bounded is tailor-made to serve his theoretical purposes' and 'does not seem to rest on an independent judgement on Williamson's part of the cognitive capacities and limitations of individuals'.

We thus see that opportunism and bounded rationality can be better interpreted as instrumental assumptions about individuals to explain the efficiency of different governance structures. This in spite the rhetoric to present them as realistic. The choice for these instrumental definitions becomes understandable if we refer to Latsis' (1976) observation that neo-classical economic models are guided by what may be called 'the method of single-exit reduction'. This means that the model is thus defined that it singles out one best course of action. So, irrespective the agent's characteristics, the situational determinism of the model will determine the appropriate action. A similar approach seems to characterise transaction cost economics. Given bounded rationality, opportunism, and a certain level of asset specificity, one best form of governance will result. The definitions of opportunism and bounded rationality are not so much inspired by their realism but by the need to

achieve theoretical closure. However, the instrumental definition of bounded rationality and opportunism makes application fully dependent upon differences in asset specificity. This interpretation would explain several characteristics of transaction cost economics like the importance of farsightedness, the ever-present danger of opportunism, and the lack of firm heterogeneity.<sup>100</sup> However, this qualification of transaction cost economics is not beyond discussion. Groenewegen and Vromen actually consider theoretical closure impossible because of 'the type of rationality, opportunistic behavior, and relationships with the complex, uncertain environment' (Groenewegen and Vromen, 1996, 368). Nevertheless, they also acknowledge that Williamson wants to stay close to the neoclassical approach in order to save 'rigorous analysis'. It appears that it is precisely the theory's ambiguity in assumptions that makes it impossible to settle this issue.

At the same time, this ambiguity has important consequences for the operational possibilities of transaction costs economics. According to Williamson (1998), the operational possibilities of transaction costs economics are good and empirical applications have grown exponentially. However, one can question this assessment as it is hard to suppress the idea that precisely the instrumental, closed and binary formulation of the assumptions has contributed to the theory's applicability. Once a transaction has been identified, we can implement a transaction cost analysis. However, we must wonder if it always leads to a better understanding of the issues at hand. '[T]he issue is whether the mechanisms so identified are in fact *plausible explanations of the phenomena under study*' (Foss, 1997a, 8). In other words, the concepts create their own answer and thus their own importance. If you focus on transaction costs, the answer will be transaction costs but this focus will not always be equally relevant.

The instrumental definition of the major concepts also impacts the various attempts by both Williamson and his critics to improve the transaction cost framework. We have already seen how Williamson (1996a, 1996b) has ascribed a role to the institutional environment and feedback effects like organisations' 'life-of-their-own'. Unfortunately, these attempts have not been sufficient to satisfy his critics. They have, for instance, pointed out the need for the 'endogenisation' of opportunism (Groenewegen, 1996) and the inclusion of trust (Noorderhaven, 1996).

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<sup>100</sup> In this respect, transaction cost economics is very similar to the evolutionary theory of Nelson and Winter (1982). Their concept of routines also has a dual status. On the one hand, the routines are defined from the behaviour of firms; on the other hand, routines are defined according to the genes metaphor. Moreover, Nelson and Winter's evolutionary theory also shows a similar need for theoretical closure. 'Winter's main reason for assuming that firms follow routines seemed to be that definite results can be derived from his simple evolutionary model only under this assumption' (Vromen, 1995, 73).



However, as will have become clear by now, these improvements appear destined to fail as long as transaction cost economics maintains the objective of definite outcomes.<sup>101</sup> A good example concerns the inclusion of the institutional environment, important enough for Williamson (1975) to qualify his approach as ‘new institutional economics’. However, the actual treatment of institutions is very limited. In the end, governance is determined by bounded rationality, opportunism and asset specificity and the impact of the institutional environment as a ‘shift parameter’ appears very limited if not non-existent.

These issues subscribe to the choice to focus on the explanatory logic of, in this case, transaction cost economics.<sup>102</sup> This choice frees us from the necessity to include both opportunism and bounded rationality as instrumental and binary variables and allows for the improvements as proposed by both Williamson and his critics.<sup>103</sup> Moreover, it also enables us to include another but highly complementary approach which focuses explicitly on the governance of employment, the literature on internal labour markets (e.g. Doeringer and Piore, 1971; Osterman, 1984a, 1984b, 1994).

Doeringer and Piore (1971, 1-2) define an internal labour market as ‘an administrative unit...within which the pricing allocation of labor is governed by a set of administrative rules and procedures’. Firms can often exercise substantial discretion in their employment practices and this enables firms to use their employment practices for motivational and training purposes besides rewarding productivity. Subsequently, it is the rigidity of these administrative rules that is important. If these rules are responsive to changing market circumstances, their impact will be minimal, but if rigid they will interrupt or transform direct market forces, causing the internal labour market to respond differently to changing circumstances than the market. The similarities to transaction cost economics are clear and it is hard to interpret internal labour markets as anything else than a choice for governance over the market. The protection it offers enables investments in firm-specific knowledge.

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<sup>101</sup> It is likely that most critics do not expect to achieve definite outcomes and settle for a more open approach to transaction costs and transaction cost analysis, possibly comparable to the concept of logic as developed in this chapter. However, it is striking that at least to my understanding this issue has hardly been made explicit.

<sup>102</sup> See one of the later sections on the logic of the firm for a discussion of this choice.

<sup>103</sup> Williamson himself states how he appeals and pushes ‘the logic of transaction cost economizing relentlessly – the object being to deepen our understanding and to develop the refutable implications that this point of view uniquely affords’ (Williamson, 1985, 2). This chapter subscribes to this logic but questions the possibilities for refutable implications and propose a relative open use of this logic.

However, the work on internal labour markets is not limited to mere economic arguments, as in the transaction cost perspective. Economic efficiency is an important determinant of employment governance but sociological, political, and institutional factors also play a role.<sup>104</sup> The development of governance goes together with the development of social customs, routines and norms. Moreover, as it is the essence of internal labour markets that governance replaces market relations, there obviously exists a sliding distinction from the direct governance of the internal labour market to its embedded norms and customs. Contradictory to transaction cost analysis, except for the half-hearted acknowledgement that organisations can have a life-of-their-own, it is simply not the case that governance remains an outside structure.<sup>105,106</sup>

Finally, we should stress the relation between internal labour markets and firm-specific skills. Without the importance of firm-specific knowledge and on-the-job-training, the internal labour market loses much of its competitive edge.<sup>107</sup> The relationship works in two directions. First of all, skill-specificity incites the development of internal labour markets as a governance structure to protect the investments in firm-specific training. This is the basic transaction cost economics argumentation. However, once established, an internal labour market contributes to the further development of firm-specific skills. The system of job ladders and internal promotion permits the development of skills through the system of on-the-job training. Skill-specificity and on-the-job-training thus reinforce each other; the need for firm-specific skills strengthens the use of on-the-job-training and on-the-job-training is very likely to contribute to the firm-specificity of the skills acquired. Moreover, the job ladders themselves can be another factor that contributes to the specificity of employees. Even if the skills in a certain job are rather general, the particular set of skills that constitute a job might be specific. As an interesting twist

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<sup>104</sup> Osterman (1994) actually distinguishes two competing perspectives within the literature on internal labour markets. One group states the importance of performance considerations, the other group focuses on the impact of customs, norms, and politics.

<sup>105</sup> Transaction cost economics claims to discard these factors because of their secondary nature but, as indicated, it is likely that these factors are mainly dismissed because they hinder the possibility of definite outcomes.

<sup>106</sup> The existence of social customs, routines and norms and thus the 'embeddedness of governance' explains why a change in governance structure tends to be a relatively slow and long-term process. Williamson (1998) acknowledges that changes in governance usually take about 10 years but his analysis remains rather quiet in explaining the reasons for this period. His analysis in terms of opportunism, bounded rationality and asset specificity suggests that change in governance can be immediate.

<sup>107</sup> Osterman (1994) also lists other conditions that determine the contribution of internal labour markets on performance, namely technology, the skills the labour force brings to the firm, and the characteristics of product markets. The next chapter on the contingencies of Japanese employment practices discusses these issues in detail.

in traditional transaction cost logic, we can conclude that governance not just manages but also creates specificity. This might appear counterproductive but the next chapter will show how such specificity can be an important source of motivation.

In summary, we can conclude that internal labour markets can be interpreted as an elaboration of transaction cost arguments for the replacement of market relations by governance. Moreover, because of the inclusion of social elements, the resulting perspective is richer than that of transaction cost economics. Most striking is the treatment of an organisation's 'life-of-its-own', which basically remains outside analysis within transaction cost economics but achieves central stage in work on internal labour markets through the discussion of norms and customs. At the same time, this comes at a cost as the aesthetic simplicity of transaction cost economics is replaced by a more muddled framework. However, as the next chapter will show, the added insights appear to outweigh these costs.

### **Operational issues capabilities perspective**

Just like transaction cost economics, the capabilities perspective – particularly, the resource-based view – has also received its fair share of criticism.<sup>108</sup> However, this section focused on one specific issue that has major implications for its operational possibilities. It concerns the criticism that the resource-based view should be qualified as a tautology. Various authors have voiced this criticism but the most elaborate discussion probably concerns the debate between Priem and Butler, on one side, and Barney, on the other, in the *Academy of Management Review* in 2001.

Priem and Butler (2001a) focus on the following statement: 'valuable and rare organizational resources can be a source of competitive advantage' (Barney, 1991, 107). By substituting the definitions for resources, valuable, and competitive advantage as included in Barney's article, they reveal this statement as analytical and thus true by definition. They criticise the resource-based view's sole focus on the firm's resources with the exclusion of the firm environment and the processes behind their development.<sup>109</sup> Barney (2001) admits that the determination of the

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<sup>108</sup> Foss, for instance, gives the following assessment: '[t]he capabilities perspective 1) does not explain *the existence of the firm*; 2) does not convincingly explain *asset ownership*; 3) is not *predictive*; 4) does not explain *when capabilities matter* for economic organization and when they don't; and 5) lacks clear *microfoundations and modelling heuristics*' (Foss, 1997a, 13).

<sup>109</sup> Just like transaction cost economics and its dependence on the neoclassical production view, the resource-based view appears haunted by its past. Barney (1991) explicitly presents the resource-based view as an antidote against two earlier biases in strategy research, that firms possess homogeneous resources and strategies and that resources are highly mobile. However, as pointed out by Priem and Butler (2001a), the resource-based view has similar simplifying assumptions; in this case, on the demand side.

value of a firm's resources is exogenous and points out that the 1991 article already acknowledged a complementary role for the so-called 'environmental models of competitive advantage'. However, Priem and Butler (2001b) are not convinced by these arguments and maintain their criticism. They also point out that the overall resource-based perspective can thus not be tested. If a certain valuable resource does not lead to competitive advantage, it would not falsify the resource-based view but merely point out that this particular resource is not valuable; at least not without certain complementary resources. So, Priem and Butler reach the following, harsh conclusion. '[T]he RBV has little to contribute to the explanation or prediction of competitive advantage. That is, advantage can be identified once it has been achieved, but it cannot be explained or predicted with the RBV' (Priem and Butler, 2001b, 63-4).<sup>110</sup>

Overall, Barney only seems to offer us a potentiality when it comes to the impact of resources on competitive advantage. Valuable resources *can* be a source of competitive advantage. The resource-based view assumes that competitive advantage is tied directly to the distinctiveness of resources but, as the discussion has shown, resources are a necessary condition, not a sufficient one. The potentiality requires another mediating force which creates success, which transforms the potentiality into a reality. The question is which force is responsible. The statement creates a background, a field for further analysis, and the resource-based view has provided a new but incomplete 'paradigm'.<sup>111</sup> In reference to the discussion of the

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<sup>110</sup> In the end, part of the disagreement can be reduced to Priem and Butler's decision to use the sentence 'valuable and rare organizational resources can be a source of competitive advantage' as a representation of the resource-based view. This turns out a wrong representation because the resource-based does not analyse the value and rarity of resources but merely assumes such resources to exist. Barney actually admits this in both the 1991 and 2001 article. However, he also deserves part of the blame for this confusion since he discusses the possible conditions for competitive advantage (value, rarity) on equal footing with the sources for sustainability (imperfect imitation and lack of strategically equivalent substitutes). Moreover, he creates the impression that the resource-based view discusses all four conditions and the remark that the 'value variable in Barney (1991) is not fully parameterized' (Barney, 2001, 43) can be considered a true understatement. Finally, since resources themselves are already defined as attributes that enable the implementation of strategies that improve efficiency and effectiveness, the seeds for tautology are already there in the discussion of 'valuable resources'.

<sup>111</sup> This conclusion seems to be confirmed by the different conclusions of Priem and Butler (2001a) and Barney (2001). The first claim that studies of 'knowledge-based resources and firm performance' have been achieved, while 'the foundational RBV appears not to be essential in making these arguments' (Priem and Butler, 2001a, 33). However, Barney stresses the importance of the resource-based view for these analyses. 'Given that RBV logic was instrumental in pointing to the kinds of variables that should be included in this recent work..., it is difficult to understand what Priem and Butler mean when they say that this work makes significant contributions "without the RBV itself making an elemental contribution"' (Barney, 2001, 51).

last few chapters, we can conclude that the resource-based view provides an explanatory logic that nevertheless remains incomplete without reference to the environment. This raises the question if these problems are specific for the resource-based view with its equilibrium perspective. As a matter of fact, several other approaches within the capabilities perspective do not seem to suffer in a similar extent as they subscribe to the need to include the environment.<sup>112</sup> Moreover, if we stretch the capabilities perspective to include evolutionary approaches, we can, for instance, refer to the dynamics capabilities approach, which explicitly introduces the environment. However, to an important extent, these approaches are susceptible to similar criticism. The discussion of the dynamic capabilities has, for instance, shown how this approach remains reminiscent of the resource-based view in its focus on capabilities that are ‘honed to a user need’ (valuable) and ‘unique’ (rare), without actually defining these characteristics.

Moreover, the difficulties in determining value and rare resources run deeper than so far acknowledged. The danger of tautology is not only caused by the failure to include the environment but also by the characteristics of capabilities themselves. This becomes clear when we focus on the concepts of causal ambiguity and social complexity as they were introduced in the discussion of the resource-based view. Causal ambiguity exists when the link between resources and a firm’s competitive advantage is not fully understood. ‘[W]hen faced with the complexities of a real firm, it is often difficult to identify which of a firm’s many “resources”, singly or in combination, account for the firm’s success’ (Foss, Knudsen, and Montgomery, 1995, 8). Social complexity is comparable and implies that capabilities often depend upon complex social phenomena beyond simple analysis. Explanations include, for instance, the interpersonal relations among managers in a firm, a firm’s culture, and a firm’s reputations among its suppliers and customers.<sup>113</sup> Whatever the precise terminology, the importance of this interplay among resources indicates that it is often an illusion to look for tightly defined, specific resources to explain competitive advantages.<sup>114</sup>

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<sup>112</sup> Rumelt (1984) starts with the need to include the environment in any analysis of resources. ‘In essence, the concept [strategy] is that a firm’s competitive position is defined by a bundle of unique resources and relationships and that the task of general management is to adjust and renew these resources and relationships as time, competition, and change erode their value’ (Rumelt, 1984, 557-8). As another example, Reve (1990) states that a theory of strategic management needs two components: a theory of competitive positioning and a theory of the firm.

<sup>113</sup> Sometimes, these issues are both included under causal ambiguity with a further distinction between the uncertain processes concerning the identification and development of resources (‘characteristic ambiguity’) and their impact on competitive advantage (‘linkage ambiguity’).

<sup>114</sup> We are actually confronted with a problem that individual resources are not in competition. Under inter-firm competition, systems or combinations of resources and capabilities are tested

The existence of causal ambiguity and social complexity, together with the tacit character of knowledge, can be considered crucial for the capabilities perspective as it is essential in achieving sustainable competitive rents.<sup>115</sup> Godfrey and Hill (1995) point out how it is precisely the existence of ‘unobservables’ in the resource-based view that enables the creation of specificity rents. If the contribution of resources to competitive success would be precisely known, this knowledge would be reflected in the assets’ prices. This creates the paradox that these assets are valued because they cannot be valued, a paradox that has two major consequences (Wilcox King and Zeithaml, 2001). First of all, it has led to discussions about the best way to treat this ambiguity. Barney (1991) focuses on the danger of imitation by competitors and claims that the firm is best protected when it does not understand the source of its own competitive success. However, other authors including Teece, Pisano, and Shuen (1997) point to the importance of replication, the use of existing capabilities in a new economic setting. A good understanding of the link between resources and competences can therefore be an important source of growth for the firm. Moreover, better understanding will also enable improvements in efficiency and effectiveness. The situation of ‘ignorance bliss’ as proposed by Barney is thus a caricature of reality and another unfortunate consequence of the resource-based view’s equilibrium perspective. Secondly, the existence of unobservables also holds obvious consequences for any attempt to make the capabilities perspective operational. If even firms cannot fully understand the relation between resources and capabilities or competences, any outsider is in a very difficult situation. Because of these difficulties, it can be no surprise that Doz (1996) mentions how some empirical researchers discuss competencies almost entirely by default. Priem and Butler speak of the ‘in search of excellence problem’ as ‘it is quite easy to identify, a posteriori, many “valuable” resources in high-performing firms’ (Priem and Butler, 2001a, 33).

Overall, the outcome is comparable to that of transaction cost economics, as both approaches know important operational problems. In the case of transaction cost economics, the instrumental definition of the major concepts leads to a wide applicability that might actually surpass its relevance. In the case of the capabilities perspective (including more evolutionary theories like the dynamic capabilities approach), the danger of tautology dawns because of the lack of environmental focus and the attempt to discuss that which cannot be precisely known. As these problems

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and the contribution of individual elements can often not be determined; also because important complementarities can exist between the different resources.

<sup>115</sup> In a related matter, we also see how issues of causal ambiguity do not play a role within transaction cost economics. This difference seems very much inspired by the need for theoretical closure in the latter case.

are comparable, so is their solution. Once again, the concept of logic provides the answer. It enables the use of the various insights of the capabilities perspective while acknowledging its limitations. The next section discusses how this can be achieved.

### **The logic of the firm**

All the perspectives and theories as discussed in this chapter provide important insights in the economic implications of the firm and the way it is organised. This is not changed by the operational difficulties that we encountered. Moreover, we can ‘accommodate’ these difficulties if we interpret the perspectives as providing a certain logic, as theories that bring important aspects of the firm ‘into the open’. This in accordance with the first chapter that defined logic as ‘making something visible’, ‘bringing it into the open’, ‘letting it be seen’. The different theories of the firm might not fully define the ‘existence, boundaries and the internal organisation of the firm’, how different transactions are grouped together, how transaction costs and production costs relate, or which resources are responsible for competitive success, but they do provide perspective, they do define the type of answers we are looking for.<sup>116</sup> The remainder of this chapter discusses how the different theories can be used to analyse the economic implications of the firm’s employment practices; or more precisely, to bring certain implications of Japanese employment practices into the open. As it best fits the dynamic perspective of the current study, the dynamic capabilities approach appears a good candidate to start this discussion.

In case of the dynamic capabilities approach, the focus is on the processes, positions and paths that constitute the dynamic capabilities. All three prove highly relevant in the case of employment practices. Concerning processes we see the importance of efficient and effective coordination and the management of human resources is obviously an integral part of this coordination. Aoki’s (1988) discussion of horizontal coordination in the Japanese firm and the complementary role of employment practices, as it is discussed in the next chapter, is an excellent example of the importance of coordination. Processes that organise training are of similar importance. The second issue, positions, points to the human resources themselves. Past investments in training will determine the quality of employees, particularly

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<sup>116</sup> The fact that this happens through instrumental definitions and apparent tautologies, is not insurmountable. Instrumental definitions and tautologies are not necessarily useless as shown by Vromen’s (1995, 51) reference to Whitehead and Russell’s *Principia Mathematica*. ‘Whitehead and Russell note that although definitions are theoretically superfluous, they often convey important information. First of all, the *definiens* (the concepts that are used to define the *definiendum*, the concept to be defined) indicates what subjects are taken to be worthy of careful consideration. Furthermore, a definition may give definite meaning to an already familiar idea that previously was more or less vague.’

when firm-specific skills are important and the external labour market is underdeveloped as in Japan. A second important type of position concerns the so-called ‘institutional assets’. Institutions are a critical part of the environment and this also holds for the institutions that shape the labour market. Moreover, important international differences exist in these institutions, as implied by this study’s focus on national employment practices. Finally, the concept of paths underlines how changing circumstances can transform human resources and employment practices from an asset into a liability, as a firm’s previous investments and routines determine the possibilities of future behaviour. The discussion of embeddedness and its implications for change is insightful in this respect.

The capabilities perspective also offers important insights concerning the governance of employment. As a matter of fact, this perspective and the resource-based view in particular has been a major inspiration for recent work on (strategic) human resource management.<sup>117</sup> It poses two fundamental questions concerning human resources and their development: (1) are human resources valuable and rare and (2) are they non-tradeable, non-imitable and non-substitutable? (Dierickx and Cool, 1989) The answer to the second question follows directly from the discussion of the resource-based view and is relatively easy. Human resources and their management can be non-tradeable, non-imitable and non-substitutable. Although all three characteristics are dependent on the capabilities of competitors, their relevance in the case of human resources has been relatively undisputed because they can be considered socially complex and historically sensitive. Moreover, the issue of causal ambiguity further contributes to the likelihood that valuable human resources can be difficult to isolate and thus a source of sustainable competitiveness. This also makes the step towards ‘rarity’ relatively minor because human resources will be rare when they cannot be easily bought, imitated and substituted. Unfortunately, the issue of value is more difficult to settle; at least within a strict capabilities perspective as the resource-based view. However, several theories have been developed to fill this void.

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<sup>117</sup> Various authors (e.g. Boxall, 1996; Boxall and Purcell, 2000; Priem and Butler, 2001a; Wright *et al.*, 1992; Wright *et al.*, 1994; Wright *et al.*, 2001) have pointed out the strength of this relation and discussed how human resources can be a possible source of sustained competitive advantage. Boxall (1996) points out how the resource-based view has not only provided the field of HRM with a conceptual basis but also allows for an analysis of employment practices that goes beyond the ‘matching’ or ‘positioning’ or ‘environmental’ models that dominated the field of strategic management in the 1980s (e.g. Porter, 1980). Wright *et al.* (2001) also underlines the importance of the resource-based view for the SHRM and claim that ‘the RBV has become by far, the theory most often used within SHRM, both in the development of theory and the rationale for empirical research’ (Wright *et al.*, 2001, 703).



One example is the introduction of perceptions, visions (e.g. Penrose, 1959; Fransman, 1999). When we look at the entrepreneur, we see the perception of value.

Moreover, in the current study, we are in the fortunate position that the focus is on national employment practices. This makes issues like imitation and rarity somewhat irrelevant because the presence or absence of these practices is basically a given, depending on a firm's location in or outside Japan. The dependence upon 'institutional assets' makes that firms are not in danger of losing their competitive advantage to their competitors. There is thus no need to protect the advantage that these practices offer and this has facilitated the analysis of value.<sup>118</sup> The next chapter makes extensive use of past analyses of Japanese employment practices and this will provide a good understanding of their implications and the circumstances under which they are likely to lead to competitive success.

In the case of transaction cost economics, the focus is on asset specificity, bounded rationality, opportunism and the development of an efficient governance structure in response to these factors. However, the complexities of reality make it difficult to develop truly efficient governance and it is insightful to discuss when such failure takes place. Two possible failures are distinguished by Dyer, '[t]ransaction inefficiencies occur for two primary reasons: (a) the failure to effectively align governance structures with transactions, and (b) the failure to make performance-enhancing, specialized investments' (Dyer, 1996, 651). Both types of failure are rather self-evident. In the case of human resources, it basically points out the danger of losing well-trained employees because of insufficient governance against the 'poaching' by competitors and a lack of training out of fear that this happens. Besides, if we acknowledge change and the fact that asset specificity does not automatically lead to better productivity, there is also a possible third failure, (c) the failure to adapt the most productive level of asset specificity to changing circumstances. Moreover, if circumstances change, a certain form of asset specificity can lose its value. We have to remember that a certain governance structure comes at a cost. In the case of labour, this concerns the costs of all the different employment practices. Even when some advantage remains, the costs of existing governance structures might no longer be justified. We thus must be critical about the extra value of specific assets and their costs.

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<sup>118</sup> At the same time, firms try to adjust their management of human resources in response to changing circumstances and the extent to which they succeed at this, can be an important source of competitive strength. The case-studies in later chapters illustrate this possibility. However, this study's focus on national employment practices also means that the firms involved share important advantages or disadvantages that cannot be easily changed.

In addition, we can analyse other employment issues from a transaction cost perspective when we include insights from the research on internal labour markets. One issue stands out. Besides offering protection against asset dependence, employment governance also has to motivate the employees. The original distinction in transaction cost economics between high- and low-powered incentives proves too simple as internal labour markets can be an important instrument in the motivation of employees. We have already established that governance can be a source of asset specificity next to an answer and it is exactly this characteristic that can align individuals' interests with those of the firm, increasing worker commitment and reducing the danger of opportunism. The next chapter on Japanese employment practices will show how long-term employment contracts create an important dependence between firm and employee that proves instrumental in motivating employees.<sup>119</sup>

These are some early indications how the various theories of the firm can inspire the importance of employment practices for firm performance. Because we have decided to focus on the logic of these approaches, the operational problems can be accommodated for. However, this choice requires a somewhat different approach to the various perspectives. It requires an open approach in which each perspective brings certain economic aspects of the firm into the open. As a consequence, the perspectives do not offer a complete explanation but this can hardly be considered surprising after the defence of pluralism in the first chapter. In case of the evolutionary and certain theories of the capabilities perspective, this open and interpretative approach is a self-obvious step because they do not constitute a complete and closed theory but rather present a set of ideas on knowledge, firm heterogeneity, and path-dependence. Nelson (2002, 24) describes such an approach as 'semi-formal'. For the other theories like transaction cost economics and the resource-based view, this approach appears an important modification as they appear to constitute well-developed and closed theoretical perspectives. However, the analysis in the preceding sections has shown how both theories cannot justify this approach.

By now, it will have become clear how the concept of logic is instrumental in combining these various perspectives in spite of the important mutual differences as were discussed in one of the preceding sections. As mentioned in the introductory

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<sup>119</sup> It appears equally possible for firms to influence the impact of bounded rationality. Certain practices aimed at learning and the exchange of information can unbound knowledge. However, it is important to remember that transaction cost economics focuses on transactions and that the 'rationality' it requires also concerns these transactions. An example is the development of screening mechanisms when hiring new employees.

chapter, all these theories offer important insights in the economic implications of the firm and its organisation and a discussion of the various theories of the firm in terms of logic enables us to combine these insights. As such, the current chapter also contributes to discussions on a possible combination of the various perspectives. Several authors (Foss, 1997a, 1997b; Nooteboom, 2002; Langlois, 1992; Hodgson, 1998) discuss to what extent the different perspectives can be combined. All these attempts are motivated by the awareness that the perspectives individually cannot do justice to 'the complex nature of economic reality and the fact that a number of causal mechanisms are simultaneously at work' (Hodgson, 1998, 26). An explicit choice for the eclectic use of their different logics therefore appears as a good solution. Some will consider this the line of least resistance but it appears an illusion to expect otherwise. Finally, the critical juxtaposition of the various logics is more than an extra but instrumental in keeping them 'under control'. We have discussed how the instrumental definition of concepts makes that transaction cost economics has achieved a applicability likely to surpass its relevance. The logics as defined in this section are obviously vulnerable to similar criticism and the critical comparison between the various theories is a necessary antidote against this danger. So, possible contradictions between theories are not the basis for dismissing one of the approaches, as it was suggested in the discussion of pluralism, but function as a reminder that none of them is beyond criticism.

### **Concluding remarks**

This chapter has discussed various perspectives and theories of the firm to develop a theoretical framework that enables us to analyse the impact of employment practices and changes therein on the performance of the Japanese firm. It has done so in accordance with the eclectic pluralism of different explanatory logics as proposed in the introductory chapter in the belief that it has, in particular, been the strength of their logic that contributed to the popularity of these perspectives. Not only does the concept of logic allow the use of these theories in spite of their operational limitations, it also makes it possible to combine the various perspectives. Finally, there is one other issue that subscribes to this use of logic in analysing the impact of employment practices. It takes into account that a discussion of employment practices will always provide a partial explanation of firm performance. Focus in this research is not directly on the firm's performance but on the contribution of employment practices to firm performance. However, it is obvious that many other factors co-determine a firm's performance. We can thus not expect to provide precise and quantitative outcomes but have to settle for the logic of employment practices. The next chapter will discuss what this logic looks like in the case of Japanese employment practices.

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[T]he reward structure of Japanese firms is designed so as to alleviate various incentive problems associated with the structure of its work organization. Differences in pay, promotions, and employment relations from the Western firm can also be attributed to differences in work organization (Itoh, 1994, 234).

## **4. Productivity and Flexibility**

### **The logic of Japanese employment practices**

*Employment practices at stylised, large firms. The 'adjustment logic' of Japanese employment practices. The capabilities of the Japanese firm. The accompanying employment governance. The 'productive logic', firm-specific skills and firm-specific governance. Contingencies for success. Concluding remarks. References.*

#### **Employment practices at stylised, large firms**

The second chapter presented the practice of lifetime employment as the defining feature of the human resource management at Japanese firms. However, its economic implications were hardly discussed and this chapter fills this void by discussing the employment logic of Japanese employment practices. As a matter of fact, this employment logic is twofold. The greater part of this chapter discusses the 'productive logic' of Japanese employment practices, which describes how its employment practices, in particular the implicit promise of lifetime employment, provide a crucial contribution to the specific capabilities of the Japanese firm. However, the offer of lifetime employment cannot be unconditional as firms need the ability to reduce employment in response to weak demand. The chapter therefore lists the strategies Japanese firms use to achieve this reduction, together described as the so-called 'adjustment logic' of Japanese employment practices, before it proceeds by discussing these practices' productive implications.



In discussing these two types of logic, the chapter provides a stylised description of large Japanese firms. This is in accordance with the work of Aoki (1988, 1989, 1990), who can be credited for developing the best-known theory of the Japanese firm (Fransman, 1995). Aoki (1988) introduced the 'J-firm' as an explanatory abstraction to analyse the specific economic rationale of the large Japanese firm. This chapter follows a similar approach by combining the theoretical framework as developed in the last chapter with past analyses of the Japanese firm and its employment practices. This results in an 'under-socialised' analysis (Granovetter, 1985) but is a necessary step to analyse the economic implications of the employment practices.<sup>120</sup> A similar argument holds for the focus on large firms. Some will question this choice as large firms only employ a minority of Japanese employees and changing practices might be more likely to be found at small entrepreneurial companies in emerging industries. However, at least two reasons justify this focus on employment practices at large firms. First, these are the practices which have become known as the Japanese employment system and were until recently considered one of the cornerstones of competitive strength. A study on changing employment practices and their economic impact must therefore analyse the practices at large firms. Secondly, these practices are more important than we might conclude on the basis of their statistical presence. Chapter two has shown that wide societal support has made these practices 'a normative model for the rest of society' (Dore, 1973, 305).<sup>121</sup>

The structure of this chapter is as follows. As mentioned, it first presents the 'adjustment logic' that enables Japanese firms to offer lifetime employment to a group of core employees and can thus be considered a necessary condition for its existence. The chapter then turns to the productive logic of Japanese employment practices by discussing specific Japanese capabilities, the accompanying governance of employment, and the implications in terms of firm-specific skills, wage-tenure profiles, and the duration of the employment relationship. Finally, the chapter discusses the contingencies for success as a stepping stone to the empirical chapters on change.

### **The 'adjustment logic' of Japanese employment practices**

The Japanese firm uses various strategies to reduce its labour input in response to weak economic demand. In discussing these strategies, we can make a fundamental

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<sup>120</sup> Moreover, the discussion of embeddedness in the second and the analysis of the specific case-studies in later chapters provides the necessary antidote.

<sup>121</sup> This relevance was actually illustrated during the field research, which included interviews with several representatives of medium-sized enterprises. The outcomes of these interviews have not been included in this dissertation but it is safe to say that these firms expressed a similar support to the various employment practices.

distinction between numerical and functional employment flexibility. Numerical flexibility means that firms adjust the number of workers or the number of working hours, functional flexibility that the organisation of work is adjusted by the reallocation of employees to new positions.<sup>122</sup> This second form of flexibility requires that employees can perform a variety of tasks and suggests the importance of a relatively broad training. As the remainder of this chapter shows, this flexibility is particularly well-developed within Japanese firms through practices like job rotation, and firms often transfer employees between departments or even divisions in response to changing circumstances.<sup>123</sup>

However, the existence of numerical flexibility is also important in the reduction of employment as various groups of non-regular employees function as a buffer that enables the employment protection of regular employees.<sup>124</sup> We can distinguish the following strategies by Japanese firms to adjust their labour input under the condition of lifetime employment (Odagiri, 1994; Usui and Colignon, 1996).<sup>125</sup>

- (1) The reduction of overtime work and bonuses.
- (2) The reassignment (*haiten*) and transfer of workers. Concerning transfers, we can distinguish between *shukkkō* and *tenseki*. Under a *shukkkō*-agreement an employee is temporarily lend to another firm. The original employment contract remains in place and a second contract is drafted to stipulate the

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<sup>122</sup> Pinfield and Atkinson (1988) distinguish two additional types of employment flexibility. The first, 'distancing', refers 'to the displacement of employment contracts, as exemplified by subcontracting. Rather than organize its own work force to meet peaks in workload, a firm contracts out those peaks to other individuals or organizations' (Pinfield and Atkinson, 1988, 18). The second alternative source of flexibility is 'pay flexibility', the possibility to adjust remuneration to attract scarce employees, to reward individual performance, or to reduce labour costs in case of harsh economic circumstances. Both of these types of flexibility appear to play a significant role in Japan as firms make elaborate use of subcontracting and pay large bonuses. However, it remains to be seen if these are truly instruments of flexibility as the possible reasons for subcontracting are various and bonuses have proven rather inflexible.

<sup>123</sup> This is also part of the post-war settlement, when unions traded job security for the employers' relative control over transfers and job definitions (Gordon, 1985).

<sup>124</sup> Precise data on the percentage of employees with lifetime employment are not available as can be expected given the implicit character of its commitment. Estimates have varied between one-fourth (Abegglen, 1958) and one-third (Odagiri, 1994) of all employees. However, chapter two has also shown that the practice has achieved normative implications and inspired the government's total employment strategy, which enabled smaller firms to implement similar or derived strategies. Moreover, all permanent employees with indefinite period contracts (as of August 2001, 87 per cent of all workers) are legally protected against arbitrary discharges (Araki, 2002).

<sup>125</sup> Some of these measures were already distinguished by Abegglen (1958). He, for instance, recognized the use of temporary employees and the practice to temporarily send employees home.

relation with the new but temporary employer. The dispatching firm usually compensates the employee for the lower wage at the receiving firm. In the case of *tenseki*, the transfer is definite and the employee becomes a full employee of the receiving firm.<sup>126</sup>

- (3) The reduction of mid-career hiring and hiring of new graduates.
- (4) The reduction of part-time, seasonal or temporary workers.
- (5) The allocation of holidays and extended vacations.
- (6) The temporary closure of factories. This can involve so-called 'temporary layoffs' (*ichiji kaiko*), which means that someone retains his or her status as an employee but does not come to work and receives a certain percentage of his or her basic wage.
- (7) Voluntary retirements and the dismissal of workers. In spite of the other measures, it can be necessary to resort to layoffs. This usually concerns older workers who are offered favourable retirement benefits to encourage voluntary early retirement.<sup>127</sup>

These strategies show how Japanese firms can reduce their labour input while upholding the practice of lifetime employment. Their flexibility was severely tested after the 1973 oil crisis, which initiated a personnel reduction in manufacturing that totalled more than one million employees in the subsequent years, a decline of nearly ten per cent (Rohlen, 1979).<sup>128</sup> The development of employment during these years shows the impact of the different strategies. Rohlen (1979) describes how the number of female employees and part-timers quickly decreased during the first two years but recovered afterwards. The number of male and regular employees, on the other hand, declined slowly but the decline continued for the full four years of his

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<sup>126</sup> It is important to note that personnel transfers are not always motivated by the need to adjust employment. Nagano (1997) distinguishes the following objectives: (1) the development of the corporate organisation, (2) technological and managerial assistance to subsidiaries, (3) the training of young employees and, indeed, (4) the adjustment of labour input. Dirks (1999) gives a similar classification. The existence of these alternative objectives has the added advantage that they lessen the negative connotation of *shukko*.

<sup>127</sup> As a matter of fact, a distinction can be made between existing, long-term 'early retirement' schemes and one-time, special offer 'voluntary retirement' schemes. The first are often included in the statistics under 'natural attrition' (see i.e. table 5.2, note 1).

<sup>128</sup> Rohlen (1979) lists the most important adjustments made by 250 of Japan's largest companies between March 1974 and March 1978. They are as follows (with in brackets the percentage of firms implementing that particular adjustment): suspension mid-career hiring (52.5%), voluntary early-retirement plans (47.4%), stop hiring new graduates (31.8%), lay-off part-time and temporary workers (30.3%), introduction special holidays (28.9%), and the transfer of workers (28.1%). In addition, he also lists the reduction of overtime, cuts in the bonuses for management-level employees, the enforcement of price reductions by subcontractors, and the use of government subsidies.

study. This is explained by the fact that, at first, the relatively easily disposable, often female, part-time workers were fired or not rehired. Subsequently, the number of regular employees was adjusted in the form of 'natural attrition', a stop or decrease in the hiring of new employees. Particularly in the case of female regular workers, who showed a relatively high turnover rate during the 1970s, this proved very successful. The process was further accelerated by the promotion of early retirements and a stop on the rehiring of older employees.

These strategies for employment adjustment have been confirmed in later years. Usui and Colignon (1996) investigated the adjustments in the years 1975, 1986, and 1994, as they were necessitated by, respectively, the first oil-shock, the rising value of the yen, and the 'bubble' and its consequences. The reaction of firms during these years was very similar as 'companies engaged in a sequence of gradual and incrementally severe employment adjustment strategies for all three recessions' (Usui and Colignon, 1996, 555). Usui and Colignon found that firms basically use the various strategies in the order as they were listed on the previous pages.<sup>129</sup> We can thus conclude that these strategies have been a constant force in the employment adjustment by Japanese firms and can speak about the 'adjustment logic' of Japanese employment practices. It underlines that the typical Japanese employment practices have an inbuilt flexibility. The next chapter will discuss if this flexibility is sufficient for the adjustments as necessitated by the economic malaise, this chapter continues by discussing the economic implications of Japanese employment practices.

### **The capabilities of the Japanese firm**

The most likely starting point for a discussion of the specific capabilities of Japanese firms is the organisation of work and the skills this requires and promotes. This organisation of work is characterised by the existence of simple, broad job descriptions and an ambiguity or fluidity of jurisdiction. Assignments are flexible because of practices like the rotation of inspection positions among shop floor workers and regular job rotation. This has important implications for the ability of employees as they must have the broad skills that enable the required functional flexibility.<sup>130</sup> Most of all, it requires that employees are trained to work in different positions. The core method is a combination of job rotation and on-the-job training (OJT), as this is an excellent means to achieve the necessary skills for broad job

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<sup>129</sup> However, their conclusion about the order in which the strategies are used should only be accepted with some reservation as the data by Rohlen (see previous footnote) suggest a somewhat different order.

<sup>130</sup> Aoki mentions how such multi-functionality also contributes to achieving *shōjinka*, 'a reduction in the number of workers required' (Aoki, 1988, 14).

classifications and flexible assignments. Moreover, these broad job classifications and flexible assignments also support job rotation and on-the-job training as they facilitate the sharing of knowledge and we thus see a symbiosis between broad job descriptions, flexible assignments, on-the-job training, and job rotation. An important characteristic of the skills thus achieved is their firm-specific character as both training and skills are strongly embedded within the organisation. This firm-specific character is widely acknowledged (e.g. Mincer and Higuchi, 1988; Matsuzuka, 2002) and even when certain jobs are similar among firms, career paths can differ substantially. Koike (1995), for instance, describes how the percentage of 'veteran' workers will influence the breadth of job descriptions and career paths as these employees are capable to handle broad jobs themselves together with close supervision of junior employees.

This section will discuss these skills as a crucial constituent of the capabilities of the Japanese firm. It focuses on three skills in particular: the intellectual skills as discussed by Koike (1995, 1997), the contextual skills as discussed by Aoki (1988, 1995a, 1995b), and the innovative skills as discussed by Nonaka and Takeuchi (1995). Together, these skills can be considered among the most important sources of the competitive strength of the Japanese firm.

Koike (1995, 1997) describes how broad knowledge provides Japanese employees with 'intellectual skills'. These skills, sustained by the practices of job rotation and on-the-job training, enable workers to handle unusual operations, defined as the reaction to changes and the handling of problems. Koike stresses the recurrent character of unusual operations when working on mass-production assembly lines, which in spite of their repetitive character, tend to be characterized by frequent changes and problems. He distinguishes five areas of change: product mix, output, new products, production methods, and workforce composition. All these changes ask for versatile workers. A similar story holds for the handling of problems like mechanical failures and defective products. Failures have to be detected, diagnosed, and fixed. This requires that employees are used to unusual operations and have a wide knowledge of the production process.<sup>131</sup> Overall, Koike sees these intellectual skills as an important source of the Japanese success as it increases the number of workers that can deal with problems and the speed at which problems are dealt with. Moreover, the need for intellectual skills challenges the production workers and contributes to their motivation and the further development of skills.

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<sup>131</sup> Koike also states how the importance of these intellectual skills explains 'the white-collarization' of blue-collar workers. 'The wage curves are similar because the basic skills expected of Japanese blue-collar workers are similar to those of white-collar workers' (Koike, 1995, 66). See Koike (1988) for a discussion of 'white-collarization'.

Along similar lines, Aoki (1988) provides an analysis on the organisational efficiency of Japanese firms. He explicitly refers to Koike's intellectual skills but extends their role to the horizontal coordination between work shops and refers to the necessary skills as 'contextual skills'. These skills enable an organisational mode that Aoki (1995a, 1995b) describes as a 'horizontal hierarchy'.<sup>132</sup> In a horizontal hierarchy, the centralised planning only provides a general framework while the actual transfer of materials and parts is co-ordinated by the shops themselves. The most striking example of this type of coordination is the well-known *kanban* system at the Toyota factory, a system in which 'the downstream shop "pulls" the operation of the upstream shop' (Aoki, 1988, 23).<sup>133</sup>

Aoki (1988, 1995a, 1995b) discusses the horizontal hierarchy by comparing it to the well-known organisational mode of the decentralised hierarchy. The horizontal hierarchy achieves efficiency through the flexible allocation of employees with broad training while the decentralised hierarchy emphasize efficiency through specialisation and sharp job demarcations. The former integrates operating and coordinating tasks, the latter separates these. Overall, the horizontal hierarchy stresses the importance of learning and flexibility while the decentralised hierarchy stresses the importance of specialisation. In the end, the horizontal hierarchy can offer two major advantages. As coordination is direct, there is no time lag for involving a third party for communication. Moreover, communication can be based on "knowledge of particular circumstances of time and place" available only to the people on site' (Aoki, 1995a, 16-7).

Aoki (1995a, 1995b) also provides a more technical comparison of these organisation modes by discussing their treatment of stochastic events. These events can be said to have a systematic and idiosyncratic component. The systematic component concerns those events that simultaneously affect the productivity of all tasks, the idiosyncratic component concerns those events that affect the productivity of individual tasks.<sup>134</sup> In a horizontal hierarchy, all units collectively observe the

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<sup>132</sup> Aoki (1988) does not speak about organisational modes like the horizontal hierarchy but only speaks about 'horizontal coordination' and discusses the difference between the 'J-firm' and 'A-firm' as stylised descriptions of Japanese and American firms. Aoki (1990) also speaks about the 'J-mode'. The discussion of 'organisational modes' can be found in Aoki (1995a) and Aoki (1995b). This chapter uses the terminology of these later publications.

<sup>133</sup> The development of the *Kanban* system is actually a good example of the long time that is needed to build capabilities. Aoki (1988, 24) describes how '[i]t took Toyota almost 20 years from the initial experiment to achieve state-of-the-art operation and to surpass Western competitors with its remarkable productive efficiency'.

<sup>134</sup> Certain shocks in the flow of work will only make themselves felt where they take place as the employees' intellectual skills will enable them to contain the impact to their specific work shop. This would make a stochastic event idiosyncratic. However, other shocks like the breakdown of

systematic component of stochastic events (and exchange this information), while each unit individually observes the idiosyncratic component of these events. 'Such a mechanism may be called horizontal hierarchy, as information-processing is structured in a hierarchical manner, i.e., collective information processing regarding systematic environment supplemented by individual information processing regarding idiosyncratic environments, without involving the authority relationship in decisionmaking' (Aoki, 1995a, 17). This differs from a decentralised hierarchy, where 'the factory layout and job classification should be designed so as to control and minimize the systematic effect of stochastic events. To the degree that such control is technically possible, this mechanism can utilize economies of specialization' (Ibid.). We can thus conclude that in particular the treatment of idiosyncratic risk determines the difference between these organisational modes. In the case of the horizontal hierarchy this treatment is based on the unit's own judgement, in case of the decentralised hierarchy it is based on the organisation's prior knowledge.

This comparison already suggests how both organisational modes have their specific advantages and disadvantages and the specific circumstances will determine their efficiency.<sup>135</sup> Aoki (1988) states how horizontal coordination is likely to be more efficient under circumstances of product diversity and environmental change, as they limit the importance of scale economies. Moreover, as direct communication is the forte of the horizontal hierarchy, it will be efficient in industries with high stochastic (risk) correlation and high technological complementarity. This corresponds to the industries in which Japanese firms have been successful. 'For example, the production processes of the assembly industries (e.g., autos and electric machinery) and the continual process industries producing relatively homogenous products (e.g., steel) are comprised of many steps subject to common risks (e.g., the

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machines and quality defects will make themselves felt in other shops as well and can thus be considered systematic.

<sup>135</sup> Aoki (1988) provides an elaborate discussion of advantages and disadvantages. He refers to Williamson (1975) who lists the following advantages of (decentralised) hierarchies: (1) low buffer of inventory costs, (2) economies of specialisation, (3) economies of centralized handling of shocks, and, as the main disadvantage, a lack of work incentives. Aoki adds the following disadvantages: (1) increasing inventory costs, (2) the adaptive costs of specialisation, (3) communication costs in hierarchies, and (4) the bargaining costs under specialisation (see Aoki, 1988, 28-31). In a similar vein, he also lists the advantages and disadvantages of horizontal coordination. Advantages include (1) savings on inventory costs, (2) dynamic efficiency of flexible job demarcation, and (3) administrative efficiency through less need for administrative offices. Possible disadvantages include (1) bargaining costs between shops and (2) a lack of centralised information. Overall, we can conclude that Williamson's static perspective makes his approach blind for the efficiency gains that come with the flexibility to adjust to changing circumstances.

breakdown of the assembly line, product quality affected by events arising at the border of adjacent steps) and technological complementarity (e.g., the requirement of a precise combination of various parts)' (Aoki, 1995a, 22-3). More about this in the later section on the contingencies of success for Japanese capabilities and their accompanying employment practices.

A third capability of Japanese firms concerns their innovative strength as it has been described by Nonaka and Takeuchi (1995). They describe how Japanese firms are successful because of their skills in 'organizational knowledge creation', defined as 'the capability of a company as a whole to create new knowledge, disseminate it throughout the organization, and embody it in products, services, and systems' (Nonaka and Takeuchi, 1995, 3). Important in their analysis is the tacit character of knowledge as this makes the exchange of information a difficult process. To analyse this exchange, Nonaka and Takeuchi distinguish four types of knowledge conversion: from tacit to tacit (socialization), from tacit to explicit (externalization), from explicit to explicit (combination), and from explicit to tacit knowledge (internalization). It is, in particular, the conversion of tacit into explicit knowledge that is considered crucial for innovation. A further characteristic of these processes is their organisational dimension, as tacit knowledge needs to be 'organizationally amplified' through these four types of conversion. '[O]rganizational knowledge creation is a spiral process, starting at the individual level and moving up through expanding communities of interaction, that crosses sectional, departmental, divisional, and organizational boundaries' (Ibid., 72).

Nonaka and Takeuchi hardly discuss the embeddedness of these conversion processes within the organisation. Most of their examples concern the establishment of project teams that operate largely outside the main organisation. Instead, they explain the Japanese strength in knowledge creation from its specific epistemological tradition. While Western firms are said to view the organisation as a machine for 'information processing', Japanese companies view knowledge as primarily 'tacit'. Their inclusion in the current section is therefore not self-evident. However, it is hard to ignore the fit with the previous discussion of intellectual and contextual skills. Acquired through on-the-job training, these skills are predominantly tacit and therefore seem of crucial importance for the process of organisational knowledge creation. As a matter of fact, we can ask ourselves whether it is the conversion processes per se, or the rich tacit knowledge base itself, that explains the innovative capabilities of Japanese firms. Secondly, we should also consider the organisational character of knowledge creation. This is clearly supported by the long-term relation between employers and employees as effectuated by the practice of lifetime employment. This contrasts with the



‘Western’ focus on professional knowledge and it is tempting to conclude that, although the two are clearly related, Westerners might be more ‘opposed’ to organisational knowledge than to tacit knowledge.

In summary, we have seen how all three capabilities as discussed in this section can be traced back to or are, at least, dependent upon the organisation of work and the accompanying skills. Moreover, this also appears true for other strengths that have become associated with the Japanese firm, like teamwork and quality circles. However, these capabilities cannot stand on their own and have important implications for the governance of employment. The next section discusses these implications.

### **The accompanying employment governance**

The last section discussed the importance of job rotation and on-the-job training for the development of the intellectual, contextual, and tacit skills that constitute the capabilities of the Japanese firm. Given this importance of job rotation and on-the-job training, the development of skills requires a long-term process of continuous training as it takes employees time to learn and acquire the skills needed for their various positions. This has important implications for employment governance as evaluation and remuneration need a similar long-term perspective. This section discusses how the employment practices support the development of the necessary skills by providing such a perspective.

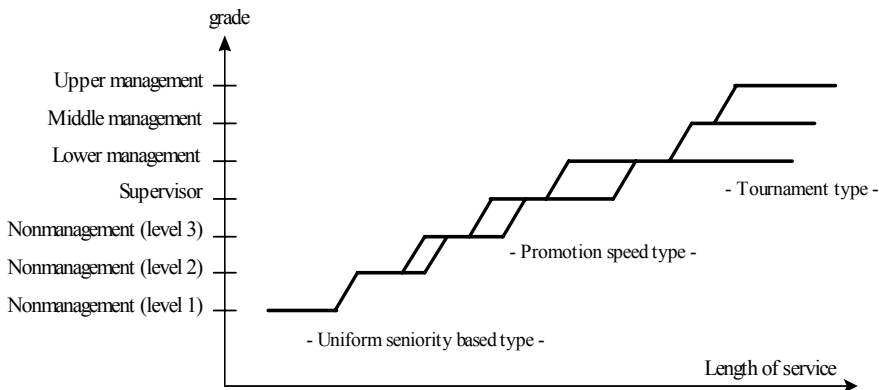
The need for a long-term perspective is confirmed by Koike (1997), when he concludes that pay-for-job nor pay-by-result plans can be effective in the context of intellectual skills as they cannot be a fair assessment of skill development. Under pay-for-job plans, employees are not motivated to extend the breadth of their experiences as this plays no role in the determination of their compensation. A similar argument holds for payment by results. This would imply that employees who move to another job because of job rotation are likely to see their pay decrease, as they are unaccustomed at their new position.<sup>136</sup> As a solution, Koike presents pay-for-skill plans, a system that bases promotion and pay on ‘job grades’, which are ascribed to individuals on the basis of the breadth and depth of their experience. Not surprisingly, this solution corresponds to the actual employment governance by Japanese firms. Many authors (e.g. Aoki, 1988; Itoh, 1994; Imada, 1995) describe its basic structure as a ranking hierarchy ‘in which the remuneration paid to an employee depends on his or her rank and internal promotion from lower to higher

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<sup>136</sup> Itoh (1994) also discusses several reasons that explain the lack of direct pay-for-performance. However, the analysis by Koike appears to provide ‘sufficient reason’.

ranks is based on a certain formalized standard. In this structure, ranks are not directly associated with particular jobs' (Aoki, 1988, 72). Within this hierarchy, a distinction is made between vertical and horizontal ranks. Vertical ranks are associated with hierarchical titles and promotion to a higher vertical rank (*shōshin*) implies changes in authority and responsibility. The horizontal ranks are artificially created grades, used for a differential treatment of individuals in terms of status and pay only, and promotion to a higher horizontal rank (*shōkaku*) does not imply a change in authority, responsibility, or job.

The criteria for promotion depend on the level within the hierarchy. Imada (1995) describes how they change from a rather uniform seniority-based system, to a speed race-oriented, to a tournament race-oriented system. The phases of promotion are schematically shown in figure 4.1.



**Figure 4.1 The multi-stepwise promotion system**

Source: Imada, 1995

During the first years of a career, the criteria are strongly based on seniority.<sup>137</sup> Afterwards, promotion is no longer uniform and employees of the same initial cohort are promoted at different moments. According to Imada, the artificial created ranks play an important role in this differentiation because employees of equal seniority do not differ more than one vertical rank. Finally, promotion during the last

<sup>137</sup> The existence of seniority also has an important role in the development of cooperative behaviour. Competition for promotions can easily lead to intense rivalry between employees. This would be particularly problematical for Japanese firms because of organisational characteristics like the prevalence of teamwork, horizontal coordination through information-sharing, and the development of contextual skills through on-the-job training. However, since the conditions for promotion are partly related to seniority, the ranking hierarchy also promotes cooperative behaviour between senior and junior employees.

stage of a career takes place according to a tournament type, which distinguishes those who are promoted from those who are not.

This analysis is confirmed by Holzhausen (2000) who describes how the weight of seniority and personal assessment changes during an employee's career. In spite of elaborate personal assessment or personnel rating (*satei* or *jinji kōka*), the seniority rule dominates the early stages of a career.<sup>138</sup> This actually is understandable as the long-term development of skills makes ability dependent upon seniority. As employees become older, qualification becomes more important. According to Holzhausen, this shift is gradual and only becomes decisive after ten to fifteen years. Crucial for the evaluation of employees is the so-called 'ability qualification system' or 'qualification grading system' (*shokunō shikaku seido*), which translates the results of personal assessment into ranks. This system was introduced at the end of the 1960s to complement the seniority rule and its importance has been increased ever since. Instead of simply assuming that longer tenure implies higher productivity, it actively monitors the development of human capital.<sup>139</sup>

As mentioned, the ranking hierarchy is also the major structure in the determination of remuneration. Holzhausen (2000) describes the basic wage (*kihonkyū*) as a combination of a person-related (*zokujinkyū*) and a job-related wage (*shigotokyū*). Aoki (1988) makes a similar distinction but speaks about '*honninkyū*' in the case of the person-related payment. The person-related payment is determined by the position in the ranking hierarchy and based upon both seniority and (past) merit. The job-related payment is, in principle, determined by a job evaluation scheme but since job demarcations and assignments are rather fluid, jobs tend to be evaluated on the basis of employees' skills and experiences in a very broad sense. Finally, the thus determined pay can be supplemented by a merit payment (*nōryokukyū*), which concerns an additional payment based on the supervisor's assessment of individual merit but, at least until recently, the size of this last component was usually modest. Unfortunately, the impact of the other factors is somewhat ambiguous. Koike stresses the importance of the grade in the ranking hierarchy but the seniority element might be more important than it appears, as it was shown to be an important determinant of promotion; in particular, during the

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<sup>138</sup> Holzhausen (2000) remarks how this does not mean that these employees have no idea about their future prospects. Most employees at the age of 30 have a good impression of their future prospects although the results of assessment are not yet reflected in their actual position. Holzhausen interprets such informal communication as a corrective to the seniority rule, which limits the risk of losing talented employees.

<sup>139</sup> Important for the allocation of employees is the personnel department which occupies a central position in the Japanese firm.

early stages of a career. Finally, we also have to acknowledge the importance of additional types of remuneration like the semi-annual bonuses and the lump-sum payment at the time of mandatory retirement (*taishokukin*). In particular, the interpretation of bonuses, which are substantially higher than in Western countries, has proven to be a challenge. Hart and Kawasaki (1999) show how they have been considered disguised wages, compensation for effort, a share in the profits, and a return to the investment in firm-specific skills. As the outcome of this discussion does not significantly influence the logic of employment practices, this section does not discuss the matter any further. The same cannot be said for the payment at the time of separation. As the next section shows, this proves important in the interpretation of seniority-based wages.<sup>140</sup>

### **The ‘productive logic’, firm-specific skills and firm-specific governance**

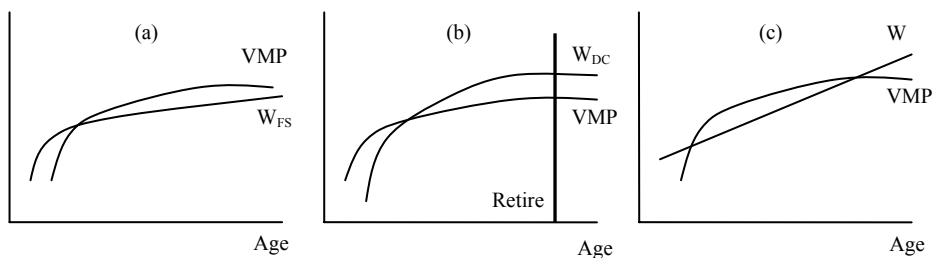
After this description of employment governance, we can now analyse its outcomes. Crucial in this analysis are the rising wage-tenure profile and the long-term employment relationship as the most striking characteristics of the Japanese ‘system’ of employment governance.

The best-known explanation for the existence of a rising wage-tenure profile and long-term employment is the human capital theory as originally developed by Becker (1964). This theory interprets the rising wages and long-term employment relation as a reflection of the increased productive value of employees who have developed firm-specific skills. The firm-specificity of skills is considered crucial as it has important consequences for training and the payment of training costs. In the case of general skills, firms expect employees to bear the full expenses of training because they may quit at any time to capitalise on their new skills. However, firm-specific skills are of lesser value at another firm and the danger that the employee leaves after receiving training is thus mitigated. In this case, the costs are therefore shared between the firm and its employees. As the firm shares in the cost of training, the employee is willing to earn less than his or her productive value in later years, as long as his wage remains higher than at another firm. However, the higher productivity and the lower demands for investments in training for senior employees justify higher seniority wages. So, both the firm and the worker recoup their investment as they share the quasi-rents from the firm-specific skills. Graph (a) of figure 4.2 illustrates this relation between productivity and wage. The relevance of this explanation in the Japanese setting is obvious. The previous discussion of

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<sup>140</sup> In addition, there are also welfare allowances. However, just as the bonuses, they do not fundamentally change the logic of employment practices and therefore not discussed. See, for instance, Hart and Kawasaki (1999) for a discussion of their importance.

Japanese capabilities already emphasized the importance of firm-specificity for intellectual, contextual and tacit skills. Moreover, the theory explains why firms that invest heavily in training offer longer terms of employment. As larger firms usually spend more on training, it explains ‘that the major participants in Japanese employment practices are older workers in larger firms’ (Matsuzuka, 2002, 25-6).



**Figure 4.2 Relation between the value of marginal product (VMP) and wages (W); as explained by (a) the human capital theory, (b) the delayed compensation model, and (c) a combination thereof.**

Source: Matsuzuka, 2002, 25-7

However, the human capital theory does not provide a full explanation. It does, for instance, not explain the existence of mandatory retirement at, usually, 60 years. This leads us to a second explanation of the rising wage-tenure profile and long-term employment, alternately named the ‘agency’, ‘delayed compensation’ or ‘incentive’ approach and developed by Lazear (1979). It emphasises how seniority wages can function as an incentive mechanism because a delayed compensation induces greater work effort. Young employees are paid less than their productive value in order to create the possibility for high seniority wages above productive value. As the future wages are most substantial, employees are motivated to refrain from shirking and compete for promotions that determine the distribution of future wages. Young employees can thus be said to invest part of their income into the firm. The resulting wage and productivity pattern, as shown in graph (b) of figure 4.2, is opposite to that predicted by the human capital theory.<sup>141</sup>

This second explanation is also highly relevant in the Japanese setting. Because promotion is partly based on tenure or seniority, it tends to be rather slow. Itoh (1994) therefore describes promotion as a so-called ‘late-selection approach’ in which ‘career concerns’ are used as an incentive device. Employees are careful with

<sup>141</sup> Another approach that points out the existence of an initial wage below productive value is the implicit contract hypothesis. However, its contribution to the understanding of Japanese employment practices is limited. See Matsuzuka (2002) for a discussion of its relevance.

shirking because this can harm their career and future earnings. Itoh presents the career concerns as an important complement to the explicit incentives through direct pay-for-performance. 'Career concerns are strong when workers are young and have many potential promotion possibilities; for these workers, the link between pay and performance is weak. On the other hand, pay-for-performance is important for those whose career concerns are weak, e.g. because they are close to retirement' (Itoh, 1994, 246).

A crucial role in this process is reserved for the ranking hierarchy, whose characteristics make it an excellent instrument to function as an incentive mechanism. First of all, the horizontal ranks provide elaborate possibilities to differentiate between employees and use the promotion system as an incentive device. Moreover, the ranking hierarchy provides some flexibility in the number of promotional positions. The motivational strength of this approach requires that employees are promoted to a higher rank when they require the skills for such a position. Imano (1995) therefore calls Japanese management 'supply-side oriented'. The ranking hierarchy answers to this need by, in particular during the early stages of career, the suggestion that some flexibility exists in the number of promotional possibilities as 'firms may lead workers to perceive that there is always room at the top for a good performer' (Aoki, 1988, 75). Aoki therefore distinguishes the ranking hierarchy from the rank-order tournament where a pre-determined number of slots are divided among employees. The flexibility to promote employees to higher ranks is also related to Aoki's claim that it is misleading to refer to the ranking hierarchy as an internal labour market because remuneration is associated with ranks and not with particular jobs. However, this flexibility is limited. The ranks are not directly associated with specific jobs but a rather strong correlation exists because certain ranks are a necessity for performing certain jobs (Itoh, 1994). Moreover, the promotion to higher ranks implies higher wages and these must be justified by similar increases in productivity. This requires that employees are promoted to hierarchical positions that make use of their increased skills. We thus see how the ranking hierarchy works as an incentive device by promising employees the reward for good performance. However, a firm also has to consider organisational needs.<sup>142</sup> In the end, organisational growth is needed to achieve a constant creation of positions for promotion and the next section therefore discusses growth as one of the major contingencies for the 'late-selection approach'.

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<sup>142</sup> Firms do have some freedom to add managerial positions (and thus decrease the span of control). Although efficiency considerations limit this leeway, Ariga *et al.* (2000) show a substantial overall decline in the span of control during the period 1976-1996.

This second interpretation of the rising wage-tenure profile explains various aspects of Japanese employment governance like the existence of mandatory retirement, the (delayed) compensation paid at the time of separation (*taishokukin*), and the preference to lay off senior workers when layoffs are considered necessary. We are thus left with two explanations of rising wage-tenure profiles and long-term employment that appear equally relevant. It is therefore tempting to combine the human capital theory and delayed compensation model as they do not have to be exclusive and both grasp certain features of the existing wage-tenure profile. Graph (c) in figure 4.2 illustrates this situation. When a worker is young, his productive value is lower than his wage as focus is mainly on training. After a certain period of training, the employee has accumulated a substantial amount of firm-specific skills and productivity rises above his or her wage. But as the worker grows older, wage continues to rise and surpasses productivity. This is particularly the case if we also assume that an employee's productivity is likely to decline after a certain age.

This combined perspective also explains the existence of lifetime employment as both employers and employees gain by their long-term relationship. The firm-specific skills and delayed compensation make it unattractive for employees to pursue a career elsewhere. In addition, Aoki (1988) also points out the existence of an implicit agreement among firms not to hire each others former employees. For the employer, a similar analysis holds. First of all, the employer is obviously interested in the surplus value of an employee with firm-specific knowledge. Moreover, the promise of lifetime employment must be kept to maintain a good reputation necessary to attract new employees. Finally, firms may infer that an outside employee is of low ability because he or she has not been successful in his or her former company and they are aware that hiring outsiders can negatively influence the morale of existing employees as it limits promotional possibilities.

In the end, this combination of a 'human capital' and 'incentive' component also raises an interesting situation concerning the firm-specificity of employees. Traditionally, this has been interpreted as specificity of skills. The discussion of intellectual, contextual, and tacit skills is illustrative in this respect. However, as shown by the current and previous chapter, the internal labour market or the ranking hierarchy can also contribute to the specificity of employees because there is an inversion by which governance actually becomes the source of firm-specificity. We can think of enterprise-specific skills as emerging during a career, defined as a series of jobs through which a worker develops skills. The internal labour market and ranking hierarchy are institutions that create firm-specific skills and are just as much a reason for as an answer to the existence of firm-specificity. The productive logic of

Japanese employment practices as it was discussed in this chapter can therefore be considered a combination of firm-specific skills and firm-specific governance.<sup>143</sup>

### **Contingencies for success**

The success of the capabilities and employment governance as discussed in this chapter is dependent upon various contingencies. In this respect, we can distinguish between those contingencies that directly concern the governance of employment and those that concern the organisational capabilities as supported by intellectual, contextual and tacit skills. Overall, at least six major contingencies for success or dependencies exist, equally divided between the governance of employment (one to three) and the organisational capabilities (four to six). They are as follows: (1) the dependence on firm-specific skills, (2) the dependence on growth and a pyramid-shaped labour force, (3) the dependence on the wider institutional environment, (4) the dependence on manufacturing, (5) the dependence on certain technologies, and (6) the dependence on certain product markets.<sup>144</sup> The changed circumstances that are expected to inspire changing employment practices make it instrumental that we take a critical look at these contingencies for success. As such, this discussion is a crucial step towards the subsequent chapters on changing employment practices.

#### **(1) The dependence on firm-specific skills**

The discussion on firm-specific skills, as both a constituent of Japanese capabilities and an explanation of seniority-based wages, makes this dependence rather self-evident. In the past, the strong growth made that investments in firm-specific skills yielded high rates of return. Moreover, as improvements were incremental, these firm-specific skills were well-suited. However, many claim that firms can no longer depend on firm-specific skills in today's world of 'techno-globalism'. The debate on changing employment practices, as discussed in the introductory chapter, presented such views. In this respect we can also refer to the Nikkeiren reports on 'business management in the new era', which point out that firms have become more interested in functional and industrial specialists (Nikkeiren, 1995, 1996). To some extent, a lack of firm-specific skills can be overcome by firm-specific governance

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<sup>143</sup> It is obvious that the development of skills is almost always dependent upon some form of governance, possibly with the exception of real trial-and-error. However, it is usually assumed that skills can be taken out of their governance structure and still maintain their qualities, while in this case, the skills are partly dependent on the governance that defines them.

<sup>144</sup> Other contingencies can also be distinguished. Koike (1995), for instance, states how success requires workers to have sufficient education and aptitude to develop intellectual skills. For many decades this has been the case and Japanese education has been a success story. However, there seem to have risen some cracks in the wall as the new environment is said to require creativity and specialist skills that are not being taught in the education system.



but it seems likely that, by itself, this cannot be a sufficient source of specificity as the lack of firm-specific skills increases the temptation for certain employers to poach the well and generally trained employees of their competitors.

(2) The dependence on growth and a pyramid-shaped labour force.

Just like the human capital theory, the interpretation of rising wage-tenure profiles as an incentive mechanism suggests an important dependence. Sato (1997) formulates three conditions for the late-selection approach: (1) a reasonable high rate of, and therefore opportunities for, promotion, (2) a small dispersion in skills before selection occurs, and (3) the shared aspiration among workers to climb to the ranks of management. More than anything else, this makes continuous economic growth an important condition for success (e.g. Matsuzuka, 2002, Matanle, 2003). First of all, growth has strong implications for the overall labour costs. Under the practice of seniority wages, Japanese firms profited from relatively low wage costs in the early decades of the post-war period because they had a relatively large group of young employees. In order to maintain this profitable balance, the firms had to achieve substantive growth. In addition, growth is also important in the creation of positions for promotion, as they are essential for the motivation by career concerns. Finally, growth is not sufficient in the absence of an overall pyramid-shaped labour force as this is a necessary condition to hire sufficient numbers of young employees. It is obvious that the economic malaise of the lost decade and the ageing of the population make this dependence particularly problematical, as discussed in the next chapter on change.

(3) The dependence on the wider institutional environment

A third contingency concerns the dependence on the wider institutional environment. The wide support among firms, representative organisations and the government provides a crucial contribution to the efficiency of these practices. One can, for instance, think of the absence of a competitive labour market because all large Japanese firms adhere to the practice of lifetime employment, even to the extent that they maintain a certain implicit agreement not to hire mid-career employees from other companies. If a substantial group of firms would start hiring mid-career employees, this would endanger the willingness of firms to invest in their employees. Moreover, the wide acceptance of these practices is also a crucial condition for firms to keep their promise of lifetime employment in order to maintain their reputation as a good employer. One could interpret this support from the wider institutional environment as a direct outcome of the consequence of the employment practices. The absence of an external labour market can, for instance, be considered as a direct consequence of the existing practices, as an alternative equilibrium outcome (Itoh,

1994). However, this would be beside the point because it ignores the important normative implications that these practices have achieved in the Japanese setting. The second chapter has discussed these implications in detail.

#### (4) The dependence on manufacturing

A striking element in the description of both intellectual and contextual skills is their strong dependence on manufacturing. Although the definitions do not necessarily imply such dependence, the examples tend to concern manufacturing. This dependence is particularly relevant because of the decreasing importance of the manufacturing sector in Japan. Moreover, several studies have reported a comparatively low white-collar productivity.<sup>145</sup> As, at least to our understanding, the reasons for differences in productivity between Japanese blue- and white-collar employees have not been studied, any analysis is tentative but it appears that the training through job rotation and on-the-job training is particularly relevant in a manufacturing setting. The manufacturing process offers a highly organised and tightly functioning system that can be complemented by a clear separation of tasks. These clear tasks enable both job rotation and on-the-job training through the movement between related tasks. The production process thus defines the working activities on the shop floor and, although there are many disruptions and changes, overall structure is strong. In comparison, more freely organised processes for white-collar activities are not so vulnerable to disruptions but also do not provide the structure of the shop floor. This could be an important reason why what works in the factory might lead to inefficiency in the office. This does obviously not mean that white-collar workers do not need intellectual skills; quite the contrary. However, it does seem to have consequences for the kind of intellectual skills and in particular their contextual character. It is just not as easy to divide the processes in the office in a similar sequence of separate activities as the steps in the production process. This might also explain why the job charts that monitor the width and breadth of blue-collar workers' skills are absent for white-collar employees (Koike, 1995). Moreover, this conclusion also agrees with Sato's (1997) findings that a large number of white-collar employees only performs a narrow range of activities during their career.

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<sup>145</sup> Direct measures of low productivity are obviously difficult to come by because international differences in data but Hori (1993) mentions how cross country studies have estimated that productivity in service industries in Japan is as much as 40 per cent lower than that in the US. In addition, the Economist (1994) refers to an analysis by Nikkeiren which claims that Japanese white-collar workers are only two-thirds as efficient as those in the US.

## (5) The dependence on certain technologies

A first characteristic of technology is that it determines the need for specific skills but its importance extends further. The dependence on technology is most directly related to Aoki's discussion of the horizontal hierarchy. As mentioned before, the horizontal hierarchy is particularly efficient in case of a high stochastic correlation and technological interdependencies among tasks. They both mean that the events in one part of the production process have a strong impact on others and mutual coordination is therefore of imminent importance. Moreover, the technological dependencies also strengthen possibilities for job rotation and on-the-job training. As was mentioned, this is reflected by the industries in which Japanese firms have been most successful. Dyer (1996, 650) observes that 'Japan's success in world markets has been greatest for "complex product" industries, defined here as industries whose production processes involve a large number of components, functions, and process steps'.

However, the organisational mode of horizontal coordination has in recent years lost some of its advantages because of, in particular, developments in information technology. This has made it feasible for organisational units to independently process environmental information and has inspired a new organisational mode, which Aoki (1995a, 1995b) labels the 'differentiated information structure'. It differs in two important aspects from the horizontal hierarchy. First, the possibility for communication extends beyond the formal boundary of the firm. Secondly, the interpretation of the outside information is likely to differ between organisational units in the firm. In terms of risk, both organisational modes make operational units responsible for the processing of information but while the systematic risk is shared within the horizontal hierarchy, organisational units in the differentiated information structure develop a particular answer. This new form is therefore expected to be more efficient if tasks are substitutes instead of complementary, a condition that has increasingly been fulfilled by the development of products that 'are assembled from sophisticated, yet "standardized" parts produced in module...If supplies of standardized parts can be procured timely through out-sourcing, interdependence of intraorganizational units would be greatly reduced and scarce intraorganizational resources, such as design capability and financial resources, may be utilized more effectively' (Aoki, 1995b, 341). The relevance of these arguments will become clear in later chapters as they will show how modularisation has indeed become important in certain industries.

## (6) The dependence on certain product markets

Besides the stochastic correlation and technological interdependencies among tasks, Aoki distinguishes the volatility of the environment as a third contingency for the

success of horizontal coordination. The flexibility achieved through the horizontal hierarchy comes at a cost and is not unlimited. 'If the organizational environment is fairly stable, it may not be worth relying on horizontal coordination at the sacrifice of economies of task specialization. On the other hand, if the environment is volatile, it would be costly to invest in the accumulation of enterprise-specific skills *ex ante*, as they may easily become obsolete or ineffective under changing situations' (Aoki, 1995a, 22). In summary, Aoki states how the Japanese organisation is efficient for fairly complicated production processes and if demand fluctuates continuously but not too drastically. Once again, the differentiated information structure provides new competition as it enables the firm to process large amounts of environmental information. In this respect, Aoki refers to emerging industries where standards have not been set and activities need continuous information about outside events.

### **Concluding remarks**

This chapter has discussed the 'adjustment' and 'productive logic' of Japanese employment practices. The adjustment logic describes how Japanese firms achieve the flexibility to adjust their labour input while upholding lifetime employment for core employees. If this flexibility is sufficient to handle the adjustments as they are necessitated by the economic malaise of the lost decade remains to be seen and will be an important topic in the next chapter. In addition, the chapter also discussed the productive logic, which is constituted by the contribution of the employment practices to the development of skills that give the Japanese firm its specific capabilities while at the same time motivating employees through 'career concerns'. It was shown how firm-specific skills and firm-specific governance were crucial elements of this productive logic.

In addition, the chapter also discussed various contingencies that determine the efficiency of Japanese capabilities and the productive logic of Japanese employment practices. The relevance of these contingencies will become clear in the subsequent chapters on the empirical research. Finally, we acknowledge that the description of capabilities and governance in this chapter has been rather crude and has ignored inter-industry and inter-firm differences. As mentioned in the introduction, this was considered necessary to analyse the economic implications of the employment practices. Later chapters will remedy this deficiency as they explicitly focus on inter-firm and inter-industry differences.

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# **PART II**

## **EMPIRICS**

The next chapters present recent adaptations in Japanese employment practices. Chapter five, an overview of the literature and statistics on change, presents the environmental circumstances that are said to require change and several likely and actual adaptations in employment practices. The subsequent chapters subscribe to the need to study heterogeneous firms by discussing case-studies of individual firms from four industries, namely the automobile, electronics, construction and retail industry. The case-studies are predominantly based on interviews with representatives of the respective companies. These interviews, based on the list of interview questions included as appendices three and four, were set up rather freely to learn about those issues that were considered important at the respective firm. However, the more important issues were discussed in all interviews. Besides, the interviewees were asked to fill in a questionnaire with additional questions (appendices five and six). This information was then supplemented by company-documents on the firms' human resource management and publicly available data. Issues of confidentiality limited the openness of some firms in this respect and, as a consequence, the level of detail differs between the case-studies. Finally, each of the industry-chapters ends with an overview of the changes in human resource management (HRM) at the various firms.





[T]he question of change still looms large. Will Japanese firms, faced with an aging workforce, slower growth, more competition from abroad, and rising aspirations for leisure, mobility, and affluence on the part of the Japanese people ultimately jettison what the world has come to know as Japanese management? (Lincoln, 1993, 71).

## 5. Statistics of Change

### **Persisting employment stability, changing HRM**

*Introduction. Recent employment adjustments and remaining lifetime employment. Past developments in employment practices. Environmental change and its pressure on employment practices. The rise of performance-based pay. The diversification of employment types. The rise of non-regular employment. The rise of labour mobility. Concluding remarks. References.*

#### **Introduction**

The first chapter introduced the debate on changing Japanese employment practices as it has been inspired by the economic malaise and various long-term changes in the environment that are expected to change the efficiency of these practices. However, we have also seen how change is not self-evident as the employment practices are widely supported and embedded in Japan's society. As the initial debate focused predominantly on lifetime employment, this continued support can explain why the debate on change appears to have withered a little in recent years. At the same time, the focus on lifetime employment, so natural given its position as the defining characteristic of Japanese employment practices, can hide important changes in other practices.

In discussing these changes we need to make a distinction between the adjustment of employment and the adjustment of employment practices. The previous chapter introduced the ‘adjustment logic’ of Japanese employment practices to denote the strategies Japanese firms use to adjust the labour input while upholding their support to lifetime employment. The next section discusses if Japanese firms have indeed responded to the economic malaise of the ‘lost decade’ according to this logic, meanwhile upholding the practice of lifetime employment. However, the extent of the environmental changes makes adjustments in employment practices inevitable.<sup>146</sup> This chapter discusses this issue by taking another look at the various environmental changes and the pressures they exert on the typical Japanese employment practices.<sup>147</sup> In addition, it also discusses some of the important trends in human resource management as they have been distinguished in the literature and statistics on employment practices. These trends are an increasing importance of performance, a diversification of employment types, a rise in non-regular employment, and a rise in labour mobility.

### **Recent employment adjustments and remaining lifetime employment**

The employment situation in Japan around the turn of the century was considered severe, as acknowledged by various government publications on the labour market. They, for instance, speak about an employment situation that is ‘becoming increasingly serious’ (Economic Planning Agency, 1999, 23), ‘increasingly severe’ (Japan Institute of Labour, 2002a, 59) or ‘remains in a severe state’ (Japan Institute of Labour, 2004a, 71). The economic indicators subscribe to this assessment. Unemployment rose from roughly 2 per cent in the 1980s to 5.4 per cent in 2002

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<sup>146</sup> Unfortunately, this distinction between employment adjustment and the adjustment of employment practices is not always drawn consistently as it depends on the definition of Japanese employment practices. Whittaker (1990) quotes an article from the Asahi Shinbun, which raises the following question, ‘what would you do if your company turned around to you and said, “the age of the ‘company man’ is over, we are sending you out to a subsidiary”’ (Asahi Shinbun, 15-01-1988 as quoted by Whittaker, 1990, 321). This quotation interprets an employee transfer as the end of ‘Japanese-style management’. The reaction by the media to announcements of employment reductions, as discussed by Usui and Colignon (1996), shows a similar tenor. Another and more scientific example concerns Ahmadjian and Robinson (2001), who interpret downsizing activities as an indication of the end of lifetime employment. ‘[D]ownsizing in the 1990s...was accomplished through reduction in hiring, early retirements, sending employees to affiliates and, in some cases, layoffs...[A]ll four represent violation of the norms around permanent employment’ (Ahmadjian and Robinson, 2001, 632). However, the previous chapter has shown how transfers (both *shukkō* and *tenseki*) can be considered as a strategy to adjust employment while upholding lifetime employment.

<sup>147</sup> This chapter concerns the years around the change of the century. However, in the sense that the structural developments have a long-term character and date back as far as the 1970s, the discussion in this chapter is not specific to these years.

(appendix one, table A-1) and in 1998 the average wage (total cash salary) fell for the first time in post-war history as a consequence of drastically reduced overtime wages and bonuses (Economic Planning Agency, 1999, 23). In addition, we see the perception of excess employment in recent years and the rise in unemployment caused by the mismatch between job openings and jobseekers since the latter half of the 1990s, representing over 75 per cent of total unemployment in the first quarter of 2003 (Japan Institute of Labour, 2004a, 23).<sup>148</sup>

Given the severe employment situation, one expects a large number of firms to have reduced their labour input. Table 5.1 gives the ratio of companies planning personnel adjustments and the strategies they use. The table also includes the aggregate percentages in 2000, which indicates an important increase in adjustments.

(percentages of firms, multiple answers)

	Total	Construction	Manufacturing	Wholesale retail	Finance, Insurance	Services	Total 2000 <sup>1</sup>
Implementing adjustments	31	35	42	23	14	22	20
Restrict overtime	16	14	24	11	4	10	11
Increase # of paid holidays, vacation days	4	7	6	2	1	4	3
Dismiss / refrain renewing temp., seasonal, or part-time contracts	5	7	7	2	1	3	1
Suspend / curtail mid-career hiring	5	6	8	4	2	3	4
Reassign personnel	10	8	15	6	3	7	7
Employee loan (transfer)	5	4	10	2	3	2	6
Lay off personnel	3	3	6	1	-	1	1
Volunteers early retirement, dismissal	7	10	9	6	4	3	2
None of the above	69	65	58	77	86	86	80

**Table 5.1 Personnel adjustments by industry (January-March 2002)**

Source: Japan Institute of Labour, 2002a, 7

<sup>1</sup> Source: Japan Institute of Labour, 2001, 7 (period of investigation: July-September 2000)

<sup>148</sup> Although all industries share this perception of over-employment, substantial differences exist depending on industries and type of jobs. Most striking is the excess of employees in skilled, manual, clerical and administrative positions, while a shortage exists for specialists and technical workers (Economic Planning Agency, 1999, 127; *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2003, 100-9).

However, by ignoring the more common strategies of natural attrition and employment restraint these data actually underestimate the employment adjustments. This is shown in table 5.2, which refers exclusively to firms that made adjustments. Natural attrition and employment restraint are by far the most common methods used.<sup>149</sup>

(percentages of firms, multiple answers)

	Total	Construction	Consumer Manufacturing	Machinery manufacturing	Wholesale, trade, food	Finance, Insurance
Natural attrition <sup>1</sup>	81.6	81.0	81.5	85.0	81.3	89.9
Employment restraint <sup>2</sup>	76.9	82.8	78.5	81.3	77.8	77.2
Voluntarily retirement invitation & early retirement preference <sup>3</sup>	34.2	48.3	36.9	44.9	19.6	25.3
No Contract renewal for contract and part-time employees	29.7	22.4	35.4	42.1	27.1	11.4
Expansion of <i>shukkō</i> and <i>tenseki</i> <sup>4</sup>	26.0	46.6	18.5	30.8	29.2	24.1
Dismissal	6.9	1.7	10.8	5.6	7.6	2.5
Others	1.3	0.0	0.0	2.8	2.1	2.5

**Table 5.2 Strategies for personnel adjustment by industry**

Source: *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2002

<sup>1</sup> Including employees reaching the age limit, leaving at personal convenience, already existing early retirement preference systems, *shukkō*, *tenseki*, etc.

<sup>2</sup> Including new graduates, mid-career hiring, short-term, seasonal and part-time employees, etc.

<sup>3</sup> The creation or expansion of.

<sup>4</sup> The percentages of *shukkō* employees are actually very limited. In 2000, the percentages for the different age groups were as follows: 20-24: 0.23%; 25-29: 0.18%; 30-34: 0.23%; 35-44: 0.26%; 45-54: 0.35%; 55-59: 0.41%. Moreover, these percentages have been rather stable since the height of the bubble in the late 1980s.

These adjustments can be considered a confirmation of the adjustment logic as discussed in the previous chapter. On average only three per cent of firms has actually laid off personnel. Almost all conventional adjustment strategies are present and actually implemented in a similar order as in previous periods, starting with the restriction of overtime (16%) and the reassignment and transfer of workers (in total,

<sup>149</sup> This chapter does not further discuss the impact these strategies have on employees as it is rather self-evident. Table A.2 in appendix one shows that four effects stand out in importance, namely a decrease in employees' morale, an increase of working hours, improvements in productivity, and an outflow of superior talent. The subsequent table A.3 shows that these effects are relatively independent of the chosen adjustment strategy.

15%).<sup>150</sup> Moreover, the outcome does not differ substantially if we focus on the manufacturing industry as the industry that shows the highest percentage of adjustment. At the same time, one striking difference exists in the extensive recruitment of volunteers for early retirement and dismissal. Usui and Colignon (1996) state how this strategy was hardly used during previous periods of adjustment; presumably because its consequences were considered most radical. However, these considerations have not prevented the recruitment for early retirement and dismissal to become the third-most adjustment strategy.<sup>151</sup> A final point of interest is the apparent increase in percentages between 2000 and 2002.

These strategies to adjust employment while upholding lifetime employment are also confirmed by data on employment duration. Matsuzuka (2002), found that the average employment duration for Japanese male workers between 1982 and 1997 basically increased; especially for workers of 35 years and older and during severe economic slumps. The only exception to increased tenure is the younger age group, which shows some decrease in tenure during certain periods between 1982 and 1987. A further division between small, medium and large firms shows that this is particularly caused by decreasing tenure for young employees at small and medium-sized firms. Other studies like Chuma (1997) confirm this overall assessment on employment duration. Moreover, the developments seem to have continued. Table A.4 in appendix one shows the years of continuous employment by sex and male age groups. After a slight decrease for the younger age groups in the late 1980s and early 1990s, tenure has increased for all groups. These figures are confirmed by table A.5 in appendix one on the percentage of employees changing employment, which shows that rising percentages are limited to very young male employees.

To evaluate the seriousness of the current employment situation, it is insightful to make an explicit comparison to the recession after the first oil crisis in 1973. At first sight, the current adjustments appear somewhat minor compared to those in the 1970s. Rohlen (1979), who investigated the employment adjustments at 250 large Japanese firms between March 1974 and March 1978, found that almost 75 per cent of firms implemented employment adjustments; with over 50 per cent suspending mid-career hiring and almost 50 per cent recruiting volunteers for early

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<sup>150</sup> As mentioned in the previous chapter, Usui and Colignon (1996) found the following order in adjustments: (1) reduction of overtime, (2) reassignments and transfer of workers, (3) reduction mid-career hiring and hiring of new graduates, (4) reduction of part-time, seasonal and temporary workers, (5) allocation of holidays and extended vacations, (6) temporary factory closing and layoffs, and (7) voluntary retirements and dismissals.

<sup>151</sup> On the other hand, the order in adjustments is in accordance with the data by Rohlen (1979) as discussed in footnote 128.

retirement.<sup>152</sup> In comparison, the current figures tend to appear rather modest. However, this impression might be deceiving, as the study by Rohlen concerns a much longer period (four years) and this is likely to raise the percentage of firms adjusting their labour input. Moreover, the long duration of the 'lost decade' makes it likely that firms have adjusted employment during certain periods of this 'decade'. The data of table 5.1 and 5.2 can therefore be considered a somewhat random indication of the activities during this period and are certain to underestimate the adjustments.

Overall, the most striking differences with the 1970s concern, respectively, the position of firms and the situation on the labour market. Rohlen concludes that in spite of the overall success of the employment adjustment during the 1970s, the system was pushed to its limits. Significant assistance from the government, banks and related group companies was often needed and '[a] more severe or prolonged recession might have brought the entire employment system, including many healthy firms as well as the troubled ones, to its knees' (Rohlen, 1979, 256). At the same time, the long-term but less intense character of the recent economic downturn appears to have enabled firms to adjust their employment relatively successfully. However, we have also seen how the situation on the labour market is considered very severe. In particular, the relative high unemployment, in spite of a total employment strategy, makes it understandable that many consider the current circumstances as the most difficult ever. The labour market no longer appears capable to create sufficient new employment.<sup>153</sup> So, even though firms have been relatively successful in adjusting their labour input, the overall situation has become very serious and this has strongly contributed to the reconsideration of employment practices.

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<sup>152</sup> In this respect, the data by Rohlen (1979) thus show a striking difference with those by Usui and Colignon (1996). This difference might be caused by the different periods of investigation as Rohlen investigates the period between 1974 and 1978 and the study by Usui and Colignon is limited to the year 1975.

<sup>153</sup> Part of this change can be explained by certain contingencies that smoothed the adjustments in the 1970s but are no longer present. For instance, the employment situation at small- and medium-sized firms is rather different. Rohlen (1979) states that these firms had faced a labour shortage in the decade before the oil crisis and were thus able to absorb part of the redundancies at large firms. However, during the current recession firms with less than 500 employees have also slashed the number of employees since 1998 (Economic Planning Agency, 2000). Another example of changing circumstances is the behaviour by female employees. During the 1970s, many female employees left the labour market in a reaction to the severe employment situation. During recent years a similar process took place but to a far lesser extent, as shown by relatively stable participation rates (Japan Institute of Labour, 2003, table 13).

### Past developments in employment practices

Before we discuss the environmental changes that require adaptation, it is good to take another look at the most important long-term developments that have characterised Japanese employment practices. The second chapter discussed how in the middle 1950s a balance was reached between management and unions which became typical to the post-war decades. However, although the practices of lifetime employment and seniority wages became firmly established by the early 1960s, they have not been immune to change. Almost from the beginning we see changes in the promotional and compensational structure and we need to take these changes into consideration. Too often the Japanese employment practices are represented as a system of functionally interdependent practices. This has proven instrumental in the analysis of their economic implications, as illustrated by the previous chapter, but it, almost by definition, leads to a static perspective that ignores their dynamics. Based on such a static conception of employment practices, any change appears revolutionary and an indication of collapse.

The most important change has been the gradually growing importance of ability and an accompanying flattening of wage-tenure profiles.<sup>154</sup> Crucial in this development has been the introduction of the ability qualification system (*shokunō shikaku seido*) in the late 1960s (see e.g. Holzhausen, 2000; Rebick, 2001). The introduction of the ability qualification system meant that remuneration and promotions became co-dependent upon ability. However, as we have seen in the previous chapter, part of a person's payment remained dependent upon seniority. As the development of skills takes time, this dependence is understandable. Holzhausen (2000) therefore concludes that the system was not introduced to replace the seniority rule but to complement it. The new system gave firms more freedom to adjust the criteria for promotion and remuneration and provided the flexibility to deal with changes in work content in the quickly growing Japanese firms of the 1960s and 1970s. It received an additional boost during the 1970s, when the first oil crisis and the subsequent need to cut costs motivated management to use the ability qualification system to reduce personnel costs by tightening the criteria for promotion and limiting pay rises.

The data on wage-tenure profiles confirm the diminishing importance of seniority on remuneration. Several authors (e.g. Ariga *et al.*, 2000; Holzhausen, 2000; Rebick, 2001; Matsuzuka, 2002) point out this development. Unfortunately, these authors use different types of data and this makes it difficult to compare the

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<sup>154</sup> A second long-term development concerns the decline in the percentage of regular employees. However, as this decline has been particularly striking since the 1990s, it is included in the discussion of recent adaptations later in this chapter.



outcomes. However, they all point towards a similar downward trend. Rebeck (2001) describes how this trend was particularly strong in the 1970s, Ariga *et al.* (2000) show how the trend continued in respectively the 1980s and 1990s. Part of the findings of Ariga *et al.* is presented in table 5.3 as an illustration.<sup>155</sup> Matsuzuka (2002) confirms the trend for the years from 1987 to 1997.

Tenure	1980-4	1990-4
0	100	100
5	147.0	134.2
10	201.9	173.6
15	263.9	216.4
20	295.8	259.8

**Table 5.3 Index figures changing wage-tenure profiles at large Japanese firms**  
Source: Ariga *et al.*, 2000, 234

**Environmental change and its pressure on employment practices**

This chapter opened with a confirmation of the adjustment logic in the response to the economic malaise of the ‘lost decade’. However, as mentioned before, more substantial changes are expected from certain structural changes and this section gives an overview of the most likely causes for change. These are (1) a substantial decrease in economic growth, (2) changing technologies and the declining importance of firm-specific skills, (3) a shift from manufacturing to service industries, (4) globalisation, deregulation and the increase of competition, (5) the ageing of the population, (6) a changing role of female employees, and (7) changes in employees’ values, work- and lifestyle.<sup>156</sup> Not surprisingly, some of these developments appear as the mirror image of the contingencies as discussed in the previous chapter. As a matter of fact, the developments are not specific for the recent years but often go as far back as the 1970s. However, it appears that their impact has long been hidden and absorbed by the economic successes of the post-war period. This hints at the importance of the economic malaise as a trigger or catalyst for change.

<sup>155</sup> It is important not to take this table at face value. Ariga *et al.* (2000) also present data conditioned by rank, which show a flatter profile. Moreover, the outcomes will be somewhat different if we focus on the profile for specific cohorts. However, none of these adjustments will change the tenor of the findings.

<sup>156</sup> This list can actually be subdivided in two groups. The first four developments can be considered a consequence of the maturing of the Japanese economy from a developing economy to a fully advanced economy. The subsequent three concern social changes, which can also be related to the maturing economy but differ in character.

## (1) Substantial decrease in the growth of sales

The last chapter presented organisational growth as a major contingency for success to the Japanese employment practices, as growth both keeps average labour costs low and enables the creation of positions for promotion, so important under the late selection approach. High economic growth has therefore been recognised as one of the crucial conditions for the success of Japanese employment practices. As is well-known, this contingency was fulfilled during most of the post-war history. During the 1950s and 1960s, real GNP growth of more than 10 per cent was no exception and even during the 1970s, average growth remained substantial (table A-1, appendix one). Subsequently, the promotion and remuneration of employees was very smooth. Matanle (2003, 50) describes how the personnel system in the 1960s functioned almost entirely according to seniority, at least to a certain hierarchical level, and introduces a company director who states that 'more or less everyone would become *kachō* and then *buchō* [general manager]'.

However, this situation changed when growth further continued to fall during the 1980s and became insignificant or even negative during many years in the 1990s. The percentage of firms with negative growth in sales during the 1990s, amounted to 52.8 per cent, a strong rise from the 10.8 per cent of the preceding decade. The development of employment was similar as 61.5 per cent of firms had negative growth of employment in the 1990s, up from 49.8 per cent in the 1980s (Economic Planning Agency, 1999). This has had important consequences for the employment situation at Japanese firms, as they have become top-heavy with many senior and relatively few young employees.<sup>157</sup> The Economist (1994, 11) stated that in 1977, 25 per cent of division chiefs were younger than the median age of 45-49 while this figure had dropped to 15 per cent ten years later (The Economist, 1994, 11). Striking are also the figures about 'over-employment'. About 75 per cent of excess employment concerns employees in their fifties (Economic Planning Agency, 2000, 54). An interesting consequence is that many firms have seen the promotional gap between the top and bottom in the same age group expand because of a 'lack of promotional positions' and tighter criteria for promotion (Yashiro, 1997, 117).<sup>158</sup> In this respect, the strategy to deal with excess employment by the use of natural

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<sup>157</sup> Of course, one can easily claim that even if growth would have continued, those young people would simply not have been there since the Japanese society is ageing faster than any other. This is definitely true and will be discussed later.

<sup>158</sup> Other developments strengthen the problem of diminished growth and its consequences for promotional possibilities. Besides its contribution to new paradigms of production as described by Aoki (1995a, 1995b), information technology has also enabled a centralisation of planning and decision-making, flatter organisations, and a diminished role for middle management in the collection, organisation, and transmittance of information. This has further diminished the number of positions for promotion.

attrition and the decreased hiring of new graduates can be considered a double-edged solution. It decreases the number of employees but also aggravates the seniority problem.

## (2) Changing technologies and the declining importance of firm-specific skills

The maturation of the Japanese economy has not only influenced its potential for growth but also holds important consequences for its technological position. In the past, focus was on mass production and process-oriented innovation. Successful human resource management required teaching large groups of employees the general capabilities to adopt and improve existing technologies. To create flexibility, employees were trained in different positions through regular job rotation. The development of firm-specific intellectual, contextual and innovative skills proved very successful. Moreover, the strong overall growth generated a high rate of return to the investments in firm-specific skills. In return, the firm-specific character of skills contributed to the long-term employment relation. The previous chapter therefore discussed the importance of firm-specific skills as a crucial contingency for the success of Japanese employment practices.

However, once again, circumstances have changed. As a consequence of Japan's rise to technological leadership, it has become rather difficult to predict which technology will bear fruit. Critics therefore claim that firm-specific skills have become a rather uncertain asset as they hinder the ability to react to discontinuities. The lack of an efficient external labour market, a direct consequence of the employment practices, further diminishes the ability of firms to react to discontinuities. Other developments, like the shift from manufacturing to service industries, have reinforced this declining importance of firm-specific skills (see e.g. Matsuzuka, 2002). In combination with the rising wage costs mentioned before, firm-specific skills are thus characterised by rising costs and lower revenues. According to this view, a better developed and more flexible labour market is needed in order to attract the specialist skills firms need. This conclusion is, for instance, expressed by the Economic Survey: '(1) increasing competition and (2) growing uncertainties about technology and future demand are reducing the importance of firm-specific human capital' (Economic Planning Agency, 2000, 140). However, we should also be aware that many of these analyses are largely based on conjecture. Data show a shortage of specialist and technical workers but this seems a natural consequence of a system that focuses on the development of firm-specific and rather general skills, and is not necessarily specific for the current period.

(3) The shift from manufacturing towards service industries.

The shift from manufacturing to service industries contributes to the diminished impact of firm-specific skills. The percentage of the working population employed by the service sector rose from 29.6 per cent in 1950 to 63.7 per cent in 2000. Moreover, the forecast for 2010 is 67.7 per cent. At the same time, manufacturing has a decline in employment from 34.1 per cent in 1975 to 30.7 per cent in 2000, the forecast for 2010 being 28.4 per cent. This development is confirmed when we compare the percentage of firms making personnel adjustments (see table 5.1) in manufacturing (42%) to those in wholesale and retail (23%), services (22%), and finance and insurance (14%). This shift towards service industries has important consequences in both the existence of conventional employment practices and their outcomes. The dependence on manufacturing and certain technologies hints at a lower productivity. Moreover, as the chapter on the retail industry will show, firms in the service industry are often characterised by different employment practices.

(4) Globalisation, deregulation and the increase of competition

The issues of globalisation and deregulation have drawn wide attention since the early years of the economic malaise. Globalisation has very wide implications including an increase in foreign competition and the relocation of production outside Japan by many Japanese manufacturing firms, the so-called '*kudōka*' or 'hollowing-out' of industry (Legewie, 1997). Deregulation, on the other hand, is seen as an important means to revitalise the Japanese economy. Although the process of deregulation has been going on for several decades, and has contributed to the demise of the total employment strategy, the outcomes are usually considered insufficient. In recent years, deregulation has played a major role in the financial sector but it has extended to almost all areas of the Japanese economy. If we limit the discussion to the labour market, we can, for instance, distinguish the relaxation of worker dispatching relations in 1994, 1996, 1999. The 1999 Revision of the Worker Dispatching Law generally liberalised worker dispatching by lifting the general prohibition with exceptions into a general consent with exceptions (see Araki, 2002). Together the forces of globalisation and deregulation are seen as processes that increase competition on the Japanese market and thus facilitate its recovery. However, this increased competition is likely to diminish firms' ability to offer lifetime employment.

(5) The ageing of the population

The force of change most widely discussed is undoubtedly the ageing of Japanese society. Its high visibility but also its consequences for future government budgets definitely contribute to this attention. The change in population structure has been

tremendous and measured by the share of population of 65 years and older, Japan has overtaken all other (industrialised) countries.<sup>159</sup> The consequences of this development would be huge for any country but the seniority-related wage system aggravates the situation. It will therefore be no surprise that many observers claim that the changing age structure signifies the end of the seniority-based wage system. In addition, the mandatory retirement age of previously 55 years became unrealistic because of peoples' higher life expectancy. It is therefore that already in 1986 the 'Employment Security Act for Older People' was passed. After modifications in 1990 and 1994, the law now establishes 60 years as the mandatory retirement age while firms are expected to promote continuous employment of workers until the age of 65. In 2003, 67.4 per cent of firms had an employment extension system, a rehiring system, or both (Japan Institute of Labour, 2004a, 54).

#### (6) The changing role of female employees

The level of education for women, who traditionally were expected to leave the firm when they married, has increased consistently over the past decades and this has changed their position on the labour market. Better education and later or no marriages mean that many women attach more importance to their career. This process has been strengthened by the acceptance of the Equal Employment Opportunity Law in 1985 and its revision in 1997 (brought into force in 1999). However, in spite of a substantial increase in the labour force participation rate, the process towards equal opportunities is slow (see e.g. Japan Institute of Labour, 2001). For instance, the rise in the participation rate is mainly caused by a rise in part-time employment (Japan Institute of Labour, 2003). In addition, the ratio of female management employees has remained modest (table A.7, appendix one). The slow economic growth has also not helped in achieving an increased participation rate of female employees as core employees. A stronger economic urgency could have been the crucial complement to the legal changes and catalysed the long-term but slowly changing social perceptions on female employment. In this respect, all is not lost that is delayed. Because of the ageing population, a further and more equal participation of qualified female employees is inevitable. However, given the multitude of more short-term problems, this issue has so far played a minor role in the discussions on changing employment practices.

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<sup>159</sup> The population structure, which used to be truly pyramid-shaped, can no longer be described as such. The first and second baby boom are clearly visible and the group around 50 years is currently the largest group in Japanese society. Moreover, the development will continue and in 2050, the number of people is expected to increase almost every time one moves an age group higher until about 75 years old. If anything, the population then resembles an inverse pyramid (Japan Institute of Labour, 2001, 2004a).

## (7) Changes in employees' values, work- and lifestyle

The changing role of women can be considered an important manifestation and catalyst of more general changes in values that are likely to impact the perception of employment practices. Several authors (Dore, 1998, 2000; Matanle, 2003) discuss changing values towards, for instance, work and family life. However, the extent of these changes and their impact on employment practices are hard to determine and deserve a separate analysis. We will therefore limit the present discussion to the core practices of lifetime employment and seniority wages. Several questionnaires have investigated the attitude towards these practices. First of all, as shown by table 5.4, support for lifetime employment remains strong and even appears stable. This is a clear confirmation of the discussion in the second chapter.

(percentages of firms)		
	1999	2003
(basically) maintain the practice	34	36.1
Partial adjustment is inevitable	44	40.0
Fundamental review is necessary	17	15.3
Do not have lifetime employment	4	5.2
Cannot forecast	1	-
Unknown, no response	-	3.3

**Figure 5.4 Attitude of firms towards the future of the lifetime employment system<sup>160</sup>**

Sources: Hattori and Maeda, 2000, chart 15 (research held by *Kigyō Keiei Koyō Kankō Senmon Inkai*) and Japan Institute of Labour, 2004a.

The seniority system, on the other hand, is under strong pressure to change. Recent data is not available but a 1998 government survey predicted the demise of seniority-based wages. Table 5.5 presents the outcomes of this research.

(percentages of firms)		
	1998	In 5 years
Seniority-oriented	10	1
Relatively seniority-oriented	47	8
Relatively performance-oriented	34	55
Performance-oriented	9	36

**Figure 5.5 1998 situation and expectation for the pay-system in five years**

Source: The Japan Times, 04-05-1998

<sup>160</sup> The data of both table 5.4 and 5.5 refer to the support among firms. However, there is absolute no indication that the support is not shared by employees.

Overall, the various developments put the Japanese employment practices under serious pressure; in particular because several of these changes reinforce one another. In the short run, three consequences stand out. First of all, the problem of rising wage costs. The low growth has provided firms with an ageing workforce, which under the existence of seniority-based wages leads to higher wage costs. Moreover, the ageing of the population makes this development inevitable. Even if the high levels of growth were maintained, the traditional pyramid employment structure would no longer be possible. A second strongly related problem is the subsequent decline in promotional possibilities. Once again, the lack of growth is a fundamental cause for this problem but the trend towards flatter organisations also plays an important role. Somewhat counterintuitive, the ageing of the population adds to this problem as it has led to an increased average age of employees, thus clogging the hierarchy. The problem is aggravated by the supply side-oriented human resource development that motivates employees to improve their capabilities in return for promotion and the growing number of qualified female employees. The possibilities for promotion are thus under pressure from both the supply and demand side. A final issue concerns the qualitative changes in the human resources needed. We have, for instance, seen how employees with specialist rather than firm-specific skills are needed. The shift towards service industries also changes the skills required. Moreover, the need to employ female employees in core positions means that the current employment practices, with their bread-winner-based orientation, have to be reconsidered. Overall, changing social values reinforce this trend.

We thus see how the various environmental changes require a subsequent adaptation of employment practices and the call for change is therefore more than a reflex to the economic malaise of the 'lost decade'. The literature of the recent years has discussed many possible adaptations in evaluation, promotion, and remuneration. Table 5.6 gives a comprehensive overview of the elements that play or are expected to play a role in the human resource management at Japanese firms. As the table indicates, the list of possible developments can be extensive and this chapter therefore classifies the adaptations into four major categories. These are (1) the increasing importance of performance, (2) the diversification of employment types, (3) the rise in non-regular employment, and (4) the rise in labour mobility. Once again, we should be careful not to overestimate the revolutionary character of these changes. As mentioned in the introductory chapter, the debate on changing employment practices is as old as the awareness of their specific character. Many changes that are currently proposed have already been around for a long time. Innovations like the so-called 'specialist career track' and management by objectives were already discussed in the late 1960s and early 1970s (Matanle, 2003).

	(percentages of firms)			
	'99	'00	'01	Trend
Ability wages ( <i>shokunōkyū</i> ), management layers	80.9	82.4	67.0	↓
Ability wages, non-management, middle layers	85.2	87.0	76.1	↓
Ability wages, non-management, general layers	-	-	76.7	
Functional wages ( <i>yakuwarikyū</i> ), management layers	21.1	43.9	62.5	↑
Functional wages, non-management, middle layers	17.7	24.9	38.6	↑
Functional wages, non-management, general layers	-	-	16.2	
Annual salary system ( <i>nenpōsei</i> )	22.7	25.2	34.8	↑
Age-salary ( <i>nenreikyū</i> ), management layers	78.2	72.8	32.3	↓
Age-salary, middle layers	-	-	59.6	
Age-salary, general layers	-	-	73.2	
Periodical salary increase system ( <i>teishō seido</i> )	89.0	87.3	-	
Occupational wage system ( <i>shokushu betsu chingin seido</i> )	19.2	16.0	15.6	↓
Double track (type) personnel system ( <i>fukusengata jinjiseido</i> )	-	33.9	29.5	↓
Stock-option system	7.6	12.6	22.7	↑
Achievement-related bonus ( <i>gyōseki rendōgata shōyo</i> )	34.4	32.9	31.0	- / ↓
Discrete work (invisible labour) system ( <i>saiyō rōdōsei</i> )	17.7	18.9	23.0	↑
Discrete work (planning service) system	-	3.0	4.4	
Many-sided evaluation system ( <i>tamen hyōka seido</i> )	-	11.3	10.3	-
Competency (53)	5.7	5.6	11.2	↑
Internal recruitment system ( <i>shanai kōbosei</i> )	-	21.6	34.5	↑
Internal FA system	-	-	2.7	
Complaint treatment system ( <i>kujō shori seido</i> )	33.8	31.8	36.6	↑
All-year employment ( <i>tsūnen saiyō</i> )	26.8	35.3	40.4	↑
Occupation specific employment ( <i>shokushubetsu saiyō</i> )	37.2	-	49.0	↑
Internship system	13.9	24.9	28.0	↑
Plan of notice dispatched employees ( <i>shōkai yotei hakenshain</i> )	2.6	-	13.3	↑
Early retirement preference system ( <i>sōki taishoku yūgū seido</i> )	-	58.8	44.8	↓
Change of employment support system ( <i>tenshoku shien seido</i> )	-	26.9	23.6	
Career counselling	-	-	8.0	
Age limits for posts ( <i>yakushoku teinen seido</i> )	53.0	53.1	46.9	↓
Advance payment retirement sum ( <i>taishokukin senharai seido</i> )	1.6	1.0	0.9	-
Retirement payment points system ( <i>pointo taishokukin seido</i> )	-	24.6	29.5	↑
Pension on the basis of determined contribution	2.5	3.3	1.5	-
Employment continuation after retirement age	-	6.3	7.4	↑
Cafeteria plan	3.2	4.0	5.9	↑

**Table 5.6 Changes in the personnel system**Source: *Seisansei Rōdō Jōhō Sentā* (Productivity Labour Information Centre), 2002**The rise of performance-based pay**

As we have seen in one of the earlier sections, the importance of ability in the evaluation of employees has slowly increased over the years. Since the introduction of the ability-wage qualification system, remuneration has been dependent upon



both seniority and ability. In the early phases of a career, the seniority characteristics tended to be predominate. Subsequently, the seniority rule gives away for ability as the main criterion for remuneration and, in particular, promotion. Given this importance of ability, the debate on the replacement of seniority by performance-oriented pay (table 5.5) appears rather surprising. However, there appears an important change in the time-perspective of evaluation. Until recently, the evaluation of ability was characterised by the long-term focus that is implied under seniority wages. This explains why Holzhausen (2000) describes the ability qualification system as a complement to the seniority rule. However, a number of new instruments suggests a shift towards a short-term evaluation of performance. It implies that it is no longer the skills an employee has acquired over the long-run but the actual job performance that determines his or her wage. If so, this certainly constitutes a major change in Japanese employment practices. Unfortunately, the distinction between ability and performance is often not made very clearly; partly because the differences are gradual in reality as ability tends to be a reflection of past achievements. Nevertheless, we can see a number of ways in which short term performance has become more important.

(1) A direct relation between performance or results and bonuses.

In recent years, several companies have decided to link remuneration (explicitly) to overall corporate performance. In particular, the bi-annual bonuses have become strongly dependent upon the evaluation of results, as illustrated by table 5.7.

		Result evaluation	Ability evaluation	“Emotion and will” <sup>1</sup>	Other
Salary	<i>Tantōsha (ippanshoku)</i>	32.3	44.6	18.9	4.2
	<i>Sōgōshoku</i>	35.3	44.4	16.3	4.0
	<i>Kakarichō</i>	40.4	43.2	11.7	4.7
	<i>Kachō</i>	53.5	35.6	6.9	4.0
Bonus	<i>Tantōsha (ippanshoku)</i>	56.8	17.8	21.9	3.5
	<i>Sōgōshoku</i>	62.7	16.8	18.7	1.9
	<i>Kakarichō</i>	69.7	13.1	14.1	3.2
	<i>Kachō</i>	80.8	9.8	7.7	1.8
Promotion	<i>Tantōsha (ippanshoku)</i>	29.8	47.2	19.3	3.8
	<i>Sōgōshoku</i>	31.8	49.4	15.6	3.2
	<i>Kakarichō</i>	38.9	46.6	11.2	3.3
	<i>Kachō</i>	48.3	40.0	7.3	4.4

**Table 5.7 The average weight of merit factors on salary, bonus, and promotion**

Source: *Rōmu Gyōsei Kenkyūjo* [Labour Administration Research Institute], 2002, 90

<sup>1</sup> Refers to sense of responsibility, initiative, cooperation, and discipline.

Seemingly in contradiction with this development, table 5.6 shows how the percentage of firms with achievement-related bonuses has remained constant or even decreased slightly in the years 1999 to 2001. However, this table does show a strong rise in functional wages, another development that increases the impact of short-term factors. Moreover, as the case-studies in later chapters show, firms indeed have introduced various schemes that make bonuses dependent on performance or results.

(2) The annual wage system (*nenpōsei*).

Under *nenpōsei*, wages are determined on an annual basis. Focus is on the employee's performance over the year compared to certain goals set at the beginning, a clear change from the past focus on accumulated skills. Moreover, it usually implies that wages can go down if the performance drops from one year to another. Interestingly, the main reason behind its introduction appears the desire to boost white-collar productivity rather than to reduce labour costs (Ornatowski, 1998). This is confirmed by Morishima (1995) who blames the traditional focus on training for a lack of appropriate performance measurement. However, its degree of introduction is a topic of debate. On the one hand, interest has increased to the extent that organisations like Nikkeiren and the Japan Employment Information Centre have published guidelines on its implications (Ornatowski, 1998). Moreover, almost 35 per cent of firms had introduced *nenpōsei* in 2001 (Japan Institute of Labour, 2001; *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2003). However, the number of employees involved usually appears limited to certain management classes.

(3) Management-by-objectives (MBO).

A third instrument, which appears to have gained the strongest popularity, is management-by-objectives (*mokuhyō kanri seido*). As mentioned, this instrument was already discussed in the late 1960s and early 1970s but its implementation has only taken off in recent years. Table 5.8 shows that almost 70 per cent of firms has already implemented management-by-objectives, while another 22.5 per cent is either planning or studying its introduction. The implications of management-by-objectives are listed in table 5.9.

	%
Already implemented	69.9
Implemented but halted or abolished	2.7
Not yet implemented but already planned	8.3
Not yet implemented but under study	14.2
Not implemented and no plans to do so	4.4
Others	0.6

**Table 5.8 Introduction of management-by-objectives**Source: *Seisansei Rōdō Jōhō Sentā* [Productivity Labour Information Centre], 2002, 45.

	All firms		> 3,000		1,000 – 2,999		< 1,000	
The level of difficulty is taken in consideration	62.7		82.9		60.8		56.0	
Weights are set for evaluation	71.5		73.5		72.0		70.5	
Self-evaluation exists	91.0		73.5		92.2		87.9	
	<b>Ma<sup>1</sup></b>	<b>Ge<sup>2</sup></b>	<b>Ma</b>	<b>Ge</b>	<b>Ma</b>	<b>Ge</b>	<b>Ma</b>	<b>Ge</b>
Level of achievement is directly reflected in wages	61.6	51.4	65.6	53.1	66.7	52.5	57.0	50.0
Level of achievement is only used in setting wages	28.9	37.7	25.0	34.4	16.7	27.5	38.0	45.5
Level of achievement is directly reflected in bonuses	71.1	63.2	75.0	57.6	76.0	66.7	66.7	63.8
Level of achievement is only used in setting bonuses	25.9	34.0	21.9	39.4	20.0	31.0	31.0	33.3
Level of achievement is directly reflected in promotion	39.5	33.8	42.9	31.0	37.2	34.2	39.5	34.9
Level of achievement is only used in deciding promotion	45.6	51.5	42.9	51.7	39.5	36.8	50.0	60.3

**Table 5.9 Characteristics of systems for management-by-objectives (percentages)**Source: *Rōmu Gyōsei Kenkyūjo* [Labour Administration Research Institute], 2002, 106-8.<sup>1</sup> Management employees<sup>2</sup> General employees

In spite of these developments, the rising importance of direct performance at the expense of developing ability through an ability qualification system is not without difficulties. First of all, the motivation of employees to develop their capabilities through long-term association with the firm will suffer when wages are determined by short-term performance. This seems a major reason why ability and even seniority remain relatively important for younger employees (see e.g. tables 5.6, 5.7, and 5.8). Another impediment concerns the actual evaluation of short-term performance as most parties seem very well aware of the difficulties involved. The discussion of the case-studies in later chapters will show how Japanese firms have approached this difficulty.

### The diversification of employment types

Several writers (e.g. Sako, 1997; Dore, 1998) stress the change from a predominantly homogenous to a more differential treatment of employees. The following strategies can be considered representative of this development.

#### (1) A double-track human resource system.

An important differentiation between groups takes place in the form of a so-called 'double-track human resource system' (*fukusengata jinjiseido*) or 'job career path programme' (*kosubetsu koyō seido*). This implies a pre-selection that differentiates between groups with different potential and/or career wishes. This system divides employees into two groups; the 'general staff group' or 'general track' (*ippanshoku*) and the 'executive candidates group' or 'career track' (*sōgōshoku*). The employees in the first track perform supportive tasks and will not be promoted to the position of manager. The second group of employees is expected to be eventually promoted to a management position and receives the training to make this possible, usually by experiencing various jobs through job rotation. Several writers (e.g. Kyotani, 1999; Broadbent, 2003) point out how this innovation was an answer to the establishment of the Equal Employment Opportunities Law in 1986 and stress how this policy works out as a means of segregating male and female employees.<sup>161</sup> Broadbent (2003) describes how the demands of the career track, like heavy workloads, long hours of overtime, and a possible transfer to distant (foreign) sites, make that female employees with domestic responsibilities have no choice but to opt for the general track. Finally, figures about the numbers of firms implementing such a double-track system are somewhat elusive. An indication comes from table 5.6 which provides a rather constant or even slightly decreasing ratio of about 30 per cent.

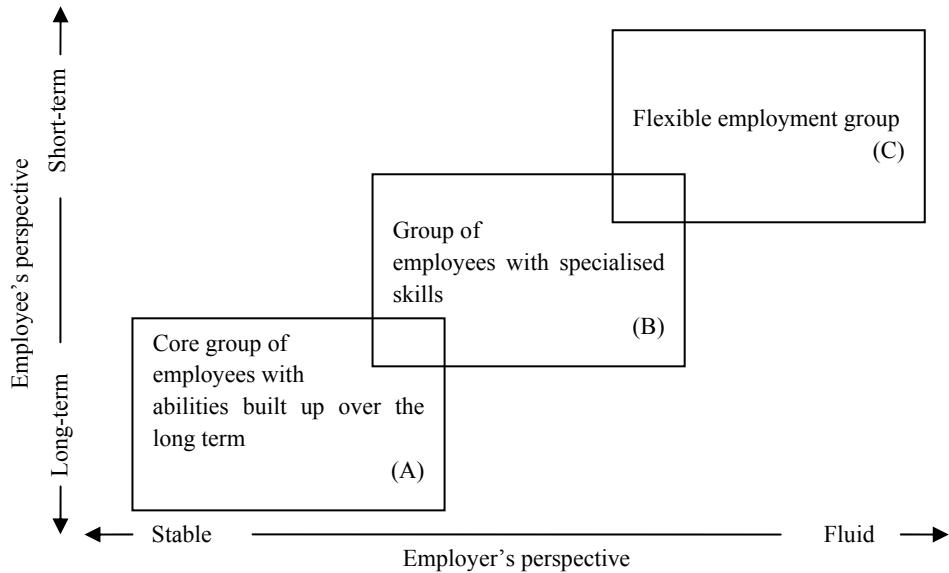
#### (2) A multi-track personnel system.

In 1995, Nikkeiren proposed the introduction of a so-called 'multi-track personnel system' (Nikkeiren, 1995). This initiative comprehended a reorganisation of the corporate 'employment portfolio' into three groups of employees. These groups are (1) a core or 'elite' group of long-term employees, (2) a group of specialists for dealing with specific, possibly short term, problems, and (3) a peripheral group for simple routine tasks.<sup>162</sup> Figure 5.1 shows how these groups differ from the firms'

<sup>161</sup> As a matter of fact, the double-track human resource system can be interpreted as an explication of past practices because the Equal Employment Opportunities Law required a proper justification for differences in treatment.

<sup>162</sup> Whittaker (1990) mentions how in some cases the title 'specialist' was a conciliation prize for those qualified employees who could not become a manager. However, he also mentions how in other companies like Sony the title is indeed awarded for achieving specialist skills.

perspective (stable vs. fluid) and the employees' perspective (long- vs. short-term). Each track has its own type of employment contracts and different rules for promotion, remuneration, training, etc. The first group is employed by open-ended employment contracts, the other two groups by fixed-term contracts. Table A.8 in appendix one gives a full overview of the typical characteristics of the different groups.



**Figure 5.1 The three groups of employees in Nikkeiren's employment portfolio**  
Source: Japan Business Federation, 2003, 20

Nikkeiren acknowledged at the introduction of the employment portfolio that several firms had already developed their employment practices in such a direction and that its analysis actually made these developments more explicit. As a matter of fact, the 'traditional' approach already knew two employment tracks of respectively regular and non-regular employees and the innovation of the Nikkeiren proposal mainly concerns the third track for specialists. It is therefore not surprising that, for instance, Holzhausen (2000, 231) speaks about a so-called 'specialist career system' (*senmonshoku seido*). Finally, in spite of the major press that the Nikkeiren proposal has received and the continued support Nippon Keidanren provides (Japan Business Federation, 2002, 38), the actual implementation of the specialist career system has remained rather constant and even seems to have decreased in recent years. For 1999, the figures were about 20 per cent for all firms and about 50 per cent for firms with over 5,000 employees (table A.6, appendix one). The rise in non-regular

employment could imply a diversification of employment along the lines as proposed by Nikkeiren but more about this in the next section.

(3) The formation of individualist personnel management.

The double- and multi-track personnel systems have so far been discussed from the perspective of the firm but several authors mention how these systems fit into a trend in which employment practices have become more adjusted to the individual wishes of employees. Publications like those by the Japan Institute of Labour (2001) point out how firms increasingly give consideration to the wishes of employees when assigning them to new positions. The introduction of additional tracks for specialists is provided as an example of this development. Table 5.4 provides some other examples like the internal recruitment system and occupation specific employment. Table A.6 in appendix one also shows how possibilities for childcare and nursing leave have strongly increased. At the same time, and in spite of the overall positive development, serious problems remain. The employment tracks only offer two or three alternatives, defined by the employer, and as long as female employees feel forced to opt for the general track there is a long way to go towards true individualistic personnel management.

We thus see several signs that suggest the diversification of employment types. At the same time, the extent of these developments is not clear. The formation of individualistic personnel management is slow and tentative. In addition, the introduction of dual career tracks appears mainly inspired by the demands for equal treatment as formulated in the Equal Employment Opportunities Law. It mainly seems a confirmation of the traditional distinction between core and supporting regular employees. As such it is an attempt to maintain the status quo rather than a sign of change. Finally, in the case of Nikkeiren's employment portfolio, it is ambiguous to what extent firms have complied with the recommendations. In particular the development of specialist career tracks appears to have stalled. At the same time, there does appear a rise in the percentage of employees with non-regular employment as the next section discusses.

### **The rise of non-regular employment**

The number of non-regular employees has increased substantially during the recent decades. Table 5.10 gives the changing percentages of regular workers, part-timers,

*arubaito*, and a rest category including *shokutaku* and dispatched workers.<sup>163</sup> We see a strong decline in the percentage of regular employees from 79.4 per cent in 1992 to 72.8 per cent in 2001. During the second half of the 1990s the decrease was very fast, particularly in light of the continuing employment security for regular employees.<sup>164</sup>

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Regular	79.2	79.7	79.1	78.5	76.8	76.4	75.1	74.0	72.8	71.3	69.7
Part-timers	11.9	11.7	11.8	12.3	12.9	13.2	14.0	14.7	15.4	14.3	15.2
<i>Arubaito</i>	5.0	5.0	5.5	5.7	6.2	6.6	6.9	7.3	7.6	6.6	6.9
<i>Shokutaku</i> , dispatched, etc.	3.9	3.6	3.7	3.6	4.2	3.8	4.1	4.0	4.2	7.8	8.2

**Table 5.10 Percentages of employees by type of employment**

Source: Japan Institute of Labour (2002b); Data 2002 and 2003: Japan Institute of Labour (2004b)

Note: These data are from the Special Survey on the Labour Force and the Labour Force Survey. The title of the original survey was changed in 2002.

A number of the environmental changes mentioned before plays a role in this development. First, there is the shift from manufacturing to service industries, as part-time employees have always been more prevalent in these industries. Secondly, the weak economy has also contributed to this development. Table 5.11 presents an overview of the reasons for hiring non-regular employees. It shows the ‘need to control labour costs’ as most prevalent, with the ‘need for additional personnel on a daily or weekly basis’ as a distant second. Finally, for hiring dispatched workers (in contradiction to part-timers), the need for persons ‘with experience and expertise’ and ‘capable of doing specialised work’ also plays an important role. This illustrates the aforementioned need for employees with specialist knowledge. However, the issue of costs remains most important.

<sup>163</sup> *Shokutaku* are employees on temporary contracts, often re-hired after mandatory retirement. However, the term is also used to refer to employees with specialist skills on fixed-term contracts.

<sup>164</sup> Gordon (1985) points out that the percentage of, what he calls, marginal workers has diminished substantially between the 1950s and 1970s; in particular for men. The rise in non-regular employment can therefore be considered an inversion of the trend of the post-war decades.

(percentages of firms, multiple answers)			
	Short-time part-time jobs	Other part- time jobs	Temporary agencies' staff
Need to control labour costs	61.5 (52.3)	59.1	40.3 (35.9)
Require additional personnel on a daily or weekly basis	36.2 (34.4)	21.9	8.1 (15.7)
Need to adjust hiring practices due to changes in business conditions	26.9 (20.7)	24.8 (18.6)	26.2
Require more workers because of extended business hours	23.9 (19.7)	17.3 (3.1)	6.0
Need to meet temporary or seasonal demand	19.1 (15.8)	18.2 (12.1)	22.8
Allow regular workers to specialise in important work	14.6	12.2	14.2
Require persons capable of doing specialized work	11.5 (9.5)	11.6	23.8 (37.8)
Require persons with experience and expertise	10.6 (6.5)	14.2 (22.9)	31.0
Unable to recruit regular workers	9.3 (20.3)	10.9 (16.0)	8.5
Wish to re-employ older workers	5.5 (5.2)	7.0 (2.0)	0.9
Substitute for regular workers on childcare or family-care leave	4.7	4.0	7.5
Others	6.1 (7.4)	6.4 (5.7)	5.8

**Table 5.11 Reasons for hiring non-regular employees 1999 (between brackets, 1996).**

Sources: Survey of the Diversification of employment Status, Ministry of Labour, 1999 (Japan Institute of Labour, 2004, 19); Survey of the Diversification of Employment Status, Ministry of Labour, 1996 (Passet, 2003, 193).

### The rise of labour mobility

The previous chapter described how lifetime employment can be considered an outcome of the importance of firm-specific skills and employment governance through career concerns. Moreover, firms were also said to uphold an implicit agreement not to hire one another's former employees. This led to a labour market equilibrium with almost no mid-career hiring of regular employees. Kono and Clegg (2001, 281) speak, in this respect, about lifetime employment as a 'catch-22' as 'no company wants to employ someone who leaves his present employer in order to join another one'. However, this situation appears to be changing as several developments suggest a rise in labour mobility. First of all, the decline in the percentage of regular employees is likely to imply a similar decline in the percentage of employees with strong commitment to the firm. The development of a specialist career track is also likely to weaken this commitment. Moreover, we do see a rise in the importance of mid-career hiring. Table 5.12 shows how the ratio of



firms that hire mid-career employees has become rather high, in particular among larger firms. The increased use of all-year employment as listed in table 5.6 is further indication of the rising importance of mid-career hiring. The most important reasons for such hiring are the wish to (1) compensate for the loss of workers due to retirement and job switching, (2) secure human resources possessing ready skills and abilities, (3) expansion of business, and (4) vitalise the organisation by obtaining diverse human resources (see appendix one, table A.9).

(percentages, multiple answers)

	Management	Clerical	Technical, research	Non-clerical
All firms	10.4	28.1	16.1	53.9
> 5,000 employees	20.0	51.5	43.5	38.8
1,000 – 4,999 employees	24.2	49.2	30.3	48.8
300 – 999 employees	21.5	45.6	26.3	53.6
100 – 299 employees	16.1	37.1	21.6	59.5
30 – 99 employees	7.3	23.2	13.0	51.0

**Table 5.12 Ratio for hiring mid-career workers, 2001.**  
 Source: Ministry of Health, Labour and Welfare, Survey of Employment Management (Japan Institute of Labour, 2004a, 29).

This rise in mid-career hiring suggests the development of an active external labour market. However, predictions in this direction still appear as conjecture because the data remain ambiguous. In particular the data on job tenure and the percentage of workers who change employment provide no indication that the external labour market has achieved or is achieving substantial growth. Moreover, it is important to note that ‘mid-career hiring’ usually concerns employees in their 20s or early 30s. As such, it has been an established practice for, in particular, employees who join a larger company after a number of successful years at a smaller firm. Finally, we should point out that table 5.12, although it provides an important indication that mid-career hiring has become an accepted practice, does not tell anything about the number of employees that firms hire mid-career. Once again, the discussion of case-studies in subsequent chapters must improve our understanding in this respect.

**Concluding remarks**

This chapter has discussed the employment adjustment in response to the economic malaise, which has so far followed the conventional adjustment logic. In accordance, the practice of lifetime employment remains strongly supported, a confirmation of the discussion in the second chapter. However, the support for lifetime employment should not be interpreted as an indication that Japanese employment practices are not changing. We have seen how various environmental changes exert a serious

pressure on the employment practices in terms of rising wage costs, congested hierarchies, and the need for alternative skills. Together, these problems require substantial changes. In discussing these changes, we have distinguished four major categories of change, namely an increasing importance of performance, a diversification of employment types, a rise in non-regular employment, and a rise in labour mobility. Overall, these developments can have important implications for the productive logic of employment practices as it was discussed in the previous chapter. However, before we can discuss the possible implications we need a better understanding of the character of these changes. The case studies in the subsequent chapters answer to this need by providing a detailed understanding of the rationale of adaptations as they are made by specific firms.

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## 6. The Automobile Industry

### The prevalence of the productive logic

*Introduction. Industry Characteristics. Employment practices in the automobile industry. Firm A: background, strategies and competitive outlook. Firm A: changes in human resource management. Similar for firm B. Concluding remarks. References. Overview changing employment practices.*

#### **Introduction**

This chapter discusses the changes in human resource management (HRM) at two major Japanese automobile manufacturers. Moreover, it relates these changes to the specific characteristics and situation of these firms and therefore opens with a discussion of the automobile industry as it constitutes the firms' direct environment. In addition, it also discusses the employment practices as they have been specific in this industry. The analysis is then specified towards the level of the individual firms. The discussion of each firm is twofold as it presents the firm's characteristics, strategies and competitive outlook before it focuses on the important changes in HRM. In addition, the chapter presents some concluding remarks on the findings and their implications for the employment practices in the automobile industry. It ends with a detailed overview of all the changes at the respective firms.

### Industry characteristics

It does not take much imagination to interpret the development of the Japanese automobile industry as representative of the post-war Japanese success.<sup>165</sup> After the Second World War, the Japanese automobile industry, in particular the production of passenger cars, was in dire straits with a clear lack of production facilities, materials, and components. However, the industry soon entered a path of growth very similar to Japan's overall economic development. In addition, it also provided an important contribution to the development of the specific institutions of Japan's economy. It, for instance, played a major role in the post-war settlement of industrial relations and the development of specific *keiretsu* relations between final assemblers and suppliers.<sup>166,167</sup> Moreover, it was also an important beneficiary of government policies to protect and promote certain domestic industries (Mutoh, 1988).

The consecutive successes of the automobile industry have become well known. Japanese firms achieved two major advantages over their foreign competitors, namely lower costs and better (production) management, and at the end of the 1970s the Japanese production of cars had outgrown that of the US.<sup>168</sup> Moreover, the strong presence of Japanese firms in the US market made that, in 1980 a 'voluntary' export restraint agreement of 1.68 million units was negotiated between the US and Japan. This agreement turned out to be something of a mixed blessing for the US as it basically forced the Japanese firms to organise exports through a cartel and the resulting higher prices directly contributed to high profits. Moreover, the agreement inspired Japanese firms to extend their product line towards larger models, as this was more profitable given the maximum limit on cars.

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<sup>165</sup> In spite of several attempts for domestic car production since the beginning of the twentieth century, the pre-war automobile industry was dominated by the Japanese production facilities of Ford and GM. However, government limitations on production, soaring costs and the worsening relationship between Japan and the US led to their exit from the Japanese market in 1939.

<sup>166</sup> '[T]he 1953 strike at Nissan that lasted for more than three months had the most profound impact as it ended with the industry-based union being replaced by company-based unions supported by the management' (Odagiri & Goto, 1996, 193).

<sup>167</sup> Odagiri and Goto (1996) describe how Nippondenso, originally a parts factory within Toyota, was disposed of to free necessary capital. Other factories followed and these firms joined the already existing Toyota suppliers associations, thereby constituting the basis of the *keiretsu* system. Eventually, this led to the development of just-in-time (JIT) production to decrease the inventories necessary and save important costs; both in and between firms. Moreover, this approach also reveals bottlenecks in production and, as such, gives practical guidance for improvements in the production process.

<sup>168</sup> Luck also played an important role in the successful development. Japanese success was, for instance, helped by the increased foreign demand that came with the Korean war, and the two oil crises in the 1970s and the rise of environmental concerns that contributed to an increased demand for the smaller Japanese cars.

In addition, the Japanese transferred assembly operations to North America in order to avoid the quota. Several firms also implemented this last strategy in Europe under the actuality and possibility of the so-called ‘Ford Europe’. Table 6.1 shows the impressive growth in the production, sales and exports of passenger cars until 1990.

Year	(number of cars)				
	Production	Domestic sales	Exports	Production North-America	Production Europe
1950	1,594		7		
1955	20,268	20,055	2		
1960	165,094	145,227	7,013		
1965	696,176	586,287	100,716		
1970	3,178,708	2,379,137	725,586		
1975	4,567,854	2,737,641	1,827,286		
1980	7,038,108	2,854,176	3,947,160		
1985	7,646,816	3,104,083	4,426,762		
1987				632,976	
1988				796,456	130,326
1989				1,132,701	203,215
1990	9,947,972	5,102,659	4,482,130	1,320,031	223,164

**Table 6.1 Production and sales of passenger cars by Japanese firms 1950-1990**

Source: Japan Automobile Manufacturers Association (JAMA), 2003

As a matter of fact, the Japanese automobile industry lost some of its former advantages from the middle of the 1980s. Most importantly, the former advantages in terms of management and costs disappeared to an important extent. Rising wage costs and the appreciation of the Yen after the 1985 Plaza Accord led to skyrocketing labour costs when expressed in foreign currency. Moreover, since the late 1980s there has been a worldwide adaptation of Japanese manufacturing techniques that have become known as lean management.<sup>169</sup> The situation has been aggravated by the weak domestic demand during the ‘lost decade’. Table 6.2 on the next page shows the decline in the number of both domestic sales and exports since 1990. This led to a large excess capacity, a problem aggravated by the overwhelming growth in domestic sales (see table 6.1) and cheap capital during the ‘bubble’ period. This initiated a wave of investments, which raised production

<sup>169</sup> Probably the most influential publication in this respect is ‘The Machine that Changed the World’ by Womack *et al.* (1990), a book that describes ‘Japan’s revolutionary leap from mass production to lean production – and what industry everywhere can learn from it’ (book cover). This book, together with similar publications, describes and contributed to the spread of Japanese manufacturing management, emphasising the importance of factory and labour relations, the organisation of product development, and supplier relations.



capacity to 15 million units (including trucks). As indicated by the data in table 6.2, a large part of this capacity prove idle in the 1990s. Moreover, the situation is unlikely to change as demographic developments and the long-term trend towards 'localised' production limit future domestic demand and exports.

Year	(number of cars)					
	Production	Domestic sales	Exports	Production N-America	Production Europe	Production Asia
1990	9,947,972	5,102,659	4,482,130	1,320,031	223,164	
1995	7,610,533	4,443,906	2,896,216	1,944,977	614,524	
1996	7,864,676	4,668,728	2,860,080	1,943,471	702,768	
1997	8,491,480	4,492,006	3,579,131	1,934,290	777,682	
1998	8,047,929	4,093,148	3,684,430	1,930,266	877,327	
1999	8,097,082	4,154,084	3,757,460	1,839,266	894,191	
2000	8,359,434	4,259,872	3,795,852	1,834,255	898,065	
2001	8,117,563	4,289,683	3,568,797	1,760,769	949,323	
2002	8,618,357	4,441,354	4,012,371	1,830,408	1,098,287	1,570,100

**Table 6.2. Production and sales of passenger cars by Japanese firms 1990-2002**

Source: Japan Automobile Manufacturers Association (JAMA), 2003

Another important problem concerns the excess in car models and parts.<sup>170</sup> For many decades, the Japanese automobile industry was characterised by a relatively large group of manufacturers in a growth market. Intense rivalry led to vigorous product segmentation as firms quickly imitated the successful models of competitors. This process was reinforced by the successes in product development through *keiretsu* relations. At the same time, strong growth and little communication between product engineering teams meant that there was little attention for the cost advantages of common parts. Overall, it led to an excessive growth in both car models and variations and the number of parts. This problem was aggravated by technological changes that placed new demands on manufacturers. Important technological changes like the development of hybrid and fuel cell powered vehicles led to an increasing need for research and development and, consequentially, an increase in fixed costs and potential economies of scale. Smitka (2002) estimates that, in the case of passenger cars, the increased costs for research and development

<sup>170</sup> Some other but apparently less influential problems have also been distinguished. First of all, traffic congestion has hampered the efficiency of the JIT system. Moreover, demographic changes and the perception of factory work as characterised by the three K's (*kitanai*, *kitsui*, and *kiken* – dirty, hard, and dangerous) created a labour shortage in the early 1990s. The economic malaise of the 'lost decade' and the subsequent rise in unemployment have lessened this problem but the overall trend remains the same.

require a minimal total production of four million units. This contributed to the trend towards lesser parts through modularisation and standardisation, a development that appears opposite to the Japanese strength in developing many different models and parts. In addition, it also led to the use of common car platforms to combine economies of scale with regional and product differences. Most firms have responded to this development by participating in business tie-ups or mergers. In the case of Japan, this has included the tie-up between Nissan and Renault, Ford controlling Mazda, GM controlling Isuzu and holding a major stake in Suzuki and Fuji Heavy Industries (Subaru), and Daimler-Chrysler controlling Mitsubishi Motors. Within Japan, Toyota took over Hino and Daihatsu.<sup>171</sup>

Overall, the outlook for Japanese automobile firms is thus not as attractive as in the pre-1985 period.<sup>172</sup> Domestic demand has suffered from the overall economic malaise and worldwide demand has also been sluggish. In addition, competition makes new demands amid global corporate mergers and acquisitions. At the same time, several firms still are rather successful. Smitka (2002) states that in early 2002 Japanese brands accounted for 27 per cent of the US market, the highest percentage ever. Moreover, makers like Toyota and Honda, have recently enlarged their European production capacity. However, we see important differences in performance among firms. While Toyota and Honda have remained successful, other firms like Nissan, Mitsubishi, Mazda and Daihatsu have felt compelled to merge with or give up control to both domestic and foreign competitors. The differences also show in the firms' employment situation. Honda, for instance, has hired workers in recent years while Mitsubishi and Mazda have made extensive use of early retirement programmes (Smitka, 2002). Firm heterogeneity has thus become crucial in analysing the success of the Japanese automobile industry.

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<sup>171</sup> Changes are actually rather slow but according to Smitka, this is not specific for the Japanese automobile industry. 'I argue that slow change is the norm, and not just in Japan. After all despite its brush with bankruptcy in 1980, Chrysler did not launch thoroughgoing reforms until 1989; General Motors lost market share every year between 1980 and 2001, before hiring the individual who engineered Chrysler's turnaround. Little fundamental happens in the auto industry in under a decade' (Smitka, 2002, 3). Smitka lists several reasons for this, including the difficulty of strategic reform for all large firms and the dynamics of the automotive industry, which 'operates on an eight-year product planning cycle'.

<sup>172</sup> More than the other industry characteristics, the economic situation can change substantially within a relatively short period of a number of years. We have therefore decided to focus on the economic situation at the time of the interview (October 2002 – March 2003). As the main interest of the current study was the issue of change, it appeared best to focus on those circumstances that were relevant during the period of change. A similar argument holds for the discussion of each firm's competitive outlook.

### **Employment practices in the automobile industry**

In discussing the employment practices in the automobile industry we can basically refer to the discussion of the productive logic in chapter four. That chapter pointed out how analyses about the superior efficiency of firm-specific knowledge achieved through practices like on-the-job-training (OJT), job rotation and broad job descriptions have almost exclusively been set in a manufacturing setting. As a matter of fact, it has particularly been the automobile industry that has inspired most of these analyses. The most significant example is Aoki's (1988) discussion of the *kanban* system, developed at Toyota, as the best-known type of horizontal coordination. Moreover, other important analyses (e.g. Koike, 1995, 1997; Dyer, 1996) also make extensive references to the automobile industry. The various contingencies for success subscribe to this assessment. Besides the dependence on manufacturing, the automobile industry also fulfils the dependence on certain technologies (characterised by both stochastic correlation and technological interdependencies among tasks) and the dependence on certain product markets (continuously fluctuating demand). Although the success of the productive logic is not limited to the automobile industry, it has clearly been the main inspiration.

In spite of this fit, the automobile industry has known its fair share of employment reduction in recent years. We actually see a steady decline in employment and adjustments appear to have been achieved through natural attrition. In spite of the difficult circumstances the base wage levels have actually risen for most of the 1990s. Overall, Smitka (2002, 19) concludes that '[t]he data...suggest that the "lifetime employment system" in Japan still dominates manufacturing. Firms on average are slow to adjust employment levels, and continue to increase base wages as their workforce ages. Hours worked – more accurately, overtime – remains an important margin of adjustment.' Nevertheless, firms have also implemented policies that used to be considered unthinkable like the closure of factories and the sale of subsidiaries and important stockholdings.

### **Firm A: background, strategies and competitive outlook**

Firm A is one of Japan's main automobile manufacturers with a history of about 70 years. Over the years, it has been perceived as a firm with excellent engineering and product planning. However, weaknesses in management and marketing have made it difficult to take advantage of these strengths and financial results have been poor for a long time. This led to the development of a major restructuring plan in the early 1990s. The firm announced the closure of one plant and reduced both investments and hiring. However, sales continued to decline and additional plans had already been drafted (at affiliates implementation had begun) when an alliance was formed with a major foreign competitor in 1999. The measures that the new management

team inherited included a freeze in hiring (effectively trimming employment by 1,000 a year), the disposal of new car channels and about 10 per cent of dealerships, the sale of shareholdings in a variety of auto parts makers, and the closure of several plants at affiliates. Moreover, since the start of the alliance two additional plans for renewal have been drafted

The first plan, which followed soon after the start of the alliance, presented product development and cost reductions as the two major strategies towards future growth. In the early years cost reductions were most important as the plan listed three major commitments: (1) the return to profitability within one year, (2) a minimum operating margin of 4.5 per cent within three years, and (3) a reduction of debt by 50 per cent within three years. In order to achieve these goals, the firm took several steps like the reduction of purchasing and sales, general and administrative costs by 20 per cent. In addition, it closed several plants to raise the capacity utilisation rate from about 60 to 80 per cent. All regular employees involved were offered a transfer to other facilities but the firm nevertheless achieved an employment reduction of over 20,000 employees through natural attrition, an increase in part-time employment, and the spin-off of non-core businesses. Finally, the firm freed up capital resources by concentrating on core businesses to reduce its debt. These activities proved very successful and the strong operating performance enabled the firm to achieve its overall objectives within two years. Moreover, the firm also renewed its commitment to R&D by hiring an additional 1,000 engineers, and making important investments in R&D (to 4.5% of revenues) and capital expenditures (to 5.5% of revenues).

When the objectives were achieved within two years, the firm developed a new plan which focused more specifically on growth. Besides a further improvement of the operating margin and a reduction of debt to zero, it strived for a substantial rise in sales. The strategies to achieve these objectives were rather similar to those of the previous period. Within one year, the two financial goals were already achieved. In particular cost reductions contributed to this success. The third objective will be more difficult to accomplish but the firm has made substantive investments in R&D and many new models have and will be introduced to increase sales. Overall, the competitive outlook is positive as the recent financial results have been very sound.

### **Firm A: changes in human resource management**

Not surprisingly, the firm also re-evaluated its human resource management in its attempts to revitalise the firm. A shift towards a performance-based system was considered crucial in this respect. The 1999 annual report states the following.

‘[T]he company’s appraisal and compensation system has been shifted from the traditional Japanese seniority-based system, to a performance-based system. In the new system, the individual will be regularly evaluated based on their capabilities and work performance measured against set objectives. The new system aims to be age-neutral, recognizing the importance of experience, but not limiting career options for outstanding performers.’<sup>173</sup>

In order to achieve these changes, many ‘outsiders’ from other departments like R&D and manufacturing were brought in because the HRM department was considered too conservative. As a matter of fact, the background to these changes appears rather different from that at most Japanese firms, as it is related to the alliance with a Western firm. Just like ‘Japanization’ was an issue in the early 1990s, the situation at firm A could be considered a process of, in lack of a better word, ‘Westernisation’. The firm saw as its major challenge to create a hybrid system on the basis of traditional Japanese practices and the Western inspired ideas that came with the new management. An interesting manifestation of both the shift towards performance and its ‘Western’ inspiration has been the introduction of a stock option program in 2000, for which more than 500 employees qualified in the first year.

Central among the changes is the shift towards performance-based pay. In the past, appraisal was not so much based on actual performance but on the behaviour towards the job. ‘He works hard, he does as told, his attitude is very good, such elements were plenty.’<sup>174</sup> This has now shifted towards performance; in particular for the evaluation of management employees. In case of management, four ‘contribution levels’ are distinguished: (1) start, (2) apply, (3) influence, and (4) transform. The meaning of each of these levels is rather self-evident. All managers are ascribed one of these levels during appraisal and this defines the salary band for annual wages. The actual wage is then set by a discussion among a person’s superiors. A relative element exists in the sense that if one employee in a department receives above average wages, another will receive below-average wages. It is interesting to observe that this approach still very much focuses on the existing capabilities of the employees, on their ability. It is felt that there should not be an up-and-down movement in basic salary because it is a reflection of ability, which is

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<sup>173</sup> Without disregarding the extent of the adaptations made in advance, this statement seems to suffer from the common tendency to exaggerate changes by sketching a rather stereotypical image of the former practices.

<sup>174</sup> The impact of the alliance also shows in this respect because, while most firms stress the importance to reduce costs, Firm A stresses the importance of motivating people with the right spirit. As a consequence, there is much attention for the communication between boss and subordinates. A good understanding of objectives and one’s personal role in achieving these objectives is seen as instrumental for a person’s motivation. Traditionally, Japanese managers do not pay much attention to this form of communication.

considered permanent. Performance in the strict sense is measured by the achievement of targets and is reflected in the bonuses.

In addition, Firm A has also introduced several changes that indicate a diversification of employment. Striking are the changes in job ladders for the lower level employees. Basically, the moment when an employee ‘specialises’ has been moved forward. The changes in hierarchical levels and career courses are summarised in table 6.3.

Until April 2003	Since April 2003
N2 (General manager) <sup>1</sup>	N2 (General Manager)
N1 (Manager) <sub>2</sub>	N1 (Manager)
SA (Assistant manager)	<b>PG1 or PE2<sup>3</sup></b>
J5 – J6	<b>PG2 or PE2</b>
J1 – J4	<b>PX</b>

**Table 6.3 Changed hierarchical levels and career courses**

<sup>1</sup> At the GM level, there are five different roles:

1. Strategic leader: corporate officer
2. Operational leader: line management for the main functions like manufacturing, R&D, marketing and sales, etc.
3. Support operational leader: line management for supporting functions like HR, finance and accounting, purchasing, etc.
4. Programme leader: leader of a project
5. Expert: legal, design, research, etc.

<sup>2</sup> At the Manager level, there is only the role of “value creator” because managers are expected to create value in all divisions.

<sup>3</sup> From April 2003, there will be two courses:

1. Pro-General (PG): various functions with a focus on management
2. Pro-Expert (PE): develop a more specific expertise.

The distinction between Pro-General (PG) and Pro-expert (PE) for the non-management levels introduces two courses which require a rather different competence. Employees choose around 30 years old, after seven or eight years of experience. Before they choose there will be an interview with their supervisor who gives advice. Obviously, engineers will often opt for the expert course. If the employee decides to choose a course for which there are no immediate positions in his or her department, he should either change his decision or seek another department. In addition, various other developments exist that could also be interpreted as the diversification of employment. The firm has, for instance, introduced so-called ‘career advisors’ who search key employees with high potential. If new projects are being created, like a new plant in China or South-America, there is a need for people with relevant expertise but, in the past, management was often not aware where such people could be found in the organisation. The new system

would be implemented from April 2003, with the candidates expected to have a wide view and good people-skills. Another sign of diversification is the introduction of so-called 'diversity projects'. In these projects, representatives of various functions offer advice on several issues and this has, for instance, already improved the working conditions for women (and men) in terms of childrearing.

Important changes have also taken place concerning mid-career hiring. As mentioned, the number of employees was strongly reduced after the start of the alliance.<sup>175</sup> However, at the time of the interview firm A was hiring about 1,000 people a year, almost all engineers.<sup>176</sup> Because of the high number of new employees, the quality of the jobs was actually suffering a little. The new people needed to be trained and this proved a rather heavy burden on the other employees.<sup>177, 178</sup> Mid-career hiring constitutes 50 per cent of all hiring as the objective to develop many new models created the need for qualified employees. Mid-career hiring was also valued because of an additional reason. As these employees (rather than new graduates) already have working experience, they can offer a new culture or values. Every month during the ceremony for newcomers, they are asked to 'respect their values, cultivation, and speak out about differences to their supervisor'. However, as the number of mid-career hiring is still rather

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<sup>175</sup> Employment adjustment took place with the same percentage (10%) over all departments; except R&D that was exempted. The reduction was achieved by an early-retirement programme for people over 45 years. The choice to 'leave' was left to the employees because of the strong relationship with the union. As a result, the right person in the right place has not yet been achieved and the quality of employees could be better.

<sup>176</sup> In the case of white-collar employees, the firm hires (1) permanent (*seishain*), (2) short-term contracted, and (3) employees dispatched from employment agencies. Short-term contracts are offered to employees with special skills and knowledge because it enables the firm to pay salaries over those defined by the hierarchy and to hire employees with special skills that would not work for 'regular' salaries. The percentage of dispatched employees is rising quickly (10 to 20%) and they are hired for all functions at staff level. For blue-collar employees, there are no employees with short-term contracts.

<sup>177</sup> Overall, there is the danger of a vicious circle. Because the supervisors and senior employees have to cover for their subordinates, they might have no time for guidance and training, which might lead to more mistakes, etc. From both sides this might lead to decreased motivation.

<sup>178</sup> The firm has actually intensified its training activities to improve the quality of employees. A variety of training programmes exists. One the one hand, we see traditionally 'Japanese' types of training like four days of assembly training to all employees (except manufacturing employees) when entering the firm, training in firm fundamentals (common values and common tools), training in all specific areas of the firm like marketing and finance, and additional on-the-job training after they have been handed over to their division. New types of training also exist, like training in both leadership and management (explicitly distinguished) for managers. A special variant is the so-called 'global executive training' for employees who are considered possible future leaders by top management. For incumbents, regular managers, a good training programme was still being developed at the time of the interview.

limited, the danger exists that they become assimilated. It is therefore felt that more of these workers are needed, because of both skills and diversity.

With the rise in mid-career hiring, the recruitment of the right people has become an important issue. As firm A has once again become well-respected, employees are proud to join and willing to adopt its company culture. However, in several cases the match has not been as expected from either the employee's or the firm's side. This can be related to the organisation of work as the absence of clear job descriptions and the intentional overlap between jobs complicates mid-career hiring. At the same time, the firm confirmed the advantages that this organisation of work offers at the shop floor in terms of flexibility, the limitation of headcount, and the diminished need to adjust job descriptions to changing circumstances. The advantages and disadvantages of this approach were particularly felt since the start of the alliance. In spite of the advantages it offers at the blue-collar level, the traditional style of bottom-up coordination through cross-functional teams can also hinder innovation as it leads to compromises. On the other hand, there is the Western approach where superiors set clear objectives to be implemented by their subordinates. It is important to combine the two approaches as both have their advantages.

### **Firm B: background, strategies and competitive outlook**

Firm B has a relatively short history of about 50 years and launched its automobile business in the mid 1960s after it had become successful with the production of motorcycles. Nowadays it is one of Japan's leading manufacturers of both automobiles and motorcycles. In addition, it also produces so-called 'power products' like engines, power generators, and tillers. From its start, the firm has had a very specific character, which is ascribed to its founders who established an entrepreneurial and innovative culture. They, for instance, stated that the acquisition of as much technique and knowledge as possible is essential for the development of new products and that single-skill jobs and excessive specialisation do not lead to creativity. Failure was not something to be feared as something can be learned from failure. Another manifestation of its innovative character is the establishment of an independent research laboratory which is not restricted by the profit considerations that tend to characterise a company-bound research and development division. Its specific character has even earned firm B the distinction of a specific productive model, built upon innovation and flexibility (Boyer and Freysenett, 2002). Finally, the firm also has a strong global character. As a relative latecomer to the Japanese automobile market, it met strong domestic competition and decided to focus on foreign markets, in particular the US market. Global fame as a motorcycle



manufacturer paved the way in this respect. The firm thus was an initiator in the trend towards localised foreign production.

The recent strategies also breathe these characteristics. In its vision for the future the firm distinguishes three directions: value creation for customers through high-value innovative products, localised global operations in each region in which it operates, and a commitment to the future by improving safety and minimising environmental consequences. In addition, the manufacturing system has been changed rather fundamentally in order to raise quality, efficiency and flexibility. Overall, the firm has achieved very good results. In spite of the difficult market circumstances, unit sales and financial indicators reached record levels. These results also hold a good promise for the firm's competitive future. A possible weakness might be the limited relative size as firm B has maintained its autonomy amid the recent wave of mergers but is now substantially smaller than the large conglomerates headed by the likes of GM, Ford, Daimler, Toyota, and Volkswagen. If future economies of scale will be as large as predicted, this might endanger the firm's future success. However, this conclusion is rather tentative.

### **Firm B: changes in human resource management**

In line with its maverick character, firm B has a history of specific HRM. From its start the firm has eliminated the requirements of educational background and seniority and has successfully applied the principle of 'ability first'. A specialist staff system was introduced that gave all employees a chance to achieve promotions to specialist posts, ranking as high as managerial functions. Young engineers were given the scope to develop new products and the room to have their say. In spite of this specific character, the firm has also strengthened the importance of performance in recent years. It has, for instance, abolished the traditional *teikishōkyū*, the automatic annual increase in basic wages, for large groups of employees. Under the past system individual performances were important but every employee would have some implicit guarantee that his salary would be raised, as organisational growth made it possible to create positions with accompanying responsibility. However, under the recent severe circumstances this was no longer considered possible and the firm has therefore abolished *teikishōkyū* for more senior employees.<sup>179</sup>

The new personnel system concerns all employees and distinguishes the hierarchical classes and functions as shown in table 6.4. Initial placement depends on a person's background when entering the company (high school, university,

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<sup>179</sup> The system has been maintained for the K-class and abolished for the H- and M-class as they are distinguished in table 6.4.

doctor degree).<sup>180</sup> Employees hired during mid-career are placed according to their experience, based on the number of service years and an interview. For the younger employees (*kaihatsu sankyū*, development-third-class or K-class), evaluation is based on ability. For the other two levels, *hakki-nikyū* (exercise-second-level or H-class) and the management level (M-class), performance plays a more important role. In the H class, a salary table determines basic pay, similar to the description of the ranking hierarchy in chapter four. In addition, employees are rewarded marks (A, B, C) for their performance and these determine additional payment. However, the differences are rather limited as these employees are still members of the union. In the case of the management class, there is a stronger link between evaluation and remuneration. Downward adjustments are possible. However, the new scheme was only introduced in October 2002 and a four-year adjustment period was agreed with the labour union. Finally, bonuses are awarded twice a year according to another table than those for the determination of wages.

Hierarchical Class	Sub-class	Hierarchical functions
Manager-class	M	<i>Kachō</i> and higher
<i>Hakki-nikyū</i>	H1	<i>Kakarichō</i>
	H2	<i>Kakarichō</i>
	H3	Staff
	K1	Staff
	K2	Staff
	K3	Staff
<i>Kaihatsu-sankyū</i> <sup>1</sup>		

**Table 6.4 Hierarchical classes and functions**

<sup>1</sup> Promotion from these classes is within reach of all regular employees. It is the speed of promotion that will differ. A good employee can move to the H-class in his late twenties, for others this might only happen in their late thirties.

In spite of these changes, ability remains a crucial criterion for promotion. Depending on a person's special skills, he or she is awarded technical or special titles. These titles are than the basis for awarding hierarchical functions like *kakarichō* and *buchō*. The slogan is '*hajimeni shikaku ariki*', first there has to be qualification, ability. The criteria for titles are developed in the different '*bunkakai*', specialty groups of employees with similar types of skills. In each group, the different steps for on-the-job training define the steps for development and thus qualification. At the same time, the firm acknowledges that under the recent

<sup>180</sup> Most employees are *seishain* (about 30,000). To handle changing levels of sales, temporary staff (*jikanjūgyōin*) is hired on three-month contracts that can be renewed. Their number obviously depends on the level of sales but is currently 3,000 to 4,000 employees. The use of detached employees is determined by the departments and the exact number is therefore not easily achievable but it will not be very high (only a few per cent).

economic circumstances the number of posts for promotion has become limited, and the danger exists that employees cannot be promoted according to ability. The firm has therefore clarified and tightened the criteria for promotion.

Finally, an interesting innovation is the 2002 introduction of a special scheme that transfers decision-making power to subordinates. Employees are asked to present ideas to their superior after which he or she evaluates the proposal. The firm thus wants employees to consider their personal role and tap into their individual ability. The scheme differs from MBO in the sense that the employee takes the initiative in setting the objectives. Sometimes the employee works according to his own plan, sometimes he works according to the boss's orders. Harmonisation contributes to overall success.<sup>181</sup>

### **Concluding remarks**

Although firm A has known a long period of weak financial performance, both firms have been successful in recent years. The innovations in HRM therefore appear to have been implemented in a positive atmosphere. In the case of firm A, the impact of the alliance with a Western competitor stands out. The firm's dual (both Japanese and 'Western') character shows; for instance, in the focus on motivation through good communication about an employee's personal role and in the diversification of employment through 'career advisors' and 'diversity projects'. In the case of firm B, the apparent smoothness of the adaptations is striking. It seems that the past focus on ability rather than educational background and seniority and the past successes have contributed to a smooth transition, nevertheless in line with the signs of the time. The adaptation therefore appears rather natural, in spite of the possibility of downwards adjustments in wage for management employees and the introduction of the new scheme for personal initiatives.

In spite of these changes, the productive logic as discussed in chapter four has hardly been questioned. Firm A is particularly interesting in this respect because of its confrontation between Japanese and Western practices. As the discussion has shown, the firm confirmed the success of the typically Japanese organisation of work on the shop floor. The HRM at both firms also acknowledged this success and continued to emphasise the importance of ability in the assessment of employees. Firm A distinguished 'contribution levels' that can be considered a reflection of

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<sup>181</sup> A first evaluation took place in the following December. Employees were asked three questions: (1) do you agree with the aim of the new system? (2) have you understood the contents of the new system? (3) do you think it will re-activate the workplace? The first and second question was generally answered positive, the third questions drew a mixed response (roughly equal numbers of yes and no answers). The firm hoped that better evaluation by superiors would raise the positive answers to the last question.

individual ability, firm B maintained a principle of ‘ability first’. Moreover, in spite of an overall development towards non-regular employment types, these firms have remained dependent on regular employees who receive long-term training and, subsequently, have long-term employment. Overall, the productive logic therefore prevails, as announced in the sub-title of this chapter. This can hardly be a surprise since the automobile industry has been the main inspiration of past analyses of Japanese capabilities and employment practices and fulfils all contingencies as discussed in the fourth chapter.

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Overview changing employment practices

AUTOMOBILE		Firm A	Firm B
Firm Characteristics	Age	About 70 years	About 50 years
	Main products	Automobiles	Automobiles, motorcycles
	Competitive strength	Known for excellent engineering and product planning. However, relatively weak in marketing and the weak financial performance of the past decades had created a weak financial position until the alliance with a major foreign car manufacturer several years ago.	Entrepreneurial and innovative culture. Strong commitment to research and development and, as a relative latecomer to the by that time highly competitive domestic market, globalisation. Also known for its flexibility.
	Business strategies	Has implemented several restructuring plans in the past decade because of the long-term weak financial results. However, this received an important boost after the alliance with a foreign manufacturer, which led to two important plans. The first mainly stressed the importance of cost reductions, the second mainly stresses product development. An important strategy of the first plan has been the closure of several plants and the reduction of employment by about 20,000 employees (consolidated).	Current strategies stress the need for (1) continuously better creation of value for customers, (2) manufacturing globally grasping local needs, and (3) a commitment to the future in terms of safety and the environment.
	Economic situation	Characterised by a long period of poor financial results. However, after its alliance with a foreign firm and subsequent cost cutting, the firm now seems in a very good position. New investments in R&D have to contribute to growth of sales.	In spite of the difficult market circumstances, the results have been very good and the firm seems to be in good shape. A possible weakness in future years might be its limited size relative to its competitors after the wave of mergers in recent years.
Most Urgent HRM Issue	Idiosyncrasies	Partly under foreign ownership. This has created an interesting encounter between Japanese and foreign practices.	-
	Until recently, the reduction of employment. Nowadays, the training motivation of employees.		To adjust the evaluation system in response to the severe economy and lack of growth and the subsequent lack of positions.

AUTOMOBILE		Firm A	Firm B
Inflow	Composition	White-collar employees: (1) permanent ( <i>seishain</i> ), (2) short-term contracted, and (3) employees dispatched from employment agencies. For blue-collar employees, there are no short-term contracted employees.	Most employees (about 30,000) are permanent ( <i>seishain</i> ). Temporary staff ( <i>jikanjigyōin</i> ; currently 3,000 – 4,000) is hired on three months contracts that can be renewed for flexibility. Employees from employment agencies (not many) are hired by the individual departments.
	Changing numbers / percentages	At the time of the previous reorganisation, there was an important reduction through the decreased hiring of new graduates.	-
	Mid-career hiring	Strong usage of mid-career hiring (about 50%). No difficulties in finding employees because the firm is respected and considered successful.	Mid-career hiring is quite high (about 50%). No difficulties in finding employees because many people would like to work at firm B. Interviews are used to find suitable candidates. Employees are placed according to experience, based on years of service and an interview.
Internal Flow & Rewards	Different career tracks & their possibilities	After about 7 to 8 years of experience, employees choose between Pro-General (PG) and Pro-Expert (PE). A rather different competence is needed for these courses.	-
	Criteria for evaluation: seniority, ability &/or performance (results)	Performance has received more weight in evaluation rather than a past focus on the 'behaviour towards the job'.	Performance has received more weight in evaluation as posts for promotion have become limited. Attempted to make evaluation clearer and more severe.
	Reason(s) for change	Need to revitalise the firm. The important question is how to motivate people with the right spirit.	-

AUTOMOBILE	Firm A	Firm B
Evaluation forms & procedure	<p>Performance is particularly important in the evaluation of management employees. At this level, four contribution levels are distinguished: (1) start, (2) apply, (3) influence, (4) transform. Within each level, a broad salary band exists. A striking element is the relative character of wages through a salary cap for the department.</p> <p>There is a strong focus on the way individuals can contribute to the achievement of overall management objectives. As a consequence, there is much attention for the communication between boss and subordinates. A good understanding of objectives and a person's role in achieving these is seen as instrumental for a person's motivation.</p> <p>(1) MBO: performance is measured on a one-year basis through achievement of targets and will be reflected in the bonus.  (2) FY2000: Introduction stock option programme for a limited number of employees  (3) Career adviser system: to find likely high performers for strategic projects. Candidates will need a wide view and ability to deal with people.</p> <p>Based on ability as, for instance, determined through the four contribution levels for managers.</p> <p>Based on the achievement of objectives.</p> <p>Based on the contribution levels.</p>	<p>Overall, there is a distinction between younger and senior employees. For the younger employees (3<sup>rd</sup> level), evaluation is based on ability. Moreover, traditional automatic annual wage increases (<i>teikishōkyū</i>) still exists. For the 2<sup>nd</sup> (H) and 1<sup>st</sup> (management) level, evaluation is based on performance. For management employees <i>teikishōkyū</i> has been abolished and downward adjustment of wages would be possible.</p>
Specific new instruments (MBO, <i>nenpōsei</i> , etc.)		<p>A special scheme has been introduced that transfers some of the decision power from boss to subordinates. Employees can propose own projects. This in order to make them consider their individual role and develop their ability.</p>
Wages (criteria for determination & differences)		<p>In the H class, a salary table determines pay. In addition, employees are rewarded marks (A, B, C) for additional payment. However, the differences are still rather limited.</p>
Bonuses (criteria for determination & differences)		<p>Based on another table.</p>
Promotions (criteria for promotion)		<p>Ability is measured in terms of 'specialty for the job'. Depending on a person's specialty, he or she is awarded technical titles and these are the basis for hierarchical functions ('<i>hajimeni shikaku ariki</i>').</p>

AUTOMOBILE		Firm A	Firm B
	Training: OJT, OffJT, other	OJT takes place in the different departments. Additional training programs were cut back in the past but are nowadays considered crucial for the development and motivation of employees. Several new programmes have been initiated: leadership development, management development, firm fundamentals, common business understanding, etc. Open entry system at the operational level: an internal employment agency where employees can apply for jobs in other departments.	Important role for OJT. Within the so-called ' <i>bunkakai</i> ', speciality groups, the requirements for each level and thus requirements for OJT are clearly established.
	Candidacy system		-
	"Diversity management"	'Diversity project': representatives of various functions and backgrounds offer advice on several issues like the combination of work and family life. Mid-career hiring is also supposed to bring diversity: newcomers are asked to 'respect their values, cultivation and speak out to their supervisor'.	More focus on the needs and wishes of the individual. In the past, achievements and speciality were directly linked to promotion but now more differences exist. An employee might for instance want to improve his or her technical capabilities.
	Transition-period	-	The new evaluation scheme was introduced in 2002 but with a four-year adjustment period. Changes were negotiated with the labour union. Moreover, ability has always been important.
	Protection long-term employment	The practice of lifetime employment is honoured.	The practice of lifetime employment is honoured.
Outflow	Reduction number of employees	A few years ago, employment was reduced equally over all departments by 10%. An important means was an early retirement programme for people over 45.	-
	Job rotation	-	Focus on speciality. There is job rotation but usually within one division. For instance, in different companies, in different countries, in different markets but all within human resources. Workers who specialise in instalment, should have experience in door instalment, tire instalment, etc. In particular, management candidates should experience various places and environments.
Work Systems			



AUTOMOBILE		Firm A	Firm B
Outcomes	Ambiguous job descriptions	An exceptionally interesting point is the vague, flexible job descriptions and intentional overall between jobs. At the blue-collar level, this has led to worldwide success through operational flexibility, cross-functional discussion and bottom-up coordination. However, there also tend to be many compromises. In the West, superiors set clear objectives to be implemented by supervisors. Both approaches have their advantages and the firm is currently trying to combine the two directions.	-
	Quality (commitment, competence, & congruence) Cost efficiency	Overall, no real complaints. Because of the high level of mid-career hiring, the quality has suffered a little. These employees need training and this asks a lot from the existing personnel.  -	Overall, no real complaints about the commitment, competence, and congruence of employees.  The need to control the wage costs.

## 7. The Electronics Industry

### **Modularised production and increased competition**

*Introduction. Industry characteristics. Employment practices in the electronics industry. Firm A: background, strategies and competitive outlook. Firm A: changes in human resource management. Similar for firms B, C, D, and E. Concluding remarks. References. Overview changing employment practices.*

#### **Introduction**

This chapter discusses the changes in human resource management (HRM) at five major Japanese electronics firms. Just like the previous chapter, it relates these changes to the specific characteristics and situation of these firms and therefore opens with a discussion of the electronics industry as the firms' direct environment. In addition, it discusses the employment practices that have characterised this industry. The analysis is then specified towards the level of the individual firms. The discussion of each firm is twofold as it presents the firm's characteristics, strategies and competitive outlook before it focuses on the important changes in HRM. In addition, the chapter presents some concluding remarks on the findings and their implications for the employment practices in the electronics industry. It ends with a detailed overview of the changes at the respective firms.

### Industry characteristics

The development and perception of the Japanese electronics industry has, in many respects, been similar to that of the automobile industry. Together, these industries have been Japan's most successful sectors and the core of its export-led post-war economic development. Just as in the automobile industry, firms built a competitive advantage through a combination of high quality, low costs, and short development cycles.

Although the history of the Japanese electronics industry dates back to the early days after the Meiji Restoration, the firms faced a major technological gap with their foreign competitors after the Second World War.<sup>182</sup> 'With few resources in finance, materials, and information readily available, the Japanese industry had to begin another effort to narrow the technological gap. The technological base accumulated before and during the war helped the catch-up process. Yet this was neither easy nor smooth' (Odagiri and Goto, 1996, 156). Given the difficult post-war circumstances, it is not surprising that international successes were rather limited during the 1950s. It was only in the 1960s that Japanese firms developed into serious competitors to their American and European rivals. The growth rates were truly impressive. At first mainly through domestic sales but from the mid-1970s also through exports. Table 7.1 shows the rise in production until 1990. In the meantime, the technological capabilities of Japanese firms developed from relative backwardness to industrial leadership in many market segments.

The factors that contributed to success were various.<sup>183</sup> First of all, they include the general factors that contributed to the success of all Japanese export industries like low labour costs, a committed workforce, low-cost of capital, a ready access to foreign markets, and an undervalued Yen. On the domestic market firms profited from a high income elasticity for their products and the protection from

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<sup>182</sup> The Japanese electronics industry developed from the production of telegraph equipment in the early 1870s under the commission of the Ministry of Industries (Fransman, 1995; Odagiri and Goto, 1996). As the technological lag between Japan and its Western competitors was still rather small in the field of electrical and communications equipment, skilled craftsmen and engineers were able to import products and learn through reverse engineering. However, in spite of some early successes, the new and small Japanese companies found it hard to compete with their foreign competitors and towards the end of the nineteenth century most firms saw no other possibility than some kind of alliance with foreign competitors. Through these alliances, the Japanese firms were able to acquire important technologies and management methods. Moreover, they also invested in own R&D and established their own laboratories. In this way, they were able to narrow the technological gap with their foreign competitors, although 'they had not yet really caught up with the West by the time World War II started' (Odagiri and Goto, 1996, 156).

<sup>183</sup> Maclean *et al.* (2001) provide an elaborate discussion of these factors and this has been a major source for the discussion in this section.

foreign competition through import restrictions, while the strong rivalry between domestic firms contributed to further development of the industry. At the same time, there was ready access to Western technologies, in the early days often through the intermediation by the government.<sup>184</sup>

(Millions of Yen)				
Year	Consumer equipment	Industrial equipment	Components & devices	Total
1960	219,523	42,364	123,241	385,128
1965	331,451	142,979	175,474	649,903
1970	1,438,934	822,248	675,418	2,936,599
1975	1,568,433	1,655,568	1,132,757	4,356,757
1980	2,954,411	3,041,305	2,693,727	8,689,443
1985	4,850,202	7,648,395	6,156,025	18,654,622
1990	4,154,046	11,563,619	8,352,815	24,070,480

**Table 7.1 Japan's electronics production by category 1960-1990<sup>185</sup>**

Source: Recent data are from the Japan Electronics and Information Technology industries Association, [www.jeita.or.jp](http://www.jeita.or.jp); the data for earlier years are calculated on the basis of index numbers as presented by Maclean *et al.* (2001). As a result, the data will show small 'rounding off' differences.

The firms were able to take full advantage of these circumstances by achieving high quality standards, a responsiveness to customer needs, and the ability to adjust to changing circumstances. In this respect, it is also important to point out that the sources of competitive strength changed during the post-war period. Maclean *et al.* (2001) use a 'mountain climbing' metaphor to describe how the Japanese electronics

<sup>184</sup> Early government policies had an indisputable impact on the import of foreign technology. First of all, restrictions on foreign direct investments in the early post-war decades made that foreign firms could only 'access' the Japanese market through joint ventures or by licensing their technologies. Next, the government control of the import of technologies might have hampered the amount of technologies imported but also made sure that the Japanese firms were not played out against one another when they wanted to acquire certain foreign technologies. In later years, the support by the Japanese government became particularly visible through the support to research consortia, albeit with strong differences in success. See, for instance, Callon (1995) and Fransman (1995) for a discussion of these consortia.

<sup>185</sup> The classification of this table is used by the Ministry of Economics, Trade and Industry (METI, previously MITI). However, the electronics industry offers a wide variety of products and different classifications exist for its subdivision. Moreover, the ever continuing developments in the electronics industries tend to blur these segmentations. Nowadays, the Internet is, for instance, seen as an important application that determines which products and technologies are considered complementary and thus a ground for re-categorisation. In addition, developments like megatronics (integration electronics and precision machinery), optronics (electronics and optical technology), or the fusion between electronics and bio-technology all blur the dividing lines (Young, 2004).

industry rose from knowledge dependence to knowledge creation, from a competitive advantage based on costs to one based on technological leadership. 'The powerful upward movement in production and exports...over successive decades may give the impression of a simple yet compelling logic at work...In fact, the industry displayed a remarkable capacity to re-invent itself in the face of cost and market imperatives' (Maclean *et al.*, 2001, 10). Together, all these factors eventually contributed to a 'virtuous circle of growth that saw the Japanese electronics industry go from strength to strength' (Ibid., 13). As a consequence, the Japanese firms had taken a leading role in most fields of the electronics industry by the early 1990s.<sup>186</sup>

In spite of the shared success, there are also some interesting differences with the automobile industry; in particular, concerning the development of specific Japanese management and manufacturing techniques. In the electronics industry, the specific Japanese character has been less outspoken than in the automobile industry. 'Japan's electronics corporations...have broad product lines, decentralised division structures, are vertically integrated into parts-making and subassemblies, and deal at relative arms-length with a larger base of suppliers who participate less in design and development' (Lincoln and Ahmadjian, 2000, 3). Several reasons explain this difference. Most important is probably the modular and standardised character of electronic components. By designing projects according to a so-called 'open architecture', firms can cooperate easier with a large number of (global) suppliers of modular components (Young, 2004). As this enables arms-length contracts with suppliers, it mitigates the need for specific investments and the danger of dependence. At the same time, firms make most of the important components in house as the need for short development cycles makes it difficult to involve outside suppliers. However, these differences with the automobile industry should not be overestimated. Although, in particular, the relations with suppliers differ, plant management is highly similar. This also holds for the importance of the firm-specific skills and its accompanying employment practices.

In contrast to the past success, most Japanese electronics firms have suffered from harsh business conditions in recent years. Table 7.2 shows how production has plummeted in recent years and is currently far below that of the early and late 1990s.

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<sup>186</sup> However, the Japanese firms have not been successful in all segments of the electronics market. A well-known exception is software development, in which they have always compared unfavourable with US competitors (Shimada, 1997).

**(Millions of Yen)**

<b>Year</b>	<b>Consumer equipment</b>	<b>Industrial equipment</b>	<b>Components &amp; devices</b>	<b>Total</b>
1990	4,154,046	11,563,619	8,352,815	24,070,480
1991	4,449,640	11,945,104	8,864,562	25,259,307
1992	3,468,644	10,728,313	7,931,590	22,228,547
1993	3,062,053	10,032,922	7,914,490	21,009,465
1994	2,775,752	10,272,168	8,526,935	21,574,854
1995	2,440,013	10,738,311	9,559,375	22,737,698
1996	2,211,660	12,563,235	9,576,049	24,350,943
1997	2,241,572	13,432,656	10,196,495	25,870,723
1998	2,118,905	11,876,304	9,453,688	23,448,897
1999	2,040,654	11,497,587	10,012,487	23,550,728
2000	2,196,544	12,244,310	11,758,716	26,199,580
2001	1,884,878	10,914,178	9,078,885	21,877,941
2002	1,973,782	8,113,750	8,749,737	18,837,269
2003	2,313,147	7,800,587	9,182,322	19,296,056

**Table 7.2 Japan's electronics production by category 1990-2003**

Source: Japan Electronics and Information Technology Industries Association,  
[www.jeita.or.jp](http://www.jeita.or.jp)

A first problem is the worldwide slump that was initiated by the 'burst' of the internet bubble. On the Japanese markets, there is also the well-known problem of an overall weak demand. Moreover, the problems run deeper as the industry faces important structural changes. More than any other industry, the electronics industry has dispersed over Asia.<sup>187</sup> In particular the domestic production of consumer electronics has suffered from the shift of manufacturing to Asia. In accordance, Japan's share of the global market has shrunk from 18.6 per cent in 1998 to 15.7 per cent in 2002. Striking is the rise of the Chinese electronics industry, whose share of the global market has risen from 4.7 to 10.1 per cent in the same period and is expected to surpass the Japan electronics industry within a few years (Young, 2004). The Japanese firms have actually played a major role in this development. From the mid 1980s, rising costs prompted Japanese firms to transfer their manufacturing operations to first the newly industrialised economies of Asia (Korea, Taiwan, Hong Kong, Singapore) and later to ASEAN countries and, nowadays, predominantly

<sup>187</sup> A good example is the Japanese position in the semiconductor industry. In the early 1990s, Japanese firms (NEC, Toshiba, Hitachi, Fujitsu, Mitsubishi Electric, and Matsushita Electric Industrial) featured among the ten largest semiconductor manufacturers in the world. However, Asian competitors have basically taken over this market (Fransman, 1995).

China.<sup>188</sup> In many ways this can be considered a natural consequence of the developments as they have taken place in the preceding decades. Current wage levels make it no longer possible to produce domestically against low costs and the Japanese firms are forced to concentrate on advanced products, while shifting their relatively simple manufacturing activities to lower cost countries in Asia or leaving the production of these products to so-called 'Electronic Manufacturing Services' (EMS) companies. The discussion of the case studies will show how they attempt to do so and the consequences these attempts hold for human resource management.

### **Employment practices in the electronics industry**

The employment practices in the electronics industry also functions according to the productive logic that was discussed in chapter four. The skills and commitment of employees appear to have been equally important as in the automobile industry. Odagiri and Goto (1996), for instance, point out the important role of production workers in *kaizen*, improvements in the production process. Moreover, the contingencies as discussed in chapter four are to a large extent fulfilled and it can be no surprise that Dyer (1996, 650) includes the electronics industry among the 'complex industries', characterised by 'a large number of components, functions, and process steps'. However, there also appear some differences with the automobile industry. First of all, the training horizon in the electronics industry, in particular concerning manufacturing, appears shorter than that in the automobile industry. Moreover, the high level of modularisation diminishes the stochastic and technological interdependencies among tasks; or more precisely, these interdependencies can be 'standardised'. This diminishes the possible advantages offered by the horizontal hierarchy, the organisational mode described in chapter four, and makes the electronic firms more inclined to hire non-regular employees.<sup>189</sup>

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<sup>188</sup> China has become a very attractive location for electronics manufacturing because its low costs, its capability to handle relatively advanced electronic manufacturing technologies and, as an important extra, its potentially huge and fast growing market. In particular since 2000 there has been a new boom in Japanese investments in China, with the electronics industry responsible for a large percentage (30 per cent in 2000) of these investments (JETRO, 2002). As we will see in the remainder of this chapter, all firms discussed are extending their presence in China.

<sup>189</sup> Stochastic (risk) and technological interdependencies mean that events in one stage of the production process have their implications for other stages. In this case, the direct and rich coordination through the horizontal hierarchy can be very successful. However modularisation diminishes the interdependencies and thus the need for coordination. See chapter four for an elaborate discussion of these issues.

### **Firm A: background, strategies and competitive outlook**

Firm A has a history of about 70 years. It started with the production of photo cameras but has successfully diversified into copying machines, computer peripherals, business systems, and optical products. The firm is known for its global and innovative character. US and European branch offices were already opened in the 1950s and, nowadays, the firm's activities are truly global with over 70 per cent of sales outside Japan. In addition, successful innovations have been a consistent source behind its past entrance into new markets and, for over a decade, the firm has been among the top in receiving US patents.

The firm's strategies in recent years have been formulated as two phases of a global business plan. The first phase ran from 1996 to 2001 and aimed to improve the firm's financial condition through better group management, widespread cost reductions, and more competitive products. Important strategies included the implementation of wide-ranging management reforms. Moreover, all business activities were re-evaluated with an emphasis on profitability until no unprofitable businesses were left. In 2001, phase two was initiated with the goal to continue reforms while further expanding the business and improving profitability. The major objective is to achieve the worldwide No. 1 position in all core business areas. However, increased sales should not be achieved at the expense of decreased profitability. Strategies to achieve this objective include production reforms, cost reductions, reforms in the global sales and marketing structures, and improvements in manufacturing and R&D.<sup>190</sup>

Despite the weak electronics market, the firm has shown very good results with growing sales for several product categories. Moreover, management and manufacturing reforms have strongly contributed to overall efficiency and the firm has achieved an almost persistent growth in net income during the past decade. Likewise, the number of employees has also grown consistently. Because of these results, the technological capabilities, the huge number of patents, and the strong

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<sup>190</sup> An important manufacturing reform concerns the shift from conveyor belts to a cell production system at almost all of the firm's global manufacturing facilities. Under the cell production method, groups of several employees, and sometimes even a single employee, undertake the entire production process in specially designed areas called 'cells'. This method removes conveyor belts from plants, contributes to a more efficient use of space, and increases efficiency. This resulted in the removal of 20 kilometres of conveyor belts, the clearance of 17,000m<sup>2</sup> of floor space, and a reduction in labour costs equivalent to the work of 8,000 employees. In addition, the firm has also introduced a so-called 'Expert System' in 2000. Experts are employees who possess a wide variety of skills and are capable to adapt rapidly to new production orders. To achieve the rank of expert, employees must be able to handle every facet of the production process.



global presence, the firm is in a very strong position and can look confidently towards the future.

### **Firm A: changes in human resource management**

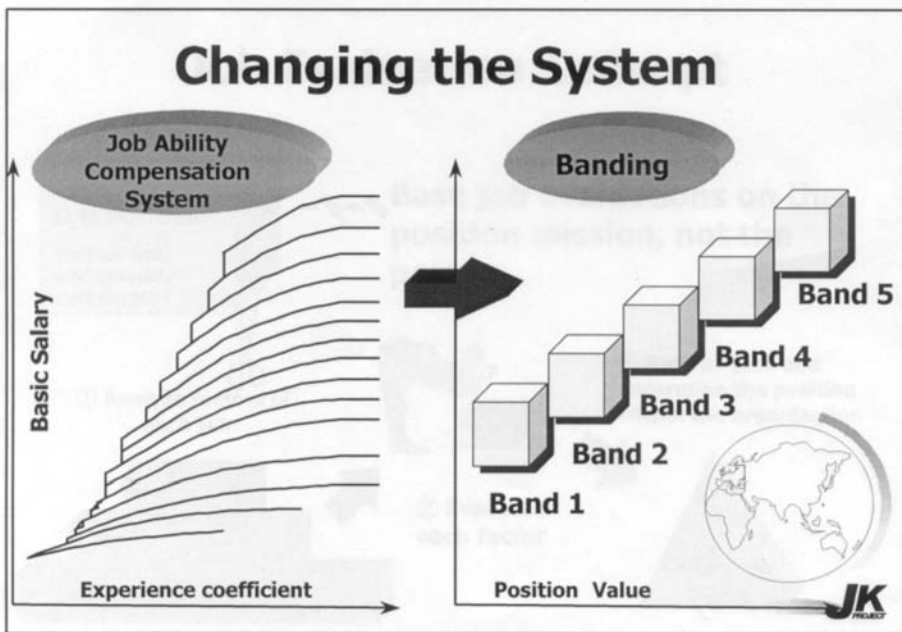
The major issue in human resource management concerns manufacturing as the need to relocate manufacturing activities to Asia requires a reduction of blue-collar employment in Japan. However, this reduction has been rather smooth as the firm already stopped hiring regular employees for manufacturing in the mid 1980s. Instead, the firm hired employees on short-term contracts and through so-called ‘internal contractors’ (*ukeoi* or *kōnai ukeoi*). Under an *ukeoi*-arrangement, subcontracting companies send their workers to the outsourcing company rather than have the work performed at their own facilities.<sup>191</sup> Moreover, in some cases, regular manufacturing employees have been retrained for other functions like software development. Finally, the adjustment has obviously been eased by the growing sales in recent years. Overall, there is an extensive use of non-regular employees. About 25 per cent of employees is *ukeoi*, about 5 per cent are temporary workers. Recently, some contract workers have even been hired for R&D positions. These employees create numerical flexibility and provide an important buffer that protects the (lifetime) employment of regular employees.<sup>192</sup>

The most important change in human resource management concerns the adaptation of the evaluation system in 2002 towards a so-called ‘job-based system’ (*shokumūkyū*) in order to increase global competitiveness. Moreover, the need was felt to differentiate between good and weak performers as foreign competitors on the Japanese markets tend to offer higher wages to good performers and the firm is in danger of losing these employees. The former system was based on experience but this had a strong correlation to age and in spite being named a ‘job ability qualification system’, it could be considered a seniority-based ability system. *Teikishōkyū*, the regular annual rise in pay, also existed. Under the new job-based system, different bands of positions are distinguished, all with a lower and upper limit of pay. The bonuses are included among these bands. Figure 7.1 gives an overview of this change.<sup>193</sup>

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<sup>191</sup> This form of dispatching was considered an answer to the prohibition against hiring employees from temporary work agencies in manufacturing. The *ukeoi*-type of dispatching was also considered illegal but could exist because of lax enforcement of regulations (Imai, 2003).

<sup>192</sup> The firm explicitly commits to lifetime employment because it considers this a necessity in the absence of a well-functioning (external) labour market.



**Figure 7.1 Changing the system**

Specific job descriptions do not exist but the requirements for positions are sketched in general terms. Each position is ascribed to a certain band through its rating on a variety of factors like the scope of responsibilities, knowledge and experience needed, the impact on company profits, the position within the organisational structure, and the number of subordinates. An important distinction exists between management and non-management employees. For the non-management employees, so-called 'job group bands' are distinguished, for management employees 'management mission bands'. Figure 7.2 gives an overview of these bands.

The job group bands (E, J1, J2, J3, and J4) are still training- and ability-oriented.<sup>193</sup> For these positions, evaluation is based on a combination of ability-related and job/performance-related factors. MBO is crucial in the evaluation of

<sup>193</sup> A transfer period was introduced to enable a soft landing for older employees. Because of good profitability it has been possible to refrain from wage cuts. As a matter of fact, employees did understand that the firm needs to make adjustments to remain competitive in the future.

<sup>194</sup> The focus on training is considered a necessity under the existing social infrastructure of a freshman-employment culture. Several forms of training have been developed for the different levels. OffJT-training is often seen as a necessary addition to OTJ-training. Job rotation is particularly important for managers as they need to experience different business areas and/or have experience overseas. Even R&D employees are sent overseas to learn foreign management styles and develop intercultural understanding.

performance with three objectives for each employee. The objectives are sometimes formulated to fall outside a position's specific scope in order to prevent the objectives from distorting overall performance. The impact of ability and performance (including MBO) is dependent on the specific band. For band E, the build-up of pay is as follows: 10 per cent MBO, 40 per cent for overall job achievement, and 50 per cent for matters like capability, manners, work ethics, understanding of company culture. For band J2, the percentages are respectively 20, 40, and 40 per cent. For management employees (management mission bands M1 to M5), pay is fully determined by job/performance-related factors. Once employees reach this level, they are considered (fully) trained and evaluation based solely on achievement is therefore considered fair. With this new system, the wage differences have increased. For instance, in the case of a 35 year old engineer, possible differences have increased from 10-20 to 30-40 per cent. In the early stages of careers, there is not much difference but after several years, differences in pay can become quite substantial. Employees can also become manager at a younger age. However, as ability and training still play a major role during the first stages of a career, a substantial minimum age persists.<sup>195</sup>

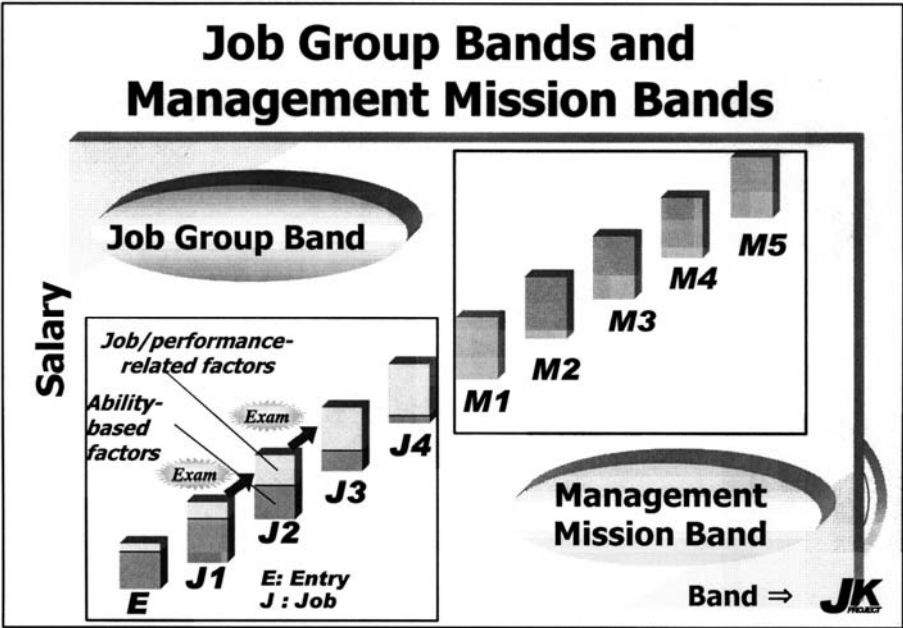


Figure 7.2 Job group bands and management mission bands

<sup>195</sup> Engineers are also awarded management mission bands after a certain level even if they do not work as manager but chose for an alternative career track as high quality specialist.

Another development concerns a rise in mid-career hiring, in particularly among engineers as their specialist knowledge makes it relatively easy to adapt to their new firm. Corporate culture is important but, for engineers, it is not essential. Nevertheless, mid-career hiring still mainly concerns relatively young employees as they can still adjust to the firm's R&D style. When the firm enters a new field, outsiders are sometimes hired as manager. As a matter of fact, the weak economy has contributed to the availability of mid-career candidates; also from 'leading' companies. However, in spite of these developments, mid-career hiring still remains limited and the 2002 annual report still states rather proudly that the board members have all been with the firm for 30 years or more. At the same time, the outflow of mid-career employees has so far been mainly limited to a few employees that have left for (foreign) firms with a 'more exciting wage structure'.

### **Firm B: background, strategies and competitive outlook**

Firm B, whose origin dates back over a hundred years, is a global supplier of systems, components, services and integrated solutions for computing and communication applications, 'encompassing everything from software to operation and maintenance services'. Important products include computer hardware and software, systems integration services, network infrastructures, and communication equipment like mobile phones.

In recent years, the firm has faced very difficult circumstances. Some segments performed reasonably well but overall performance was weak as many of the firm's major markets deteriorated. Moreover, the firm suffered from strong competition by Asian Electronics Manufacturing Services (EMS), which often show superior cost competitiveness. In particular the cost advantages of Chinese companies have been striking. As a consequence, sales have declined and net income has been small or negative in recent years. The firm has answered to these difficulties by various attempts to restructure and reorganise its business. An important example is the decision to dispose of its semiconductor business. Other businesses have also been liquidated or sold and production activities have been outsourced to EMS companies in China. To improve innovative strength, the firm has established several joint ventures with other high capability firms. In addition, it has taken various actions to improve efficiency. An example concerns the improvements in procurement like a decline in the number of suppliers, the procurement from overseas suppliers, and the design for standardised components. The seriousness of the situation is reflected by the character of the changes, as many of the firm's strategies can be considered rather reactive and we do not see clear three- or five-year plans as at many other firms. At the same time, the firm still has

its strong markets and good technological and innovative capabilities, which can be a source of regained competitive success.

### **Firm B: changes in human resource management**

The major issue in human resource management for firm B is directly related to the high cost of domestic manufacturing in comparison to its foreign (Chinese) competitors. The adjustments needed have led to an excess of employees and the firm has used various strategies to reduce the number of employees. These strategies include natural attrition through a reduced hiring of new graduates (about 1,500 new employees versus about 3,500 natural retirees), early retirement with additional *taishokukin* (about 10,000 employees), and the transfer of employees to more profitable business units through retraining. Finally, entire plants have been sold 'including' employees to EMS companies under a clause that the quality of the working conditions will not be lowered.

In addition, the firm has also changed its overall HRM system in 2000 to inspire and challenge employees to change their consciousness and activities. Overall, four different career perspectives are distinguished. The employees belonging to the enterprise union (this category is almost equal to that of non-management employees) are divided over three classes. Class A is the future manager class, university graduates who are likely to achieve a management position and can have global careers. The B class also concerns white-collar employees but they are clerks and secretaries that remain in one branch, in one area. The C class concerns physical labour. Finally, the system also distinguishes a D class, a rest-category for employees whose evaluation falls outside the general rules. These employees (known as *shokutaku*) prefer to be paid for their specialist skills and have a closed-term contract. Table 7.3 gives an overview of the different classes and their grades.

Each class has its own, precisely set criteria for evaluation and promotion.<sup>196</sup> The actions and skills that are important for each position are named 'practise'. For each role / function a 'conduct-standards-document' known as 'practise file' has been set that describes the skills ('competencies') for that specific function and evaluation is based on the achievement of the requirements as they are set for that specific file. This then determines the ranking of an employee. As a matter of fact, two different forms exist. Common for all union employees is the so-

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<sup>196</sup> Within the A category, three levels or grades are distinguished. All new people are put in the 3<sup>rd</sup> grade. People can be promoted if they fulfil the requirements of their category. Promotion from the 3<sup>rd</sup> to the 2<sup>nd</sup> grade is relatively easy. Promotion to the 1<sup>st</sup> grade is more difficult. It is not just a matter of fulfilling absolute requirements but also selection (relative evaluation).



Japanese context.<sup>197</sup> An important advantage of these changes is that motivation has become less dependent on promotion. Employees can now be motivated through ‘pay for performance’, something particularly useful as the lack of organisational growth has strongly limited the possibilities for promotion.<sup>198,199</sup>

Finally, concerning the diversification of employment types and the rise in mid-career hiring, the developments at firm B have been modest. However, for the important group of system engineers, evaluation has been adapted to their specific capabilities. Through the introduction of a so-called ‘inner standard of qualification’, these employees are now evaluated for their specialist knowledge and can substantially raise their wages without having a management career. Mid-career hiring takes place for new business fields but is almost non-existent for the firm’s core activities and actual mid-career hiring is relatively rare (less than a hundred employees a year), just as the loss of employees through mid-career hiring.

### **Firm C: background, strategies and competitive outlook**

Firm C was established about 90 years ago and is a world-leading manufacturer of industrial instruments. Major product areas are industrial automation and control, test and measurement equipment, and information systems. In 2000, the firm decided to transform its business structure and revitalise group management in the understanding that reductions in income and earnings were not only cyclical but also attributable to structural industry changes. Several actions were taken to achieve these objectives. A first example is the consolidation and realignment of the firm’s manufacturing companies. Just like the other electronics firms, production has been shifted towards China and other Asian countries. As a consequence, the firm has decided to select four of its almost 20 domestic production facilities for high value-added production and close the others. Moreover, personnel has been shifted from so-called ‘back-office operations’ to direct business operations such as sales, services, and manufacturing. Finally, the development of new products is stressed as a means to expand. An example is the expansion of the firm’s EMS and original design manufacturing (ODM) business for products that require the sophisticated manufacturing techniques in which the firm excels.

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<sup>197</sup> The interviewees actually referred to one of their competitors where the introduction of rather drastic changes led to a distortion of work processes, as employees gave insufficient attention to those tasks that were not explicitly included in the evaluation of performance.

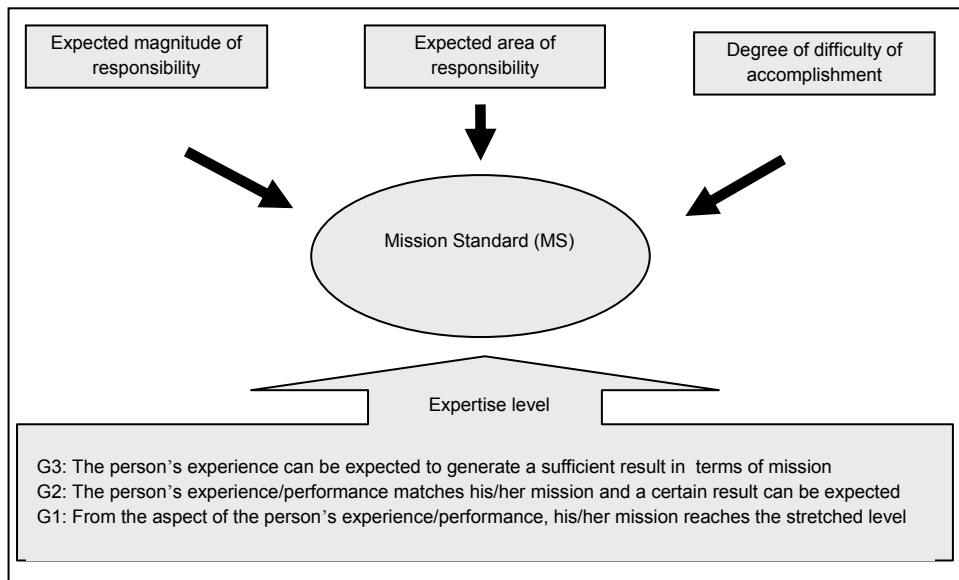
<sup>198</sup> The interviewees jokingly referred to departments that were previously ‘crowded’ with *kachō* and *buchō*.

<sup>199</sup> Motivation is further strengthened by the possibility for employees to apply for other jobs within the firm. This system was already introduced about ten years ago and is open for all employees.

In spite of these actions, financial results have been weak. Sales have stalled and net income has been low or negative. Besides an overall industry recovery, much will depend on the cost reductions and efficiency gains that can be achieved through the strategies for reorganisation. At the same time, some successful markets exist. Moreover, as a world-leading manufacturer the firm remains a well-respected and trusted company, known for its technological prowess and engineering capabilities.

### Firm C: changes in human resource management

A major part of the actions to improve firm performance has been the introduction of a new evaluation and compensation system for management employees that 'rewards management personnel in a manner commensurate with their value-added contributions'.<sup>200</sup> The new system is based on so-called 'mission standards' (MS), which reflect the value added, the contribution to the firm. The size of a mission ascribed to a position determines the salary level. The basic system is described in figure 7.3.



**Figure 7.3** The new 'mission standard' evaluation system

Three issues determine a position's mission standard: the expected magnitude of responsibility, the expected area of responsibility, and the difficulty of

<sup>200</sup> For union employees the previous system has been maintained.



accomplishment.<sup>201</sup> One additional consideration is the ability of the person who holds the position, for which three levels (G1 to G3) are distinguished. Overall, each person is thus ascribed a mission standard that belongs to his or her position and a grade that belongs to his or her individual ability in the performance of the work that comes with this position. This combination of mission standard and grade will determine basic pay.<sup>202</sup>

In addition, part of a person's remuneration is based on actual achievements. Figure 7.4 gives an overview of the process by which this part of pay is determined.

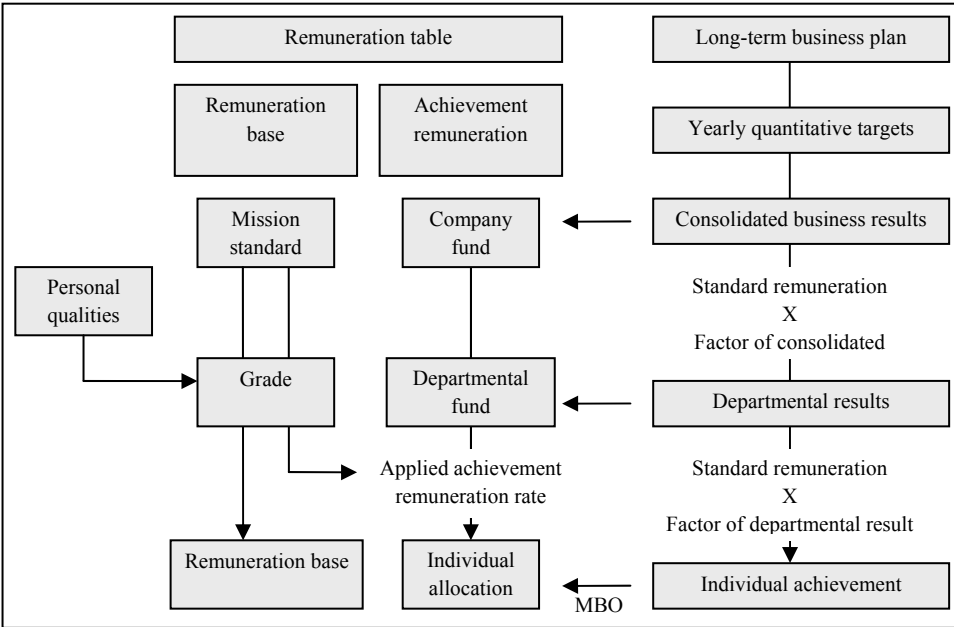


Figure 7.4 The remuneration of achievements

<sup>201</sup> As a consequence, two hierarchically similar positions may have a different mission standard. For example, a position in a planning department might be ascribed a higher mission standard than a similar position in a manufacturing department because the latter has a more repetitive character and the first has a stronger impact on company results.

<sup>202</sup> Several actions have been taken to smoothen the introduction of the new system. A consultancy firm was hired to define the different mission standards on the basis of the three criteria mentioned before. Moreover, their definitions were not accepted without discussion and some departments achieved an increase of mission standard after an appeal to the human resource department or the president. After half a year, there was a mission standard re-evaluation. Another strategy to smoothen the transition has been the decision to keep the mission standards of the different positions secret to the other employees. In principle, it was felt that the standards should be open to further stimulate efficient behaviour, but management was not yet convinced that this was already possible.

First, the overall funds available are determined by a comparison of the consolidated business result to the targets as set in the firm's long-term business plans. A similar process applies for the inclusion of department results. Based on these results, a company-wide and department fund is determined and these funds are allocated over the individuals based on the mission standard of their positions and their individual achievements; the latter is determined according to personal objectives that are set by a MBO system. The achievement-based payment takes place through the bi-annual bonuses and the differences can be quite substantial. The bonus varies between 1.5 times the standard if goals have been achieved (upper limit) to 0.25 times the standard in the case of deficit (lower limit). Finally, the overall evaluation will also be the ground for promotions.<sup>203</sup>

Various reasons have inspired these changes in the evaluation and wage system. First of all, it was considered a matter of fairness as the new system rewards those employees that really contribute to the organisation. In addition, the new system is expected 'to well treat, nurture and manage people (human resources) who are able to take action in order to win competition in the midst of drastic changes of the external environment, to truly actualise a healthy and profitable management' (from one of firm C's internal publications). Finally, the system enables the firm to bring overall wage costs in line with company performance. It was explicitly acknowledged that under the former system, which predominantly rewarded employees on the basis of their ability, wages could deviate from market values. But by the assignment of mission standards, employees hold their hierarchical titles while they can be rewarded according to their actual contribution to the organisation.

Once again, the changes in the other areas of HRM are rather modest in comparison to these changes in the evaluation and remuneration of employees. We see the replacement of certain regular employees by other types of employees, like part-timers for relatively simple manufacturing work and an increased use of 'outsourcing'. Mid-career hiring exists but only if the need for certain professional skills exists. The overall policy is to limit such hiring as there is an excess of employees.<sup>204</sup> Because of the circumstances on the labour market, it is relatively

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<sup>203</sup> Seniority has been completely removed as a ground for evaluation. However, the interviewee also acknowledged that (and this would be particularly relevant for the non-management employees who are still evaluated according to an ability qualification system) seniority still has an informal impact in Japan. 'The basic notion that qualification rises with age is still present and used widely in Japanese companies. At [this firm] such a basic notion also still exists.'

<sup>204</sup> The closure of domestic manufacturing operations has led to many redundant employees but the practice of lifetime employment is being honoured. *Shukkō* takes place within the consolidated group (also for training purposes). For employees between 45 and 58 years that move outside the group, assistance is provided through a so-called 'second life plan'.

easy to find good candidates. Even though there are no well-defined job descriptions (these are set on a half-year basis), there do not seem to be much adjustment problems. It is expected that newcomers adapt to the firm's culture and usually there are no problems in this respect. Finally, there has also been a paradigm shift in training. Nowadays, besides the direct OJT, emphasis is on MBO training and 'career plan' training, in which the individual sets his or her own objectives for training. Actual training is thus very much the responsibility of the individual employee, who also bears most of the costs.

### **Firm D: background, strategies and competitive outlook**

Firm D has a history of over about 65 years but its beginnings can actually be traced back all the way to the beginning of the Japanese electronics industry. Nowadays, the firm is one of the largest comprehensive electrical machinery manufacturers, whose products include information and communication systems, social infrastructure systems (supporting such systems as water supply), power systems (power generating equipment), digital media, home appliances, and medical systems. Since 1999, activities are divided over ten in-house companies with the autonomy to develop the business strategies and operating style that best suit their market.

In 2001, the firm formulated a new 'action plan' to enhance performance. An important element was the introduction of a new method to measure the value created by comparing results against the cost of capital invested. A downward trend in the value created results in additional monitoring and improvement measures and if the trend still continues, the business becomes a 'selected business', making it a candidate for a merger, joint-venture or even withdrawal. The instrument has already led to several decisions, including the withdrawal from the commodity DRAM business and the participation in various joint-ventures. Other important strategies included a decrease in procurement costs by 20 per cent and a reduction of assets to improve the firm's financial position.

In spite of these actions, the financial results have been meagre in recent years and the firm had its first ever operating loss.<sup>205</sup> The firm acknowledges that it cannot match the cost competitiveness of some of its Asian competitors. In this respect, there is no other solution than to use the overseas companies through EMS-production and build own facilities in these low-cost areas. At the same time, there is the remaining strength in product creation, including applications and software. Moreover, the firm tries to strengthen its innovative capabilities, both through a

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<sup>205</sup> A large part of this loss actually concerned the costs for restructuring and a one-off voluntary early retirement programme.

reorganisation of its own R&D and through joint ventures with other high capability firms.

### Firm D: changes in human resource management

Firm D also felt compelled to make employment adjustments in response to the difficult industry circumstances. The 2001 action plan asked for a reduction in the workforce by 10 per cent. This was achieved by use of outplacement and financial support for early retirement. 10,000 employees were transferred within the group, early retirement support was offered to 8,000 employees. 'Job change training' exists to enable the reallocation of employees. The subsequent objective was to maintain the number of core employees while enhancing the flexibility of the workforce by an increased use of outsourcing, temporaries and *shokutaku* (2, 3 year contracts). Until recently the majority (about 90 per cent) of employees was regular and this is why change is needed. In accordance, yearly hiring had decreased to 1,000 from somewhere between 2,000 and 3,000 employees in the past.

In addition, firm D has also changed its system for evaluation. An important distinction is made between ability and performance. Salary is based on ability, bonuses on performance. Performance is measured through MBO by a form that is presented in table 7.4.

Organisation / Division Objectives							
Objectives	Weight	Assignment / Task (task – deadline – metric – process)	Evaluation Comments		Level of difficulty	Level of achiev.	
	%		EE.		Pts.	Pts.	
			Mgr.		Pts.	Pts.	
					Pts.	Pts.	
			EE.		Pts.	Pts.	
			Mgr.		Pts.	Pts.	
			EE.		Pts.	Pts.	
			Mgr.		Pts.	Pts.	
			EE.		Pts.	Pts.	
			Mgr.		Pts.	Pts.	
			EE.		Pts.	Pts.	
			Mgr.		Pts.	Pts.	
			EE.		Pts.	Pts.	
			Mgr.		Pts.	Pts.	
		Employee Self-evaluation			Evaluation by the manager		
Total Score		Difficulty	Achievement	Total	Difficulty	Achievement	Total (a)
		pts. *	pts. =	pts.	pts. *	pts. =	Pts.

**Table 7.4 MBO Evaluation form**

Twice a year (April and October), five assignments or tasks are set by the supervisor. The (kinds of) objectives that are set depend on the division, function and person. However, it can probably be said that for younger employees, the objectives are more oriented towards training, while those for older employees will be more result-oriented.<sup>206</sup> The weight of each task is expressed as a percentage.

Afterwards both the employee and his/her superior evaluate the results in terms of the level of difficulty and the level achievement. Both are expressed on a five point scale as defined in tables 7.5 and 7.6. The points are then counted and multiplied. Moreover, the employee can earn two additional points. One for other significant achievements and one for work effectiveness (half points can be awarded). The overall score will then determine ability rating, salary increases, and bonuses. In the case of promotions, the expectation if the person can do the new job is decisive. Finally, this evaluation process is complemented by two tables in which the employee's achievement of objectives is recorded on a monthly basis.

Level	Description
5	An objective that is considered difficult for the manager of the individual
4	An objective that is considered adequate for the manager of the individual
3	An objective that is considered difficult but achievable by the individual
2	An objective that is adequate for the individual's position, achievable on his/her job
1	An objective that is easy to achieve for the individual

**Table 7.5 Guidelines for the rating of difficulty (the rating should reflect both the quality an quantity of each objective)**

Level	Description
5	Employee meets the task objectives and exhibits exceptional performance.
4	Employee meets the task objectives and significantly exceeds expectations for his/her job
3	Employee meets the task objectives and exceeds the expectations for his/her job
2	Employee exhibits standard performance; meets the expectations for his/her job
1	Employee did not achieve all objectives
0	Employee did not achieve any objectives

**Table 7.6 Guidelines for the rating of achievement and results**

The band for differences in bonus has been set explicitly and is quite substantial. For managers and above, high performers will enjoy 2 times the bonus of low performers; for the non-management positions, high performers will enjoy 1.75

<sup>206</sup> There had not been any problems that employees focus solely on these explicit objectives, thereby harming overall performance. This obviously depends on the kinds of objectives that are set.

times the annual bonus of low performers. Because both bonuses and promotions are based on individual performance, this new scheme is expected to provide stronger incentives.<sup>207</sup>

Concerning the diversification of employment developments are modest. There is a distinction between blue- and white-collar employees but no further distinction among white-collar employees. An internal job posting system allows employees to change positions on their own initiative.<sup>208</sup> Concerning mid-career hiring, the developments have been quite substantive. It was started about 10 years ago and has become rather common. About 400 of the 1,000 employees hired every year are hired mid-career. There were no problems known about employees that did not fit in. Moreover, the number of employees leaving is also very low.<sup>209</sup>

A final issue is the invigoration of training to further the capabilities of employees. Overall, both OJT and OffJT exist. Moreover, additional training programmes have been developed for each level; other programmes are directed at specific topics like internationalisation and business skills. In particular the training for higher managers and specialists has been strengthened. These elaborate programmes for later stages of people's career were considered necessary because, when people move through the ranks, technology becomes more specific and specific training is needed. Such specific training will often be the responsibility of the in-house companies. Job rotation does exist but not necessarily for all employees. It exists for management people in order to achieve broad knowledge and flexibility of mind. However, such rotation tends to take place within one field like, for instance, human resource management. For technical employees, training focuses on the knowledge of specific technological aspects. These employees should be able to focus on their research and job rotation plays a rather limited role. If it does happen, it is usually because the employee's expertise is needed or because businesses are reorganised. Finally, training is documented through a so-called 'CDP', a Career Development Program Card. On this form, last year's assignments are filled in by

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<sup>207</sup> Overall, the changes have been accepted with relative ease. Many employees share the conviction that those people who show better performance should receive higher wages. Even senior employees, who might feel cheated because they were expecting high seniority wages, know that Japan has to change. Moreover, the interviewees also acknowledged that seniority still plays a role.

<sup>208</sup> Interestingly, the problem of an unbalanced workforce was not really felt. According to the interviewees, employees can have enough responsibilities even if they are not hired as manager.

<sup>209</sup> However, the interviewees did confirm the trend towards job hopping. In the future, people will more easily change companies. This does not necessarily mean the end of lifetime employment. One interviewee believed that companies see the importance of lifetime employment but, at the same time, people have the possibility to change employer.

the employee. In addition, the manager draws up a three-year career plan with the accompanying training requirements.

### **Firm E: background, strategies and competitive outlook**

Firm E is a comprehensive electronics manufacturer with a history of about 65 years. Besides a wide variety of electronic components and peripheral computer products, the firm also produces various types of car electronics, good for over one third of total sales. In response to the structural changes in the industry, the firm has strengthened its focus on innovation and globalisation. In the case of innovation, several technologies, like nano-processing and radio-frequency technologies, are considered crucial. In addition, the firm has also tried to promote a technological mindset throughout the company; not just in technological but also in marketing, manufacturing and administration departments. Concerning the issue of globalisation, firm E wants to develop, manufacture, and sell wherever there is a market for its products. This means true embeddedness in the countries in which it operates and not a mere search for the lowest labour costs.

In addition, the firm has also implemented various structural reforms and cost-improvements in recent years. Examples include the reduction in the number of business divisions, the establishment of business unit sales departments to quickly identify customer needs, and the establishment of a business development headquarters to identify technological trends and to accelerate the rate of technological development and the introduction of new products. As a consequence, the firm has avoided an operating loss in spite of the difficult circumstances. Finally, the future outlook can probably be best summarised by the opposite forces of competition from China versus the possession of several successful and highly innovative products.

### **Firm E: changes in human resource management**

Firm E shows a similar dual focus as most other firms in electronics, combining a reduction in employment with an increased role for performance in evaluation. The excess in employment is particularly felt among the employees who operate the machines and among divisions whose products can be better produced in China. The reduction of employment has been mainly achieved through reduced hiring for manufacturing positions and 'voluntary retirement' (*kibō taishoku*), a one-time offer of early retirement in 2000 which was accepted by about 1,000 employees.

At the basis of the new employment system lies a distinction between two different employment tracks, *kikakushokugun* and *jitsuinshokugun*.<sup>210</sup> The tracks are similar to respectively the *sōgōshoku* and *ippanshoku* employment tracks as discussed in chapter five. The first track is for graduates from universities and technical colleges, the second track is for graduates from junior colleges and (junior) high schools.<sup>211</sup> For the employees in the *kikakushokugun* track, MBO has been introduced in recent years. In principle, ability is still evaluated through a 'traditional' ability qualification system with documented standards for the various qualifications and pay rises in case of a promotion to a higher rank.<sup>212</sup> However, this system has been enriched by the inclusion of an MBO system, which can be considered as one item of the ability qualification system. One advantage of this inclusion is that the use of MBO-objectives has not distorted the employee's overall contribution. The impact of MBO differs with the ability-level. At the highest level (one step before management), it could be the basis for half the pay.

Similar changes have been made in the evaluation of management employees. For ranks of (middle) management and higher, including the employees in the specialist (*senmonshoku*) track, a *nenpōsei* system has been introduced. At the beginning of the year objectives are set and the employees are evaluated on their achievement of these objectives.<sup>213</sup> However, even in the *nenpōsei* system, five ranks are distinguished and an individual's pay is based on the qualification he or she has plus the individual performance. Nevertheless, the performance part has a large impact on pay.

As innovation is considered crucial, the firm has renewed its commitment to the training of creative, capable employees. A strong focus is on creating an interesting manufacturing environment. Young employees are given the responsibility to actively take part in the business rather than just do what their

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<sup>210</sup> A major innovation in HRM was already introduced in 1993; also in response to the weakened performance under the globalisation of competition. At that time focus shifted from potential to apparent ability. According to the interviewee, it was already quite close to performance-based pay.

<sup>211</sup> In later years, most employees of the *kikakushokugun* move to the subsequent ladder of 'basic management work' (*keiei-kinka-shokugun*). Within this category, two further types of work are distinguished: 'management-work' (*kanrishoku*) and 'specialist-work' (*senmonshoku*).

<sup>212</sup> Twice a year, the superior evaluates an employee. The employee also fills in a self-evaluation form. Afterwards there is an alignment-interview between employee and superior. Next is a meeting between the direct superior and his superiors. Finally, there is a feedback interview between employee and direct supervisor. From time to time, there is also horizontal evaluation where superiors from other departments evaluate the employee. This evaluation is considered additional and has been introduced to reflect that an employee usually has contact with other departments during his daily work.

<sup>213</sup> The evaluation process is very similar to that of the non-management employees.



superior tells them to. OJT is still central for the training of (specialist) knowledge and skills but OffJT also takes place and an important trend is the co-operation with universities. There is joint research with universities and employees are also sent to university laboratories. Finally, there are also some developments in the use of non-regular employees. Besides regular employees, the firm hires employees with a closed-term contract (*teikishain*) and employees hired for special skills (*shokutaku*). At the offices, there are also many temporary employees from employment agencies. Overall, the ratio of regular employees has decreased and at the time of the interview about one-third of employees was non-regular.<sup>214</sup>

### Concluding remarks

The situation of the Japanese electronics firms is characterised by a weak market and strong competition from Asia where firms achieve substantial cost-advantages in comparison to Japanese domestic production. As a consequence, almost all the firms investigated, with firm A as the exception, have seen their financial results decrease, with most firms actually showing a negative loss during one or more of the previous years.

In the response to these circumstances, the similarities between the firms are striking. First, all firms have responded by reducing (certain types of) employment as the 'shift' towards Asia appears to have made this unavoidable. At the same time, all firms nevertheless continued to support lifetime employment and the employment reductions have been according to the conventional adjustment logic as it was discussed in chapter four. Another major adaptation that has been implemented by all firms is the strengthening of the performance-element in evaluation. The impact of performance clearly differs between firms and, even more so, positions but the trend is undeniably there. The other changes like the diversification of employment types and the rise in mid-career hiring are less clear and rather firm-specific.

A final conclusion concerns the continued relevance of the productive logic of Japanese employment practices. A good example is the introduction of a cell manufacturing system by firm A, as described in footnote 190. The new cell production method depends on a group of employees, and sometimes even a single employee, to undertake an entire production process. In addition, firm A also introduced an 'expert system', which ascribes a special role to experts who possess a wide variety of skills and are capable to adapt rapidly to new production orders. Moreover, the dependence on OJT as the basic type of training shows a continued

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<sup>214</sup> Another and related trend that has been very apparent from 1995 is the use of so-called '*seisangyōmugyō*' in manufacturing, something very similar to EMS.

importance of firm-specific skills. Interesting are also the experiences at firm D. The firm acknowledged the need to maximise the productivity of engineers and/or researchers, their largest segment of employees. However, this was not so much an issue of quality, as the quality of employees was hardly an issue, but a matter of allocation. The firm tried to improve productivity by shifting employees from low to high growth areas. Finally, we should once again point out the fulfilment of the contingencies for success as discussed in chapter four. At the same time, we have also seen how the demands for horizontal coordination have been lowered by the processes of standardisation and modularisation. In comparison to the automobile industry, firms have therefore been able to use a higher percentage of non-regular employees. Chapter ten discusses these differences in detail.

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**Overview changing employment practices**

ELECTRONICS					
	Firm A	Firm B	Firm C	Firm D	Firm E
Age	About 70 years	Over 100 years	About 80 years	About 70 years	About 60 years
Main products	Cameras, office automation equipment, and computer peripherals.	Information and communication equipment	Industrial instruments	Comprehensive line of electrical products	Electronic components, car audio equipment, and logistics of electronic products.
Competitive strength	Innovative and global character. Aspires to a truly global presence rather than just worldwide sales.	Large domestic market share in communications equipment, semi-conductors and computers. Good technological & innovative capabilities.	Worldwide trusted and leading firm with strong capabilities in the production of industrial instruments.	Overall assortment of electrical products varying from home appliances to E-solutions. Good track record of product development.	Several successful and highly innovative electronic products.
Business strategies	Two major phases in recent years. The first was directed at improving the firm's financial position through better management, cost reductions, and more competitive products. The second at expanding business and boosting profitability through production reforms, further cost reduction, and the use of R&D to develop new products and businesses.	Concentrate on growth fields (Internet-related) through innovation and restructure unprofitable businesses including sale and liquidations of businesses. Actions to increase efficiency (e.g. overseas procurement and standardised components). Establishment JV's with other high capability firms.	Implemented a new vision and strategy to restore profitability by transforming the business structure and revitalising group management. Important actions include consolidation and realignment of manufacturing companies (closure of most domestic factories), expansion of its EMS business, and a new compensation framework.	Business plan towards better competitiveness and leaner management through, e.g. (1) measuring results against the cost of capital invested, which has already led to withdrawal and the choice for JV's, (2) reduction of procurement costs by 20% and workforce by 10%, and (3) reduction assets to improve financial position.	Focus on innovation and globalisation (manufacture where the market develops). Several structural reforms like a new employment system and the establishment of business unit sales departments and HQs to identify customer needs and technological trends.
Firm Characteristics					

ELECTRONICS		Firm A	Firm B	Firm C	Firm D	Firm E
Economic situation		In spite of the harsh economic circumstances, the firm has known very good financial results and the number of employees has increased continuously.	Very difficult circumstances. Many of its market have deteriorated through the downturn in IT market. Also suffers from weak domestic market and competition from Asian competitors (China). The firm expects to profit from its technological and innovative capabilities.	The financial results have been weak with net losses in recent years. The firm has clearly suffered from the slowdown in the IT sector. Besides market recovery, much will depend on the success of cost reductions. On the plus side, some good markets do remain.	Results have been meagre in recent years. The firm also suffers from the clear changes in the electronics industry and the impossibility to match the cost consciousness of Asian competitors. However, innovative strength remains.	Suffered from the difficult circumstances in electronics industry but financial results have remained positive. The future is best characterised by the opposing forces of competition from Asia and the possession of several successful and innovative products.
	Most Urgent HRM Issue	Consequences of the relocation of manufacturing to Asia.	The costs versus Chinese competitors and the subsequent need to reduce employment.	Introduction of a new evaluation system for management employees to reflect contribution to the firm.	Maintain the current number of core employees while flexibility is improved through increased hiring of non-regular employees.	Need to adjust quantity (because of shift to China) and quality (because of technological development) of employees.
Inflow	Composition	(1) regular (19,000), (2) <i>ukeoi</i> (6,500), and (3) temporary (1,500).	(1) regular (mostly engineers), (2) <i>shokutaku</i> , (3) temporary (also: (outsourcing of production).	-	(1) regular (so far about 90% but expected to decrease), (2) <i>shokutaku</i> , (3) temporary (also: outsourcing of production).	(1) regular, (2) ST-contract employees, (3) <i>shokutaku</i> , (4) Part-timers (very few), (5) temporary staff, and (6) <i>ukeoi</i> ( <i>seisangōmugyō</i> ).
	Changing numbers / percentages	-	Reduced hiring new graduates.	-	Decreased hiring core employees; increased flexibility through <i>shokutaku</i> and outsourcing.	Reduced hiring for manufacturing.

ELECTRONICS		Firm A	Firm B	Firm C	Firm D	Firm E
Mid-career hiring		Rising. Mainly (young) engineers at lower levels who can still easily adjust but sometimes also experienced candidates for new fields; many good candidates are available.	For new business fields (rare; less than 100/year). Mid-career hiring in core areas is basically non-existent.	For specialist positions but the overall policy is to limit MC-hiring. However, if necessary, it is usually easy to find good candidates and they also adapt easily.	Started 10 years ago and has become rather common (about 400 out of 1,000 new regular employees). No problems fitting in the new employees.	-
	Different career tracks & their possibilities	For engineers there is the choice to become either a manager or a high-quality specialist.	4 different categories: (A) potential management employees (B) other white-collar, (C) physical, (D) special functions ( <i>shokutaku</i> ). Each category has its own rules for evaluation and promotion.	-	Distinction between <i>sōgō-</i> and <i>ippanshoku</i> is considered but currently not in place.	Among non-managers, two career courses: <i>kikaku</i> (incl. MBO) for college graduates and <i>jitsuin</i> . For middle management and higher a <i>senmonshoku</i> career track and a management career track ( <i>kanrishoku</i> ).
Criteria for evaluation: seniority, ability &/or performance (results)	From job ability and experience (rather closely related to age) to a so-called 'job-based system'.	Importance seniority is disappearing (except for young employees).	The former qualification ability system is maintained for union employees but a new evaluation system for management employees, which focuses on their contribution to the firm.	Shift towards evaluation according to achievement; however, there is still a role for seniority.	New HRM in 1993 that shifted focus from potential to apparent ability. The trend has been strengthened in recent years.	
Internal Flow & Rewards						

ELECTRONICS	Firm A	Firm B	Firm C	Firm D	Firm E
Reason(s) for change	(1) Increase global competitiveness, (2) prevent problems ageing workforce, and (3) reward and hold on to good employees.	-	To bring remuneration in line with market circumstances.	-	The globalisation of competition.
Evaluation forms & procedure	Under the new job-based system, different bands are distinguished for the various positions with the inclusion of bonuses. For non-management employees, there are so-called 'job group bands'; for management employees, so-called 'mission bands' exists. The first combine ability and performance criteria, the last solely know performance criteria. Performance is evaluated through MBO and 'overall job achievement'.	Within the A category, three grades are distinguished. Promotion from the 3 <sup>rd</sup> to the 2 <sup>nd</sup> grade is based on absolute criteria and relatively easy; promotion from the 2 <sup>nd</sup> to 1 <sup>st</sup> grade is more difficult and involves selection.  Evaluation forms have about 30 points. The concrete actions and skills required are described in a common 'practise file' and a work- and department-specific 'professional practise'.	Introduction of so-called 'Mission Standards' (MS) to nurture and manage people that win competition in a fast changing environment. 3 considerations exist in determining MS: (1) magnitude responsibility, (2) area of responsibility, and (3) difficulty to accomplish. An additional consideration is the ability of the person who holds the position. 3 ability levels (G1-G3) are distinguished.	At the beginning of every half' year, five assignments or tasks are set. Afterwards, the achievements are evaluated in term of the level of difficulty and level of accomplishment. Both are expressed on a 5-point scale. In addition, employees can earn two additional points, one for other significant achievements and one for work effectiveness. The overall score will determine ability rating, wage increases, and bonuses.	Ability is measured according a 'traditional' ability qualification system. For employees on the <i>kikakushoku</i> career track, MBO is one element of the ability qualification system.  For middle and higher management (including <i>semonishoku</i> ), there is <i>nenpōsei</i> . 5 ranks are distinguished based on qualification.

ELECTRONICS	Firm A	Firm B	Firm C	Firm D	Firm E
Evaluators(s)	-	Self-evaluation and evaluation by superior. The evaluation by the subsequent superior and the opinions of colleagues are also relevant.	-	Self-evaluation and evaluation by superior.	Self-evaluation and evaluation by superior (2/year). Occasionally, there is an evaluation by superiors of related departments.
Specific new instruments (MBO, <i>nempōsei</i> , etc.)	MBO with “stretched” objectives.  FY2000> Expert system: experts are employees who possess a wide variety of skills and are able to adapt quickly to new production orders and provide guidance to new colleagues.	MBO (2/year)	MBO	MBO. The kind of objectives depends on the function and division. However, the objectives of senior employees tend to be more result- rather than ability-oriented.	MBO. For non-managers, MBO can be considered one items of the ability qualification system; the impact depends on the level but can rise to about half the pay at higher levels.  <i>nempōsei</i> (middle management and higher).
Wages (criteria for determination & differences)	See information concerning bonuses	Based on ability	Based on MS and grade.	Based on rank. Two people of the same rank, will get a similar wage.	-

ELECTRONICS	Firm A	Firm B	Firm C	Firm D	Firm E
Bonuses (criteria for determination & differences)	Both wages and bonuses are included in the group and mission bands. The differences increase during a career. Overall, differences have increased.	On average, between 4 to 6 months of salary, partly based on performance. The differences in bonus depend on the level of employees. For managers, bonus is completely determined by performance.	Based on actual achievements through personal objectives by MBO. The overall funding is dependent on firm and department results. The actual bonus varies between 0.25 and 1.5 times the standard.	Based on performance. High performers receive 2 times (managers) or 1.75 times (non-managers) the amount of low performers.	-
Promotions (criteria for promotion)	For the lower levels, there is an examination.	Less important for motivation because employees are now also rewarded for performance.	Based on the evaluation of achievements. Seniority plays no formal role (but is hard to remove informally in Japan).	Based on performance but the expectation if a person can do the job is decisive.	-
Training: OJT, OffJT, other	Particularly during the early stages of careers there is a strong focus on training.	OJT exists. Besides, a hands-off approach that stresses individual responsibility. A 'firm university' provides courses.	MBO-training and career plan training. Employees have to take responsibility, set their own objectives, and bear most of the costs.	OJT and OffJT. Elaborate training programs exist to improve the capabilities of employees. An individual's training is documented on a CDB (Career Development Programme Card). For specialists, training often takes place within the in-house companies because of specificity.	OJT is still central. OffJT also exists and an important trend is the cooperation with universities. Young people are given responsibility and chance to take an active role.



ELECTRONICS		Firm A	Firm B	Firm C	Firm D	Firm E
	Candidacy system	-	Job application system which allows employees to other jobs within NEC (since 10 years ago).	-	An internal job posting system allows employees to change positions at their own initiative.	-
	Transition-period	Yes, for a soft landing. It has been possible to refrain from wage cuts.	As a matter of fact, the transition has not been as big as it might appear.	An elaborate process was followed in ascribing the MS to posts. Moreover, the MS have so far been kept secret.	Changes are well-accepted. People understand and even support the changes.	-
Outflow	Protection long-term employment	Yes. The firm acknowledges that the lack of an external labour market makes unemployment very severe.	Yes	Yes	Yes. Long-term employment is seen as a major source of loyalty and motivation.	Yes
	Reduction number of employees	Limited to the reduction of manufacturing employees. Since the firm already stopped hiring regular employees for manufacturing in the mid 80s, this reduction has been rather smooth. In some cases, these employees have been re-trained.	Several means: (1) reduced hiring and early retirement (about 10,000), (2) intra-industry movement to related firms, (3) intra-firm movement, and (4) selling plants including personnel to EMS with a clause that working conditions will not be lowered.	<i>Shukkō</i> within the consolidated group (also for training purposes) and a 'second life plan' through which people receive retirement allowance.	Outplacement and financial support early retirement. Reduced employment by 10% through replacement within the group (10,000) and early retirement (8,000).	<i>Kibō taishoku</i> (one-time offer for voluntary retirement). In FY2000, 1,000 people decided to make use of this offer.

ELECTRONICS		Firm A	Firm B	Firm C	Firm D	Firm E
	Job-hopping	Only a limited number of employees leaving for foreign firms with 'more exciting wage structures'.	Not many employees leaving.	-	Employees leaving during mid career are very rare.	-
	Job rotation	Particularly for management employees with a stress on foreign experience (even for R&D).	-	-	Mainly limited to management employees within one field. For technical employees, focus is on specific technological knowledge.	-
Work Systems		Shifted from conveyor belts to a cell production system at all manufacturing facilities. Under this system, groups of employees or one employee undertake an entire production process. This has already led to a reduction of labour equivalent to the work of 8,000 employees.	Performance has always been important but is now made more explicit. The interviewee confirmed that a certain vagueness in wage determination has long been a Japanese cultural characteristic.	-	-	-

ELECTRONICS	Firm A	Firm B	Firm C	Firm D	Firm E
Quality (commitment, competence, & congruence)	No problems except for a so-called 'engineering mismatch', a general Japanese condition that the firms' requests are different from the university curriculum.	-	-	Not an issue. The problem is one of allocation. Japanese people are indeed hesitant to speak out but this is culture rather than employment practices. At this firm, people are motivated to speak out.	Consensus in Japanese society might indeed hamper creativity.
Structure hierarchy	Employees can now become manager at a younger age. The practical 'minimum age' for <i>kachō</i> has been lowered from 36/37 to 33.	-	-	No problem of an unbalanced workforce through ageing employees. Employees can have enough responsibility without becoming manager.	
Outcomes					

## 8. The Construction Industry

### Dealing with a shrinking market

*Introduction. Industry Characteristics. Employment practices in the construction industry. Firm A: background, strategies and competitive outlook. Firm A: changes in human resource management. Similar for firm B. Concluding remarks. References. Overview changing employment practices.*

#### **Introduction**

This chapter discusses the changes in human resource management (HRM) at two major Japanese construction firms. Once again, it relates these changes to the specific characteristics and situation of these firms and therefore opens with a discussion of the construction industry as the firms' direct environment. In addition, it discusses the employment practices that have characterised this industry. The analysis is then specified towards the level of the individual firms. The discussion of each firm is twofold as it presents the firm's characteristics, strategies and competitive outlook before it focuses on the important changes in human resource management. In addition, the chapter presents some concluding remarks on the findings and their implications for the employment practices in the construction industry. It ends with a detailed overview of all changes at the respective firms.

### Industry characteristics

The construction industry has a very long history and several of the leading firms have been around from before the Meiji Restoration. As such, these firms have played an important role in the modernisation of the Japanese economy and for a long time their successes were correspondingly. Even nowadays the industry is known for its important position in the Japanese economy, responsible for nearly 15 per cent of GDP and about 10 per cent of employment (White Paper on Construction 2000).

Overall, the industry is characterized by a small number of large and a multitude of medium-sized and small companies. The firms that stand out are the major general contractors (the so-called '*Zenecon*', a Japanese acronym for *general contractors*). As general contractors these firms are capable to perform the entire range of construction and engineering activities, including design.<sup>215</sup> The five largest '*Zenecon*', namely Kajima, Obayashi, Takenaka, Shimizu, and Taisei, are usually grouped together as the 'big five'. Sometimes, Kumigai Gumi is included, making this group into a 'big six'. In addition to these large firms, a huge number of smaller contractors exists (in total, 586,000 firms existed at the end of March 1999). However, most of these companies are really small and nearly 50 per cent of construction firms concerns one-man operations (Hasegawa, 1988). A working relation exists between the large and smaller firms as the large firms do not perform all the activities themselves but subcontract work to various subcontractors and equipment installers. Usually, these subcontractors employ their own subcontractors, resulting in a pyramid-shaped division of work. Hasegawa (1988) therefore compares the actions of general contractors to the organising and financing activities by general trading companies. This strategy provides the large construction firms with advantages in both flexibility and costs.

During the early post-war decades, the construction industry was very successful. Hasegawa (1988) describes how market volume increased more than 20 per cent a year between the late 1950s and the first oil crisis in 1973. The strong growth enabled the large and smaller firms to share the market through a symbiotic relationship and the general strategy of the (general) contractors proved successful in taking advantage of the strong growth. However, the situation changed with the first oil crisis in 1973, in retrospect described as 'the beginning of an Ice Age' for the construction industry (Hasegawa, 1988). The subsequent collapse of a market used to strong growth resulted in a severe competition among firms. Larger firms decided to compete for the smaller orders they had ignored in previous years and the

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<sup>215</sup> In order to do so, these firms have design departments, staffed by large groups of architects and engineers.

coexistence between large, medium and small firms was severely tested. Paradoxically, the number of contractors increased by 70 per cent in the 10 years after the 1973 crisis (Hasegawa, 1988). This surprising development illustrates that the construction industry appeared to play a rather anti-cyclical role in the Japanese economy, as it tended to absorb many of the redundant agricultural and manufacturing employees.

This anti-cyclical role has been supported by the government which increased its expenditures for public construction projects but this proved insufficient to compensate for the decline in private demand. This government support nevertheless illustrates another important aspect of the Japanese construction market, the rather close relation with the government. The implications of this relationship are somewhat ambiguous but the mutual support has definitely contributed to the importance of the construction industry for the Japanese economy. This relationship was confirmed during the 1990s when high government spending actually came a long way in compensating for the decreased demand from the private sector, albeit with various negative consequences for both the government's financial position and the environment.<sup>216</sup>

A related issue concerns the bidding process for public works. In principle, bidding for public works takes place according to an open bid system. However, '[a]s a rule, Japanese public offices place orders following a designated competitive tendering system whereby selected ranks of construction companies are invited to take part in bidding according to the nature of the public works project' (Hasegawa, 1988, 6). Embeddedness thus appears crucial for competitive success in the Japanese construction market. However, there are signs of change. The White Paper on Construction 2000 calls for more transparency and competition in order for 'companies with technical and managerial expertise' to grow. Actions have also been taken, like the approval of the 'Agreement on Government Procurement' of the WTO in 1996. This agreement requires all central government entities, quasi-government entities, prefectures and designated cities to adopt non-discriminatory

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<sup>216</sup> Given the importance of the construction industry for the Japanese economy, it will not be surprising that Japan has often been characterised as a 'construction state'. Several authors have focused on the toll this has drawn and draws on government finances and the environment. See, for instance, Kerr (2002) for a particularly vicious analysis. Moreover, there have been several court cases on bribery of politicians by construction firms. An example that drew wide attention was the case against Toru Ishii in the 1990s. This former mayor of Sendai was sentenced to three years in prison for receiving 140 million yen in bribes from construction companies in connection with public works projects. The companies involved were Hazama, Shimizu, Nishimatsu Construction, Mitsui Construction, Taisei, Kajima, and Obayashi. In addition, twelve defendants from the contractors received suspended sentences. See Japan Policy and Politics (2000), Normile and Shimegi (2001), Wall Street Journal (1993), and Woodall (1996) for more information on the dark side of Japanese construction.

bidding and contracting procedures.<sup>217</sup> In spite of these developments, the position of foreign firms (at the end of March 2000, 68 foreign companies and Japanese subsidiaries of foreign companies were active on the Japanese market) remains modest. In addition to the complications of the bidding process, these firms have struggled to develop close business relations with Japanese subcontractors and to obtain a good understanding of the specific Japanese business practices.

In spite of the government support, the circumstances in recent years have been extremely severe, easily exceeding those of the other industries in this research. The industry, which never recovered after the first oil crisis, suffered from the burst of the bubble and the subsequent economic malaise.<sup>218</sup> The White Paper on Construction 2000 states how the annual average increase rate for private investments in construction between 1990 and 1995 was minus 4.9 per cent. In particularly non-housing investments decreased substantially, minus 12.9 per cent on average. At first, the known strategy of increased government spending (plus 7.2 per cent) offered some compensation for the lack in private demand. However, this strategy appears to have reached its limits amidst bribery scandals, environmental consequences, and the huge government deficit. Overall the market stagnated and declined a little (minus 0.4 per cent) between 1990 and 1995, a trend that continued and accelerated after 1995. In FY2002, construction sales in Japan dropped below 60 trillion yen for the first time in 16 years. This means that construction activity has fallen by one third in a period of only seven years from fiscal 1996 when industry sales surpassed 82 trillion yen. In response, the large firms once again increased their overall market share at the expense of the SMEs in order to keep up their sales. Table 8.1 shows the extent of this development. Overall, the severe circumstances have had major consequences in terms of rising bankruptcies and bad debts.

1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
38.0	38.8	39.8	40.2	40.2	40.5	40.8	41.8	44.1	46.0

**Table 8.1 Percentage of orders won by the largest five contractors**

<sup>217</sup> Other signs also point to change. In 2000, Yasuo Tanaka, a political independent, won the governorship of Nagano prefecture on a pledge to review all dam construction. Overall, bribery scandals, environmental consequences, and the increased government deficit have soured the public's willingness to accept further investments.

<sup>218</sup> First of all, as a largely domestic industry, it has suffered clearly from the lack of overall demand. Moreover, the industry has also been hit relatively hard because of the direct impact of decreasing land prices, as it has strongly limited the return on construction investments.

Besides a shrinking market, the industry is hampered by high costs, thin profit margins, and problems of asset quality (see Business Wire, 1998).<sup>219</sup> Moreover, adjustments are slow because of the industry's counter-cyclical character as both a traditional haven for redundant employees from other industries and a traditional beneficiary of the government's stimulus packages. Another major problem is the lack of and even decline in productivity. Important in this respect is the lack of innovation in routine construction technologies like the unitisation and pre-fabrication of components. In addition, the strategy to be a general contractor was successful during the period of high growth but appears to have become a serious weakness. 'Featureless generalisation is uninteresting to customers, and the indistinguishability of the individual general contractor...in the minds of customers invites stiff underpricing competition' (Hasegawa, 1988, 36). Hasegawa therefore expected that firms would decide to specialise but, as the discussion of our two cases will show, this expectation has not yet materialised. In contrast, as opportunities are limited on the Japanese construction market, firms have taken highly similar choices and actions. In the end, it will be their executive ability concerning these plans that will make the difference.

Finally, some strengths remains in the case of large contractors. The five largest contractors enjoy long-term relationships with major clients based on their ability to provide a wide range of construction work using advanced technologies, and strong operational and financial track records in undertaking projects that span several years. The proven ability to take market share from the smaller firms underlines this relative strength.

### **Employment practices in the construction industry**

The employment practices in the construction industry can be considered 'traditionally' Japanese. However, it is not clear to what extent this is a matter of functionality. Although work on the construction site can be considered complementary and stochastically correlated, and in that sense suited for the horizontal hierarchy as described in chapter four, technological and model changes appear less common than in the automobile industry and good possibilities exists for standardisation. However, it appears that these have been insufficiently realised.

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<sup>219</sup> The White Paper on Construction 2000 states how the average profit margin, which was 3.4 per cent in 1990, gradually decreased to 1.6 per cent in 1998. Amid the weakening demand, some contractors accept low margins and sometimes loss-making private-sector projects to maintain sales volume. The contractors are also weakened by high costs structures, reflecting the labour-intensive nature of the industry, multiple layers of subcontractors, and high material costs. The asset quality problems are caused by delinquent payments of receivables, bad real estate investments, and weakening financial conditions of affiliate companies.



Instead, the large size and long history of the general contractors makes it tempting to conclude that issues of legitimacy and path dependence have played a more important role than functional considerations in the development of employment practices in the construction industry. Moreover, the competition for public works through closed bidding underlines the importance of legitimacy and embeddedness. We will return to this issue in chapter ten on inter-industry differences in employment practices. Finally, the current market circumstances obviously require the reduction of employment. The discussion of the two case-studies will show how these adjustments have been substantial but, at the same time, according to the conventional adjustment logic.

### **Firm A: background, strategies and competitive outlook**

Firm A is a major general contractor with a history that dates back to the Edo period. Nowadays, its operations are divided over three business categories, the main activities of construction and real estate development, and 'other businesses'. This last category covers activities related to construction and real estate development, like the sale and leasing of construction equipment and the provision of financial services.

The firm has formulated two important strategies for future growth. The first concerns a strengthening of the main business. The firm tries to increase its share of the construction market by strengthening technological competitiveness, maintaining priority markets and further expanding its remodelling and renovations market. Focus is on the few fields in construction that have grown in recent years like the markets for medical, welfare and educational facilities. Another possible area of growth is the so-called 'Life Cycle Partner' business, which means that the firm wants to develop a long-term relation and become a partner during the entire life of a project. The second major strategy involves the development of new businesses like, for instance, urban redevelopment, remodelling of existing buildings, and the so-called 'Private Finance Initiative' business.<sup>220</sup> Important in these new markets is the development of alliances with other firms to combine strengths. The activities to materialise these strategies are numerous and include, for instance, the upgrading of skills in IT, further improvements in technology, the training of personnel, the rationalisation of management, the strengthening of market power, and the upgrading of sales activities. A special focus is the improvement of organisational efficiency in order to create a slim and productive organisation. In particular, the reduction of costs and the number of employees has been very

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<sup>220</sup> This refers to legislation enacted in July 1999 which allows for a new financing method for public sector projects that target the private sector.

successful, as shown in table 8.2. Finally, there have been important reductions in the interest-bearing debt.

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003
Expenses (consolidated)				100	94.7	87.7	82.5	79.8	
Expenses (unconsolidated)	100	99.1	91.0	84.7	80.2	73.0	68.5	64.0	55.9
# of employees (unconsolidated)	100	99.2	97.5	94.8	90.7	88.4	84.0	81.4	78.5

**Table 8.2 Index numbers for selling, general and administrative expenses and the number of employees.**

Note: Consolidated expenses: 1998 = 100; non-consolidated expenses and number of employees: 1995 = 100.

In spite of these strategies, the firm still faces an extremely difficult operating environment. The shrinking market has led to intense competition for new orders and a persistent decline in prices, and a clear downward trend in both orders and sales. Operating income has been relatively stable because of reductions of costs and improvements in organisational efficiency but has nevertheless been negative or very low. Moreover, as the market is expected to contract, expectations for the immediate future are equally grim. At the same time, the firm has a relative strength; in particular in comparison to its smaller ‘competitors’. Examples of this strength include the capability to provide comprehensive engineering and construction, the technological capabilities, the trust by customers, and the possibilities for renovation work that are created by the firm’s long history.

### **Firm A: changes in human resource management**

The major employment issue in an industry with such difficulties as the construction industry is obviously the reduction of the number of employees. At firm A, this problem is aggravated by the related problem of an uneven distribution of its employees. The ideal workforce would be pyramid-shaped but the actual situation is characterized by a heavy top and a relatively small representation in the lower and middle groups. Two well-known strategies were used to address this problem. First, the number of employees was reduced through limited hiring, the recruitment of volunteers for early retirement with additional *taishokukin*, and by offering new openings in other companies. These strategies have proven rather successful as the number of employees decreased by over 20 per cent (see table 8.2). An additional strategy has been the increased hiring of employees on one-year contracts at the

regional level, as these employees offer an important cost advantage.<sup>221</sup> Those with the necessary ability are afterwards offered an open contract with lifetime employment.

In addition, it was decided to strengthen the ability and/or performance element in the evaluation of employees in order to make the wage costs less dependent upon the average age of employees.<sup>222</sup> At the basis of the evaluation system is a distinction between different forms of employment. Branch office employees work their entire career in the same area and are somewhat limited in the scope of work they can do. For the regular employees, who all qualify for lifetime employment, two employment tracks are distinguished, a career track (*sōgōshoku*) and a general or auxiliary track (*ippanshoku*).<sup>223</sup> One evaluation system, which bases evaluation on both ability and performance (results), exists for all employees but the weight of these factors depends on the age and position of the employee. The weight of performance tends to rise with age, during the younger years focus is more on ability. So, even when actual performance is so-and-so, a young employee who seems to have a good future will receive a predominantly positive evaluation on the basis of his or her (potential) ability.<sup>224</sup> In addition, the importance of performance also depends on the position. For instance, construction site managers from 30 years and beyond are responsible for certain projects and are evaluated according to performance more than others as they can have a strong impact on results.

In the case of ability-evaluation, a description exists of the ability one has to possess in order to receive a promotion to a higher rank. However, the criteria tend to be framed rather ambiguous like 'the ability to become a leader in a particular division'. This enables a transfer between departments and allows the firm to use a

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<sup>221</sup> In addition, these employees are not included under the number of employees listed in the annual report.

<sup>222</sup> One interviewee made an interesting distinction between '*jō*' and '*ri*', meaning emotion and logic. *Jō* would refer to the old process in which wages and thus the quality of life would rise according to age. This would qualify as 'emotional' because companies reward employees for their proven commitment. *Ri* refers to a system that rewards employees for their performance, irrespective to age or seniority. It is tempting to ascribe these approaches to different periods of time. Seniority wages in the past, performance in recent years. However, it seems more appropriate to conclude that both forms of considerations – *jō* and *ri* – have been around for a long time and are still relevant. However, their weight has clearly shifted from seniority towards performance, from *jō* towards *ri*.

<sup>223</sup> The employees on the general course mainly provide assistance in office work. Employees on the career course can receive promotion to the management level and can also be transferred to other branches or even overseas.

<sup>224</sup> As a matter of fact, young people often like to have their performance evaluated but usually cannot take sufficient responsibility and are dependent on their superiors.

single wage system.<sup>225</sup> In the past, such criteria sometimes included certain minimal timeframes but this is no longer so and good people can move fast.<sup>226</sup> In the actual evaluation process, management-by-objectives has come to play an important role. One form, used for the evaluation of all regular employees, is used for the evaluation of both ability and performance. During a bi-annual interview between boss and subordinate, the personal assignments for the subordinate are set. These assignments are based on overall management plans as much as possible but can be both ability-oriented and result-oriented. Each objective receives a certain weight, the total of all weights being hundred per cent. At the end of the period, the level of achievement of each assignment is evaluated using a five-point scale. The possible levels of achievement are listed in table 8.3.

5	Very satisfactory
4	Satisfactory
3	Acceptable (as indicated)
2	Dissatisfactory
1	Very dissatisfactory

**Table 8.3 Five-point scale to evaluate achievements**

Next, the weights of each assignment are multiplied with the level of achievement and expressed as a number of points. For instance, in the case a certain objective counts for 20 per cent and the result is satisfactory (+ 4), it yields 80 points ( $4 * 20$ ). After the points for each assignment are aggregated, an overall score results and this determines the final evaluation. The possible outcomes are listed in table 8.4.

481 – 500 points	SA
451 – 480 points	SAA
351 – 450 points	A
251 – 350 points	AB
151 – 250 points	B
100 – 150 points	BC

**Table 8.4 Points and outcome evaluation**

<sup>225</sup> It seems likely that the ambiguous character of these criteria is also a means to balance the needs of the organisation with the ability of employees. It allows the firm to 'delay' promotion if there are too many employees with ability for promotion relative to the posts available.

<sup>226</sup> The interviewees acknowledged that it is very difficult to measure ability. Even when an employee appears to have the ability to move to the next level, it remains to be seen if that person can keep up his or her performance after promotion.

Based on the scores achieved, an organisational unit and department ranking is determined.<sup>227</sup> As mentioned, the impact of this evaluation is dependent upon age and position. Overall, the direct consequences in wage differences between employees with equal positions are limited. One interviewee estimated this to be about 10 per cent. The differences in bi-annual bonuses are more result-based and were estimated to be about 30 per cent. In addition, the change to this new system has additional consequences. The minimum age for *kachō* had fallen to 36 years and appeared to come down further. Moreover, it was particularly the number of younger managers that had risen and it had become accepted that young people can surpass their seniors.<sup>228</sup> Finally, the introduction of this new system met very little resistance but this was (partly) achieved because the changes were first discussed for one year. Moreover, there still seemed to be a transition period. A logical structure was created that focused on performance and ability but the human resource department still considered age and checked if people of the same age were not left out. Huge discrepancies did therefore not arise.

Finally, the situation concerning both training and mid-career hiring is rather representative of most case-studies. Overall, OJT under guidance of a senior worker (*senpai*) is considered crucial. OffJT usually takes place within the first five years after entering the corporation. It actually is a must and a curriculum is set (specific for each department). People know what is expected from them and what they have to achieve at what stage. If this is not achieved, promotion will be stalled. In some cases, there is also additional OffJT like (overseas) MBAs. Within the various departments training is provided to develop specialists in that field. Job rotation takes place for (future) managers but hardly exists for specialists like architects who usually stay in the same department. It can exist for specialists but this is not so much for training purposes as to enable organisational flexibility. Future management employees, on the other hand, are usually sent to the branch offices within five years of entering the company; sometimes employees go overseas. This training is considered sufficient and, unless the firm decides to enter a truly new business, there is no lack of qualified people or complaints about their quality. Mid-career hiring exists but is limited but when new employees with a certain expertise are needed, the firm has no trouble finding potential employees because of

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<sup>227</sup> The evaluation is done by the direct supervisor and two times repeated by other management employees.

<sup>228</sup> Nevertheless, the uneven distribution of employees (the excess of senior employees) remains. The changes in the evaluation system can only partly solve this issue because people have certain ability. This problem is further aggravated because the number of recruits is actually decreasing. However, the overall experiences are positive and there has been a feeling that the new system has activated the whole firm.

its good name. However, the firm does acknowledge that the lack of clear job descriptions still makes job-hopping difficult for more senior employees as they are strongly shaped by corporate culture. The firms use similar techniques but manage the actual constructions in specific ways and mid-career hiring therefore tends to be limited to younger employees.

### **Firm B: background, strategies and competitive outlook**

Firm B is similar to firm A in terms of its long history, in this case dating back to the Meiji Era, and the major business fields of construction, engineering and real estate. It is therefore also confronted with the extremely severe market circumstances. In response, firm B has introduced a new management plan in 2001 which included three major strategies. First, the restructuring or reorganisation of redundant and unprofitable businesses and the liquidation of inefficient assets. Secondly, the strengthening of activities in high-growth fields. Examples of such fields include urban revitalisation and redevelopment, building renewal, activities in the economies of South-east Asia, the market for medical, social welfare, educational and research facilities, and the private financing initiatives. Finally, the improvement of profits by a reduction of fixed costs and increased efficiency in purchasing and construction. Changes in human resource management, like a greater mobility of personnel and the introduction of a specialist employee system, are expected to contribute to these cost savings.

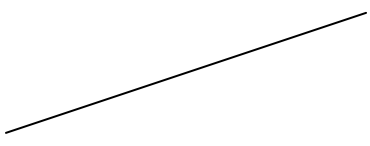
Nevertheless, the competitive situation, very hard to distinguish from that of firm A, remained extremely severe and firm B expected no short-term improvements. This shows in the meagre financial results and in 1998 the firm suffered its first loss since being listed. As a matter of fact, firm B was forced to make a downward adjustment in the quantitative objectives (orders, sales, income, and reduction of debt) as set in the 2001 management plan. Also similar to the other firm in construction, firm B expressed confidence in its competitive strength to wither the current difficult circumstances and take advantage of the limited possibilities for growth that do exist. It, for instance, referred to its capability to commission and to undertake large projects, its technological strength, and its past successes in various specific markets.

### **Firm B: changes in human resource management.**

Firm B also faced the problem of an uneven distribution of employees and the need to reduce employment in response to the shrinking market. Since the average age has been rising the system was sagging under the weight of the seniority wages. A first response was the reduction of employees through natural attrition and the offer

of early retirement with additional *taishokukin*.<sup>229</sup> Additional strategies included the use of *shukkō* and the involvement of outplacements companies. However, most people found their own path as they have good qualifications and can usually find another job.

In addition, the firm has introduced a more performance-based evaluation system in 2001.<sup>230</sup> At the basis of this new evaluation system is the distinction between different groups of employees. First of all there is the distinction between regular employees and employees that are hired for a limited period of time. In the case of regular employees, a further distinction exists between those on the ‘overall’ career track (*sōgōshoku*) and those on the general or auxiliary track (*ippanshoku* or *tantōshoku*). Table 8.5 gives an overview of the employment tracks, grades, and hierarchical positions. Within the career track, two courses are distinguished, one where people are rotated around the country and one where people work at a specific branch. The employee’s desire mainly determines which of these two courses he or she takes.

Grade	Overall career track ( <i>sōgōshoku</i> )	Auxiliary track ( <i>ippanshoku</i> / <i>tantōshōku</i> )
1	Division manager ( <i>buchō</i> )	
2		
3		
4	Deputy general manager ( <i>jichō</i> )	
5	Manager ( <i>kachō</i> )	
6		Vice manager ( <i>fukukachō</i> )
7	Acting-manager ( <i>kachōdairi</i> )	Assistant manager ( <i>kakarichō</i> )
8	Supervisor ( <i>shunin</i> )	Supervisor ( <i>shunin</i> )
9		
10		

**Table 8.5 Grades, career tracks, and hierarchical positions**

The promotion system is similar for all employees but wages are lower for branch-employees and they cannot rise higher than branch manager. Moreover, different evaluation forms exist for the different grades and tracks and for the evaluation of ability (*nōryoku*) and the evaluation of results (*gyōseki*); except for the highest three

<sup>229</sup> A few years ago, the amount of *taishokukin* was raised in order to motivate a large group of employees to accept the offer of early retirement. At the time of the interview, the system still existed but the amount of extra *taishokukin* had been reduced. If this amount would be raised again, more volunteers could be recruited but the need for a further reduction was not really felt.

<sup>230</sup> At the same time, the firm also acknowledged that the previous system had its good elements and the seniority element is not denied completely. Only after a certain age (32, 33), seniority does not matter anymore.

grades (general manager) where evaluation is limited to results. The basic structure of the evaluation forms is almost similar but the exact criteria and their weight differs. The following tables provide two examples. Table 8.6 lists the criteria and their weights and meaning for the ability evaluation of overall career track employees in grades four to seven, table 8.7 lists the criteria, weights, and meaning for the result evaluation of employees in grades one to three. In the evaluation of achievements, both the level of achievement and the importance and difficulty of the item should be considered.

Item	Evaluation content	Kinds of ability under consideration
1	Does the candidate pursue new objectives on a regular basis?	Ability for self-renewal, ability to direct policies, goal-awareness, customer satisfaction awareness, creativity, vision.
2	Does the candidate solve the objectives in a systematic way?	Ability to apprehend the situation, ability to foresee problems, ability for strategic planning, ability to solve problems.
3	Does the candidate have proper specialist knowledge?	Specialist knowledge, specialist skills.
4	Does the candidate have enough / proper drive and flexibility to pursue the objectives?	Decision-making ability, implementation ability, persuasive ability, negotiation ability, speed, sense of balance, mental strength.
5	Does the candidate utilise his full capacity to the organisation?	Communication skills, ability to lead and train.

**Table 8.6 Ability evaluation sheet, employees grade 4 – 7**

For each criterion, six different evaluation judgements are possible. These are listed in table 8.8. The evaluation is relative in the sense that each judgement is reserved for a certain percentage of employees. Finally, comment boxes are included on the evaluation forms to substantiate the judgement.<sup>231</sup>

<sup>231</sup> The evaluation procedure is as follows. At the beginning of the term the criteria are discussed. After the period has ended, the employee fills in a personal evaluation form. Afterwards, the direct supervisor holds an interview with the employee about results and ability and also fills in the evaluation form. At this time, results are not yet disclosed to the employee. The direct supervisor only sets the definite result after consultation with the section chief and the operational director. Finally, the results are disclosed to the employee during another interview. This discussion with and feedback to the employee is considered in line with the greater importance of evaluation.



Evaluation item	Weight	Meaning / implications
Achievement level of main or key tasks	4	The achievement level of main or key tasks is separated from the other tasks for evaluation. Not only the level of achievement but also the difficulty and importance of the task have to be taken into account.
Achievement level of other tasks	4	The evaluation of the achievement of other tasks. Both qualitative and quantitative aspects of overall results are taken into account.
Conduct / effort and attitude (essentially different from the first two items)	2	Concerning the actions undertaken to produce results. Even in the case this does not lead to immediate results, we value the positive actions as contribution to the firm. Evaluate the conduct and vision (point of view that considers the overall company) suitable for executive employees.

**Table 8.7 Result evaluation sheet, employees grade 1 – 3.**

S1	Much better performance than standards (excellent) (10%)
S2	Clearly better results than standards (20%)
A1	Concerning standards, satisfactory results (20%)
A2	Results are almost up to standards (20%)
B	Compared to the standards, there are unsatisfactory results (20%)
C	Clearly falling below the standards (10%)

**Table 8.8 Possible judgements in evaluation and their approximate percentages**

During roughly the first ten years of a person's career, focus is very much on training but afterwards it shifts to performance. After the age of 32/33, pay tends to be determined by performance for about 70 per cent, the other 30 per cent being determined by ability. The evaluation of performance has consequences for both wages and promotions and decreases in salary do exist. However, for any position there is a down-limit, a certain wage that is guaranteed. The difference in pay between a good and bad performer depends on the grade. For grade seven, there could be a difference in monthly salary of about 70.000 yen; for grade four, the difference could be about 175.000 yen. In addition, the bonus is completely based on performance. The transition to the new system was softened by the introduction of a two-year transition period that prevented the aforementioned downfall in wages. In addition, a 'loser-comeback-system' was introduced to keep employees motivated after some lesser performances.<sup>232</sup>

<sup>232</sup> The interviewee mentioned that there was some resistance but explanations were given to the employees. The reaction of the people differed between young and older employees. Young people were enthusiastic but older employees (50 years and over) were afraid that their wages

Finally, the situation concerning training and mid-career hiring also shows signs of change. The attitude towards training has indeed changed, albeit rather modest, towards a greater emphasis on specialist knowledge. For technical specialists two basic approaches exist. People who have a specific desire can specialise accordingly, for those who want more choice the rotation perspective would be followed. Within R&D, training and careers tend to be specialised because that is a necessary characteristic of the job.<sup>233</sup> Another change has been an increase in mid-career hiring. There is a shortage of employees in their 40s for construction site management because there is a trend towards smaller construction sites and it is particularly candidates for these positions that are hired mid-career. These candidates will become core employees and usually receive their training on-the-job.<sup>234</sup>

### Concluding remarks

At least two characteristics stand out in this chapter's discussion of two firms in the construction industry, the long-term trend of a shrinking market and the strong similarities between both firms in reacting to their changing environment. Both firms invest in the few growth markets that exist and have tried to reduce costs and improve efficiencies. Moreover, both firms put trust in their ability in comprehensive construction and engineering and technological strength. The similarities also exist for the changes in human resource management but these actually extend beyond the industry borders. Once again, we see the combination of employment reduction and a move towards performance-based pay. The reduction in employment has been very substantial as shown by table 8.2 (more than 20 per cent in eight years). Moreover, more than in any other industry the rising importance of performance also appears a means to reduce labour costs. Because of the lack of organisational growth, both firm's hierarchies have become clogged with an excess of senior employees. As these employees were primarily paid on the basis of their ability, labour costs had become very high and the introduction of the new systems is therefore aimed at restoring a proper hierarchy in terms of pay. Another issue concerns the relation to the productive logic as described in chapter four. The industry's employment practices are in accordance with this logic but, as is

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would go down and tended to be less positive. Overall, some of the income has been shifted to the younger employees as they have received part of the savings from reducing employment.

<sup>233</sup> The majority of people remains working at the construction sites. These people are hired as professionals and thus remain employed in their professional ability. Job rotation does not necessarily play an important role but employees can see several jobs when they are younger.

<sup>234</sup> The interviewee expressed the expectation that the general trend will remain towards a more active external labour market. However, he also pointed out complications because a lot of expertise is based on experience and companies differ. The present situation differs a little because several bankruptcies have left behind some candidates with good experience.

discussed in chapter ten, it remains to be seen if this agreement is based on functional or other grounds.

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# Overview changing employment practices

CONSTRUCTION		Firm A	Firm B
Firm Characteristics	Age	> 100 years	> 100 years
	Main products	General construction and real estate.	General construction and real estate.
	Competitive strength	(1) specific technologies and markets; (2) trust and past contracts; (3) comprehensiveness.	(1) technological strength; (2) specific markets it has proven successful; (3) ability to handle large projects.
	Business strategies	(1) Develop long-term relationships with customers through a life-long perspective on construction; (2) develop new businesses through alliances with other firms; (3) focus on Asia as growth market; (4) higher organisational efficiency through a reduction of costs.	(1) restructure and reorganise redundant and unprofitable businesses; (2) strengthen activities in high growth fields like urban revitalisation, new markets in Asia, and medical, welfare, and educational facilities; (3) improve profit levels through increased efficiency.
	Economic situation	In line with the state over the industry, facing an extremely difficult environment. Declining trend in sales for several years. Net income has been negative or very low. No real improvement in sight because the market is expected to contract further.	Just like company A, facing an extremely difficult environment. Downward trend in sales, small or negative net income in recent years. No real improvement in sight.
Most Urgent HRM Issue		The need to reduce the number of employees because of the declining market and the unbalanced composition of employees through an excess of senior employees.	The need to reduce the number of employees because of the declining market and the unbalanced composition of employees through an excess of senior employees.
Inflow	Composition	Regular employees, fixed-term contracts.	Regular employees, fixed-term contracts.
	Changing numbers / percentages	Decreased hiring new graduates.	Decreased hiring new graduates
	Mid-career hiring	At the regional level (max. age 40) to profit from lower wage costs. These employees are offered one-year contracts and can become regular employees after they have proven successful.	Particularly employees in their 40s for construction site management because of a tendency towards smaller but more construction sites. These employees become regular employees.

CONSTRUCTION	Firm A	Firm B
Different career tracks & their possibilities	Area-specific and area-flexible employees. At HQ, <i>sōgōshoku</i> and <i>ippanshoku</i> employment tracks (all regular employees).	<i>Sōgōshoku</i> and <i>ippanshoku</i> employment track. Among <i>sōgōshoku</i> employees, there is a further distinction between area-specific and area-flexible employees. The employee's preference mainly determines this last distinction.
Criteria for evaluation: seniority, ability &/or performance (results)	Increased role for ability and performance (results). The weight of these factors depends in the age and position of the employees. Importance of performance tends to rise with age and is dependent on position (some positions have a more direct impact on results).	New HRM system that focuses more on performance. Remaining seniority element for young employees (< 32, 33 years) because focus is still on training; afterwards, increasing importance results (besides ability). Overall performance plays a bigger role than ability.
Reason(s) for change	The high wage costs because of seniority-based wages and the need to decrease the number of employees because of shrinking market.	The high wage costs because of seniority-based wages and the need to decrease the number of employees because of shrinking market.
Evaluation forms & procedure	Evaluation takes place according to general forms that do not explicitly distinguish ability and performance. Personal objectives of the employee – as determined through a discussion with the direct supervisor – are listed. In accordance with the weight and level of achievement – ranging from very unsatisfactory to very satisfactory – for the different objectives, a total score is calculated. This leads to an evaluation outcome that can vary from BC (very bad) to SA (very good).	Different evaluation forms exist for employees in different grades and tracks. The basic structure is similar but the criteria and weights differ. Different forms also exist for the evaluation of ability ( <i>nōryōku</i> ) and results ( <i>gyōseki</i> ). For each criterion, 6 different evaluation judgements are possible. This evaluation can vary from C (clearly falling below the standards) to S1 (excellent). Importance and difficulty are considered besides achievement.
Evaluator(s) Specific new instruments (MBO, <i>nenpōsei</i> , etc.)	Direct supervisor and two other managers  MBO	The employee, the supervisor, and section chief or operational director.  MBO

Internal Flow & Rewards

CONSTRUCTION		Firm A	Firm B
Wages (criteria for determination & differences)	Limited differences between employees within the same positions (till about 10%)	Also dependent on the evaluation of results. Decreases in salary are possible but there is a lower limit for each position.	
Bonuses (criteria for determination & differences)	Differences in bonuses have become more substantial (till about 30%)	100% based on results.	
Promotions (criteria for promotion)	There is a description of abilities that one has to possess in order to receive promotion but the criteria tend to be rather ambiguous. This allows the firm to use a single wage system and enables switching between departments. Past minimal time frames have been removed.		
Training: OJT, OffJT, other	OJT – under the supervision of a <i>senpai</i> – is considered crucial. OffJT is a must and usually takes place within the first 5 years after entering the firm; sometimes additional OffJT like a MBA. Current training is considered sufficient and unless a new field is entered, there is no lack of qualified employees.	Slight change towards greater emphasis on specialist knowledge. For technicians on the construction sites there is an emphasis on seeing several techniques. Within R&D, training and careers tend to be very specialised.	
Transition-period	Yes. Moreover, elaborate discussions were held with the labour union before the changes were introduced. Finally, the new framework is there but people in the HRD still consider age. Checks exists if people are not left behind.	2-year transition period during which there are no decreases in wages; a 'loser-comeback system' was introduced to keep employees motivated after some 'bad' performances.	
Protection long-term employment	Yes	Yes	
Reduction number of employees	Various means including natural attrition, <i>shukko</i> , <i>tenseki</i> , support in job search through outplacement company, and an early retirement programme. This led to a substantial decrease in employment by roughly 25%.	Various means including natural attrition, <i>shukko</i> , support in job search through outplacement company, and an one-time early retirement programme with additional retirement payment.	
Outflow			

CONSTRUCTION		Firm A	Firm B
	Job-hopping	There is a trend to so-called 'job-hopping'. However, the lack of clear job descriptions still makes job-hopping difficult for senior employees. There appears to be a change of consciousness but the current circumstances make it difficult to find another job. However, the interviewees believe that the trend will remain.	There is a trend to so-called 'job-hopping'. However, the lack of clear job descriptions still makes job-hopping difficult for senior employees. There appears to be a change of consciousness but the current circumstances make it difficult to find another job. However, the interviewee believes that the trend will remain.
Work Systems	Job rotation	Exists for training management employees. Very limited for specialists (in this case, mainly for organisational flexibility).	
	Ambiguous job descriptions	Culture of <i>deshabaru</i> (obtrude, intrude), you can help another, coach him in his job. This is still encouraged.	There is no clear description of what a person is supposed to do; it is based on ability (for which levels are defined).
Outcomes	Quality (commitment, competence, & congruence)	Overall, no real complaints about the quality of employees. The main issue is the excess of senior, highly qualified employees.	Overall, no real complaints about the quality of employees. The main issue is the excess of senior, highly qualified employees.
	Structure hierarchy	The lower age limit (not explicitly acknowledged) is getting lower. Moreover, the number of young managers is increasing.	-

## 9. The Retail Industry

### The importance of non-regular employment

*Introduction. Industry Characteristics. Employment practices in the retail industry. Firm A: background, strategies and competitive outlook. Firm A: changes in human resource management. Similar for firm B and C. Concluding remarks. References. Overview changing employment practices.*

#### Introduction

This chapter discusses the changes in human resource management (HRM) at three firms in the Japanese service industry. More specifically, it discusses changing HRM at two supermarket chains and one restaurant chain. Once again, the chapter relates these changes to the specific characteristics and situation of these firms and therefore opens with a discussion of the industry environment as the firms' direct environment. In this case, that means a discussion of the Japanese retail industry. The restaurant chain is obviously in a different industry but has been included because of the important similarities in economic circumstances, industry character and, most importantly, employment practices. If relevant, the discussion will explicitly point out existing differences. Subsequently, the chapter also discusses the employment practices that characterise these industries. The analysis is then specified towards the level of the individual firms. The discussion of each firm is twofold as it presents the firm's characteristics, strategies, and competitive outlook before it focuses on the changes in HRM. In addition, the chapter presents some concluding remarks on the findings and their implications for the employment practices in the retail industry. It ends with a detailed overview of changes at the respective firms.



### Industry characteristics

The Japanese retail industry has achieved important growth during the post-war period. Allinson (1997) describes how the Japanese used to shop for daily necessities at small 'mom-and-pop' stores close to their homes until the 1960s saw the arrival and growth of self-service (*serufu sābu*) stores. This development continued and accelerated in the 1970s, when the rising number of suburbs and the wider use of cars supported further growth. The new stores took many different forms and we can nowadays distinguish several important formats like discounters and GMS (general merchandize stores), supermarkets, specialty chains, convenience stores and department stores. New firms like Daiei, Seiyu, Ito-Yokado and Jusco achieved strong growth and tend to operate most formats. Nowadays, the retail sector is an important part of the Japanese economy as it accounts for five per cent of GDP and 12 per cent of total employment (McKinsey, 2000). As such, it is an important example of the overall shift from secondary to tertiary industries.

A crucial factor in the development of the Japanese retail industry has been the impact of regulation and, in particular, the Large Scale Retail Store Law (LSRSL).<sup>235</sup> Introduced in 1974, and revised in 1979, this law posed several conditions for the establishment of large retail stores, which strongly shaped Japanese retailing. The original law required a detailed business plan to be submitted for approval for the establishment of department stores with floor space over 1,500 square meters (3,000 in the major urban areas). The entire process of approval took between one year and eighteen months and the final permit often included a number of demands, like a reduction in floor space, to protect local retailers. The impact of this law is widely acknowledged as it made the establishment of large-scale retail stores very difficult (Potjes, 1993). The law thus contributed to a continued importance of small stores. Ribault (2000) describes how it took forty years after the Second World War before the number of small stores started to decline. For a long time, the new and large supermarkets did not pose a real threat to the small retailers. Besides the protection through the LSRSL, the small firms were also entitled to subsidies and government-guaranteed loans.<sup>236</sup> Moreover, other factors, like the strong growth of the market and low costs as the families owning the shops had long owned the land on which their shops were built, also supported the continued viability of small stores. Finally, Potjes (1993) describes how traditionally retail employment often concerned a second career combined with a (part-time) job at

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<sup>235</sup> This part of the analysis is specific for the two supermarket firms.

<sup>236</sup> Other potential government support includes grants to buy computers and infrastructure programmes for the shopping districts where these stores are located.

another firm or a post-retirement career. Under such circumstances productivity is not always the main issue.

As part of the 1990 Structural Impediments Initiative between Japan and the US, the LSRSL was revised in 1991 (effective in January 1992). This revision led to a strong increase in the number of shops, a development that underlines the law's previous importance. The revision doubled minimal floor space to 3,000 square meters (6,000 for major urban areas). Moreover, the evaluation of applications was shifted from the local Business Regulation Councils (*shōgyō chōsei kyōgi*) to the Large-Scale Retail Store Council, a MITI advisory body. Other important changes of this revision (and the next revision that became effective in May 1994) included the possibility for longer opening hours and less and freer allocation of compulsory closing days. Moreover, in the revision of 1994 the opening of stores up to 1,000 square meters was liberalised, a change that has clearly contributed to the sharp rise in the number of convenience stores. In 2000, the law was replaced by the Large Scale Retail Location Law. The new law still requires approval for stores over 1,000 square meters but entry is now limited through social screening related to the environment. The most important changes are shown in table 9.1. The reaction to this latest revision can at best be described as mixed. According to the McKinsey report, 'a blatant entry barrier has simply been replaced with one more tricky under the guise of environmental protection' (McKinsey, 2000, 10). Moreover, the continued presence of small storeowners as evaluation committee members is likely to impact the outcome of decisions taken.

Overall, the perception of the Japanese retail industry has been negative, as acknowledged by JETRO. 'Japan's world of retailing is, to the outsider, an extraordinary combination of plenty and scarcity, service and inefficiency. Outmoded in various ways, it is regarded by many as at least 15 years behind the US retail industry' (JETRO, 1995, *The Retail Revolution*). The McKinsey report provides a good, though rather extreme, example of such a negative judgement. The retail industry, like the entire service sector, is included in the weak half of the economy where companies are 'subscale, poorly managed, antiquated, insulated from competition, and woefully unproductive' (McKinsey, 2000, 2). Most important ground for this negative judgement is the lack of productivity among Japanese retailers. The McKinsey report mentions how overall retail productivity in Japan is only half of that in the US. As major reason for this difference, it points to the lack of replacement of the old-fashioned mom-and-pops stores.<sup>237</sup> Moreover, it is not just

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<sup>237</sup> In international perspective, the percentage of these small stores in Japan is extremely high. They account for 55 per cent of retail employment in Japan while the numbers for the US and France are 19 and 26 per cent respectively. At the same time, the percentage of large-scale retailers is comparably low (12 versus 35 per cent in the US). Data from McKinsey (2000).

the abundance of traditional, small stores that is responsible for the lack of productivity. Even the productivity of large-scale formats (including supermarkets) is only 84 per cent of that of the US retail average (McKinsey, 2000, 1).

	Large Scale Retail Store Law <sup>1</sup>	Large Scale Retail Location Law
Objectives	<ul style="list-style-type: none"> <li>• Protection of small retailers</li> </ul>	<ul style="list-style-type: none"> <li>• Town planning / zoning<sup>2</sup></li> <li>• Environmental protection (traffic, noise and trash)</li> </ul>
Size of stores regulated	<ul style="list-style-type: none"> <li>• &gt; 1,000m<sup>2</sup> (type 2)</li> <li>• &gt; 3,000 m<sup>2</sup> – (type 3)</li> </ul>	<ul style="list-style-type: none"> <li>• &gt; 1,000 m<sup>2</sup></li> </ul>
Evaluation committee members	<ul style="list-style-type: none"> <li>• Local small stores</li> </ul>	<ul style="list-style-type: none"> <li>• Local residents</li> <li>• Local businesses</li> <li>• Local small stores</li> </ul>
<b>Final Decision</b>	<ul style="list-style-type: none"> <li>• Central and prefectural governments</li> </ul>	<ul style="list-style-type: none"> <li>• Prefectural and local governments<sup>3</sup></li> </ul>

**Table 9.1 2000 Revision of the Large Scale Retail Store Law**

Source: McKinsey Report, 2000

<sup>1</sup> Enacted in 1974 and gradually deregulated in 1990, 1992 and 1994

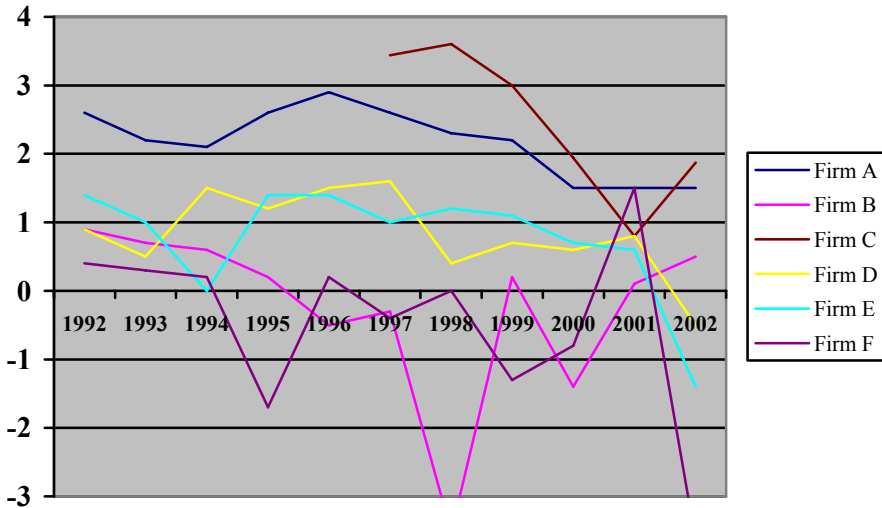
<sup>2</sup> Zoning regulated under revised city planning law

<sup>3</sup> 71 per cent of stores expect large variations in enforcement by local government

However, an important qualification needs to be made concerning the comparison of productivity figures in service industries. Gadrey *et al.* (2001) point out how these comparisons are limited to the sales value of the products and do not take into account the range of services that is offered to the customer. The remaining productivity differences can be (partly) explained by the different wishes of Japanese customers. These demands are for instance influenced by (1) the limited use of cars for shopping, (2) the importance of fresh ingredients for Japanese cooking, and (3) small houses and therefore limited space. Moreover, Japanese customers highly value quality and service, as confirmed by Ribault (2000) who gives the importance of service as another reason why small stores have been able to resist the growing competition of large retailers. Moreover, it also shows in the fact that the large retail groups like Daiei and Ito-Yokado operate the various formats next to one another. Ribault therefore concludes that the different formats are still complementary rather than competing.

As a predominantly domestic industry, the Japanese retail and restaurant chains have also suffered from the weak demand of the ‘lost decade’. Figure 9.2, which presents the net income as a percentage of total revenue for the major retail firms since 1992 clearly shows that, particularly around 1996, the results of all firms

have tumbled. However, the future still looks rather good as the market can be expected to grow when the domestic economy recovers.<sup>238</sup>



**Figure 9.2 Net income as percentage of total revenues among major supermarket retailers (including restaurant chain C)**

Source: The homepage of firm A

Finally, one other development cannot remain unmentioned. This concerns the entrance of foreign competitors, both on their own (Carrefour, Toys 'R' Us, Costco) and through participation in Japanese supermarkets as in the case of firm B. The impact of these developments is still difficult to predict but two things seem certain. First, the development will continue. Secondly, this entrance by foreign competition has shown to be more difficult than might be expected on the basis of the domestic firms' lack of productivity. To an important extent, foreign firms have to play according to the rules of Japanese retail in order to reach the Japanese customer.

### Employment practices in the retail industry

In contradiction to the industries of the previous chapters, the employment practices in the retail (and restaurant) industry differ substantially from those discussed in

<sup>238</sup> Possibly for the time being, the weak economy has led to a change in the demands of customers. During the booming years high prices were not a real issue. 'A high price was perceived as a guarantee of quality and a level of service no longer available elsewhere' (JETRO, 1995). However, the economic downturn has clearly changed this attitude and many consumers now focus on price and 'value for money', as shown by the rise of discounters.

chapter four. Striking is the high percentage of non-regular employees in these industries. The Japan Institute of Labour (2004b) describes how the share of non-regular employees in the 'wholesale and retail trade' is 44.3 per cent; in the industries of 'eating and drinking places and accommodations' the share is even 63.4 per cent (see chapter ten for a more elaborate discussion). This gives these industries a specific position.<sup>239</sup> It means that the non-regular employees perform a role that clearly extends beyond the adjustment logic as it was also discussed in chapter four. Moreover, it raises serious questions about the relevance and efficiency of the productive logic.

The non-regular employees in these industries, and retailing in particular, actually constitute a rather heterogeneous group. The most important category is that of the part-time or *pāto* employees. However, we should make a further distinction between a broad and strict definition of part-time employees. The broad definition includes all types of non-regular employment, the strict definition concerns non-regular employees with a part-time contract and thus excludes others who work as *arubaito* (casual jobs), *shokutaku*, or who are dispatched by an employment agency. Moreover, even the strict definition of part-time employees hides an important distinction. The Part-Time Work Law defines part-time workers as workers whose scheduled working hours are shorter than those of regular employees in the same workplace. Usually 35 hours is taken as the dividing line in this respect (Araki, 2002). However, many part-timers (strict definition) work more than 35 hours.<sup>240</sup> Legendary is the group of so-called 'pseudo-part-timers', employees who have a part-time status but work about the same number of hours as full-time employees (usually defined as those working more than 35 hours). In this and the remaining chapters the term 'part-timers' is used in its strict meaning and the term 'pseudo-part-timers' to refer to those part-timers that work 'full-time' hours (more than 35 hours a week).

The importance of the various types of non-regular employees differ between the industries as discussed in this chapter (retail versus restaurant) and among the different formats in the retail industry. Restaurants like firm C depend heavily on *arubaito*; just like convenience stores, where *arubaito* account for 60 to

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<sup>239</sup> Broadbent (2003) describes how in 2001 the retail, wholesale and restaurant industries employed 39 per cent of all part-time workers, with supermarkets employing almost 28 per cent overall. See table 10.1 in chapter ten for the percentages of non-regular employees in various industries.

<sup>240</sup> In accordance, firms do not necessarily define part-time work in accordance with the 35 hours limit. Broadbent (2003), for instance, mentions how the Daiichi Store takes 38 hours a week as the maximum of part-time employees. Firm A actually does take 35 hours a week as a maximum for part-time employees and distinguishes between part-timers working less than 30 hours and part-timers working between 30 and 35 hours.

65 per cent of total employment. However, other retail formats like supermarkets have so far maintained a substantial group of regular employees. As the next chapter on the rise of non-regular employment discusses, the advantages that the various employment types offer in terms of costs and flexibility differ and the differences among the various industries and formats can be explained by their specific circumstances. For example, both restaurants and convenience stores usually operate under 'extended' opening hours (in many cases, they are open 24 hours a day), and thus require the flexibility of particular *arubaito* employees to work during these extended hours.

An interesting aspect of these industries is that the distinction between regular and non-regular employees usually does not coincide with the distinction between core and peripheral employees. Gadrey *et al.* (2001, 175) describe how part-timers are sometimes considered part of the core workforce, albeit as 'permanent employees with inferior occupational status (and pay)'. We can conclude that, in these cases, the qualification of part-time employees is according to status rather than functionality. 'Part-time workers carry out jobs which approximate those of full-time workers, but irrespective of the tasks they perform, because they have the status of part-time workers, the perception is that they do not perform the same tasks as full-time workers' (Broadbent, 2003, 53). Moreover, their working circumstances also differ.

Another interesting aspect is the apparent stability of these arrangements. Gadrey *et al.* (2001) conclude that this model of various employment types seems relatively robust and not threatened by a serious crisis on the short or medium term. First of all, the employment types complement each other as they offer their specific advantages in terms of performance, flexibility and costs; advantages that correspond to the wishes of the various firms. Moreover, this employment pattern also appears to (partly) agree with the wishes and availability of various social groups. The segmentation actually has a strong relation to the segmentation in family and social roles with certain social groups (male basic income providers, housewives, students) concentrated in specific employment categories (regular employees, part-timers, *arubaito*). Students look for casual jobs to pay their living expenses, home responsibilities and the tax system encourage housewives to work part-time. However, Gadrey *et al.* (2001, 182) also distinguish some internal contradictions, which can be attributed to 'competitive pressures and "consumer revolt," which are forcing firms to lower margins and reduce wage costs by gradually increasing the number of part-timers working long hours and extending their responsibilities, at the expense of core full-timers'. This can eventually lead to established part-timers claiming 'permanent' status.

**Firm A: background, strategies and competitive outlook.**

Firm A is a large retail group with a worldwide presence and a history that dates back over 80 years. However, initially the firm was limited to a single store and it has only been since the 1960s that the firm started to grow in both number and types of stores. In Japan the group nowadays operates superstores, supermarkets, convenience stores, restaurants, department stores, speciality stores, and discount stores. In addition, it has diversified into other fields like financial services and insurance, real estate, and food production. The subsequent discussion focuses on the employment practices at the firm's superstores, large supermarkets that also sell apparel and household goods. The firm operates about 175 of these superstores, which are considered the *primus inter pares* of the entire group and contributed about 12 per cent of consolidated income before taxes in 2002.

A striking characteristic of the entire group is its focus on innovation. Past achievements that subscribe to this focus are various. The firm was, for instance, the first to introduce an integrated point-of-sale (POS) information system to monitor the trends in sales of individual products. Another example is so-called 'team merchandising', which concerns the use of information from the sales floor for cooperation with outside specialists to improve production and develop products that correspond to the needs of the customers. This focus is also reflected in the discussion of structural reforms under the heading of 'creative destruction, innovation, innovation and innovation'. Major reforms include a better attention for the business needs of individual stores with more freedom for regional differences and the introduction of store management innovations like store management by young employees in their thirties, store management by female executives, and sales floor management by part-time employees.<sup>241</sup>

In spite of the weak domestic demand, the competitive outlook of firm A appears rather good. As shown by figure 9.2, the firm has consistently outperformed its rivals in terms of net income. Moreover, it has shown a rise in sales and has a strong financial position. However, as is also shown by the figure 9.2, the firm has suffered a decline in profitability and it therefore decided to implement the structural reforms discussed before.

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<sup>241</sup> 'According to the generally accepted thinking of the past, for example, large chain stores were expected to offer unified product lines in a self-service format...Instead, bending our ear to voices from the local community, we are applying our administrative resources to product line and sales floor development based on regional needs' (Firm A's Corporate Profile). This is, for instance, achieved by having the store's administration personnel, including the store manager, move into the community a year or more before the opening of a new store.

### Firm A: changes in human resource management

Firm A in retail has not felt the problem of excess employment as sales continued to grow, albeit very modestly, and the average age of employees is rather low (about 35 years). This obviously takes away some of the pressure for change as it is felt by other firms. However, the firm has nevertheless made important changes in its human resource management. Two adaptations stand out, the increasing importance of performance in evaluation and the changed composition of its workforce.

The changes in evaluation appear rather revolutionary as underlined by the objective 'to abolish the system of seniority-based treatment for a system that bases treatment on the relation between work and results, a system that allows employees to do their work of preference after they have raised their ability. The system has to reflect the results achieved results in the treatment of any employee who has the eagerness to work, who exercises his own ability to the highest level' (translated from the firm's evaluation forms). The 2002 annual report explicitly states that age and gender can no longer play a role.<sup>242</sup> The new evaluation process knows two important elements, the evaluation of process and the evaluation of personal achievements or results. At the basis of both evaluations lies the distinction of about 60 different classes, based on differences in work and position. Although the evaluation for these different categories takes place according similar lines, the weight of the different factors differs substantially. Table 9.2 shows some examples of the criteria and weights for process evaluation.<sup>243</sup> Subsequently, a rank is ascribed to each employee, relative to the evaluation of the other employees in the store or unit. The distribution of the ranks is listed in table 9.3.

	Supervisor	Shop manager	Staff
<b>Evaluation criteria</b>			
Basic attitude and behaviour	30%	10%	10%
Role achievement	50%	50%	40%
Problem handling	20%	40%	50%

**Table 9.2 Criteria and weights process evaluation, three example positions**

<sup>242</sup> At the same time, the interviewees mentioned how the firm felt that the good elements of the Japanese system needed to be incorporated. In accordance, a certain role was maintained for seniority in the ability qualification system.

<sup>243</sup> In addition, there is much attention for the due process of evaluation. Elements like the proper measurement of ability, the importance of proper evaluation forms, and the provision of proper management tools are discussed. In the case of process evaluation, the basis is formed by a self-check system. The supervisor and the supervisor's supervisor then repeat the evaluation. The first evaluator determines the rank and after a 'peaceful' adjustment meeting between the two evaluators, the final evaluator determines the rank. Afterwards, the personnel department 'adjusts and confirms' and, in the end, the employee receives evaluation feedback.



<b>Evaluation rank</b>	<b>Rough distribution</b>
Rank 1	Max 5%
Rank 2	15 – 20 %
Rank 3	55 – 65 %
Rank 4	15 – 20 %
Rank 5	*

**Table 9.3 Distribution of ranks for process evaluation**

In case of the evaluation of results, the categories of work and position also play an important role. For each post and qualification, the accompanying responsibilities are set. These responsibilities are actually quite straightforward. For section managers it is the section managed, for store managers it is the entire store, etc. Once again, the weights ascribed to the different criteria depend on the category. Two examples are presented in table 9.4. A budget achievement rate is subsequently calculated through dividing the actual results by those budgeted. If the budget achievement rate is over 100 per cent, the employee receives bonus points, if it is lower, minus points are awarded.

	<b>Supervisor</b>	<b>Shop-manager</b>
<b>Evaluation criteria</b>		
Profit	-	50 points
Gross profit	50 points	30 points
Sales	50 points	20 points

**Table 9.4 Criteria and weights process evaluation, three example positions**

The impact of both types of evaluation on remuneration differs. Process evaluation is reflected in an individual's long-term treatment and has an important impact on qualification (and thus promotion), pay, and transfers. Besides, it has an average impact on the bonus. Result evaluation, on the other hand, is reflected in a person's short-term treatment and has an important impact on bonus, an average impact on transfer, a smaller impact on qualification, and no impact on salary. The height of the bonus is determined according to the following procedure. First, the overall company performance is evaluated. If profits are higher than projected, the amount for bonuses is increased; if profits turn out to be less than projected, the amount for bonuses is reduced. The overall amount is then divided over the individual employees on the basis of their personal performance and with consideration for the difficulty of their tasks. Some examples of the possible impact of performance on

annual bonuses, obviously dependent upon the firm's performance, are listed in table 9.5.

	Possible upward adjustment	Possible downward adjustment
Shop-supervisor	+ ¥ 36,000	- ¥ 30,000
Section manager	+ ¥ 280,000	- ¥ 180,000
Store manager	+ ¥ 600,000	- ¥ 600,000

**Table 9.5 Range for bonus adjustments, three example positions**

Another major development concerns the composition of the workforce. The section on employment practices in the retail industry already discussed the prevalence of non-regular employment. Moreover, firm A has increased its use of part-time employees to about 60 per cent of all employees (the remaining 40 per cent concerns regular employees).<sup>244,245</sup> Interestingly, the increasing percentages have also led to increased career possibilities for part-timers. An important example is the establishment of sales sections that are managed exclusively by part-time employees. Together with other innovations to vitalise stores, like stores managed by young employees in their thirties and sales sections managed by senior female staff, '[t]hese measures have been taken to promote bold sales floor innovations reflecting the current needs of local customers without reference to past experience' (from the firm's corporate profile). Since the performance of these stores and sections has shown a positive trend, the firm will extend these initiatives in the future. The better career possibilities also extend to the hierarchical positions part-time employees can achieve. Theoretically they can now even become store manager. However, this has not yet happened. Instrumental in these developments is the introduction in March 2002 of a candidacy system that allows motivated employees to become candidates for management positions they aspire to, irrespective of their age, sex, or experience. Any employee who has worked at firm A for over two years can be considered for almost any position as work history and experience are no longer the key criteria.

### **Firm B: background, strategies and competitive outlook.**

Firm B is a leading operator of supermarkets which was established about 40 years ago as a business extension by its parent firm. Nowadays, the firm operates about

<sup>244</sup> There is no further distinction among part-time employees except for a group working less than 30 hours and a group working between 30 and 35 hours.

<sup>245</sup> In accordance, there was hardly any mid-career hiring of regular employees. The system exists but there was no need at the time of the interview. However, during the 'growth years', mid-career hiring was very common and many members of top management were originally hired mid-career.

400 stores and has subsidiaries in fields like finance and real estate. However, most important are the over 200 supermarkets and the subsequent discussion focuses on the human resource management in supermarket operations.

The situation at firm B is actually rather special as the firm has recently established a business tie-up with a foreign competitor which acquired a dominant interest. This has strengthened the firm's financial stability. Moreover, the firm also believes that it will profit from the services and expertise of this foreign firm. However at the time of the interview late 2002, news about this acquisition was not yet public and the discussion in this chapter therefore ignores this development. However, as illustrated by firm B's 2003 annual report, the subsequent acceptance of the foreign firm's philosophy and strategies has been striking. In contrast, the earlier annual reports are rather summary when it comes to the discussion of strategies. Nevertheless, they state that the focus is on customers as the firm stresses its 'customer first' management philosophy more than anything else. This can be interpreted as a direct confirmation of the importance of service as it was discussed in the section on industry characteristics.<sup>246</sup> In order to serve the customers as well as possible, the firm tried to strengthen its core retail and sales capabilities by implementing numerous business reforms. Important measures taken included the increase in product appeal, the revitalisation of existing stores, an extension of operating hours, a reduction of the number of holidays, and a reduction of costs by converting fixed costs such as personnel expenses into variable costs.

The importance of these reforms is also illustrated by figure 9.2, which shows that net income of firm B has been erratic and predominantly negative since the middle of the 1990s. Nevertheless, it does appear that the reforms have indeed strengthened performance as net income appeared to be rising again and the firm had achieved important successes in the reduction of debt. However, the new alliance makes it difficult to extrapolate past results and the firm's future appears a new episode.

### **Firm B: changes in human resource management**

Contrary to retail firm A but similar to many other Japanese firms, firm B did feel the problem of an ageing workforce.<sup>247</sup> This problem showed in both rising wage

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<sup>246</sup> As a matter of fact, the interviewees acknowledged a possible tension between efficiency and service but the rule was that the customers come first. An insightful example was the help offered to a customer without eyesight at the store where one of the interviewees used to work. When this customer visited the shop, an employee would assist her for maybe half an hour, while other employees would cover for this employee.

<sup>247</sup> The difference actually shows when we compare the average age of the employees, respectively 41.5 years for firm B and 35.0 years for firm A.

costs and a declining speed of promotions and had the ironic consequence that, although age restrictions for promotions had been removed, the average age of managers had risen. Moreover, there sometimes is the problem of unmotivated people who have given up on promotion. Managers try to motivate these employees but do not seem to have the means to do so. This problem of the ageing workforce is mainly addressed by dispatching employees through the use of *shukkō*. In general the subsidiaries show a willingness to receive these employees but sometimes they are reluctant as the original terms of the employment contract have to be honoured. However, the number of firms that accept these *shukkō* employees increases annually.

At the same time, firm B has also changed its human resource management in the direction of performance-based pay and towards a wider involvement of non-regular employees, albeit more modest than firm A. As a matter of fact, the firm has changed its employment system a number of times in recent years, with the ratio of the wage dependent upon performance growing time by time. Overall, wages and bonuses are nowadays dependent on a combination of results or output and (potential) ability. Ability is particularly important when the decision concerns promotion. The evaluation of performance is based on objectives that are set at the beginning of the period during an interview between the employee and his or her direct supervisor.<sup>248</sup> The actual impact of the factors of ability and performance depends on the grade and function of the employees, as shown in table 9.6.

<Functional grade>	<Main function>	<Kind of evaluation>
1 <sup>st</sup> to 4 <sup>th</sup> grade	Store manager	Performance evaluation
5 <sup>th</sup> grade	Section manager	Performance / ability evaluation
6 <sup>th</sup> grade	Assistant manager	Performance / ability evaluation
7 <sup>th</sup> grade	Supervisor	General evaluation

**Table 9.6 Grades, functions, and the accompanying types of evaluation**

The table shows how the evaluation indeed changes from a rather homogenous treatment during the early stage of an employee's career to a sole focus on performance for store managers. However, it also appears that the actual combination of the different criteria is still rather ambiguous.

In addition, there is also a strong similarity to Firm A in the increased use of part-timers to reduce labour costs. To an important extent, part-timers have taken over positions that used to be taken by newly hired graduates, who are nowadays

employed in much smaller numbers. Moreover, these part-timers are also offered better career possibilities, albeit to a lesser extent than at firm A. Part-timers can rise as high as *kakarichō* but are more likely to become supervisor of a certain section like, for instance, that of the cash registers. A final striking characteristic is the importance of job rotation. Specialists, like employees in finance, remain in their specific department for most of their career but for others job rotation plays an important role and can take place in a particular store, between stores, and between stores and headquarters. The process is known as *tamatsuki*, billiards, as one transfer tends to initiate many others. The basic idea is that people are rotated after four years but corporate staff tends to stay in one department longer.

### **Firm C: background, strategies and competitive outlook.**

Firm C is one of the major players in Japan's family restaurant industry. It has its origin in the 1970s and actually belongs to one of the larger retail groups. Initially, it operated through a licensing agreement with a foreign firm but it achieved the independent rights for its name and format in the 1980s. At the time of the interview, the firm operated about 550 restaurants. The firm focuses on 'high quality and delicious food', 'pleasant service' and 'reasonable prices' by striving for 'quality above anything on every detail'. The firm has been very successful in this respect, with strong growth since its beginning in the 1970s.

However, the restaurant business has suffered from the lack of domestic demand and the sales of the firm's restaurants have been depressed in recent years. Moreover, the firm expects these circumstances to continue in the immediate future. In response to these harsh circumstances, it has concentrated on its core operations. First of all, it has strengthened the operating structure of the restaurants through, for instance, changes in staff recruitment and training. In addition, new restaurants are opened and low-performing outlets are being closed. Moreover, the firm has also taken several measures to boost demand. Examples include new services like a party reservation service, take-out services and special late-night meals, new menus based on popular demand and increased quality of ingredients, and better communication towards customers. Moreover, regional managers have greater discretion in developing menus and services and adapting employee-training programmes. Finally, the firm has also opened a prototype restaurant intended as a testing ground for enhanced operations during the evening meal period.

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<sup>248</sup> At half term, there is an interview with the superior about the degree to which goals are achieved and ability is exercised. At the end of the period, another evaluation interview takes place for feedback.

### **Firm C: changes in human resource management**

Firm C has no problem of excess employment. It has even increased the number of new graduates it hires because of the continuing growth in the number of restaurants. In addition, mid-career hiring exists for financial and industry specialists.

In spite of being in a somewhat different industry, the changes in human resource management are very similar to the firms in retail. Most striking is the clear development towards a higher percentage of part-time employees to balance wage costs and revenues.<sup>249</sup> About 90 per cent of employees is part-time. Moreover, the firm also offers improved career possibilities to these employees, even to an extent that surpasses the other firms. At firm C, the same ability qualification system exists for regular and part-time employees and part-timers can become manager. Moreover, employees can switch between a regular and part-time contract. A so-called 'candidate system' exists, which enables employees to express their preference for a certain position. This system was introduced in 2002 and is based on the abolishment of the distinctions between qualifications, abilities, and employees. However, it will be obvious that most part-time employees are not interested in having a 'regular' career as they are not willing or capable to invest the necessary time and energy. It was estimated that about 10 per cent of part-time employees were interested in the extended career possibilities.<sup>250</sup>

The same evaluation system thus applies to all employees. Just like at the other firms, evaluation is based on ability and performance. Overall, twenty different categories are distinguished. The hierarchy has eight ranks (N1 – N8), of which the first six (N1 – N6) each have three steps. For placement in these categories, there is no relation to the length of experience but to the evaluation of (1) service ('the basic stance towards business') and (2) achievements or results. Both these criteria are evaluated according to evaluation forms that are category or rank-specific. The form for evaluating 'service' includes categories like office regulations, business basics and the 'tackling' of work. For all the criteria included, points are deducted or added depending on the level of accomplishment. A partial example of such a form is included in table 9.7. The form for evaluating results distinguishes the 'quality of the execution of tasks' and the actual 'work achievements'. Table 9.8 gives a partial example. After a weight is determined for the various criteria, the execution of tasks and the results are evaluated on a five-point scale. The three factors are then

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<sup>249</sup> At firm C, no distinction exists between part-time and *arubaito* employees.

<sup>250</sup> As a matter of fact, there is another major distinction among employees. Since 1989, employees choose between an area-specific and a national career-track. Employees in the local career track (chosen by about ten to fifteen per cent of regular employees) can move no higher than supervisor.

multiplied.<sup>251</sup> This form is actually combined with an open MBO form for which targets are formulated. In this case the level of difficulty of the target is also taken into account. The scores for the various evaluation forms for service and achievements are then combined into an overall judgement.

		Evaluation		
		Self	Direct supervisor	Next supervisor
Office regulations	Always greet your superior, colleagues and subordinates upon arrival. Rate of absence is less than 10%. No mistake in the registration for arrival. Always register arrival before work start except in case of accident.			
	Always leave contact-information when away from place of work (or keep contact periodically). Always coordinate holidays with other staff to prevent the interruption of work. Always report before starting overtime work.			
Business basics	Have an appropriate appearance (dress and hair). Maintain social rules (punctuality, language).			
	Do not make the customers wait. In case this is inevitable, always apologize beforehand. Adhere to the times promised to the customers and business partners. No mistakes are allowed.			
	In case of a return call, always inform about the time you are present. Answer the phone within 3 rings. No long conversations.			
	Keep an eye on the time when you call outside. Identify the main points before calling. Also keep an eye on your language when making a call. Do not cause unpleasant feelings. Don't be a source of complaints.			
	Do not disclose company secrets. Always lock your desk. Always secure accounting documents. Do not forget (to take) your copies.			
	Etc.			
Execution of work.	Handle work with initiative and determination. Be aware of your own role. Do not neglect your duties. Understand directions correctly. Handle problems in accordance to urgency and need.			
	Always perform work with cost-consciousness. Always check with the budget. Minimize the costs wherever possible.			
	Be enthusiastic in proposing improvements in work and the achievement of objectives. Plan and implement methods and procedures for the achievement of goals efficiently.			

**Table 9.7 Partial example service evaluation form**

<sup>251</sup> Both forms are filled in by the employee concerned, his or her supervisor, and the supervisor's supervisor.

Promotions are determined through a combination of ability, tests (until the GM level, rank N5), customers' opinions, and costs. For employees of a certain rank, wages are equal but bonuses can differ. For the restaurant owner, the bonus is fully dependent on the restaurant's profit but his or her subordinates can also receive a bonus in the absence of sufficient restaurant profits. The difference between a successful and unsuccessful owner is about 1.5 million yen. For the main office staff, the bonus depends on the overall firm results.

Level (quality) of execution of tasks	Work achievements	Weight (A)	Execution (B)	Results (C)	(A/100) * B * C
<ul style="list-style-type: none"> <li>• How was the load of work?</li> <li>• Was is done with accuracy?</li> <li>• Was it done with attention for detail?</li> <li>• Were there any problems concerning planning and the subsequent implementation?</li> <li>• Was it done with flexibility?</li> <li>• Have problems that occurred been dealt with?</li> <li>• Has the work been performed regularly with eagerness?</li> </ul>	<ul style="list-style-type: none"> <li>• Did the results live up to the expectations?</li> <li>• Was the work executed on time without reminders?</li> <li>• Did the employee demonstrate knowledge, skills, and techniques in the job?</li> <li>• Have attempts to improve work been regular and successful?</li> <li>• Has the job been done in accordance with its importance and urgency for the department or the overall organisation?</li> </ul>				

**Table 9.8 Partial example result evaluation form**

### Concluding remarks

A first issue that stands out are the differences among the firms. Firm A can be considered an innovative firm with an eye for the future. This also shows in its HRM, which has been rather pro-active and the adjustments to the changing environment therefore appear rather smooth. A comparable story holds for firm C, which shows a similar pro-active attitude in the governance of employment. Firm B, on the other hand, appears more traditional. This is also reflected in the firm's employment practices. It seems that, in the past, the firm basically adopted national practices as it was able to offer rather generous working conditions because of the relative lack of competition on the Japanese retail market.

In spite of these differences, the firms showed strong similarities in the trend towards performance-based evaluation and the increased hiring of non-regular



employees. In particular, this last development is striking as it sets the retail (and restaurant) industry apart from the other industries in this study. Moreover, the career possibilities for these employees also appear to be rising. In particular, the situation at firm C is striking as it not only has one system for evaluation but also allows non-regular to become regular employees. It thus appears that the retail industry has further extended its specific type of human resource management. This raises interesting questions as it is clear that the productive logic discussed in chapter four is of lesser importance than in the other industries. Moreover, the implications of this development might actually extend beyond these industries as the trend towards higher percentages of non-regular employment holds for most industries. As these issues require a rather extended analysis, the next chapter discusses the rise in non-regular employment and the inter-industry differences in employment practices.

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Overview changing employment practices

RETAIL		Firm A	Firm B	Firm C
Firm Characteristics	Age	About 80 years (main growth in last 40 years)	About 40 years (extension from an older firm)	About 30 years
	Main products	Superstores	Supermarkets	Family restaurants
	Competitive strength	Innovative strength as illustrated by several important past innovations.	‘Customer-first’ philosophy (customer satisfaction).	Offers ‘delicious food’ in family-oriented, ‘American-style’ restaurants for a good price. Known for its good management.
	Business strategies	Product and management reforms through (1) attention for business needs of individual stores and (2) introduction store management innovations.	Several business reforms in recent years. Measures include the revitalisation of stores, the extension of operating hours, a reduction in the number of holidays, and converting fixed costs like personnel expenses into variable costs.	Several strategies in response to difficult circumstances like differentiating restaurants through better quality and service, changes in recruitment and training, closing low-performing outlets, developing new services, and more discretion to regional managers.
Most Urgent HRM Issue	Economic situation	Very successful compared to its direct competitors in sales, net income, and financial position. However, also suffered lower profitability because of weak demand and deflation. This has inspired the recent reorganisation.	Rather weak financial results in recent years with negative or very limited net income. However, the recent reforms appear to have enabled a return to black figures.	The restaurant business has also suffered from weak domestic demand; sales have been depressed and this is expected to continue in immediate future. However, the financial results remain relatively robust and the number of restaurants is still rising.
		The high wage costs. The share of total costs has increased and forced the firm to increase efficiency and/or cut costs.	The high wage costs under seniority wages and lifetime employment.	High wage costs under declining revenues.
Inflow	Composition	Regular employees, part-timers, <i>arubaito</i>	Regular employees, part-timers, <i>arubaito</i>	Regular employees and part-timers/ <i>arubaito</i> (no distinction made)

RETAIL		Firm A	Firm B	Firm C
Changing numbers / percentages	Increased use of part-timers (2002: 60%) to reduce costs.	Increased use of part-timers (2003: 69.6%) to reduce costs. Reduced hiring of new graduates.	Increased use of part-timers (2003: 69.6%) to reduce costs.	Increased use of part-timers/ <i>arubaito</i> (2002: about 90%) to reduce costs.
Mid-career hiring	System is in place but currently there is no need. However, it was important during the 'growth years'.	-	-	Limited to specialists in fields like finance or with knowledge of the industry.
Different career tracks & their possibilities	For part-timers, there is the distinction between those working less than 30 hours and those working between 30 and 35 hours.	-	-	Regular employees can choose between an area-specific and area-flexible career track. Employees in the area-specific career track can move no higher than supervisor.
Criteria for evaluation: seniority, ability &/or performance (results)	Performance has received more weight in evaluation because decreased growth created a gap between ability and output.	Except for the lowest grade of employees, ability and performance has received more weight in evaluation. The employment system has been changed a couple of times and the importance of job performance has subsequently grown bigger.	Except for the lowest grade of employees, ability and performance has received more weight in evaluation. The employment system has been changed a couple of times and the importance of job performance has subsequently grown bigger.	The same evaluation system applies to all employees (including part-timers/ <i>arubaito</i> ) and is based on ability and performance.
Reason(s) for change	To reduce costs and to motivate employees to take on the challenge of new work.	(1) The overall age has increased and (2) there are fewer posts for promotion.	(1) The overall age has increased and (2) there are fewer posts for promotion.	
Evaluation forms & procedure	The evaluation process knows two important elements: (1) the evaluation of and (2) the evaluation of achievements, results. Based on differences in work and position, about 60 different classes are distinguished. Although the criteria are similar, the weight of the factors can differ substantially.	Focus is on (1) the accomplishment of objectives and (2) ability (potential; in particular important for promotions). Ability and performance are established through test and interviews. The precise criteria are as follows: 1 <sup>st</sup> – 4 <sup>th</sup> grade (shop-manager); performance; 5 <sup>th</sup> /6 <sup>th</sup> grade (section / assistant manager); performance and ability; 7 <sup>th</sup> grade (supervisor); general evaluation.	Overall, 20 different categories are distinguished. The placement in these categories is according the evaluation of (1) 'service' (the basic stand towards the job) and (2) achievements or results. Both are evaluated according to their own evaluation forms that are rank-specific and subdivide these criteria into smaller categories.	
Internal Flow & Rewards				

RETAIL	Firm A	Firm B	Firm C
Evaluator(s)	In the case of process evaluation: (1) self-evaluation; (2) two supervisors determine the rank; (3) personnel department 'adjusts and confirms'. In the case of result evaluation, responsibilities and thus the evaluation tend to be straightforward and quantitative.	(1) self-evaluation and (2) supervisor.	(1) self-evaluation, (2) the supervisor, (3) the subsequent supervisor
Specific new instruments (MBO, <i>nempōsei</i> , etc.)	MBO; objectives are set every half-year. For frontline employees, focus is on direct measures like sales; for 'indirect' positions, objectives are set.	MBO	MBO
Wages (criteria for determination & differences)	Mainly determined by process evaluation.	-	Dependent upon rank.
Bonuses (criteria for determination & differences)	Mainly determined by result evaluation. The height of the bonus is dependent upon overall company performance. If profits are higher than expected, the total amount for bonuses is increased; if profits are lower, the amount for bonuses is diminished.	-	For the restaurant owner, the bonus is fully dependent on profit. Subordinates can receive bonuses in spite of insufficient restaurant profits. Office staff bonuses are dependent on overall results.
Promotions (criteria for promotion)	Promotion is according to common tests and qualification.	Particularly, (potential) ability; age restrictions for promotions have been removed.	Promotions are based on (1) ability, (2) tests (till the GM level), (3) customers' opinions, and (4) costs.
Training: OJT, OffJT, other	OJT is the main form of training. Short OffJT training after employees receive promotion.	-	-
Candidacy system	Motivated employees can become candidates for management positions irrespective to age, sex, or experience.	-	Employees can express their preference for a certain position. No decrease in hiring new graduates.

RETAIL	Firm A	Firm B	Firm C
Transition-period	-	Overall, better acceptance of changes among young employees.	It takes about 3 years for the company to adjust to important changes. There is no specific transition period (employees are free to leave).
Idiosyncrasies	Increased career possibilities for part-timers (qualitative). Actually, the company has delegated responsibility to part-timers since the beginning (e.g. store planning) but the quality of delegation has definitely improved. Three part-timers have become section chief & theoretically part-timers can become store manager. Sales sections with just part-timers have been introduced.	Increased career possibilities for part-timers although not to the same extent as at company A. Part-timers can rise as high as <i>kakarichō</i> but are more often in charge of certain sections like the registers.	Increased career possibilities for part-timers (qualitative). In many ways, part-timers are treated equally with regular employees. They are evaluated according to the same evaluation system and employees can even switch between a regular and part-time contract. Part-time employees can now become store manager (2002: 12 part-time managers).
Protection long-term employment	Yes	Yes	Yes
Reduction number of employees	No unbalanced employment structure because a relatively young industry. <i>Risutora</i> in the sense of cutting employment is not an issue. Reduced hiring and retirement is sufficient to adjust to slower growth.	In spite of the young age of the industry, there seems to be a relative excess of older employees. <i>Shukkō</i> is actively used (also to disperse knowledge through the organisation).	Also because of the increase in restaurants no excess of older workers. Average age employees of 32.5 is actually very low
Job-hopping	-	-	There are some examples of employees leaving. A fair system for evaluation is considered most important for keeping good employees.
Job rotation	Job rotation exists but is usually limited to one department, both in the stores and at the HQ.	Job rotation exists (' <i>tamaisuki</i> ' = billiard) but is usually limited to one department except for the store experience of management trainees. In the stores, employees usually remain in one section (medical, home or food).	All regular employees have to work as store manager during their career.
Work Systems			
Outflow			

RETAIL		Firm A	Firm B	Firm C
Outcomes	Quality (commitment, competence, & congruence)	Overall, no real complaints. Lack of creativity of Japanese employees is relatively true and companies that survive thus depend on direction by top management.	Overall, no real complaints. Some problems with unmotivated employees that have given up on promotion.	Overall, no real complaints.
	Cost efficiency	Main issue that is 'solved' through the increased use of non-regular employees.	Main issue that is 'solved' through the increased use of non-regular employees.	Main issue that is 'solved' through the increased use of non-regular employees.



## Part III

### Analysis

The next chapters interpret the findings of the empirical chapters by generalising the changes at individual firms to the industry- and national level. The first of these chapters discusses the industry-specific employment practices in the four industries of this study. Both the productive logic of employment practices and an alternative, so-called ‘part-time’, logic are instrumental in explaining the differences between industries. The subsequent chapter discusses the changes as they are shared at the national level, namely the rise in performance-based pay (*seikashugi*), the diversification of employment types, and the rise in labour mobility. The chapter also discusses the implications of these changes and poses the question if these developments announce a new constellation of Japanese employment practices. However, the answer to this question is predominantly negative. The last chapter then draws the conclusions of this study by discussing both the implications of the changing employment practices and some insights concerning the theories used.





# 10. Industry-Specific Employment Practices

## The rise of non-regular employment

*Introduction. The determinants of inter-industry differences in employment practices. The part-time logic of Japanese employment practices. The analysis of inter-industry differences. Concluding remarks. References.*

### Introduction

Chapter five discussed the rise of non-regular employment as one of the major developments in Japanese employment practices with the statistics, represented in table 5.10, showing increased percentages for all categories (part-timers, *arubaito*, *shokutaku*, and dispatched workers from employment agencies). The case-studies in the previous chapters appear to confirm this development, with the retail industry as the most striking example. However, the role of non-regular employment has so far played a limited role in the discussion of Japanese employment practices. Previous analyses tend to focus on (the productive logic of) core employees while relegating non-regular employment types to their role as ‘employment buffer’, as a complement to regular employment. Chapter four was testimony to this approach. However, its increased importance suggests that non-regular employment has also become an important substitute for regular employment. This chapter studies this last possibility by discussing whether the retail industry can provide the inspiration for an alternative logic of Japanese employment practices, just like the automobile

industry has in the past been the inspiration in the development of the productive logic. For lack of a better word, this alternative logic could be called the ‘part-time logic of Japanese employment practices’.<sup>252</sup>

However, in spite of a general trend, the importance of non-regular employment differs substantially between the various industries. Table 10.1, which lists the percentages of regular and non-regular staff for the industries of this study, shows the extent of these differences.

	Regular staff	Non-regular staff
All	68.5	31.5
Construction	82.3	17.7
Manufacturing	78.6	21.4
Wholesale and retail trade	55.7	44.3
Eating and drinking places, accommodations	36.6	63.4

**Table 10.1 Percentages regular and non-regular staff by industry, 1<sup>st</sup> quarter 2004**

Source: Japan Institute of Labour, 2004b, Table 5

Not all industries have the same need and/or possibilities to replace regular by non-regular employees. This introduces the second major topic of the present chapter, the existence and determinants of inter-industry differences in employment practices. Besides various similarities, like the continued support for lifetime employment and the trend towards performance-based pay, the previous chapters showed significant differences between the four industries. This chapter investigates to what extent these differences can be explained. The part-time logic of employment practices is an important candidate to explain these differences, just like the previously discussed productive logic.<sup>253</sup> In the case of the latter, we have already discussed various contingencies for success which are a likely source of inter-industry differences in employment practices. A similar situation can be expected to characterise the part-time logic and the next section discusses to what extent both the productive and part-time logic can indeed be a source of inter-industry differences in employment practices.

<sup>252</sup> This refers to the generic meaning of part-time (*pāto*), which comprises all types of non-regular employment. See the previous chapter for a discussion of the various types of non-regular employment and the double (both generic and strict) meaning of the term ‘*pāto*’.

<sup>253</sup> The productive logic, discussed in chapter four, refers to the importance of typical Japanese employment practices in the realisation of organisational flexibility and efficiency through broad, ambiguous job descriptions and the development of firm-specific skills.

### **The determinants of inter-industry differences in employment practices**

In discussing the inter-industry differences in employment practices, this chapter focuses on their functional efficiency. However, a major complication exists as employment practices are determined by more than functionality alone. Issues of legitimacy, isomorphism and path-dependence have played an important role in the development of Japanese employment practices. As social and embedded practices, they have developed rather independently from functional considerations and have become to characterise all industries. This explains the strong similarities at the national level.<sup>254</sup> The history of Japanese employment practices subscribes to the various grounds for their existence. We have seen how the core practices were developed through the early post-war struggles between employers and unions. In later years, employment conditions became important in attracting high quality employees as market success was achieved rather easily, particularly for firms that operated only on the domestic market. The impression exists that during these years, with firm B in retail as a good example, many firms did not critically develop their HRM but mostly adopted national practices, by choice or because the need for legitimacy forced them to do so.<sup>255</sup>

The employment practices are thus both an answer to the specific organisational demands of the Japanese firm and social practices with their own momentum. As a consequence, the relation between the organisational mode of the horizontal hierarchy and the accompanying employment practices is not one-dimensional but dialectical. We can thus reverse the relation as it was discussed in chapter four. Employment practices did not only develop in answer to a certain mode of organisation but this mode has also been dependent upon the existing employment practices.<sup>256</sup> As a consequence, the productive logic of Japanese employment practices can be expected to extend beyond functional expectations. In other words, we are likely to find the horizontal hierarchy, or certain of its elements, in industries that do not necessarily benefit from its presence. As long as these industries operate mainly in the domestic market, these 'inefficiencies' can endure with relative ease as the constellation achieved is the best given the existing circumstances and shared among all competitors. In this case, it is only through

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<sup>254</sup> If employment practices were solely developed on functional grounds, we would expect more variety within and less variety across countries.

<sup>255</sup> The discussion of (mimetic) isomorphism by DiMaggio and Powell (1991b) is insightful in this respect.

<sup>256</sup> This mutual relation between organisational mode and employment practices implies important criticism on theories, like transaction cost economics, that present employment governance as a strictly functional solution. See the concluding chapter for a more elaborate discussion of this issue.

international comparison that the inefficiencies show, like in the case of the Japanese construction and retail industry.<sup>257</sup>

This discussion suggests a number of possible determinants of inter-industry differences in employment practices. An initial determinant concerns the efficiency of the two different types of employment logic. In the case of the productive logic, the various contingencies are crucial; in particular the existence of manufacturing activities with strong stochastic and technological interdependencies.<sup>258</sup> In anticipation of the part-time logic of employment practices, we should also look at the extent to which industries have been able to replace regular by non-regular employees. As discussed in the next section, non-regular employees have important advantages in terms of costs and flexibility and can be an attractive alternative to certain regular employees. However, industry circumstances will determine to what extent these advantages exist. Another possible determinant of differences in employment practices is the importance of legitimacy. Ahmadjian and Robinson (2001) point out how a firm's need for legitimacy is positively related to its size, age, reputation, and wage levels.<sup>259</sup> However, the impact of legitimacy has not been an explicit focus during the interviews and functions here as a supplementary explanation. Finally, we should include the economic pressure for change as another determinant of difference. Some of the industries included in this study are confronted with very difficult market circumstances and this is likely to influence the adaptations they have made.

### **The part-time logic of Japanese employment practices**

The retail industry has been the ultimate example of the general trend towards a rising importance of non-regular employment.<sup>260</sup> This section therefore discusses to

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<sup>257</sup> As discussed before, the efficiency of the productive logic of employment practices (the efficiency of the horizontal hierarchy and its accompanying employment practices) not only differs between industries but is also dependent on changing circumstances. One can, for instance, argue that the trend towards modularisation has weakened the efficiency of the horizontal hierarchy in the electronics industry.

<sup>258</sup> Stochastic (risk) and technological interdependencies mean that events in one stage of the production process have their implications for other stages. In this case, the direct and rich coordination through the horizontal hierarchy can be very successful. However, modularisation diminishes the interdependencies and thus the need for coordination. See chapter four for an elaborate discussion of these issues.

<sup>259</sup> Ahmadjian and Robinson (2001) list 'foreign ownership' as a fifth indicator of legitimacy but this has so far hardly had an impact on the industry-level and, more crucial, is hardly a factor among the firms of this study.

<sup>260</sup> The rise of non-regular employment fits in a worldwide trend towards non-regular, peripheral or flexible employment (see e.g. Pinfield and Atkinson, 1988; Felstead and Jewson, 1999; Auer and Cazes, 2003).

what extent the retail industry can be considered a model of a part-time logic, based on the involvement of non-regular employees. The crucial question concerns the advantages that are provided by non-regular employment but the variety in non-regular employment types actually makes this a complicated issue.<sup>261</sup>

In the retail industry it is particularly the part-timers (strict definition) and among them the pseudo-part-timers who play an important role.<sup>262</sup> We have already seen how they perform jobs that approximate those of full-time workers (Broadbent, 2003) and are sometimes considered part of the core workforce (Gadrey *et al.*, 2001). Moreover, the similarities with regular employees extend further since a large group of part-time employees holds relatively stable employment. Kezuka (2001) states how 63.2 per cent of the part-time workers have a contract without a fixed term. Moreover, even employees with fixed-term contracts often have relatively stable employment because of repeated contract extensions. 'Part-time workers who have experienced extension of their employment contracts accounted for 83.6 per cent, with the average number of extensions per person being 9.5 times (males, 5.7 times; females, 10.4 times)' (Kezuka, 2001, 259). This has important consequences because, as we have seen in chapter two, Japanese case law interprets a repeated extension of contracts, or even a reasonable expectation of continued employment, as sufficient to treat a refusal of renewal as dismissal and thus amenable to the case law concerning proper dismissal. Passet (2003) therefore refers to these part-time workers with repeated contract renewals as quasi-regular-employees.<sup>263</sup>

This pseudo-regular character of part-time employment means that it offers relatively little advantage in numerical flexibility.<sup>264</sup> Instead, the lower labour costs,

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<sup>261</sup> The last chapter discussed the various types of non-regular employment as they can be found in the retail industry.

<sup>262</sup> As described in the previous chapter, a distinction can be made between part-timers who work less than 35 hours a week and the so-called 'pseudo-part-timers', employees who have a part-time status but work about as many hours as full-time employees (usually defined as more than 35 hours a week).

<sup>263</sup> This position of non-regular employees also hinders the various statistics on regular and non-regular employment. In agreement with the stable employment of many part-time employees, The Labour Force Survey (previously conducted by The Management and Coordination Agency, nowadays by The Ministry of Public Management, Home Affairs, Posts and Telecommunications) defines regular employees 'as those with contracts of unspecified duration or who have been employed for more than one year' (see Passet, 2003, 174). However, the Employment Status Survey (also conducted by The Ministry of Public Management, Home Affairs, Posts and Telecommunications) actually classifies employees 'according to how their positions are at their workplace' (see The Ministry of Public Management, Home Affairs, Posts and Telecommunications, 1997, Employment Status Survey).

<sup>264</sup> Passet (2003) states that the use of part-time employees has changed from pro- to counter-cyclical in recent years. Thus, instead of using non-regular employment as a buffer, firms have actually increased non-regular employment to reduce labour costs. The findings of the case-studies appear to support this conclusion.

as mentioned during several interviews, appear of crucial importance. This is also confirmed by the reasons for hiring part-time employees as they were shown in table 5.11, repeated here as table 10.2.

	Short-time part-time jobs	Other part- time jobs	Temporary agencies' staff
Need to control labour costs	61.5 (52.3)	59.1	40.3 (35.9)
Require additional personnel on a daily or weekly basis	36.2 (34.4)	21.9	8.1 (15.7)
Need to adjust hiring practices due to changes in business conditions	26.9 (20.7)	24.8 (18.6)	26.2
Require more workers because of extended business hours	23.9 (19.7)	17.3 (3.1)	6.0
Need to meet temporary or seasonal demand	19.1 (15.8)	18.2 (12.1)	22.8
Allow regular workers to specialise in important work	14.6	12.2	14.2
Require persons capable of doing specialised work	11.5 (9.5)	11.6	23.8 (37.8)
Require persons with experience and expertise	10.6 (6.5)	14.2 (22.9)	31.0
Unable to recruit regular workers	9.3 (20.3)	10.9 (16.0)	8.5
Wish to re-employ older workers	5.5 (5.2)	7.0 (2.0)	0.9
Substitute for regular workers on childcare or family-care leave	4.7	4.0	7.5
Others	6.1 (7.4)	6.4 (5.7)	5.8

**Table 10.2 Reasons for hiring non-regular employees 1999 (in brackets, 1996).**

Sources: Survey of the Diversification of employment Status, Ministry of Labour, 1999 (Japanese Institute of Labour, 2004a, 19); Survey of the Diversification of Employment Status, Ministry of Labour, 1996 (Passet, 2003, 193).<sup>265</sup>

The table shows the 'need to control labour costs' as the overriding reason for hiring part-time employees. This importance of costs is underlined by table 10.3, which

<sup>265</sup> The Survey of the Diversification of Employment Status also gives an overview of the reasons workers provide for working as a 'non-regular worker'. As the current study focuses on the perspective of the firm, it does not discuss these reasons elaborately but the number of hours and the time of work are major arguments. The most important reasons in the case of short-term employees are the following: 'I can choose my own hours' (43.9%), 'I want to defray educational or household expenses' (41.2%), 'working hours and working days are short' (37.7%), 'I can strike a good balance between home life and other activities' (36.0%), and 'commuting time is short' (35.5%). For the category of 'other part-time jobs', the reasons most often mentioned are 'I want to defray educational or household expenses' (32.3%) and 'commuting time is short' (31.4%). Only 19.0 per cent answered that they were not able to find a permanent position. This was more important in the case of temporary workers (29.1%), who also list 'I am not tied to an organisation' (26.8%) and 'I can put my special qualifications and abilities to use' (25.7%) as important reasons (Survey of the Diversification of Employment Status, Ministry of Labour, 1999; see Japanese Institute of Labour, 2004a, 19).

compares the labour costs of regular and non-regular employees during the 1990s. This table shows how differences in pay have actually widened, a trend that even goes back further than the 1990s. 'In 1977, for example, part-time workers received 69.7 percent of regular workers' salary, but 20 years later in 1997, they received a mere 56.7 percent' (Kezuka, 2001, 259).<sup>266</sup> The differences in pay can explain the numerical growth of the group of pseudo-part-timers.<sup>267</sup>

Year	Females			Males		
	Regular workers (¥)	Part-time workers (¥)	Wage ratio (regular worker=100)	Regular workers (¥)	Part-time workers (¥)	Wage ratio (regular worker=100)
1989	934	662	70.9	1542	855	55.4
1990	989	712	72.0	1632	944	57.8
1991	1072	770	71.8	1756	1023	58.3
1992	1127	809	71.8	1812	1053	58.1
1993	1187	832	70.1	1904	1046	54.9
1994	1201	848	70.6	1915	1037	54.2
1995	1213	854	70.4	1919	1061	55.3
1996	1255	870	69.3	1976	1071	54.2
1997	1281	871	68.0	2006	1037	51.7
1998	1295	886	68.4	2002	1040	51.9

**Table 10.3 Trends in the scheduled payment per hour for regular and part-time workers, by gender.**

Source: Kezuka, 2001, 260

<sup>266</sup> This increasing difference probably reflects the fact that labour conditions of regular employees are determined by the administrative rules of the internal labour market while part-time employees are paid for their specific tasks according to market value.

<sup>267</sup> This difference in pay has led to a discussion about a fair balance in working conditions between regular and non-regular employees. Interesting, in this respect, is a report that was released in April 2000 by the 'Study Group Concerning Employment Management of Part-time Workers'. The report proposes the distinction of two groups of part-time employees: 'Type A, engaged in the same duties as regular employees; and Type B, engaged in different duties. With regard to part-time workers in the type A group, the report calls for the application of identical methods of determining treatment and labor conditions for both regular and part-time employees...At the same time...the report allows the possibility of reasonable differences on the grounds that part-time workers do not work overtime, do not work on holidays, do not transfer to different sections, and do not transfer to different offices or workplaces' (Kezuka, 2001, 263). This actually shows strong similarities with the trend towards the replacement of regular employees in the *ippanshoku* employment track, as discussed later in this section.



The issue of flexibility, usually associated with non-regular employment, is of secondary importance.<sup>268</sup> However, it remains an important advantage. This is shown by table 10.2, which lists the need for ‘additional personnel on a daily or weekly basis’ as the second-most mentioned reason for hiring short-time part-time jobs (*arubaito*). Moreover, non-regular employees also offer the quantitative flexibility to adjust to busy periods during the day or week as extended opening hours have created the need for part-timers who work increasingly targeted hours (Ribault, 2000).<sup>269</sup> Finally, the stability of employment must be qualified. As we have seen in chapter two, the protection of part-time employees is always second-rate compared to that of regular employees. They can therefore still be expected to function as a buffer for regular employees in case of severe economic circumstances.

A subsequent question is to what extent these findings are representative of the other industries. We indeed see several areas in which non-regular employees have taken over the position of regular employees. One trend appears to be shared by all industries. This concerns the jobs in the ‘general staff’ or ‘auxiliary’ employment track as it is distinguished by many firms. The jobs in this track are relatively unskilled and repetitive and its employees have no chance to be promoted to a managerial position (Kyotani, 1999). These jobs are a candidate for replacement by non-regular employment types and various firms have indeed replaced or are replacing the (female) employees in this track by non-regular employment types like part-time and detached employees. This could actually explain why the dual track employment system appears to have lost some of its previous popularity (see table 5.6). Moreover, this development is in accordance with Nikkeiren’s multi-track personnel system which proposes a peripheral group of employees for simple routine tasks (Nikkeiren, 1995). The current trend towards non-regular employment could be considered as an important contribution to the development of this group. However, as this section has shown, a significant percentage of these non-regular jobs actually appear rather regular and stable.

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<sup>268</sup> As a matter of fact, regular employees also play an important role in achieving everyday flexibility. Ribault (2000) describes how part-time employees enjoy stable and specific working hours in return for low hourly wages and no or limited promotion prospects. Regular employees, on the other hand, are an important source of flexibility because they are expected to work overtime if necessary.

<sup>269</sup> Another major force in the growth of this type of employment is the tax and social insurance system. If annual income exceeds 1.3 million yen, a worker loses status as a dependent and this requires the payment of premiums for medical care insurance and pension payments. Moreover, transgressing this amount is also likely to have consequences for the family allowances the partner is entitled to at his (or her) place of work. ‘Under such tax and insurance systems, it is perhaps inevitable that married women engaging in part-time work should adjust their working hours to avoid liability for tax and insurance premiums’ (Kezuka, 2001, 260).

However, beyond this shared strategy, all industries appear to have their own, specific types of non-regular employment. The discussion of the retail industry has illustrated how the various types of non-regular employment all offer their specific advantages in terms of quality (skills), flexibility, and costs. Part-time employees offer relatively stable employment, with accompanying possibilities for training, *arubaito* offer flexibility, both numerical and in working times, and dispatched employees (temporary agencies' staff) are also valued for their specialisation or experience and expertise (see table 10.2). As a consequence, each industry is likely to develop its own portfolio of non-regular employment and this appears the main difference with the employment of regular employees. The employment practices towards regular employees achieved a normative status and became something firms and employees aspired to but in the case of non-regular employment, this appears unlikely.

Finally, these advantages of non-regular employment are obviously not limited to recent years. Non-regular employment has always held an importance beyond its role as employment buffer but, until recently, received little attention. However, changing circumstances like the shift from manufacturing to service industries, the shrinking margins because of the weak demand, and the revision of the Worker Dispatching Law, have led to the increase in non-regular employment. This growing importance makes it tempting to present an alternative employment logic, a part-time logic, based on the employment of various non-regular employment types which offer varying advantages in terms of quality, flexibility, and costs.

### **The analysis of inter-industry differences**

This section resumes the discussion on the relevance of both types of logic, productive and part-time, as a source of inter-industry differences in employment practices. In part, these differences have been around for many years, in part they have changed in recent years as the difficult circumstances have forced firms to replace regular by non-regular employees.<sup>270</sup> As mentioned before, an important observation need to be made concerning the productive logic as the accompanying employment practices have achieved a normative status and are likely to have spread beyond their 'functional borders'. Moreover, the dialectical relation between organisational mode and employment practices makes that this spread has extended to organisational practices and the subsequent discussion takes this possibility into

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<sup>270</sup> This chapter only discusses the adaptations in employment practices as they are relevant in the discussion of these inter-industry differences. Most adaptations in employment practices are left for the next chapter as they are shared at the national level.

account. Finally, the interpretation of these industry differences is at times rather explorative. However, this can be justified since the main interest is not so much the industries themselves but the diversity in employment practices, a diversity that tends to have been obscured by the dominant focus on national similarities in the past.<sup>271</sup>

The automobile industry can be considered as the ultimate presentation of the Japanese post-war economic success. Moreover, the productive logic of employment practices has been strongly inspired by the automobile industry and has been considered an important reason for the industry's growth. However, the success dwindled since the middle of the 1980s and in this new environment the performances of the Japanese firms have differed substantially. Nevertheless, the employment practices and wider organisational practices have hardly been questioned and are still considered efficient.<sup>272</sup> This can hardly be considered surprising as the automobile industry fulfils all the major contingencies, namely the dependence on manufacturing, the dependence on technology (complementarity and stochastic correlation), and the dependence on product markets (volatility).<sup>273</sup> We can therefore expect that changes in employment practices will be modest and quantitative rather than qualitative.

The case-studies indeed showed a continued support. The primacy of intellectual and contextual skills was confirmed as firms stressed the importance of vague flexible job descriptions, intentional overlap between jobs, and job rotation at the blue-collar level. On-the-job-training (OJT) remains crucial for the basic training of employees, just like job rotation.<sup>274</sup> Moreover, in spite of the trend towards performance-based pay, we see a continued importance for ability as a criterion for evaluation. For several reasons (motivation, training, wage costs, limited growth), the firms have increased the role of performance in evaluation but the extent of this development has so far been relatively limited. The long-term development of ability remains crucial and promotion in firm B is, for instance, characterised by

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<sup>271</sup> The interpretation of the part-time logic and the inter-industry differences in employment practices would benefit from additional field research as the findings were based on a single round of interviews and the implications of the rise of non-regular employment only became clear during the interviews,

<sup>272</sup> A possible exception is the adjustment logic that is sometimes considered an impediment to the necessary reorganisation. However, this has not led to changes at the investigated firms. Firm A had to reduce the number of employees and did so according to the conventional adjustment logic.

<sup>273</sup> As mentioned, an elaborate discussion of these contingencies is provided in chapter four.

<sup>274</sup> However, it is important to note that job rotation, also at firms in other industries, tends to be limited to positions within a similar functionality, both for blue- and white-collar employees.

criteria like 'ability first' and 'speciality for the job'. At both firms, training remains crucial for young employees and their evaluation is strongly dependent upon ability and even seniority. Performance only becomes important for senior employees and even then the direct impact remains largely limited to bonuses. Wages and promotions remain largely determined by ability and in comparison to the other industries the trend towards performance-based pay has had a somewhat limited impact.

In addition, there is a relative absence of non-regular employees. The majority of employees are regular and non-regular employment is limited to a relatively small percentage of employees on (renewable) short-term contracts.<sup>275</sup> The interviewees explicitly stated that *ukeoi*-relations were impossible because of the need for firm-specific skills. A final characteristic is the importance of mid-career hiring but these employees tend to be rather young and can be integrated into the internal labour market on the basis of their previous experience. We can therefore conclude that in the automobile industry the internal labour market, and the productive logic of Japanese employment practices, remains crucial for the governance of employees.

Electronics is the other industry in this study for which the productive logic of Japanese employment practices has strongly contributed to past success. As another 'complex product' industry, it fulfilled all the contingencies for success. Accordingly, the employment practices have been similar to those in the automobile industry, with similar expectations concerning employees' contribution to manufacturing and plant operation. However, the electronics industry has also achieved important progress in standardisation and modularisation which allows for arms-length contracts and the use of electronic manufacturing services (EMS).

In recent years, most of the Japanese electronic firms struggled with very difficult markets circumstances, including a worldwide slump in IT products and weak domestic demand. Moreover, the Japanese firms were confronted with competition by low-cost producers in Asia, particularly China, which have matched the productive ability in many product categories. The modular character of electronic components has strengthened this development, just like the relative low capital intensity which enables the transfer of factories to low-cost areas. This led to a dip in domestic manufacturing and firms have been forced to reduce employment

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<sup>275</sup> Except for the aforementioned use of predominantly temporary agency staff in auxiliary positions.

by a substantial percentage.<sup>276</sup> Once again, the means of reduction can be considered 'traditional'.<sup>277</sup>

In addition, the need to reduce labour costs has led to a relative high percentage of non-regular employees. An interesting aspect is the existence of *ukeoi* employees, who constitute a substantial share of employment at certain firms (e.g. about 25 per cent at firm A). The need to reduce labour costs also appears the main reason for the introduction of performance-based pay, which has in some cases achieved major importance in the evaluation of employees as a means to align labour costs with employees' added value. However, as in the automobile industry, younger employees are by and large excluded from these changes as they still need to develop their skills. Overall, we can conclude that electronics requires similar strengths in manufacturing as the automobile benchmark. However, because of the modular character of production, the organisational mode of horizontal coordination appears less of a necessity and this enables the use of non-regular employment types and even EMS as a major cost-cutting strategy. Moreover, the strong international competition and the subsequent need to reduce labour costs makes this inevitable. In other words, the firms in the electronics industry have the possibility but also the need to extend their use of non-regular employees.

The economic circumstances in the construction industry have been extremely severe, easily exceeding those in the other industries of this research. As a matter of fact, the weak demand in the construction market has already continued for several decades. However, the situation worsened with the burst of the bubble and the subsequent lack of demand. At first, increased government spending offered some compensation for the lack in private demand but this strategy appears to have reached its limits. Overall, the industry is characterised by weak demand, high cost structures, thin profit margins, asset quality problems, and a market that is likely to shrink further. At the same time, adjustments are slow because of the industry's counter-cyclical character. The shrinking market has nevertheless forced the large firms in the present study to substantially reduce employment. Once again, this has been achieved according to the conventional adjustment logic, with substantial results.

The employment practices in the construction industry can be considered 'traditional'. Moreover, the firms also acknowledge the importance of ambiguous

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<sup>276</sup> Firm A is the major exception because of good results and because it stopped hiring manufacturing employees in the middle of the 1980s.

<sup>277</sup> The excess of employees also seems behind the limited use of mid-career hiring because there is no other reason to explain this absence. As a matter of fact, firm D makes rather extensive use of mid-career hiring, thus employing about 40 per cent of its new employees.

job descriptions and intentional overlap between jobs. Firm A speaks about a culture of *deshabaru* (obtrude, intrude) and firm B stresses how ability rather than job descriptions determines what employees are expected to do. However, we can question the functionality of these practices. Given the constellation of practices that has developed, this culture of '*deshabaru*' is clearly beneficial but it is uncertain whether these practices are truly efficient in the construction market. The contingencies for horizontal co-ordination suggest otherwise. Work in construction can be considered complementary and stochastically correlated but technological and model changes and varieties are less common than in the automobile or electronics industry. This creates good possibilities for standardisation.<sup>278</sup> As the industry nevertheless shows many characteristics of horizontal coordination, in spite of the limited fulfilment of its contingencies, it appears a good example of the widespread tradition of 'holistic' management which, to an important extent, characterises all industries.<sup>279</sup> In this respect, it is interesting to point out that Hasegawa (1988) has criticised the Japanese construction industry for not developing the possibilities for standardisation.

The severe circumstances have also inspired the construction firms to increase the importance of performance as a criterion for evaluation. Once again, the weight of performance criteria tends to rise with an employee's age and the responsibility of his or her position. In addition, the firms in the construction industry have also raised their percentage of non-regular employees, as illustrated by the strong decline in regular employees. However, the industry appears to have achieved a specific constellation. 'Non-regular' employment is important but not in its usual definition. The firms have achieved cost advantages by increased hiring at the regional level. If of sufficient ability, these employees are offered an open contract with lifetime employment but their status as branch employees continues to offer cost advantages to the firm. Moreover, the construction industry has always made extensive use of subcontractors and equipment installers for outsourcing. This strategy, comparable to the use of EMS in electronics, also provides the construction

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<sup>278</sup> At the same time, the legitimacy of employment practices appears an important issue for the major construction firms as they are characterised by a large size, an old age, a dominant position, a traditionally strong reputation, and high wage levels. All these factors contribute to the firms' visibility and legitimacy. Moreover, the competition for public works through closed bidding underlines the importance of legitimacy and embeddedness.

<sup>279</sup> We see that employment practices are actually in line with the current mode of production – and in that sense, there is a good fit – but we also have to remember that production did not necessarily had to be organised this way. In order to analyse the impact of employment governance on the mode of production, one actually has to compare Japanese and 'foreign' producers but that is outside the scope of this study.

firms with important advantages in terms of flexibility and lower costs. Once again, costs appear to be at least as important as flexibility.

In recent years, the difficult economic circumstances have also forced the firms in the retail industry to take action in order to reduce labour costs. This has, for instance, been the major reason to strengthen the importance of performance in the evaluation of employees. Moreover, firms have also increased their use of part-timers to reduce labour costs. All firms show an extension of the role and responsibilities of part-time employees. First of all, their percentage has been increased and now varies from about 60 per cent for firm A to 90 per cent for firm C.<sup>280</sup> In accordance, the firms also provide them with better career possibilities and part-time employees can now rise relatively high in the organisation. For instance, firm A has introduced sections that are fully run by part-timers and, as these initiatives have been successful, the firm planned to extend them in the future. Firm C even has a single evaluation system for all employees and allows employees to switch between a part-time and regular contract.

As the different contingencies are hardly fulfilled, there appears no major role for the organisational mode of horizontal coordination. Or more precisely, there appears no functional ground for a major role. However, the employment practices for core employees are also in accordance with those known from the other industries. Moreover, Japanese supermarkets also show a 'holistic' approach to management that appears in accordance, if not its exact implementation, with the organisational mode of horizontal coordination. This might actually be the reason for the industry's lack of productivity compared to the retail industry in other countries. However, the alternative practices are not merely a source of limited productivity. The retail industry provides services that Japanese customers have grown accustomed to and the practices have thus achieved their place in the Japanese retail market. This could explain why most foreign entrants to the Japanese retail market have not been very successful; in particular, when compared to the industry's perceived lack of productivity. As we already concluded in the previous chapter, it appears that foreign firms have to play according to the rules of Japanese retailing.

In comparing the four industries, we see clear differences in the relevance of both types of logic. The industries that have inspired the two types of logic offer the clearest examples. In the automobile industry, the productive logic remains strong

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<sup>280</sup> As mentioned, firm C is in the restaurant business, an industry known in Japan for its very high percentage of non-regular employees (see table 10.1).

and the use of non-regular employees is limited to a group with (renewable) short-term contracts. The retail industry, on the other hand, is strongly dependent upon the use of non-regular employees. The core employees are treated similarly as in the other industries but their relative number is limited. Moreover, non-regular employees have in recent years taken over positions previously held by regular employees. This has even led to certain qualitative changes in their career possibilities. The other two industries take an intermediate position in this respect. In both industries the productive logic of Japanese employment practices is not questioned. However, the firms in these industries have responded by changing the type of employees they hire. In the case of electronics, the *ukeoi* relations stand out as a specific type of non-regular employment. In the case of construction, it is not just non-regular employees per se that have been hired in an attempt to reduce labour costs. Instead the firms have increased the percentage of employees hired at the regional level.

We can conclude that the productive logic is indeed shared among the different industries. Given the national character of the Japanese employment practices, this can hardly be considered a surprise. However, we have also seen that the (functional) importance of this logic clearly differs. This shows in the degree to which regular employees have been replaced in recent years. Almost all firms have tried to reduce labour costs by replacing regular by non-regular employees but the possibilities for this strategy clearly differ between industries. The involvement of non-regular employees shows strong inter-industry differences; not only in the quantity but also the type of employees. Certain developments like the use of temporary agency staff to replace (female) employees in the *ippanshoku* track are shared among all industries. However, we also see how each industry appears to have its specific type of non-regular employment. Finally, we also find certain strategies that can be considered an equivalent to the extended use of non-regular employees.<sup>281</sup> Most striking examples are the importance of EMS in the electronics and subcontracting in the construction industry. Moreover, the production *keiretsu* in the automobile industry perform a similar role. These strategies are very similar and the duality between regular and non-regular employment relations is thus reminiscent of the well-known dual economy. However, this brings us to another discussion outside the scope of this study on Japanese employment practices.

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<sup>281</sup> Pinfield and Atkinson (1988, 18) speak in this case about distancing, 'the displacement of employment contracts, as exemplified by subcontracting. Rather than organise its own workforce to meet peaks in workload, a firm contracts out those peaks to other individuals or organisations' (Pinfield and Atkinson, 1988, 18).



### Concluding Remarks

This chapter discussed the specific employment practices of the four industries of this study. All of these industries indeed show the relevance of both the productive and part-time logic of Japanese employment practices. However, we see important differences in these logics' manifestation and implications. In the case of regular employment, the manifestation of employment practices is actually very similar. All industries employ regular employees under the typically Japanese employment practices as discussed in chapter four. However, the economic implications of these employment practices differ substantially. While the practices have been a source of competitive strength in the automobile and electronics industry, this does not appear to have been the case in the other two industries. In the case of non-regular employment, on the other hand, its implications appear rather similar but not its manifestation. Although costs appear the overriding advantage across all industries, the manifestation has been specific to the industries and an important role exists for (renewable) short-term contracts (automobile), *ukeoi*-relations (electronics), and temporary and daily workers (construction). Finally, we have also seen how firms use certain strategies that could be considered an alternative to non-regular employment, like EMS in electronics and subcontracting in the automobile and constructions industry. In this respect, we could conclude that one firm's regular employees are another firm's (equivalent to) non-regular employment.

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# 11. Changes in Japanese Employment Practices

## The likelihood of a new constellation

*Introduction. The rise of performance-based pay (seikashugi). The diversification of employment types. The rise of labour mobility. The likelihood of a new constellation of employment practices. Concluding remarks. References.*

### Introduction

As became clear in the previous chapters, changing circumstances have had their impact on the efficiency of both the Japanese employment practices and the accompanying mode of organisation. The firms have responded by changing their employment practices and, in spite of the differences between firms and industries, the adaptations show important similarities. This can hardly be considered a surprise as the employment practices are strongly embedded in terms of both functionality and legitimacy. As a consequence, firms cannot unconditionally change their employment practices. This also explains the most obvious characteristic of the Japanese employment practices in recent years, the continued support for lifetime employment. All firms in this study showed this continued support and, in particular, the apparent strength of their commitment was striking. The possible abolition of this practice did not appear an issue.

Besides this continued support for lifetime employment, we also found several changes in human resource management. The previous chapter already

discussed the rising importance of non-regular employment, this chapter discusses three other potential changes already introduced in chapter five. They concern the rise of performance-based pay, the diversification of employment types, and the rise in labour mobility. These developments are all of particular interest as they directly concern the internal labour market and thus the conventional employment logic for regular employees.<sup>282</sup> Moreover, they appear to be related. For example, performance-based pay and the diversification of employment (e.g. specialist career tracks) could make it easier for employees to switch employers, thus strengthening a possible trend towards higher labour mobility. This chapter therefore concludes with a discussion of a possible new constellation of Japanese employment practices.

### **The rise of performance-based pay (*seikashugi*)**

Chapter five discussed the trend towards performance-based pay and provided statistical data in support. This trend, which also exists outside Japan (see e.g. Redman, 2001), was confirmed by the field study. All firms in this research have in recent years strengthened the importance of performance as a criterion for evaluation and this trend actually stands out as the most striking adaptation in employment practices.

The reasons given for the shift towards performance-based pay are various and include the rise in the average age of employees, the decrease in promotional positions, and the unbalance that exists under the combination of the traditional ability-based system and the excess of senior employees. However, all these reasons can be summarised under the need to reduce labour costs. Interestingly, almost none of the firms presents the shift as a means to improve the motivation of employees. Instead, they stress the importance of a better allocation of employees to more productive positions and departments.<sup>283</sup> Improvements at the level of the individual are hardly considered. Some interviewees expressed the expectation that the performance-based wages might lead to better individual performance but such goals seem second-rate to reducing labour costs. The firms A in the automobile and electronics industry appear somewhat of an exception in their respective focus on better motivated employees and the fear for job-hopping to competitors.

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<sup>282</sup> This implies a crucial difference with the increased importance for non-regular employment as discussed in the previous chapter. That development took largely place outside the sphere of the internal labour market (with as a possible exception the development of a subordinate employment track in the internal labour market for part-time employees). In other words, the previous chapter discussed an alternative or complement to the internal labour market while this chapter discusses this market itself.

<sup>283</sup> This focus on allocation appears characteristic of the importance of functional flexibility in Japanese organisations.

At the same time, the case-studies show a wide diversity in their attempts to strengthen the link between performance and pay. All firms use management by objectives (MBO, *mokuhyō kanri seido*), but its type and place among the other criteria for evaluation differs. The subsequent discussion distinguishes 'open' and 'closed' MBO forms but these could probably be best interpreted as the ends of a continuum. In addition, the firms of this study also show two other instruments that signify a trend towards performance-based pay, namely job-based and competence pay.

(1) 'Open' MBO forms.

Many firms have introduced forms that enable employees and supervisors to develop the precise criteria for evaluation. Firm A in construction and firm D in electronics provide good examples. These 'open' forms have the important advantage that their character can be adjusted to the specifics of a certain division, function, and person. This, for instance, enables training-related objectives for younger employees while the objectives are more result-oriented for senior employees. Because of this flexibility, a sliding scale can exist between the evaluation of ability and performance.

(2) 'Closed' MBO forms.

Several firms have evaluation forms with pre-determined criteria for evaluation. These criteria can be formulated relatively open (e.g. firm B in construction) but can also be very specific (e.g. firm C in retail) and even quantitative (e.g. the result evaluation through criteria like 'profits' and 'sales' at firm A in retail). In case of 'closed' forms, it is obviously crucial to distinguish between different groups of employees as illustrated by the distinction of about 60 different classes, based on differences in work and position, at firm A in retail. Finally, the differences with 'open' MBO forms tend to be gradual as 'closed' forms predominantly specify the items and criteria for evaluation but not the actual objectives.

(3) Job-based pay.

In addition to MBO several firms have also introduced job-based wages. A good example is firm A in electronics, which has rated all jobs on a variety of factors. This rating determines the lower and upper limit of possible wage that a person is entitled to. However, the actual wages are determined by ability- and job/performance related factors with three subsequent criteria for evaluation: (1) individual ability, (2) MBO and (3) 'overall job performance'. We therefore should conclude that the jobs actually provide a intermediate step towards the determination

of wages.<sup>284</sup> Another example of job-based wages is provided by firm C in electronics. At this firm, each position is ascribed a so-called 'mission standard' (MS) based on three criteria: (1) the magnitude of responsibility, (2) the area of responsibility, and (3) the difficulty of accomplishment. The actual wage is then determined by incorporating a person's ability in performing this job. As in the previous example, the mission standards can thus be considered an intermediate step in the determination of pay.

#### (4) Competence pay.

Another approach towards performance-based pay has been introduced by firm B in electronics. It has developed certain ideal types of good performance in the form of so-called 'platform practises' and 'performance practises'. These practices formulate the standard conduct for each position and function. This approach concerns a type of competence pay, 'a method of rewarding people wholly or partly by reference to the level of competence they demonstrate in carrying out their roles' (Armstrong and Murlis, 1998; quoted by Lewis, 2001, 107).<sup>285</sup> This approach is valued because it identifies the competencies that are central to good performance, which includes processes besides results and makes it easier to give useful feedback (Lewis, 2001).

These examples show how firms have developed a variety of adaptations in their attempts to make pay dependent upon performance while maintaining a balance with the existing practices. Moreover, the differences are not limited to these examples. Other differences that appear from the case-studies include the types of evaluation (self-evaluation, upward appraisals, the number of evaluators), the impact of performance on either bonuses or overall pay, the groups subjected to performance-based evaluation, and the relative impact of performance next to other factors (e.g. ability, seniority, 'emotion and will', and allowances). All these issues testify of the variety that characterises the trend to performance-based pay.

Given the changed circumstances, the shift to performance-based pay is sensible and possibly even inevitable. The ageing population and the lack of

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<sup>284</sup> This approach actually shows strong similarities to the practice of 'broad banding', which can be defined as 'the compression of pay grades and salary ranges into a small number (typically four or five) of wide bands. Each of the bands will therefore span the pay opportunities previously covered by several separate pay ranges' (Armstrong, 1996; quoted by Lewis, 2001, 110). This approach can bring several advantages like a greater functional flexibility through intra-firm transfers and better possibilities for training (see Lewis (2001) for a more detailed discussion).

<sup>285</sup> Competencies can be defined as 'sets of skills, knowledge, abilities, behavioural characteristics, and other attributes that, in the right combination and for the right set of circumstances, predict superior performance' (Flannery *et al.*, 1996; quoted by Lewis, 2001, 108).

positions for promotion, due to the slow growth and the trend towards flatter organisations, make it necessary to change the former supply-oriented ability system and tighten the rules for promotion. At the same time, the change can have important implications for the logic of employment practices and we should take the likely consequences into consideration.<sup>286</sup> A natural point of departure is Koike's (1997) claim, as discussed in chapter five, that pay-for-job and pay-by-result plans cannot be effective in the context of the typical Japanese organisation. He considers ability wages a necessity for motivating employees to widen their work experience and build sufficient capabilities. All firms in this study have tried to solve this dilemma by limiting performance-based pay to senior employees. Ability and even seniority remain important criteria in the determination of pay for younger employees.<sup>287</sup> An illustrative example is the case-study of firm A in electronics, which explicitly discusses the differences in evaluation criteria between management and non-management employees. Moreover, most firms limit the impact of performance on pay to the bonus (exceptions are firm B in construction and firm A in electronics). This shows that firms are not forced to implement one single payment scheme and the choice as presented by Koike can be considered a simplification.

Another issue concerns the consequences that the shift towards performance-base pay holds for the importance of 'career concerns'. We have seen how the changed circumstances, in particular the lack of organisational growth, have weakened the relevance of career concerns.<sup>288</sup> However, what has been the impact of the shift towards performance-based pay? At first sight, it appears that the shift towards performance-based pay has further weakened the relevance of career concerns as future pay has increasingly become dependent upon performance. At the same time, these changes do not necessarily change the dynamics of employment

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<sup>286</sup> We will focus on Japanese employment practices and not further discuss the well-known drawbacks that can hamper performance-oriented approaches. However, as an indication, the following list presents an overview of some of the major drawbacks that can be distinguished: (1) the concentration on past results could be at the expense of the future, (2) the focus of achieved results could lead to a lack of training, (3) the danger that objectives only cover part of the job and evaluation thus becomes skewed, (4) the difficulties in measurement and the existence of jobs 'where the meaningful is not measurable and the measurable is not meaningful' (Wright, 1991, as quoted in Redman, 2001, 73), (5) the existence of effects that may distort the performance appraisal like the halo effect, the horn effect, the doppelganger effect, the crony effect, the Veblen effect and the impression effect, (6) the issue of costs, and (7) the danger that the evaluation becomes a ritual bureaucratic exercise. See Redman (2001) for an elaborate discussion of the possible drawbacks of performance appraisal.

<sup>287</sup> Besides the need for training, this is also a concession to the need for a stable income among union employees.

<sup>288</sup> Other factors that have weakened the possible relevance of career concerns include the ageing of the population, the slow growth, the trend towards flatter organisations, and the rising number of university graduates.



governance.<sup>289</sup> Under performance-based pay promotion is no longer sufficient but still offers the possibility for high wages during the later phase of the career. In other words, promotion remains a *sine qua non* for high future wages. So, as long as the internal labour market remains relatively closed and pay dependent upon promotion, career concerns remain important.

However, the room for career concerns might be limited by two developments that have accompanied the trend to performance-based pay. First of all, several firms have brought forward the moment at which evaluation shifts from seniority to ability to performance, as described by Imada (1995), in order to bring labour costs in line with actual performance. This shortens the period during which career concerns are dominant. Secondly, the criteria for evaluation have become more explicit under the new systems of performance-based pay. As was confirmed by several interviewees (e.g. the firms in construction, firm B in electronics), promotional criteria used to be framed rather ambiguously in order to create 'promotional flexibility'. This ambiguity not only allows for a single set of criteria among all employees, which facilitates job rotations and transfers, but has also been important in the supply-oriented human resource management which makes promotion dependent upon an employee's ability. The vagueness of criteria provided firms with some flexibility to adjust the 'promise' of promotion to organisational needs. The explicit criteria under performance-based pay limit this flexibility. As a consequence of these developments, employees gain a better understanding of their future career possibilities and this is likely to lower overall motivation. This fear was indeed felt by certain interviewees. Pay-for-performance is obviously the direct alternative to motivate employees but as most firms have mainly focused on the need to reduce labour costs, the danger exists that the employees' motivation suffers. Moreover, it remains to be seen if motivation by performance-based pay can compensate for the possible loss in career concerns.

Finally, in spite of the rhetoric that usually accompanies these changes, we should not overestimate the shift towards performance-based pay. An interesting example is the shift from ability- to job-based pay at firm A in electronics. In principle, this shift has major implications because pay is no longer dependent upon a person's individual ability but on his or her organisational position. However, the job only determines the possible range of wages and the wages are adjusted to personal ability. In the end, there might not be much difference between basing pay on ability with an adjustment for the job performed and basing pay on the job

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<sup>289</sup> This is not the only imaginable outcome. It is, for instance, also possible that the trend towards performance-based pay leads to a greater inter-firm mobility among employees and thus ends the importance of long-term career concerns.

performed with an adjustment for a person's ability. Another interesting example is firm E in electronics which has integrated MBO in its ability qualification system, thus maintaining ability-based wages while at the same time incorporating performance. Finally, even when the system for evaluation is changed actual behaviour might not follow immediately or change to a similar extent. In the end, it all depends on the actual assessment and some firms admitted that seniority continued to play an informal role (e.g. firm C in electronics). As a solution, many firms decided to train managers in using the new criteria for evaluation (e.g. firm A in electronics).

We can therefore conclude that the current criteria for evaluation in Japanese firms are varied and often exist in combination. We must therefore dismiss the current validity of past presentations of the Japanese pay system which stress the existence of a single basis for evaluation. It is not either seniority or ability or performance wages, nor is it pay-for-skills plans or pay-for-job plans or pay-for-results-plans, but usually a combination of all three, adapted to the position and function of the employee. Rengo, as one of the few, has actually acknowledged this and states that *seikashugi* usually refers to some type of 'comprehensive job-focused wages' which concerns a certain combination of seniority-focused, job-focused, capacity-focused, and achievement-focused wages (Rengo, 2003, 15).<sup>290</sup>

### **The diversification of employment types**

The case studies did indeed confirm the existence of several career tracks. Several firms distinguish career and general or supportive tracks (usually referred to with the well-known terms of *sōgōshoku* and *ippanshoku*) or specialist career tracks (*senmonshoku*). A number of firms also distinguishes area-specific or local and area-flexible (national or international) tracks. The construction firms and firm E in electronics provide good examples of firms with various employment tracks. However, many firms do not make a distinction between tracks nor do they consider that possibility. In particular when compared to the important adaptations in evaluation criteria, changes in these tracks appear a minor issue. A similar conclusion is likely with respect to the trend towards more individualist personnel management. We see innovations like 'diversity management' and a 'candidacy system'. The first development stresses the need to acknowledge the individual circumstances of employees like the need to combine work and family; the second

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<sup>290</sup> 'The achievement-focused model has been greatly praised in recent years, but...the achievement factor by itself accounts for only 0.3% while the work factor, namely the combination of job, capacity, and achievement, accounts for 67% of the wage. All told, the wage system in Japan remains within the realm of comprehensive determination' (Rengo, 2003, 15).

allows employees to apply for other jobs within the organisation. However, these developments were limited to a few of the firms in this study (e.g. automobile firm A). It is likely that a tighter labour market or new labour regulations are needed for these instruments to become popular.

A possible exception concerns the multi-track personnel system as it was proposed by Nikkeiren (Nikkeiren, 1995). This distinguishes three major groups of employees, a core group of long-term employees, a group of specialists, and a group of peripheral employees. The previous chapter has already discussed how the rise in non-regular employment could be interpreted as an important intensification of the peripheral group, although with rather stable employment. In addition, most firms (e.g. firm B and E in electronics) also hire so-called '*shokutaku*', specialist employees with short-term contracts. However, this never concerns specialists in the firm's core technologies and their number remains limited. Nikkeiren has therefore pleaded for an extension of the maximum period for such contracts from three to five years as it would offer better possibilities to develop this type of employment. However, it is hard to suppress the idea that employees simply prefer employment as core employees because this offers them high employment security while enabling them to quit if they want to do so.

The limited attention for career tracks among the firms of this study can be considered surprising since they could offer a solution to certain difficulties in human resource management as they create the possibility to diversify employment governance. Moreover, these tracks could be beneficial for the development of specialised skills. Automobile firm A provides a good example as it has introduced two different career tracks, pro-general (PG) and pro-expert (PE), because a different competency is needed for management and technical employees. However, other considerations explain the somewhat limited success of these employment tracks. Firms do distinguish between employees in terms of their ability. Automobile firm B, for instance, distinguishes specialist groups of employees with similar skills. In these firms specialists exist but the need for specific employment tracks is not felt. Instead, firms prefer to maintain a single employment system that facilitates functional flexibility. As was discussed in the previous section, several firms intentionally keep the criteria for evaluation somewhat ambiguous as this enables them to use the same criteria for different departments and functions.

### **The rise of labour mobility**

As we have seen in chapter five, the signs concerning a possible rise in labour mobility among regular employees are tentative at best.<sup>291</sup> The rise in the percentage of firms that hire mid-career employees is promising but the data on job tenure and job changes give no indication that the external labour market has achieved or is achieving substantial growth (Appendix one, Table A-4 and A-5). In this respect, it was interesting to find several firms which employ a substantial number of mid-career employees. Examples include both automobile firms and firm D in electronics. However, most firms had an excess of employees and preferred not to hire mid-career employees unless they needed some specific kind of speciality or to fill the gaps in the organisation. Firm A in retail, for example, has a system to hire mid-career which was used extensively during the 'growth' years but did not need the extra employees.

An interesting issue concerns the possibilities these firms see for mid-career hiring and the problems they have encountered. In particular the existence of firm-specific skills can be expected to complicate mid-career hiring. Since the importance of firm-specific skills varies between industries, a general answer is impossible but a few remarks can nevertheless be made. First of all, mid-career hiring mainly concerns relatively young employees or specialists in supportive roles (e.g. accountants) whose skills are (still) rather independent from their organisation. Moreover, the firms of this study are all major and well-respected firms. As a consequence, they do not experience difficulties in finding employees, especially given the weak labour market, and motivating them to adjust to their organisation. This is also illustrated by the relative lack of job hopping by employees from these firms. However, firms did experience certain difficulties concerning mid-career hiring. A few interviewees mentioned how it is sometimes difficult to find a good match between the wishes and expectations of the firm and the individual because the lack of detailed job descriptions and the somewhat vague promotional criteria. This suggests that, as a source of firm-specificity, governance is at least as important as skills. It is not directly the skills themselves that complicate mid-career hiring but the inward orientation of employment governance through internal labour markets.

This study of a limited number of cases does not enable us to draw conclusions about the extent of mid-career hiring. However, the attitude of firms towards mid-career hiring seems to be changing. It is well-known that, in the past,

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<sup>291</sup> Several observers consider a rise in labour mobility as a necessity for the economy as a whole to restructure in response to the environmental changes. As a consequence, analyses often appear to be inspired by the supposed necessity of such a development rather than the actual developments.

employees who changed employment during their career were treated with distrust but several interviewees, also outside the cases included in this research, expressed a positive attitude towards mid-career hiring (e.g. automobile firm A, electronics firm D). At the same time, the employees concerned are still relatively young (non-managers), hired for special functions and projects, and 'traditional' in their ambition to find employment at a larger, more established firm. Moreover, although a few interviewees stressed the need for employability, most employees still see mid-career hiring as an exception during their career, and regular employees are still hired for careers rather than specific jobs. The litmus test for this trend will be a tightening of the labour market which will force firms to find additional candidates for employment besides new graduates.

### **The likelihood of a new constellation of employment practices**

The three developments as discussed in this chapter can actually be related to one another. Performance-based pay makes pay dependent upon immediate performance and thus differs from the long-term perspective that characterises remuneration under the ability qualification system. This could contribute to a rise in labour mobility. A similar argument holds for the diversification of employment types, which introduces different governance regimes for different groups of employees. This could strengthen the trend towards performance-based pay for certain groups of employees. Moreover, the inclusion of a specialist career track implies that the employees concerned develop functional- rather than firm-specific skills, another development likely to raise labour mobility. Together, these developments could therefore be interpreted to suggest a possible new constellation of Japanese employment practices.<sup>292</sup> This section discusses its likelihood.

What would this new constellation look like? First of all, the quantitative importance of the internal labour market will diminish as positions at the fringe of this market are increasingly taken by non-regular employees. At the same time, certain groups of non-regular employees can actually hold a position in a subordinate employment track of the internal labour market. In addition, the internal labour market for regular employees will show increasingly better access to outsiders, somewhere along the line losing its internal character. This is to be achieved by performance-based pay, the existence of specialist career tracks, and a greater propensity for mid-career hiring. While career concerns are likely to remain important for a small group of core employees, the direct rewards for the other employees create an inter-firm flexibility that helps Japanese firms to reorganise in

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<sup>292</sup> Such a new constellation is rather similar to the proposal by the 'critics' in the debate on Japanese employment practices as discussed in the first chapter.

response to market changes. Analogous to the field of corporate governance we could distinguish between an insider- and outsider-oriented system of employment practices.<sup>293</sup> While the past constellation mainly focused on the insiders with core regular employment, and only acknowledged a secondary role for non-regular employees, the new constellation is outsider-oriented, both in the chances for non-regular employees and in the increased mobility of regular employees.<sup>294</sup>

However, as the discussion in this chapter has shown, this new constellation is still far from a reality. Moreover, the previous analysis stressed the complexities of change because of issues like legitimacy and 'embedded functionality'.<sup>295</sup> The current changes appear more like a calibration of the internal labour market through an (accelerated) continuation of the long-term trends towards a smaller percentage of regular employees and a stronger impact of performance appraisal. This gradual character does not rule out a substantial change in employment logic but that remains unlikely. The crux in this discussion is lifetime employment as the core of the Japanese employment practices. As we have seen, this practice remains strongly supported and even developments that appear otherwise are in accordance with the existing practices. A good example is the rise in mid-career hiring, which largely remains limited to young employees who can still be embedded in the organisation. As long as the support for lifetime employment remains this strong, the internal labour market and the accompanying productive logic will continue to hold a crucial role among the Japanese employment practices.

These considerations are based on the extrapolation of recent developments and concern the direct future of Japanese employment practices. It is, however, also tempting to give some thought to the more distant future and this suggests more far-reaching changes. Matsuzuka (2002) list three reinforcing conditions for the effectiveness of the lifetime employment: (1) the development of firm-specific skills, (2) a steep tenure-earnings profile, and (3) low turnover of employment. According to Matsuzuka, the fulfilment of these conditions has weakened during the 1990s as the development of firm-specific skills and the steep tenure-earnings profiles have

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<sup>293</sup> See, for instance, Sheard (1998) for a discussion of these two types of corporate governance.

<sup>294</sup> As a matter of fact, the distinction between regular and non-regular employees loses much of its clarity with the growth of the various intermediate categories.

<sup>295</sup> An important example is the issue of training. So far, training has very much been the responsibility of firms that have been willing to make the necessary investments because of the long-term relation with their employees. A shift towards employment mobility would therefore require the development of alternative training regimes or risks a downfall in the skills of employees. Rengo has already expressed its fear that the replacement of regular by non-regular employees, often a sensible decision from the perspective of the individual firm, comes at the expense of training. Another example is the government's total employment strategy which has made firms co-responsible for employment protection and social welfare.

lost in importance. The current study has confirmed this assessment. This ‘suggests that the permanent employment system may become less meaningful in the future’ (Matsuzuka, 2002, 71). Another possible source of adaptations is long-term social change. The current adaptations of employment practices have almost exclusively been inspired by the slow economic growth and the excess of senior employees. However, in the long run, other developments like a shortage of young employees and the changing position of female employees are likely to require additional changes. The direction of these changes is still difficult to predict but particularly the likely importance of female employees appears in conflict with the breadwinner character of the present system. Although issues of legitimacy are likely to postpone these changes, the long-term trend tends to be a diminished relevance of lifetime employment. This would actually also be in line with a similar tendency in other industrialised countries (Felstead and Jewson, 1999; Auer and Cazes, 2003).

Much will depend on the developments during a next period of economic growth. Paradoxically, the importance of lifetime employment is confirmed during difficult economic circumstances when firms use the strategies that constitute the adjustment logic to refrain from firing regular employees. At the same time, lifetime employment is insignificant when the economy grows and firms are in need of additional employees. As employees have the freedom to change employment and if firms really have changed their attitude towards mid-career hiring, strong economic growth could initiate a trend towards labour mobility and inspire other innovations like individualist personnel management in order to attract sufficient employees. Eventually, this could bring an end to lifetime employment and substantial change in Japanese employment practices.

### **Concluding remarks**

This chapter has discussed three potential developments in Japanese employment practices. Among these, the trend towards performance-based pay stood out and we can now safely dismiss the past characterisation of Japanese employment practices as seniority-based. Instead, we see a wide variety of factors that determine promotion and pay in Japanese organisations. Concerning the other two developments, the diversification of employment types and the rise in labour mobility, the changes are rather modest. We see signs of rising labour mobility but this trend has not yet materialised, possibly because most firms already have an excess of employees. Overall, the productive logic of employment practices appears to have remained strong and the most striking development is probably the wider role of non-regular employment as discussed in the previous chapter. The likelihood of a new constellation of employment practices is therefore small, at least in the immediate future. Finally, one issue has been particularly striking. The shift towards

performance-based pay shows the strong flexibility of the actual employment practices. Practice appears more flexible than the theoretical concepts suggest, as illustrated by the discussion of the various payment plans (pay-for-job, pay-for-result and pay-for-skill plans) and the comprehensive character of wages.

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## 12. Conclusions

### Fading glory versus new diversity

*Changing employment practices and their implications. The theories of the firm revisited. Fading glory or a new diversity in employment practices? Reference.*

#### **Changing employment practices and their implications**

In concluding this study, it is good to return to the major research questions as they were posed in the introductory chapter. How and to what extent do the changed circumstances inspire adaptations in employment practices? And how do the changed circumstances and the different adaptations in employment practices influence the competitive strength of Japanese firms?

The answer to the first questions is rather clear-cut as two adaptations stand out. The first, also an important source of inter-industry differences in employment practices, is the increased importance of non-regular employment. Although this development could become counterproductive in terms of training and a diminished quality of employment, it has proven successful from the perspective of the firm in search of flexible and cost-efficient labour. The second major development is the trend towards performance-based pay. This trend is without a doubt the main type of adaptation in all firms visited. The dominant objective of this adaptation, just like the rise in non-regular employment, is a reduction of labour costs. The combination

of a lack of (organisational) growth, the ageing of the population, and the supply-oriented ability qualification system has led to an important increase in labour costs, which made the adaptations sensible or even inevitable. The overriding focus on the control and reduction of labour costs also underlines the fact that firms adjust to current developments, not to those of the future. Other developments like the future shortage of young and the changing position of female employees are acknowledged by organisations like Nippon Keidanren but are not (yet) reflected in firms' strategies in human resource management.

At the same time, we should not overestimate the extent of the adaptations. We have, for instance, seen how performance-based pay is usually limited to more senior employees and how pay tends to be determined by a combination of various criteria. Moreover, both the increasing importance of non-regular employment and the trend towards performance-based pay are long-term developments that originate from before the burst of the bubble. The changes can therefore be considered as an acceleration of long-term trends, as a calibration of the internal labour market to the changed circumstances. The productive logic of Japanese employment practices remains important in this respect because, in spite of the adaptations, it remains to characterise the employment of regular employees. However, the other major change, the rise in non-regular employment, makes that non-regular employment can no longer be considered as a mere employment buffer but has achieved an important role among the Japanese employment practices. The development of a part-time logic in chapter ten was a first attempt to analyse this role.

The second research question, concerning the impact of the changed employment situation on the competitive strength of Japanese firms, is more difficult to answer. Inter-industry differences further complicate the answer. As was discussed in chapter eleven, we can make an important distinction between the employment practices themselves and the possible fit between employment practices and the organisation of work. First of all, the efficiency of employment practices, in particular the strength of the career concerns has diminished. With limited growth, an ageing workforce and flatter organisations, the potential for promotion, and thus the number of employees who can realistically expect to occupy these positions, has become limited. Performance-based pay can be the alternative but also leads to earlier selection and more explicit evaluation criteria, thus further weakening the conventional governance of employees through career concerns. On the other side, with little complaints about the quality and commitment of employees, the effects of the changed circumstances on the motivation of Japanese employees appear to have so far been limited.

Secondly, we have also seen how the contribution of employment practices to competitive strength is dependent on the organisation of work. Moreover, as

discussed in the chapters four and ten, the productive logic of employment practices knows various contingencies that determine its success and, in accordance, the economic implications of Japanese employment practices are industry-specific. This last issue actually precludes the issue of change. Among the industries of this study, the productive logic has been very successful in the automobile and electronics industry, less so in the construction and retail industry. It is therefore tempting to interpret the productive logic of employment practices as one part of the explanation of inter-industry differences in productivity.<sup>296</sup> The industry-specific differences are confirmed by the rise in non-regular employment. Firms in all industries have tried to replace regular by non-regular employees but the possibilities to do so have differed substantially. The automobile industry is the best example of the continued success of the productive logic, the retail industry is the best example of the need for alternative employment practices. Overall we can conclude that, with the diminished importance of the manufacturing sector in Japan and the trend towards modularisation, the part of the economy in which the 'conventional' productive logic truly contributes to success has diminished.

These observations shed light on the paradox of past success and current failure as it was also discussed in the introductory chapter. The Japanese employment practices have indeed lost some of their initial advantages. However, the answer to the paradox lies as much in the past as in the present. It seems that the success of Japanese employment practices has been closely related to the success of the Japanese economy. In the past, the strong growth of the economy enabled Japanese firms to offer career opportunities to many of its employees. This changed after the burst of the bubble. The economic problems brought the various structural developments, until then hidden by economic success, into the open and created a harsh landing where it otherwise might have been possible to make more gradual adjustments. Beyond the initial and overall success of the growth years, the discussed contingencies of Japanese employment practices have become visible as a necessity for success and the source of inter-industry differences.

### **The theories of the firm revisited**

This is also a good moment to take another look at the theories that guided this study. The different theories of the firm provided the overall framework to analyse the employment practices from the perspective of the firm. Moreover, they proved instrumental in the discussion of the productive logic of Japanese employment

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<sup>296</sup> It remains to be seen how important this factor is for the lack of productivity in certain industries as the industry-chapters have shown that various factors explain the lack of productivity in the retail and construction industry.

practices, in the discussion of both the capabilities of the Japanese firm and the accompanying employment governance. Nevertheless, the study has also showed some of their inherent limitations.

First, it is clear that the included theories of the firm are partial to specificity and uniqueness. In the case of employment, this means that all theories assume or stress the importance of firm-specific skills and, accordingly, the importance of long-term employment. As a consequence, the advantages offered in terms of flexibility and costs by non-regular employment are for the most part ignored. The interest of transaction cost economics is proportional to the level of asset specificity in the sense that non-specific transactions are co-ordinated through the market and thus rather self-evident. The capabilities perspectives, both the resource-based view and the more dynamic theories, stress the specific or unique characteristics in search for competitive success. Once again, non-regular employment is rather insignificant in this respect as its external availability makes it an unlikely source of competitive strength. To some extent, the focus on regular employment is understandable. By definition, the non-regular employees originate outside the firm and are less open to firm control. At the same time, this analysis has shown the importance of non-regular employment in the firm's employment portfolio and any analysis that ignores the diversity of employment practices gives only a partial analysis of the firm's employment practices; maybe with the exception of the automobile industry. Moreover, as this study has shown, even non-regular employees can have a long-term relation with their firm and come with certain characteristics in terms of skills, availability, and motivation. These employees therefore also need to receive the proper training, either outside or inside the firm, or the quality of a firm's employees will diminish.

This brings us to a second issue, the complexities of governance. The study has shown how many relations exist between the wider institutional setting, the national and firm-specific organisational and employment practices, and those governed by these practices. The introductory chapter introduced the dialectic relation between national and firm-specific employment practices and this has proven highly relevant. The embeddedness of employment practices has proven crucial in the adaptations firms have made and, in spite of the differences between industries, we found strong similarities between the firms of this study. Moreover, we have also found similar dialectical processes between employment practices and the organisation of work, and between the existence of firm-specific skills and governance as both an answer and contribution to these skills. These complexities underline the simplicity or the lack of detail in the discussion of governance in the various theories of the firm. The perspectives all subscribe to the need for governance but hardly offer any detail. Given the variety in employment and

governance types this is understandable. At the same time, it makes these theories predominantly inspirational in the study of actual employment practices.

All these considerations justify the decision to 'settle' for the logic that these theories of the firm provide. On the one hand, we cannot underestimate their value in pointing out the importance of matters like asset specificity and specific capabilities as a source of competitive strength. On the other hand, the perspectives that these theories offer are indeed partial and cannot fully explain 'the existence, organisation, boundaries and competitive advantage of the firm'. As this study of employment practices has shown, the reality is much more diverse and complex than the rather functionalistic explanation of these theories.

### **Fading glory or a new diversity in employment practices?**

At the end of this study, an overall assessment of Japanese employment practices is due. In this respect, it is tempting to speak about the fading glory of Japanese employment practices. Lifetime employment and its accompanying practices have for the most part maintained their former character but lost their shine in the faltering economy. The conventional employment practices are granted to a smaller group of core employees and involve tighter criteria for promotions and rises in pay. Moreover, they are no longer considered an asset for the Japanese economy.

However, this conclusion would do injustice to the developments in Japanese employment practices. As a matter of fact, the firms appear to have been quite successful in their adjustments. The flexibility in employment practices has been surprisingly large with firms making rather substantial adjustments while, at the same time, upholding the conventional employment logic based on internal labour markets and long-term employment relations. The major problem concerning Japanese employment practices lies beyond the firm. The labour market has not been able to create sufficient new employment as the government's total employment strategy has failed in recent years. The globalisation has made it impossible for the government to provide the necessary protection to the Japanese market that long made it possible for firms to perform a part of the welfare function. This actually sheds a new light on the continued practice of lifetime employment. On the one hand, its importance has risen as employees cannot afford dismissal. On the other hand, employees have often lost the conviction that employment is really guaranteed in the long term. However, without an alternative, the support for lifetime employment remains strong. Nevertheless, it is clear that the government, together with the representatives of employers and employees, will have to adapt policies to the new situation.

However, if we take the specific circumstances of the Japanese economy in the post-war decades into consideration, we can actually draw a positive conclusion

about Japanese employment practices. As mentioned before, the economic growth of Japan in the decades before the burst of the bubble has been exceptional. Many factors like the combination of good schooling and low labour costs, the low-cost capital, the good access to foreign markets and the undervalued Yen all contributed to the economic success, creating a virtuous circle of economic growth and making Japan into Asia's first miracle economy. The employment practices, with their strong dependence on growth, were exceptionally well-suited for this period and contributed to success. However, the employment practices should indeed not be blamed for the changed state of the Japanese economy. In a certain sense, the Japanese economy is now like any other in the industrialised countries. Instead of blaming the employment practices, we should probably acclaim the new diversity in Japanese employment practices. Lifetime employment currently remains the core of Japanese employment practices but outside this core, we see a variety of adaptations that show a variety of employment types and a variety of criteria for promotion and pay. In this respect, Japan has come a long way since Abegglen's initial assessment in 1958 that 'the whole system of job evaluation' would have no place in the Japanese firm because it would clash with the existing practices based on the relationship of 'lifetime commitment'. Lifetime employment has become the basis for an elaborate and detailed variety of employment practices.

### Reference

Abegglen, J.C., 1958, *The Japanese Factory: Aspects of its Social Organization*, Massachusetts Institute of Technology, Glencoe, Illinois: The Free Press.

# Appendices

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- 1 Additional tables
- 2 The development of interview questions and questionnaires
- 3 English interview questions
- 4 Japanese interview questions
- 5 English questionnaire
- 6 Japanese questionnaire
- 7 Overview answers questionnaire



## Appendix 1 Additional tables

**Table A.1 Economic growth and unemployment**

	GDP Growth (%)	Unemployment		GDP Growth (%)	Unemployment
1970	10.3	1.1	1987	4.4	2.8
1971	4.5	1.2	1988	6.2	2.5
1972	8.6	1.4	1989	4.9	2.3
1973	8.1	1.3	1990	5.1	2.1
1974	-1.4	1.4	1991	3.8	2.1
1975	3.2	1.9	1992	1.2	2.2
1976	4.0	2.0	1993	0.3	2.5
1977	4.4	2.0	1994	0.5	2.9
1978	5.4	2.2	1995	1.5	3.2
1979	5.6	2.1	1996	5.3	3.4
1980	2.7	2.0	1997	1.6	3.4
1981	3.0	2.2	1998	-0.9	4.1
1982	3.3	2.4	1999	0.6	4.7
1983	2.4	2.6	2000	2.5	4.7
1984	4.0	2.7	2001	-1.1	5.0
1985	4.6	2.6	2002	0.8	5.4
1986	2.9	2.8	2003	2.0	5.3

Sources: (1) data 1970-1997: Matsuzuka, Y., 2002, *Changes in the Permanent Employment System in Japan: Between 1982 and 1997*, New York and London: Routledge, appendix; (2) data 1998-2003: *Main Labor Economic Indicators* on <http://jil.go.jp>.

**Table A.2 Effects of Personnel Reduction by Industry**

	All	Construction	Consumer manufacturing	Machinery manufacturing	Wholesale, trade, food	Finance, Insurance
Decrease of employees' morale	51.5	67.2	55.4	65.4	52.8	31.6
Increase of working hours	45.8	43.1	38.5	30.8	55.6	67.1
Improvement in productivity	35.9	29.3	33.8	28.0	43.8	44.3
Outflow of superior talent	33.0	37.9	35.4	48.6	32.6	22.8
Increase in leaving one's job at personal convenience	17.2	12.1	16.9	10.3	19.4	24.1
Decrease in productivity	14.3	10.3	15.4	22.4	11.1	6.3
Improvement of workers' morale	13.6	10.3	12.3	12.1	15.3	11.4
Rising employment difficulties	11.3	12.1	16.9	6.5	11.1	5.1
Others	2.4	3.4	0.0	2.8	1.4	1.3

Source: *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2002, *Kigyō no Risutora to Koyō* [Firm restructuring and employment], Tokyo, 21.

**Table A.3 Effects of Personnel Reduction by specific adjustment strategy**

	All	Natural attrition	Employment restraint	Retirement	No contract renewal	<i>Shukkō / tenshō</i>	Dismissal
Decrease of employees' morale	51.5	52.2	54.9	59.2	57.3	59.9	68.3
Increase of working hours	45.8	47.3	47.8	46.2	37.7	54.2	38.3
Improvement in productivity	35.9	36.2	36.9	32.8	33.8	32.2	23.3
Outflow of superior talent	33.0	34.1	33.6	50.5	33.8	37.0	38.3
Increase in leaving one's job at personal convenience	17.2	17.7	16.5	17.4	16.5	15.9	16.7
Decrease in productivity	14.3	14.4	14.7	16.4	23.5	16.3	28.3
Improvement of workers' morale	13.6	12.2	12.9	13.0	11.5	14.1	8.3
Rising employment difficulties	11.3	11.5	13.1	10.0	14.2	11.9	18.3
Others	2.4	2.5	2.2	1.7	3.5	2.6	1.7

Source: *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2002, *Kigyō no Risutora to Koyō* [Firm restructuring and employment], Tokyo, 24.

**Table A.4 Years of continuous employment by sex and male age groups**

Year	Female		Male							
	All	All	30-34	35-39	40-44	45-49	50-54	55-59	60-64	>= 65
1980	6.1	10.8	9.1	12.6	14.8	16.5	17.8	13.7	10.1	11.4
1981	6.2	11.0	9.3	12.9	15.1	16.8	18.2	14.2	9.9	11.5
1982	6.3	11.1	9.2	12.7	15.4	17.0	18.5	14.8	10.2	11.7
1983	6.3	11.3	9.3	12.5	15.5	17.3	18.6	15.3	10.4	11.6
1984	6.5	11.6	9.4	12.5	15.9	17.7	19.0	16.2	10.3	12.2
1985	6.8	11.9	9.4	12.6	16.2	18.1	19.4	16.8	10.5	12.1
1986	7.0	12.1	9.3	12.8	16.4	18.5	19.7	17.4	11.0	12.0
1987	7.1	12.4	9.3	13.0	16.5	19.0	20.0	17.9	11.0	12.4
1988	7.1	12.2	8.9	12.7	16.1	19.0	20.2	17.8	11.0	11.9
1989	7.2	12.4	8.8	12.8	16.0	19.2	20.5	18.4	11.2	12.1
1990	7.3	12.5	8.8	12.6	16.0	19.4	20.9	18.9	11.0	11.9
1991	7.4	12.7	8.6	12.6	16.2	19.8	21.3	19.8	11.8	12.3
1992	7.4	12.5	8.4	12.3	16.2	19.5	21.5	20.0	12.1	11.9
1993	7.3	12.6	8.4	12.0	16.0	19.3	21.7	20.5	12.6	11.6
1994	7.6	12.8	8.5	12.0	15.9	19.2	21.9	21.2	13.3	11.8
1995	7.9	12.9	8.5	11.9	15.8	19.3	22.1	21.8	13.4	12.8
1996	8.2	13.1	8.6	11.9	15.9	19.5	22.6	22.1	13.4	12.6
1997	8.4	13.3	8.6	12.0	15.8	19.5	22.5	22.6	13.5	13.2
1998	8.2	13.1	8.5	11.9	15.5	19.4	22.3	22.6	14.0	12.7
1999	8.5	13.2	8.6	12.0	15.5	19.2	22.2	22.6	13.9	13.6
2000	8.8	13.3	8.4	12.0	15.3	19.2	22.1	22.5	13.7	13.3
2001	8.9	13.6	8.6	12.2	15.5	19.4	22.5	23.2	14.8	14.1

Source: *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2003, *Yūsufuru Rōdō Tōkei* [2003 Useful Labour Statistics], Tokyo, 138-9.

**Table A.5 Percentage of employees changing employment**

Year	Employees	Regular employees	Part-time employees	Male employees 15-24 years	Female employees 15-24 years	Female employees 25-34 years
1988	4.7	3.6	10.5	9.5	9.0	6.5
1989	5.0	3.9	10.6	11.0	10.3	6.4
1990	4.1	3.3	8.1	7.5	9.1	6.0
1991	4.9	4.0	10.0	9.8	10.4	7.1
1992	5.1	4.0	10.4	9.9	10.6	7.9
1993	4.7	3.6	9.9	9.3	9.6	8.0
1994	4.5	3.5	9.7	7.9	9.4	6.8
1995	4.7	3.6	10.5	10.0	10.0	7.2
1996	4.8	3.6	10.2	9.7	10.0	7.5
1997	5.2	3.9	11.0	10.0	11.4	8.5
1998	5.6	4.0	12.0	11.5	13.7	8.5
1999	5.5	3.7	12.0	11.0	13.2	8.7
2000	5.5	3.9	11.0	12.3	12.5	9.4
2001	5.9	4.4	10.8	11.5	12.8	9.5
2002	5.6	3.9	10.8	12.0	15.4	9.8

Source: *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2003, *Yūsufuru Rōdō Tōkei* [2003 Useful Labour Statistics], Tokyo, 114-5.

**Table A.6 New HRM instruments (overall and by number of employees)**

	1990	1993	1994	1996	1998	1999
<i>Nenpōsei</i>						
All	-	-	4.3	8.6	12.3	-
> 1,000	-	-	7.9	15.9	25.6	-
Specialist career track						
All	16.2	18.1	-	19.9	-	18.2
> 5,000	57.8	60.3	-	58.9	-	51.5
1,000 < 5,000	43.0	45.3	-	44.9	-	39.2
Childcare-leave						
All	21.9	50.8	-	60.8	-	77.0
> 500	37.5	95.2	-	97.1	-	98.7
Nursing leave						
All	13.7	16.3	-	23.2	-	62.7
> 500	20.0	51.9	-	68.1	-	96.8

Source: *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2003, *Yūsufuru Rōdō Tōkei* [2003 Useful Labour Statistics], Tokyo, 239-45.

**Table A.7 Ratio of female management employees**

	90	91	92	93	94	95	96	97	98	99	00	01
Management	3.1	3.6	4.1	4.3	3.9	4.2	4.5	5.1	4.9	5.0	5.3	5.1
<i>Buchō</i>	1.1	1.2	1.7	1.6	1.4	1.3	1.4	2.2	2.0	2.1	2.2	1.8
<i>Kachō</i>	2.0	2.3	2.9	2.5	2.6	2.8	3.1	3.7	3.2	3.4	4.0	3.6
<i>Kakarichō</i>	5.0	6.2	6.6	7.3	6.4	7.3	7.3	7.8	8.1	8.2	8.1	8.3

Source: *Nihon Rōdō Kenkyū Kikō* [Japan Institute of Labour], 2003, *Yūsufuru Rōdō Tōkei* [2003 Useful Labour Statistics], Tokyo, 230

**Table A.8 Overview Nikkeiren employment portfolio categories**

	Type of employment	Employees eligible	Wages	Bonuses	Basis for advancement / promotion
Core group of long-term employees (A)	Open-ended employment contract	Managerial career track, core-technical occupations	Monthly salary or yearly remuneration package; ability-based wages; wage increment	Specified rate and sliding scale for performance	Promotion to managerial ranks; pay increase based on job performance qualifications
Specialists (B)	Fixed-term employment contract	Specialist occupations (planning, sales, R&D, etc.)	Yearly remuneration package; performance wages; no wage increment	Sharing of company performance results	Evaluation of performance
Flexible workforce (C)	Fixed-term employment contract	Clerical, technical, sales positions	Hourly wages; Job-based wages; no wage increment	Specified rate	Switch to higher-ranking position

Source: Japan Business Federation (Nippon Keidanren), 2003, *The Current Labor Economy in Japan 2002*, Tokyo, 38.

**Table A.9 Reasons for hiring mid-career employees**

		Management	Clerical	Technical, research	Non- clerical
Organisational/ management	Expansion of existing business	19.0	11.6	23.2	18.3
	Extension into new business or field	10.8	5.2	10.4	6.3
	Attempt to vitalise the organisation by making the most of a variety of experienced persons	44.9	12.2	26.3	10.6
	Request by parent company or affiliated company	13.0	3.4	4.3	3.4
Personnel management	Fill vacancies left by retirees	23.5	68.6	39.1	69.2
	Compensate for lack of recent graduates hired	0.0	2.5	4.4	2.7
	Remedy an imbalance in staff composition	3.0	4.7	3.9	6.5
	Make use of ready skills and abilities	53.7	30.6	6.5	40.5

Source: Japan Institute of Labour, 2004a, *Labor Situation in Japan and Analysis 2004/2005*, Tokyo, 32.

**Table A.10 Translation Japanese corporate titles**

Japanese	English
<i>Kaichō</i>	President, chairman
<i>Shachō</i>	President, Chief executive officer, Managing director
<i>Fukushachō</i>	Chief operating officer
<i>Senmu</i>	Executive director, executive vice-president
<i>Jōmu</i>	Vice President, Managing director
<i>Torishimariyaku</i>	Officer, Director
<i>Buchō</i>	General manager, Division manager
<i>Jichō</i>	Deputy general manager
<i>Kachō</i>	Department manager, Section manager
<i>Kachōdairi</i>	Acting manager
<i>Fukukachō</i>	Vice manager
<i>Kakarichō</i>	Section head, supervisor
<i>Shunin</i>	Supervisor (shop-floor)

Sources: [http://www.japanbiomedical.com/countryinfo\\_jpn.html](http://www.japanbiomedical.com/countryinfo_jpn.html); <http://www.jnet.clearsignals.net/bjtitles.htm>; *Djiniiasu Wa-Ei Jiten* [Genius English Japanese Dictionary]

Note: the titles are from different organisations and any firm is unlikely to distinguish all these positions. As a consequence, not all titles can be related to one another. However, the order of the titles is predominantly from low to high in the organisational hierarchy.

## Appendix 2     The development of interview questions and questionnaires

This case-study protocol describes how the case-study questions (appendices three and four) and case-study questionnaires (appendices five and six) have been developed. Most important have been the issues as discussed in the first five chapters of this dissertation. These chapters discuss the topics of interest that have inspired the various questions. Examples include the contingencies that determine the success of Japanese employment practices as discussed in chapter four and the possible adaptations in employment practices like the increasing importance of performance, the diversification of employment types, and the rise in labour mobility.

However, in order to discuss the firms' human resource management it was crucial to classify its major functions, practices, and outcomes. Fortunately, the literature on HRM offers various frameworks to do so and to guarantee a wide coverage of the research questions. A good example is the framework proposed by Beer *et al.* (1984), who present the 'map of the human resource territory', included as figure A-2.1.<sup>1</sup> They discuss under which circumstances human resource management contributes to the performance of the organisation and the well-being of individual employees and society. As its major categories, the model distinguishes policy choices, outcomes, and long-term consequences. Additional considerations are included under stakeholder interests and situational factors.<sup>2</sup>

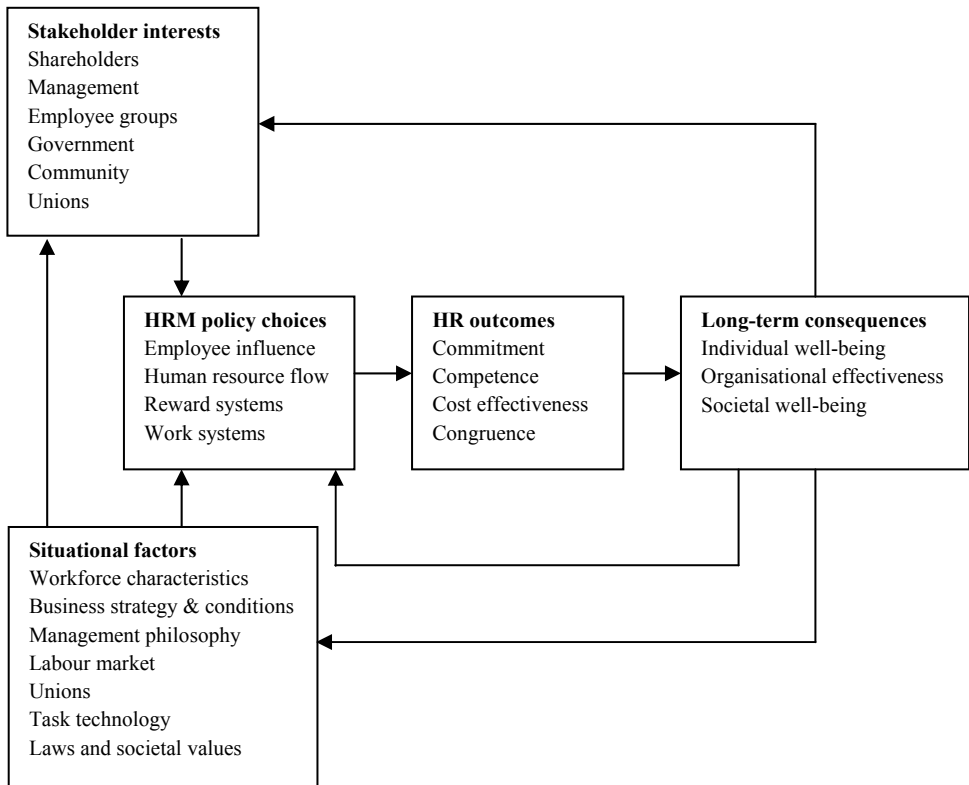
However, the heart of the model consists of the HRM policy choices and the HR outcomes. Moreover, these are the elements that are particularly relevant for classifying the various HRM activities. Most important is the human resource flow, which can be further divided into inflow (recruitment, assessment, orientation, and socialisation), internal flow (evaluation, internal placement, promotion and demotion, and training), and outflow (termination, outplacement, and retirement). In addition, reward systems not only concern the issue of pay but also play an important role in motivating employees towards desired behaviour. Finally, work

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<sup>1</sup> Similar models or frameworks are presented by other authors but as the present focus is on the main HRM functions the specifics of the various models are rather unimportant and we can safely chose the model by Beer *et al.* (1984).

<sup>2</sup> This appendix does not discuss all the stakeholders and situational factors since most are rather self-explanatory but the situational factors are obviously central to this study of a nation's specific employment practices as they are to an important extent shared by the Japanese firms. Workforce conditions, management philosophies, labour market characteristics, the character of unions, laws, and societal values all can be considered specific for the Japanese firm. Moreover, situational factors like business conditions and task technology are also likely to be shared between firms in the same industry; just like stakeholder interests are likely to be specific for the Japanese setting. However, these issues have already been elaborately discussed in the various chapters.

systems concern the way work is organised and it refers to issues like the width of job scope, the existence of job rotation, and the amount of supervision. Overall, these policies determine the HR outcomes, which can be further subdivided in commitment, competence, cost effectiveness, and congruence.<sup>3</sup> Subsequently these variables will (partly) determine individual and societal well-being and organisational effectiveness. Given the economic focus of the present study, this study focuses predominantly on organisational effectiveness.



**Figure A-2.1 The human resource management territory**

source: Beer *et al.*, 1984

<sup>3</sup> Commitment: to what extent do HRM policies enhance the commitment of people to their work and their organisation? Competence: to what extent do HRM policies attract, keep, and/or develop people with skills and knowledge needed? Cost effectiveness: what is the cost effectiveness of a given policy in terms of wages, benefits, turnover, absenteeism, strikes, and so on? Congruence: what levels of congruence do HRM policies and practices generate or sustain between management and employees, different employee groups, the organisation and community, and within the individual?



In summary, we can conclude that this model provides a way to refine the concept of employment governance by providing an overview of the different activities for human resource management and their possible outcomes. This refinement has been the guiding classification for the questions as they are posed in both the interviews and the questionnaires. Moreover, it has also been instrumental in the overview of the changes in HRM as they are presented at the end of the case-study chapters.

### **Reference**

Beer, M., Spector, B., Lawrence, P.R., Quinn Mills, D., and Walton, R.E., 1984, *Managing Human Assets*, New York: The Free Press.

## Appendix 3 English interview questions

### The current employment situation

First, I would like to discuss the current employment situation.

1. What are the major human resource management issues that are currently confronting your company?<sup>4</sup>
  - 1.1 What do you consider the major causes cause for these problems?<sup>5</sup>
  - 1.2 What actions have you taken to deal with these problems?<sup>6</sup>

### Flexibility in human resources

Today's turbulent environment has made flexibility in human resource management very important. I therefore want to discuss if your firm has difficulties in recruiting the right human resources.

2. At which positions did or do you experience overstaffing (an excess of employees)?
  - 2.1. Which methods have you used for employment adjustment?<sup>7</sup>
  - 2.2. Did you find it difficult to find new positions for excess employees?
  - 2.3. Has the flexibility provided by these methods been sufficient?
  - 2.4. Is work sharing (like Holland) an issue? [has been discussed at national level]
3. Which groups of employees do you recruit?<sup>8</sup>
  - 3.1. At which positions did or do you feel a shortage of employees?<sup>9</sup>
  - 3.2. What actions have you taken to remedy these shortages?
    - 3.2.1. Outsourcing of activities
    - 3.2.2. Specialist career track? What does it look like?
    - 3.2.3. Dispatched (agency workers) and part-time<sup>10</sup> employees (Holland)?

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<sup>4</sup> For instance, productivity, flexibility, the rising wage costs, the decrease in promotional possibilities, the need for different human resources, etc.

<sup>5</sup> For instance, decrease growth in sales, changing technologies and technological position, aging of the population, rising number highly qualified female employees, changing work- and lifestyles, consequences of the bubble economy, ignoring problems because of economic success, etc.

<sup>6</sup> For instance, decreasing bonus payments, flatter wage curves, less promotions, etc.

<sup>7</sup> For instance, restricting overtime work, transfer personnel (*shukkō* and/or *tenseki*), volunteers for early retirement, dismissal or no new contract for temporary, seasonal, and part-time employees, suspending mid-career hiring, reduction new recruits, increase paid holidays, etc.

<sup>8</sup> For instance, graduates from specific universities, focus on general skills, etc.

<sup>9</sup> For instance, specialists and technical workers.

<sup>10</sup> Make sure what they mean by 'part-time': 'not full-time' or 'not regular'

- 3.2.3.1. Can they be an alternative for certain regular positions?
- 3.2.4. Mid-career hiring?
  - 3.2.4.1. Have you changed your policy towards mid-career hiring?
  - 3.2.4.2. Is there a maximum age for mid-career hiring?
  - 3.2.4.3. What is the percentage of mid-career hiring among all hiring?
- 3.2.5. Female employees?
  - 3.2.5.1. Have you changed your policy towards female employees?
  - 3.2.5.2. How far is the development towards equal employment for women (are the employees ready yet)?
- 3.2.6. Borrowed employees?
- 3.2.7. What organisational changes have you made to accommodate specialist, mid-career, and female employees?<sup>11</sup>
- 3.3. In general, do you feel that today's environment asks for different employees?<sup>12</sup>

### **Different groups of employees**

Before we further focus on the management of human resources, I want to discuss if you distinguish groups of employees with different career perspectives.

- 4. Which different groups of employees do you distinguish?
  - 4.1. Have you introduced different career tracks? [multi-track personnel system]
    - 4.1.1. If so, what kind of distinction?<sup>13</sup>
    - 4.1.2. Do employees appreciate these different career possibilities?
  - 4.2. Did you change the percentage of regular workers (Holland)?
    - 4.2.1. What are the consequences of such replacements?

If differences exist, I would like to focus on the groups you consider most important for your firm's competitive strength. (e.g. white-collar employees, specialists, employees hired at mid-career). Of course, such employees have to fall under the interviewee's responsibility.

- 4.3. Which group or groups of employees do you consider most important for the firm's competitive performance (both now and in the future)?

I now would like to focus on the possible changes in the management of human resources by discussing the structures for promotion, development, and evaluation.

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<sup>11</sup> For instance, annual retirement pensions instead of lump sum payments (*taishokukin*).

<sup>12</sup> For instance, specialist, creative, individualistic.

<sup>13</sup> For instance, white- and blue-collar, *Nikkeiren*: core, specialist, and peripheral employees, career- (*sōgōshoku*) and general (*ippanshoku*) track.

### Promotion of employees

5. Does your firm have an ability qualification system (*shokunō shikaku seido*)?
  - 5.1. How are the criteria for promotion? [seniority, promotion-speed, tournament]
  - 5.2. Is promotion getting more selective?
    - 5.2.1. Why? [ageing workforce, slower growth, flatter organisations, principle]
    - 5.2.2. How is such selectivity achieved? [strengthening ability qualification system]
  - 5.3. Is the suggestion created that there is always room at the top for a good performer? Is there?
  - 5.4. Does possible promotion still motivate (less positions, mid-career hiring)?
  - 5.5. What kind of promotional possibilities are there for specialists?
    - 5.5.1. Are these possibilities important for their motivation?
  - 5.6. Have you changed your policy towards the seniority system?
    - 5.6.1. Has the seniority wage curve become flatter?
    - 5.6.2. Are the seniority wages crucial for the long-term motivation of employees?
    - 5.6.3. Is there the problem that good young employees cannot be promoted because of seniority rules?
    - 5.6.4. Is there an informal communication of career chances?
    - 5.6.5. Do the new, young employees support the seniority wages?

### Evaluation of employees

6. Do you consider the evaluation of employees a long-term process?
  - 6.1. If so, how is it done?<sup>14</sup>
  - 6.2. If so, do you use a pay-for-skill scheme (rather than pay-for-job or pay-by-results)?
  - 6.3. Does the long-term focus stifle the initiative of young employees?
  - 6.4. How important is the possession of broad (rather than specialist) skills during evaluation? Why this focus?
  - 6.5. How is the outcome of performance evaluation communicated to an employee?
    - 6.5.1. Are formal performance appraisal talks being held?
  - 6.6. Is there a change to a more short-term evaluation of performance?

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<sup>14</sup> For instance, job grades (based on breadth and depth of skills) and job charts (jobs capable of and problem handling experience).

- 6.6.1. Do you experience difficulties in measuring short-term performance?
- 6.6.2. Did you strengthen the relation between performance and bonuses?
- 6.6.3. Do employees accept the increasing importance of performance?
- 6.7. Have you introduced an annual wage system?
  - 6.7.1. What are the reasons for introduction (low white-collar productivity)?
  - 6.7.2. Which employees are evaluated under such a system?

### **Development of employees**

- 7. Do you have a long-term perspective on the development of employees?
  - 7.1. Do you have a policy of regular job rotation? (Why not?)
    - 7.1.1. Which employees are candidates for job rotation?
    - 7.1.2. How are the successive positions determined and careers planned?
  - 7.2. How important is OJT-training?
    - 7.2.1. Why do you consider it (not) important?
    - 7.2.2. Do you provide other forms of training besides OTJ-training?
    - 7.2.3. If available, would you prefer external schooling for certain employees?
  - 7.3. Do you feel that efficiency suffers from the need to develop employees?

### **Resistance to Change**

After all these questions about change, I would like to ask some questions about the process of change itself. In particular the resistance to change. It is well-known that existing customs and institutions can form a coherent system which makes change very difficult. Moreover, sometimes the people involved cannot conceive of alternatives or the alternatives that are conceived are discomforting and seem wrong. In Japan, many claim that it would be impossible to end the practice of lifetime employment because all groups (employers, employees, government) favour its continued existence. The following questions concern the possibilities for change in employment practices.

- 8. Is there a strong awareness among top management that change is needed?
  - 8.1. Is it difficult to adapt existing practices to changing circumstances?
  - 8.2. What are the forces that make change difficult?
  - 8.3. How has the need for change been translated into new practices?
  - 8.4. How difficult is it to develop alternatives for existing employment practices?
  - 8.5. How have changes been communicated to the employees?
  - 8.6. Do middle management and other employees support the vision of higher management?

### **The character and costs of human resources**

The final issue concerns the contribution of employment practices to the firm or department's performance. This is obviously a matter that is very difficult to establish. Before focussing on the performance of firm or department, I first would like to discuss the quality of human resources themselves. Important human resources are both valuable (or capable) and unique. First, the value or capabilities of human resources.

9. What do you consider the strength of your firm's human resources<sup>15</sup>
  - 9.1. How have these been developed?
  - 9.2. Which groups are most important and why?
  - 9.3. Are there also certain weaknesses caused by the character of human resources?
    - 9.3.1. Do people feel free to disagree with management?
    - 9.3.2. Has the focus on general skills led to average employees with lack of initiative?
10. Do you feel that the current employment practices are efficient in achieving these strengths?
  - 10.1. What are the problems as you see them? [lack of performance measurement, bubble, focus on development]
  - 10.2. What actions have you taken to address these problems?
  - 10.3. If relevant, do you recognize the problem of low white-collar productivity?
    - 10.3.1. What do you consider the causes for this low productivity?<sup>16</sup>
    - 10.3.2. Which changes did you implement to address this problem?

The second issue is the specific character of human resources. Employees that possess specific knowledge and/or know-how can contribute to a sustainable competitive advantage. Human resources can be specific because they possess specific knowledge or because of their unidentifiable contribution to teamwork.

11. Do your employees have to acquire much firm-specific knowledge?
  - 11.1. What is the ground of this specificity?
  - 11.2. How important do you consider this knowledge?
  - 11.3. Would it be possible to replace these employees by outside hiring?
  - 11.4. How do experienced employees share their knowledge (articulable, teachable, and/or observable)?

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<sup>15</sup> For instance, their ability to handle changes and problems, their ability to coordinate tasks with other departments, their broad training, their specialist knowledge, their creativity, etc.

<sup>16</sup> For instance, direct employment governance, excess of employees, the huge importance of service (*okyakusama wa kamisama desu*).

- 11.5. Do employees hired during mid-career have difficulties in understanding firm-specific issues?
- 11.6. Do you fear losing certain experienced employees to competitors? Why (not)?
- 11.7. Do you find it difficult to adjust the capabilities of employees to changing circumstances?
- 12. To what extent do employees work in teams?
  - 12.1. Are their individual responsibilities clearly defined?
    - 12.1.1. Can an employee make certain activities its own (vs. group responsibility)?
  - 12.2. Can an individual's contribution be measured? If so, does this happen?

### **Human resources and performance**

A final issue concerns the impact of employment practices on the performance of firm or department. No company has made a profit for just having excellent human resources but such resources must be translated into performance, into competitive strength. We can distinguish between performance now and the improvement of future performance through innovation. First, although I am aware that there is not necessarily a direct relationship with employment practices, competitive strength.

- 13. What happened in the last five years to your firm's (1) market share and (2) profits?
- 14. What do you consider your firm's competitive strength?<sup>17</sup>
  - 14.1. How do human resources contribute to this strength?
  - 14.2. What room is there for improvement?
  - 14.3. Has the changing environment influenced the importance of these strengths?
  - 14.4. Have you studied the productivity per employee? What happened to it?

A second topic is the importance of innovation for creating future competitive advantage.

- 15. How important is innovative strength for your firm?
  - 15.1. What kind of innovations do you develop?
  - 15.2. What kind of innovation is desirable and has been achieved: incremental or discontinuous?
  - 15.3. How do human resources contribute to this innovative strength?

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<sup>17</sup> For instance, product quality, flexibility in handling change, product costs, product research and development, service, on-time delivery, production management, technical skills workforce, equipment utilisation, technical sophistication equipment, inventory management, etc.

- 15.4. How important is the existence of wide careers for innovative strength?
- 15.5. Is there room for inter-departmental discussion and the establishment of multi-disciplinary product teams?
- 15.6. To what extent have employees the freedom to focus on improvements and innovation?
- 15.7. What problems do experience in developing an innovative workforce? (1) lack of specialists, (2) lack of creativity, and (3) lack of initiative?

### **Expectations for the future**

I would like to end with some tentative or philosophical questions about the future of Japanese employment practices.

- 16. What future do you see for typical Japanese employment practices (lifetime employment)?
- 17. Which changes do you expect to become important?
- 18. Do you expect a new equilibrium to short-term ability, more specialist employees, more mid-career hiring, a better labour market, etc.?



## Appendix 4 Japanese interview questions

### 現在の雇用状況

まず初めに現在の雇用状況についてお聞きしたいと思います。

1. 現在、貴社が面している、人的資源マネジメントの主要な問題を教えてください。<sup>18</sup>
  - 1.1. これらの諸問題の主要な原因を何だとお考えですか。<sup>19</sup>
  - 1.2. これらの諸問題に対処するためにどのような対策をとられていますか。<sup>20</sup>

### 人的資源の柔軟性

既に述べたように、技術が急速に進歩し国際競争も強まった現在の環境におき人的資源管理は非常に重要であると考えられます。そこで、貴社が人的資源の効率的な組み合わせを見つけることに困難を経験したかどうかをお聞きしたいと思います。

2. どのポジションにおいて過去に必要以上の人員が配置されていた（もしくは現在、配置されている）とお考えですか。
  - 2.1. 雇用調整のためにどのような方法を用いられましたか。<sup>21</sup>
  - 2.2. 雇用調整の対象となった社員に新たなポジションを探すのは困難でしたか。
  - 2.3. このような方法によって十分に柔軟な調整を行うことができたとお考えですか。
  - 2.4. ワークシェアリングは（社内で）議論の対象となったことはありますか。
3. どのような分類（グループ）の人たちを採用されていますか。<sup>22</sup>
  - 3.1. どのポジションにおいて人員の不足を感じますか。<sup>23</sup>
  - 3.2. この不足を補うためにどのような対策をとられましたか。
    - 3.2.1. 作業のアウトソーシング（委託）
    - 3.2.2. スペシャリスト養成のコースを設置されましたか。具体的にはどのようなコースですか？
    - 3.2.3. 派遣社員やパートタイム社員<sup>24</sup>（オランダのようなシステム）

<sup>18</sup> 例えば生産性、柔軟性、人件費の上昇、販促の機会の減少、異なる人的資源の必要性

<sup>19</sup> 例えば売上高成長の低下、テクノロジーの変化と技術的な位置、人口の高齢化、資格を持つ女性社員の増加、労働とライフスタイルの変化、バブル経済の後遺症、経済的成功のため問題が先送りされた、など。

<sup>20</sup> 例としては、ボーナスの減少、賃金曲線のフラット化、昇進の減少。

<sup>21</sup> 例えば残業への制約、出向や転籍、早期退職者募集、臨時・季節・パートタイム従業員の解雇や新たな契約の不締結、中途採用の廃止、新卒採用の減少、有給休暇の増加。

<sup>22</sup> 例えば特定の大学の卒業生、一般的なスキルへの重点。

<sup>23</sup> 例えばスペシャリストや技術者。

- 3.2.3.1. 正社員用のポジションであっても彼らが代わりに入る場合は考えられますか。
- 3.2.4. 中途採用
  - 3.2.4.1. 中途採用に関する方針に変化はありましたか。
  - 3.2.4.2. 中途採用の上限年齢はありますか。
  - 3.2.4.3. 全採用における中途採用の割合を教えてください。
- 3.2.5. 女性従業員
  - 3.2.5.1. 女性の従業員に対する方針に変化はありますか。
  - 3.2.5.2. 男女の均等な雇用への発展は進んでいるとお考えですか。  
(従業員の心の準備はできているとお考えですか)
- 3.2.6. 転職者、出向者
- 3.2.7. スペシャリスト・中途採用・女性従業員の台頭に対して組織的な変革は行いましたか。<sup>25</sup>
- 3.3. 現在の状況において（過去とは）違ったタイプの従業員が必要だとお感じですか<sup>26</sup>
  - 3.3.1. 日本の教育システムはそのような従業員を生み出しているとお考えですか。

## 従業員の分類

人的資源管理についてさらに焦点を当てる前に、キャリアに対して異なる視点を持つ従業員を別々のグループに区別しているかどうかについてお聞きしたいと思います。

- 4. 従業員をどのようにグループ分けしていますか。
    - 4.1. 異なるキャリアパスを用意していますか(multi-track system)
      - 4.1.1. もし導入しているとしたら、それはどのような区別ですか。<sup>27</sup>
      - 4.1.2. 従業員はこのような異なるキャリアの可能性を評価していますか。
    - 4.2. (オランダの企業のように)正社員の割合を変えましたか。
      - 4.2.1. 業績を落とすことなしに正社員を代えることはできますか。
- もし違いが存在するのならば、貴社の競争力に最も重要であると思われるグループ（ホワイトカラー、スペシャリスト、中途採用など）に焦点を当てたいと思います。焦点となる従業員は、インタビューを受けている方の責任の下にあることが必要です。

<sup>24</sup> 「パートタイム」とは何を指すかを明確にする：「フルタイムではない」もしくは「正社員ではない」

<sup>25</sup> 例えば、退職金の代わりに annual retirement pensions の導入

<sup>26</sup> 例えばスペシャリスト、独創的、個人主義

<sup>27</sup> 例えば、ホワイトカラーとブルーカラー、日経連：コア、スペシャリスト、周辺的な従業員、総合職・一般職のキャリア。

- 4.3. どのグループ（もしくは複数のグループ）の従業員が会社が（現在も将来も含めて）競争の中で成果を出すのに重要であると思われますか。

次に、昇進・育成・評価の仕組みをお聞きすることによって人的資源の管理における変化に焦点を合わせたいと思います。

### 従業員の昇進

5. 貴社は職能資格制度を採用されていますか。
- 5.1. 昇進の基準はどのように定まっていますか。（年功・昇進のスピード、序列競争）
- 5.2. 昇進の基準はより厳しくなっていますか。
- 5.2.1. それはなぜですか。（従業員の高齢化、低成長、よりフラットな組織、主義）
- 5.2.2. より厳しい基準はどのように達成されていますか。（強化された、もしくはより広範囲の職能資格制度）
- 5.3. よいパフォーマンスをあげた従業員に関しては上のランクに空きがあるというような示唆はなされますか。実際には空きはありますか。
- 5.4. 昇進は現在でも動機付けになりますか（より少ないポジション、中途採用の影響）
- 5.5. スペシャリストのためにはどのような昇進の機会が設けられていますか。
- 5.5.1. このような機会はスペシャリストのモチベーションの維持に重要だと思われますか。
- 5.6. 年功序列システムの方針に変化はありましたか。
- 5.6.1. 年功に基づく給与のカーブはよりフラットになりましたか。
- 5.6.2. 年齢給は従業員の長期的な動機付けには必要だとお考えですか。
- 5.6.3. 能力のある若手従業員が年功序列制のため、昇進できないという問題はありますか。
- 5.6.4. キャリアの機会に関するインフォーマルな伝達はありますか。
- 5.6.5. 入社してからの期間が短く、若い従業員は年功序列の給与を支持していますか。

### 従業員の評価

6. 現在でも従業員の評価は長期的にわたるプロセスに基づくべきだとお考えですか。
- 6.1. もしそうならば、それはどのように実行されていますか。<sup>28</sup>
- 6.2. スキルに対しての給与を採用していますか。（仕事給もしくは能率給ではなく）

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<sup>28</sup> 例えば、仕事の成績（スキルの範囲と深さによる）、仕事表（可能な仕事と問題解決の経験）

- 6.3. 長期的にわたる評価を行うことによって若い従業員のモチベーションを抑制していると感じられますか。
- 6.4. 評価時に広範囲のスキル（スペシャリスト的なスキルと対照的なもの）はどの程度重要ですか。なぜ重要視しますか。
- 6.5. パフォーマンスの評価の結果はどのようにして従業員にコミュニケーションされていますか。
  - 6.5.1. 正式なパフォーマンス査定の対話がありますか。
- 6.6. より短期的な評価への移行はありますか。
  - 6.6.1. 短期的なパフォーマンスの測定に困難はありますか。
  - 6.6.2. パフォーマンスとボーナスの間の関係を強化されましたか。
  - 6.6.3. パフォーマンスがより重要になったことを従業員は認識していますか。
- 6.7. 年俸制のシステムは導入されていますか。
  - 6.7.1. 導入の理由にはどのようなものがありますか。（ホワイトカラーの生産性が低いから？）
  - 6.7.2. どの従業員が年俸制のシステムの対象となっていますか。

### 従業員の育成

- 7. 従業員の育成は現在においても長期的視野を持って行われていますか。
  - 7.1. 定期的なジョブ・ローテーションは実行されていますか。（なぜ？）
    - 7.1.1. どのような従業員がローテーションの対象となりますか。
    - 7.1.2. ローテーションの間につくポジションはどのように決定され、従業員のキャリアはどのように計画されますか。
  - 7.2. OJT はどの程度、重要だとお考えですか。
    - 7.2.1. なぜそれが重要である、もしくは重要でない、と思われますか。
    - 7.2.2. OJT の他に研修の機会は設けていますか。
    - 7.2.3. もし可能ならば、社外での教育を受けさせたいと思う従業員もいますか。
  - 7.3. 従業員の育成の必要性によって効率性が損なわれると感じますか。

### 変革への抵抗

ここまでは変化自体についてお聞きしてきましたが、次に変化のプロセスについてお聞きしたいと思います。特に、変化への抵抗についてお聞きしたいと思います。既存の慣習や制度が一貫したシステムを形成し、変化を非常に困難にする場合がある、ということはよく知られています。さらに、関係者の人々が代替案を考えることができなかつたり、考え付いた代替案が不愉快で間違っただけのものと思われたりすることもあります。日本では、すべてのグループ（雇用主、従業員、政府）がその存続を望むため、終身雇用制を廃止するのは不可能だとする意見も根強くあります。以下の質問は雇用の慣習における変化の可能性についてお聞きします。

8. トップの経営層は変化が必要だという強い認識を持っていますか。
  - 8.1. 変化する環境に既存の慣習を適用するのは困難だと感じますか。
  - 8.2. どのような要因によって変化が困難になっていると感じますか。
  - 8.3. 変化の必要性は新たな慣行を生み出しましたか。
  - 8.4. 既存の雇用の慣習の代案を開発することに困難は感じますか。
  - 8.5. 変化はどのようにして従業員に伝達されていますか。
  - 8.6. 中間経営層や他の従業員はトップの経営層のビジョンを支持していますか。

### 人的資源の性質とコスト

最後の項目は雇用の慣習が企業や部門に与える影響についてです。この関係を明らかにすることは非常に困難です。企業や部門のパフォーマンスに焦点を当てる前に、まずは人的資源の質について考えてみたいと思います。まずは、人的資源の価値と能力についてです。

9. 貴社の人的資源の強みはどこにあるとお考えですか。<sup>29</sup>
  - 9.1. これらの強みはどのようにして開発されましたか。
  - 9.2. どのグループが最も重要ですか。それはなぜですか。
  - 9.3. 人的資源の性質が原因となって引き起こされる弱みというものもありますか。
    - 9.3.1. 従業員は管理層に異議を申し立てることは許可されていると感じていますか。
    - 9.3.2. 一般的なスキルに重点を置くことは独創性に欠ける平均的な従業員の増加につながりましたか。
10. 現在の雇用の慣習がこれらの強みを達成する上で効率的であると思われるか。
  - 10.1. 貴方が考える問題の原因を教えてください。（パフォーマンスの測定の難しさ、バブル、育成への重点）
  - 10.2. このような問題に対処するためにどのような手段をとりましたか。
  - 10.3. （もし該当するならば）ホワイトカラーの生産性の問題は存在するとお考えですか。
    - 10.3.1. この低い生産性は何が原因だと思われますか。<sup>30</sup>
    - 10.3.2. この問題に対処するためにどのような変革を起こされましたか。

二つ目の項目は人的資源の企業に特殊的な性質についてです。企業に特殊的な知識やノウハウを持っている人材は競争優位を保つのに貢献する可能性があります

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<sup>29</sup> 変化や問題に対処する能力、他の部門と協調して仕事を行う能力、幅広い分野でのトレーニング、専門的な知識、創造性。

ます。特殊な人的資源とは、特殊な知識を持っているか、チームワークを行ううえで測定できない貢献をすることを指します。

11. 業員は貴社に特殊的な知識を多く取得することを求められていますか。
  - 11.1. この特殊性は何が原因となるものですか。
  - 11.2. この特殊的な知識はどの程度、重要なものだとお考えですか。
  - 11.3. (特殊的な知識を持った) このような従業員を社外からの採用で代えることは可能だと思われますか。
  - 11.4. 経験を積んだ従業員はどのようにして自分たちの持つ知識をほかの従業員と共有していますか。(口頭で伝わるもの、教育できるもの、観察できるもの)
  - 11.5. 中途採用された従業員が貴社に特殊な問題などを理解することに困難を感じることはありますか。
  - 11.6. 経験をつんだ従業員を競合企業に引き抜かれる可能性に対する危機感はお持ちですか。それは、なぜですか。
  - 11.7. 変化する環境に従業員の能力を適応させることに困難を感じますか。
12. 従業員はどの程度、チームを組んで仕事をしますか。
  - 12.1. 個々人の責任は明確に定義されていますか。
    - 12.1.1. 作業によっては従業員の責任の下に持ってくることはできますか。(連帯責任と対照的に考えて)
  - 12.2. 個々人の貢献は測定することはできますか。もしできなければ、なぜできないとお考えなのかを教えてください。

### 人的資源とパフォーマンス

優れた人的資源を持っているだけで成功した企業というものはなく、その人的資源がパフォーマンスや競争力に結びつかなくてはなりません。現在のパフォーマンスとイノベーションを通じての将来的なパフォーマンスの改善の区別をすることができます。まずは日常のパフォーマンスから。

13. ここ 5 年間で貴社の(1)マーケットシェア(2)利益にはどのような変化がありましたか。
14. 貴社の競争優位は何だとお考えですか。<sup>31</sup>
  - 14.1. 人的資源はこの競争優位にどのように貢献しているとお考えですか。
  - 14.2. 改善の余地はあるとお考えですか。
  - 14.3. 変化する環境はこれらの強みの重要性に影響を与えましたか。
  - 14.4. 従業員一人当たりの生産性を計測されましたか。どのような変化がありましたか。

<sup>30</sup> 例えば、direct employment governance、人員過剰、非常にサービスが重要視されていること(お客様は神様です)

<sup>31</sup> 例えば、製品の質、変化に対応する柔軟性、製品のコスト、製品の研究開発、サービス、時間通りの配達、生産管理、技術の人材、設備の利用、技術的な精密機器、在庫管理、等

2つめのトピックは、将来的な競争力を作るためのイノベーションの重要性についてです。

15. イノベーション能力は貴社にとってどの程度重要なものですか。
  - 15.1. どのようなタイプのイノベーションを開発されますか。
  - 15.2. どのようなイノベーションが望ましく、またどのようなイノベーションが達成されましたか（漸進的なもの、もしくは非連続的なもの）
  - 15.3. 人材はイノベーションを生み出す力にどのように貢献していますか。
  - 15.4. 広範囲を体験するキャリアはイノベーションを生み出す力にとってどの程度重要であると考えますか。
  - 15.5. 部門間の協議や分野を超えたプロダクトチームの余地はありますか。
  - 15.6. 従業員はどの程度、改善やイノベーションに焦点を与える自由をどの程度持っていますか。
  - 15.7. 革新的な（イノベーション能力に優れた）従業員を育成するのにどのような問題を経験されましたか。(1)スペシャリストの不足 (2)創造性の不足 (3)動機の不足。

### 将来の展望

最後に、日本の雇用の慣習について試験的、そして哲学的な質問をさせていただきます。

16. 典型的な日本の雇用習慣（例えば終身雇用制）はこの先、どうなっていくとお考えですか。
17. どのような変化が重要になっていくとお考えですか。
18. 短期的な能力、より多くのスペシャリスト、より多くの中途採用、より流動的な労働市場などが特徴の新たな均衡が生じるとお考えですか。

**Appendix 5     English questionnaire**

**The way for answering the questions**

I would like you to list the answers in order of importance. The most important answer gets a 1 and thus further. Please add your own answers if necessary and list as many answers as you consider relevant. If you believe the question to be irrelevant, just leave it unanswered.

Some questions are structured differently and require either a “yes or no” answer or a choice out of multiple answers. However, I will be clear when such an alternative answer is needed.

**The current employment situation**

First, I would like to know about the current employment situation.

1. What are the major HRM issues that are currently confronting your company?

<input type="checkbox"/>	Rising wage costs
<input type="checkbox"/>	Excess employees
<input type="checkbox"/>	Low productivity
<input type="checkbox"/>	Low flexibility towards change
<input type="checkbox"/>	Decrease in promotional possibilities
<input type="checkbox"/>	The need for different human resources
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

2. What do you see as the major causes for these problems?

<input type="checkbox"/>	Low growth of sales
<input type="checkbox"/>	Post-bubble recession
<input type="checkbox"/>	Changing technologies
<input type="checkbox"/>	The ageing of the population
<input type="checkbox"/>	(Bubble induced) organisational slack
<input type="checkbox"/>	Changing work- and lifestyles
<input type="checkbox"/>	Changing position female employees
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....



3. What actions have you taken to deal with these problems?

<input type="checkbox"/>	Decreasing bonus payments
<input type="checkbox"/>	Flatter wage curves (decreased importance seniority)
<input type="checkbox"/>	Flatter organisations
<input type="checkbox"/>	Making promotions more selective
<input type="checkbox"/>	New programs for attracting and managing specialists
<input type="checkbox"/>	More use of non-regular employees (part-time, dispatched employees)
<input type="checkbox"/>	More use of mid-career hiring
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

**Flexibility in achieving the right mix of human resources**

4. At which positions did or do you experience overstaffing (an excess of employees)?

<input type="checkbox"/>	Clerical
<input type="checkbox"/>	Supervisory positions (management)
<input type="checkbox"/>	Manual production
<input type="checkbox"/>	Skilled production
<input type="checkbox"/>	Specialist / technical
<input type="checkbox"/>	Sales
<input type="checkbox"/>	Services
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

5. Which methods have you used for employment adjustment?

<input type="checkbox"/>	Restricting overtime work
<input type="checkbox"/>	Increase number of paid holidays
<input type="checkbox"/>	Dismissal or no new contract for temporary, seasonal, and part-time employees
<input type="checkbox"/>	Suspending mid-career hiring
<input type="checkbox"/>	Reduction of new recruits
<input type="checkbox"/>	Transfer personnel ( <i>shukkō</i> )
<input type="checkbox"/>	Transfer personnel temporarily ( <i>tenseki</i> )
<input type="checkbox"/>	Recruit volunteers for early retirement
<input type="checkbox"/>	Lay off personnel
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

6. At which positions did or do you experience a shortage of employees?

<input type="checkbox"/>	Clerical
<input type="checkbox"/>	Supervisory positions (management)
<input type="checkbox"/>	Manual production
<input type="checkbox"/>	Skilled production
<input type="checkbox"/>	Specialist / technical
<input type="checkbox"/>	Sales
<input type="checkbox"/>	Services
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

7. Which actions have you taken to remedy these shortages?

<input type="checkbox"/>	Special career tracks
<input type="checkbox"/>	Dispatched workers from employment agencies
<input type="checkbox"/>	Part-time employees
<input type="checkbox"/>	Mid-career hiring
<input type="checkbox"/>	Changing role for female employees
<input type="checkbox"/>	Borrowed employees
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

**The Motivation and development of employees**

The most important element of human resource management is probably the motivation and development of employees. Crucial for these activities are the structures or promotion and evaluation. I now would like to discuss the possible changes in these structures and their consequences for motivation and development.

However, it is likely that your firm’s promotional structure distinguishes between groups of employees with different career perspectives. For instance between regular and non-regular, between blue- and white-collar, or between core, specialist, and peripheral employees. In answering the remaining questions of this questionnaire, I would like you to focus on the most important (what is meant by important?) group of employees you are responsible for. If different groups of employees are of equal importance please focus on the group where problems and changes have been or are most prevalent.

8. Which group of employees do you focus on in the remainder of this questionnaire?

9. Is promotion getting more selective?

☐

Yes

☐

No (go to question 11)

10. If so, why?

☐

☐

☐

☐

☐

☐

☐

- An ageing workforce
- Slower organisational growth
- Flatter Organisations
- To improve performance
- Out of principle (merit should become more important)

.....

.....

11. Has there been a change to a more short-term evaluation of performance?

☐

Yes

☐

No (go to question 13)

12. If so, why?

☐

☐

☐

☐

☐

- To improve performance
- To accommodate specialists and mid-career hired employees
- To decrease labour costs

.....

.....

13. How important is the policy of on-the-job training?

☐☐☐☐☐

Very important – Important – Indifferent – Not so important – Not important

14. How important is the policy of regular job rotation?

☐☐☐☐☐

Very important – Important – Indifferent – Not so important – Not important

**Possibilities for Change**

After all these questions about change, I would like to ask some questions about the process of change itself. In particular, the possibilities for change. It is well-known

that existing customs and institutions can form a coherent system, which makes change very difficult. Moreover, sometimes the people involved cannot conceive of alternatives or the alternatives that are conceived are discomforting and seem wrong. In Japan, many claim that it would be impossible to end the practice of lifetime employment because all groups (employers, employees, government) favour its continued existence.

15. How do you perceive the possibilities for adapting existing employment practices?

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Difficult - Rather difficult - Indifferent - Rather easy - Easy

16. What are the forces that make change difficult?

<input type="checkbox"/>	Difficulties in finding alternatives
<input type="checkbox"/>	Government policies
<input type="checkbox"/>	The attitude of the enterprise union
<input type="checkbox"/>	The company culture
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

### **The character and costs of human resources**

The final issue concerns the contribution of employment practices to the firm or department's performance. This is obviously a matter that is very difficult to establish. I first would like to ask some question concerning the quality of human resources themselves. Important human resources are both valuable (or capable) and unique. First, the value or capabilities of human resources.

17. What do you consider the strength of your firm's human resources?

<input type="checkbox"/>	Their ability to handle changes and problems
<input type="checkbox"/>	Their ability to coordinate with other departments
<input type="checkbox"/>	Their efficiency
<input type="checkbox"/>	Their broad training an flexibility
<input type="checkbox"/>	Their specialist knowledge
<input type="checkbox"/>	Their understanding of the organisation and its goals
<input type="checkbox"/>	Their loyalty to the firm
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

18. Are there also certain weaknesses of your human resources?

<input type="checkbox"/>	Their lack of efficiency
<input type="checkbox"/>	Their lack of specialist knowledge
<input type="checkbox"/>	Their lack of ability to handle changes and problems
<input type="checkbox"/>	Their lack of flexibility
<input type="checkbox"/>	Their lack of initiative
<input type="checkbox"/>	Their lack of leadership
<input type="checkbox"/>	Their fear to disagree (with management)
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

The second issue is the specific character of human resources. Employees that possess specific knowledge and/or know-how can contribute to a sustainable competitive advantage. Human resources can be specific because they possess specific knowledge or because of employees their unidentifiable contribution to teamwork.

19. How important is firm-specific knowledge for your employees their performance?

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>				
Very important	–	Important	–	Indifferent	–	Not so important	–	Not important

20. How important is teamwork?

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>				
Very important	–	Important	–	Indifferent	–	Not so important	–	Not important

21. Are individual responsibilities clearly defined?

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>				
Clear	–	Rather clear	–	Medium	–	Rather ambiguous	–	Ambiguous

**Human resources and performance**

A final issue concerns the impact of employment practices on the performance of firm or department. No company has made a profit for just having excellent human resources but such resources must translated into performance. However, this relation is very complex and thus can better be discussed during the interview. Nevertheless, as a start, I like you to answer two questions about the firm's

performance. The first question concerns regular (everyday) performance, the second question concerns innovative strength.

22. What do you consider your firm’s competitive strength?

<input type="checkbox"/>	Product quality	<input type="checkbox"/>	Flexibility in handling change
<input type="checkbox"/>	Product costs	<input type="checkbox"/>	Product R&D
<input type="checkbox"/>	Service	<input type="checkbox"/>	On-time delivery
<input type="checkbox"/>	Production management	<input type="checkbox"/>	Technical skills workforce
<input type="checkbox"/>	Equipment utilisation	<input type="checkbox"/>	Technical sophistication
<input type="checkbox"/>	Inventory management	<input type="checkbox"/>	equipment
<input type="checkbox"/>	.....	<input type="checkbox"/>	.....

23. How important is innovative strength for your firm?

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Very important – Important – Indifferent – Not so important – Not important

My sincere thanks for completing the questionnaire.

Yours sincerely,  
Arjan Keizer

Appendix 6 Japanese questionnaire

記入方法

ほとんどの質問に複数の答えがあります。該当されると思われる答えを重要と思われる順に並べてください。最も重要であると考えられる答えに1をつけて、それ以降も同様に記入をしてください。必要である場合は自分の答えを加えてください。質問が不適切だと思ったら、その箇所は無回答で結構です。

何箇所か、「イエス・ノー」による回答や複数の選択肢による回答の形式の質問もあります。これらの箇所は分かるようになっています。

現在の雇用状況

まず初めに現在の雇用状況についてお聞きしたいと思います。

1. 現在、貴社が面している、人的資源マネジメントの主要な問題を教えてください。

<input type="checkbox"/>	人件費の上昇
<input type="checkbox"/>	従業員の過剰
<input type="checkbox"/>	低い生産性
<input type="checkbox"/>	変化に対応する柔軟性の低さ
<input type="checkbox"/>	昇格の機会の減少
<input type="checkbox"/>	異なる人的資源の必要性（スペシャリスト、技術者など）
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

2. これらの諸問題の主要な原因を何だとお考えですか。

<input type="checkbox"/>	売上高成長の低下
<input type="checkbox"/>	バブル経済の後遺症
<input type="checkbox"/>	テクノロジーの変化と技術的な位置
<input type="checkbox"/>	人口の高齢化
<input type="checkbox"/>	過去の成功による惰性
<input type="checkbox"/>	労働とライフスタイルの変化
<input type="checkbox"/>	資格を持つ女性社員の増加
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

3. これらの諸問題に対処するためにどのような対策をとられていますか。

<input type="checkbox"/>	ボーナスの減少
<input type="checkbox"/>	賃金曲線のフラット化 (年齢による昇給の縮小・廃止)
<input type="checkbox"/>	昇進の減少
<input type="checkbox"/>	昇進基準の厳格化
<input type="checkbox"/>	スペシャリストの優遇や管理のプログラム
<input type="checkbox"/>	派遣社員やパートタイム社員の増加
<input type="checkbox"/>	中途採用の増加
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

人的資源の柔軟性

4. どのポジションにおいて過去に必要以上の人員が配置されていきましたか。

<input type="checkbox"/>	事務社員
<input type="checkbox"/>	管理層
<input type="checkbox"/>	肉体労働者
<input type="checkbox"/>	熟練した労働者
<input type="checkbox"/>	スペシャリスト
<input type="checkbox"/>	営業社員
<input type="checkbox"/>	サービス
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

5. 雇用調整のためにどのような方法を用いられましたか。

<input type="checkbox"/>	残業の削減
<input type="checkbox"/>	有給休暇の増加
<input type="checkbox"/>	臨時・季節・パートタイム従業員の解雇や新たな契約の不締結
<input type="checkbox"/>	中途採用の廃止
<input type="checkbox"/>	新卒採用の減少
<input type="checkbox"/>	出向
<input type="checkbox"/>	転籍
<input type="checkbox"/>	早期退職者募集
<input type="checkbox"/>	正社員の解雇
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....



6. どのポジションにおいて人員の不足を感じますか。

<input type="checkbox"/>	事務員
<input type="checkbox"/>	管理層
<input type="checkbox"/>	肉体労働者
<input type="checkbox"/>	熟練労働者
<input type="checkbox"/>	スペシャリスト
<input type="checkbox"/>	営業
<input type="checkbox"/>	サービス
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

7. この不足を補うためにどのような対策をとられましたか。

<input type="checkbox"/>	スペシャリスト養成のコース
<input type="checkbox"/>	派遣社員
<input type="checkbox"/>	パートタイムの社員
<input type="checkbox"/>	中途採用
<input type="checkbox"/>	女性の従業員に対する方針の変化
<input type="checkbox"/>	転職者、出向者
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

従業員の昇進と評価

人的資源管理の最も重要な要素はおそらく、従業員のモチベーションと養成であると考えられます。このためには昇進と評価のシステムが不可欠な働きをします。これらのシステムにおける変化とそれがモチベーションや養成に与える影響について、これからお聞きしたいと思います。

貴社の昇進のシステムはおそらく、キャリアについて考え方が違う従業員のグループを区別していると思います。例えば、正社員とそうでない社員、ブルーカラーとホワイトカラー、コアとスペシャリスト社員と周辺の社員、といったようにです。このアンケートの残りの質問を回答するに当たって、貴殿の責任下にある従業員のグループのうち、重要と思われるグループについて回答していただきたいと思います。もし同等に重要な異なるグループが存在する場合は、最も変化が大きなグループに焦点を当てて回答をしてください。

8. 以下のアンケートでは、どのグループに焦点を当てますか

9. 昇進の基準はより厳しくなっていますか

☐ はい

☐ いいえ（質問 1 1 に進んでください）

10. それはなぜですか。

<input type="checkbox"/>	従業員の高齢化
<input type="checkbox"/>	低い成長率
<input type="checkbox"/>	よりフラットな組織
<input type="checkbox"/>	パフォーマンスの改善を促すため
<input type="checkbox"/>	実力をより重視するようになったため
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

11. より短期的な評価への移行はありましたか

☐ はい

☐ いいえ（質問 1 3 に進んでください）

12. それはなぜですか。

<input type="checkbox"/>	パフォーマンスの改善を促すために
<input type="checkbox"/>	スペシャリストや中途採用の台頭への対処法として
<input type="checkbox"/>	人件費を減らすために
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

13. OJT はどの程度、重要だとお考えですか。

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
非常に重要	重要	無関心	あまり重要ではない	全く重要ではない

14. ジョブ・ローテーションはどの程度、重要だとお考えですか。

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
非常に重要	重要	無関心	あまり重要ではない	全く重要ではない

変革への抵抗

ここまでは変化自体についてお聞きしてきましたが、次に変化のプロセスについてお聞きしたいと思います。特に、変化への抵抗についてお聞きしたいと思います。既存の慣習や制度が一貫したシステムを形成し、変化を非常に困難にする場合がある、ということはよく知られています。さらに、関係者の人々が代替案を考えることができなかつたり、考え付いた代替案が不愉快なため間違ったものと思われたりすることもあります。日本では、すべてのグループ（雇用主、従業員、政府）がその存続を望むため、終身雇用制を廃止するのは不可能だとする意見も根強くあります。以下の質問は雇用の慣習における変化の可能性についてお聞きします。

15. 変化する環境に既存の慣習を適用するのは困難だと感じますか。

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
難しい	やや難しい	無関心	やや簡単	簡単

16. どのような要因によって変化が困難になっていると感じますか。

<input type="checkbox"/>	代替的な案の欠如
<input type="checkbox"/>	政府の対策
<input type="checkbox"/>	労働組合の性質
<input type="checkbox"/>	会社の文化
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

人的資源の性質とコスト

最後の項目は雇用の慣習が企業や部門に与える影響についてです。この関係を明らかにすることは非常に困難です。企業や部門のパフォーマンスに焦点を当てる前に、まずは人的資源の質について考えてみたいと思います。まずは、人的資源の価値と能力についてです。

17. 貴社の人的資源の強みはどこにあるとお考えですか。

<input type="checkbox"/>	変化や問題に対処する能力
<input type="checkbox"/>	他の部門と協調して仕事を行う能力
<input type="checkbox"/>	効率性
<input type="checkbox"/>	幅広い分野でのトレーニングと柔軟性
<input type="checkbox"/>	専門的な知識
<input type="checkbox"/>	組織とその目標への理解
<input type="checkbox"/>	企業への忠実性
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

18. 人的資源の性質が原因となって引き起こされる弱みというものもありますか。

<input type="checkbox"/>	効率性
<input type="checkbox"/>	専門的な知識の不足
<input type="checkbox"/>	変化や問題に対処する能力の不足
<input type="checkbox"/>	柔軟性の不足
<input type="checkbox"/>	独創性の不足
<input type="checkbox"/>	率先してやるという態度の欠如
<input type="checkbox"/>	管理者層と意見が合わないことへの心配
<input type="checkbox"/>	.....
<input type="checkbox"/>	.....

二つ目の項目は人的資源の特殊的な性質についてです。ある企業に特有のコーポレート・カルチャーや組織内のプロセスについての理解は従業員のパフォーマンスにとって重要であると考えられます。その場合、経験者の外部からの採用は難しくなります。

19. 貴社で仕事をするにあたって特有な知識はどの程度、重要だとお考えですか。

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
非常に重要	重要	無関心	あまり重要ではない	全く重要ではない

20. チームワークはどの程度、重要だとお考えですか。

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
非常に重要	重要	無関心	あまり重要ではない	全く重要ではない

21. 個々人の責任は明確に定義されていますか。

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
はっきり	ややはっきり	中間	ややあいまい	あいまい

### 人的資源とパフォーマンス

優れた人的資源を持っているだけで成功した企業はなく、その人的資源がパフォーマンスや競争力に結びつかなくてはなりません。しかし、この関係は非常に複雑なものであり、インタビュー中により詳しくお聞きしたいと思います。ここでは、貴社のパフォーマンスについて二つの質問をさせていただきます。最初の質問は日常的なパフォーマンス、二つ目の質問はイノベーションの能力についてお聞きします。

22. 貴社の競争優位は何だとお考えですか

<input type="checkbox"/>	製品の質	<input type="checkbox"/>	変化に対応する柔軟性
<input type="checkbox"/>	製品のコスト	<input type="checkbox"/>	製品の研究開発
<input type="checkbox"/>	サービス	<input type="checkbox"/>	時間通りの配達
<input type="checkbox"/>	生産管理	<input type="checkbox"/>	技術者の人材
<input type="checkbox"/>	設備の利用	<input type="checkbox"/>	生産設備
<input type="checkbox"/>	在庫管理	<input type="checkbox"/>	.....
<input type="checkbox"/>	.....		
<input type="checkbox"/>	.....		

23. イノベーション能力は貴社にとってどの程度重要なものですか。

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
非常に重要	重要	無関心	あまり重要ではない	全く重要ではない

アンケートへのご協力、どうもありがとうございました。

Arjan Keizer

Appendix 7    Overview answers questionnaires

	Auto			Electronics			Constr.		Retail	
	A	A	B	C	D	E	A	A	B	C
1. What are the major HRM issues?										
Rising wage costs	4	2	2		4	3	1	1	2	1
Excess employees		3	1		3	6	2		1	
Low productivity				3	5	5		1	3	
Low flexibility towards change	3			1	1	2		3	4	
Decrease in promotional possibilities					7	4			6	
The need for different human resources	2			2	6	1			5/1	
.....	X1	X3			X14					
2. What do you see as the major causes for these problems?										
Low growth of sales	3	1	1		6	2	1	1	1/1	1
Post-bubble recession		2			7	3	2			
Changing technologies			2	3	5	1				
The aging of the population	4	3			3	4			2	
(Bubble induced) organisational slack				1	4			2		
Changing work- and lifestyles	2			2	2	5			/2	
Changing position female employees					8					
.....	X2				X15					
3. What actions have you taken to deal with these problems?										
Decreasing bonus payments		3	1			4		3	/2	
Flatter wage curves (decreased importance seniority)	1	1	2		2	2	2	2	2	
Flatter organisations						6	1			
Making promotions more selective			3			1			3	



	Auto		Electronics					Constr.			Retail	
	A		A	B	C	D	E	A		A	B	C
Clerical												
Supervisory positions (management)							3					
Manual production												
Skilled production							4					
Specialist / technical	1	1			1		1			1	1	1
Sales	2						2			/1		
Services										3		
.....				X6		X16						
7. Which actions have you taken to remedy these shortages?						-			-			
Special career tracks												
Dispatched workers from employment agencies		2					2					
Part-time employees										1/1		
Mid-career hiring		1			2		1					
Changing role for female employees												
Borrowed employees												
.....				X7	X12							X20
8. Focus-group employees	WC	SSS	CA	Ippan	All	Sei	Sei	Sei	Sei	Sei	Sei	Sei
9. Is promotion getting more selective?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Y/N	Y/N	Yes
10. If so, why?												
An aging workforce		3	4				5	1				
Slower organisations growth			3				4					
Flatter Organisations	2		1				3					
To improve performance		1		2			1			1		
Out of principle (merit should become more important)	1	2	2	1	1	1	2		*	2	2	1
11. Is there a change to a more short-term evaluation of performance?	Yes	Yes	Yes	Yes	No	No	Yes	No	-	N/N	N/N	No



	Auto		Electronics					Constr.			Retail		
	A	A	B	C	D	E	A	A	B	C			
12. If so, why? To improve performance To accommodate specialists and mid-career hired employees To decrease labour costs	*	1	1	-	-	1	-	-	-	-	-		
13. How important is the policy of on-the-job training?	VI	1	VI	1	1	VI	1	VI	I/I	VI	VI		
14. How important is the policy of regular job rotation?	I	IND	VI	VI	1	VI	1	NSI	VI/I	I	I		
15. How do you perceive the possibilities for adapting employment practices?	D	RD	D	RD	D	D	RD	RD	D/RD	RD	RD		
16. What are the forces that make change difficult? Difficulties in finding alternatives Government policies The attitude of the enterprise union The company culture .....			2		-				/2				
			3			1			/1				
17. What do you consider the strength of your human resources? Their ability to handle changes and problems Their ability to coordinate with other departments Their efficiency Their broad training an flexibility Their specialist knowledge Their understanding of the organisation and its goals Their loyalty to the firm .....		1	X8	*		2	1	*	1	1	1		
								2	/1				
			*			4		3	1				
			*			5							
						6							
			*		2	7							
	1		*	2	1	1	1						
	2		*			2	2	1			1		
	3				3	3							
				X13									
18. Are there also certain weaknesses of your human resources? Their lack of efficiency Their lack of specialist knowledge	-												

	Auto		Electronics				Constr.			Retail		
	A	A	B	C	D	E	A	A	B	C		
Their lack of ability to handle changes and problems Their lack of flexibility Their lack of initiative Their lack of leadership Their fear to disagree (with management) ..... 19. How important is employees' firm-specific knowledge for performance? 20. How important is teamwork? 21. Are individual responsibilities clearly defined? 22. What do you consider your firm's competitive strength? Product quality Product costs Service Production management Equipment utilisation Inventory management Flexibility in handling change Product research and development On-time delivery Technical skills workforce Technical sophistication equipment ..... 23. How important is innovative strength for your firm?			*	3		3	1	1	2/1	1		
		NSI	X9	VI	X17	I	I	NSI	I/I	I		
		I	I	VI	VI	VI	I	VI	VI/I	I		
		M	C	RC	M	RC	RC	RC	RA/RC	RA		
		1	*	2	1	1				*		
		4	*			11		*	*/			
						5						
						9						
						7						
						8		*				
			*			4	2	*		*		
		3	*		1	2						
						10						
		2	*	1	2	3	1					
						6						
		I	VI	VI	VI	VI	I	VI	I/I	VI		

**Legend**

\* = confirmation without listing order

Question 8:

Sei = *Seishain* (regular employees), WC = White-Collar employees, SSS = *Sōgōshoku shain* (career track employees), CA = Category A (future management employees), C/S = Core and specialist employees, Ippan = *Ippanshoku* (auxiliary regular employees)

Questions 13, 14, 19, 20, 23: VI = Very Important, I = Important, IND = Indifferent, NSI = Not So Important, NI = Not Important

Question 15: D = Difficult, RD = Rather Difficult, IND = Indifferent, RE = Rather easy, E = Easy

Question 21: C = Clear, RC = Rather Clear, M = Medium, RA = Rather Ambiguous, A = Ambiguous.

**Additional answers (in brackets the order of importance)**

X1 (1)	Train candidates for future top management	X2 (1)	Japanese educational system is behind international level
X3 (1)	Motivation of employees	X4 (2)	Introduce an evaluation system that is fair and convincing
X5 (1)	Technical work	X6 (1)	IT-related engineers
X7 (1)	Retrain internal engineers	X8 (1)	Culture of Japanese employees
X9 (*)	Profit orientation	X10 (1/2)	Meritocracy (1) / Improved evaluation system (2)
X11 (1)	All	X12 (1)	Increase motivation by introducing meritocracy
X13 (1)	Hardworking	X14 (2)	Shift abroad
X15 (1)	International differences in costs	X16 (1)	No shortage
X17 (-)	Nothing special	X18 (*)	I think it was appropriate at the time of initial allocation
X19 (1)	natural attrition regular employees, increased hiring part-timers	X20 (1)	Employ workers from other companies

## Summary

Since the ‘burst of the bubble’ late 1989 the Japanese economy has known a reversal of fortunes among the most dramatic in modern history. This change in economic success has been mirrored in the perception of Japan’s economic institutions, including the employment practices. For many years these practices were considered as one of the cornerstones of Japan’s economic success but the lack of economic growth and various structural developments, like the ageing of the population and the increasing importance of the service sector, have inspired a debate on the efficiency of Japanese employment practices and the need for adjustment. This research is inspired by and takes its position within this debate by studying the likeliness, character and consequences of changing Japanese employment practices. It analyses the impact of various environmental changes and possible adaptations in employment practices on the economic performance of the Japanese firm by discussing two major research questions:

- (1) How and to what extent do changed circumstances inspire adaptations in employment practices?
- (2) How do changed circumstances and adaptations in employment practices influence the competitive strength of Japanese firms?

To answer these questions, the study is divided into a theoretical, empirical and analytical part.

The theoretical part consists of three chapters that develop the framework for discussing the issues of institutional change and its economic outcomes. The first of these chapters analyses the institutional character of Japanese employment practices by discussing their social embeddedness. It particularly discusses the wide support for the practice of lifetime employment by the government, employers and employees, and Japanese case law. In spite of some minor developments to the contrary, this support has remained strong and constrains any possibility for change. In accordance, the chapter subscribes the study’s choice for an institutional methodology. It presents various theories of institutional change that show how contradictions between functional efficiency and legitimacy are a crucial if not sufficient condition for change. In addition, the chapter presents the firm as the major party responsible for change since it experiences the impact of both the embedded employment practices and the economic consequences of changing circumstances.

In accordance with this focus on the firm, the subsequent chapter introduces various theories of the firm that enable the analysis of the contribution of employment practices on firm performance. The chapter presents the contractual,

capability and evolutionary perspectives as three major strands of theories of the firm. In accordance, the study's methodology is not only institutional but also pluralist. A particular position is taken by the evolutionary perspective because its focus on dynamics and firm heterogeneity fits very well with this study's focus on change. The chapter also discusses three explicit examples of the different perspectives, namely transaction cost economics, the resource-based view and the dynamic capabilities approach, to study the impact of changing employment practices on firm performance. However, the use of these theories for an empirical analysis is not self-evident and the chapter discusses the problems that exist in making transaction cost economics and the capabilities perspective operational. The concept of logic is presented as a means to overcome these operational difficulties and to combine the different perspectives.

As the next chapter illustrates, this is not the only meaning that this study ascribes to the concept of 'logic'. Logic also refers to the economic and institutional implications of the employment practises as discussed in the final theoretical chapter. As a matter of fact, this logic is twofold and together the two types of logic can be interpreted as the core of Japanese employment practices and a benchmark against which we can evaluate change. The first logic is an 'adjustment logic' that enables firms to adjust their labour input while upholding the practice of lifetime employment. Secondly, the 'productive logic' explains the contribution of employment practices to the competitive strength of the Japanese firm. In discussing this second logic the theories of the firm are instrumental. Focus is on the importance of firm-specific and so-called 'contextual' and 'intellectual' skills and the way the employment practices support the development of these skills. However, the success of these skills is not self-evident and the chapter discusses various contingencies. Their (continued) fulfilment will eventually determine the success of Japanese employment practices.

The next five chapters present the empirical findings of the research. The first of these chapters summarises findings from the existing literature and statistics on the labour market and firms' strategies for human resource management. It shows that the employment adjustments in response to the difficult circumstances of the 'lost decade' can be safely considered 'traditional'. The adjustment logic prevails; layoffs remain rare and the practice of lifetime employment strongly supported. In addition, the chapter also discusses the environmental changes that are said to require adaptations in employment practices. Not surprisingly, these factors often read as the inverse of the contingencies for success discussed in the previous chapter. Together, these changes put the Japanese employment practices under serious pressure, also because several of them reinforce one another. In the short run, three

consequences stand out: (1) the rising wage costs, (2) the decline in promotional possibilities, and (3) the qualitative changes in the human resources needed. Finally, the chapter also introduces four types of adaptations in employment practices that have been presented as an answer to these changed circumstances, namely (1) the rise in performance-based pay, (2) the diversification of employment types, (3) the rise in non-regular employment, and (4) the rise in labour mobility.

The subsequent four chapters subscribe to the need to study heterogeneous firms in their specific circumstances by discussing case-studies of individual firms in four different industries: automobiles, electronics, construction and retailing. The data for these case-studies was collected through interviews, additional questionnaires, company documents, and publicly available data. All these chapters present the industry's characteristics before they switch to the discussion of the individual firms in that industry. Each case-study consists of an introduction and discussions of the firm's major strategies, its economic situation, and its practices in human resource management and their changes.

The case-study chapters already show a wide variety of similarities and differences in the adaptations firms have made in their human resource management. However, the interpretation of these findings is left for the final chapters which generalise the empirical findings to the industry- and national level. Chapter ten discusses the industry-specific adaptations in employment practices. Two types of employment logic are instrumental in this discussion. Besides the conventional productive logic as discussed in chapter four, the chapter introduces an alternative logic based on the increased involvement of non-regular employees. Changing circumstances like the shift from manufacturing to service industries and the shrinking margins because of the weak demand have led to an increase in non-regular employment as almost all industries have tried to reduce labour costs through replacing regular by non-regular employees. However, the possibilities for this strategy clearly differ between industries and important differences exist in both quantity and type of non-regular employees. The industries that can be said to have inspired the two logics – automobile and retailing – provide the clearest examples. In the automobile industry the productive logic remains strong; in the retail industry the dependence on non-regular employees is high. The other two industries take an intermediate position in this respect.

The next chapter returns to the national level as it shows how, in spite of the differences between firms and industries, the strategies for HRM are rather similar; a fact that can hardly be considered surprising given the strong embeddedness of employment practices. The chapter discusses three developments already introduced in chapter five, namely (1) the rise of performance-based pay (*seikashugi*), (2) the

diversification of employment types, and (3) the rise of labour mobility. Most striking is the rise in performance-based pay as all firms in this research have strengthened the importance of performance as a criterion for evaluation in recent years. At the same time, the firms show a wide diversity in their attempts to do so. All use management-by-objectives (MBO) but its type and place among the other criteria for evaluation differs. Moreover, in spite of these developments, the conventional productive logic of employment practices remains important as firms try to combine new strategies with existing practices. They tend to do so by limiting the importance of performance-based pay to more senior employees, maintaining ability and even seniority as evaluation criteria for younger employees. It is not either seniority or ability or performance wages but usually a combination of all three, adapted to the position and function of the employee.

The other developments in employment practices are less striking in comparison. The case studies did confirm the existence of several employment tracks but many firms do not make such a distinction nor do they consider that possibility. Overall, this does not seem an area of major development. A possible exception concerns the multi-track personnel system as proposed by Nikkeiren and the rise in non-regular employment. Finally, given the rather mixed data on the rise in labour mobility it was interesting to find various firms that employ a substantial number of mid-career employees. The negative attitude towards mid-career hiring appears to be changing. Then again, mid-career hiring continues to concern relative young employees or specialists and regular employees still appear to be hired for careers rather than specific jobs.

The chapter also discusses the likelihood of a fundamentally new constellation – logic – of Japanese employment practices as the three adaptations directly concern the internal labour market and can be related to one another. However, this new constellation is still far from a reality. The current changes appear more like a calibration of the internal labour market through an (accelerated) continuation of the long-term trends towards a smaller percentage of regular employees and a stronger impact of performance appraisal. This gradual character does not rule out a substantial change in employment logic but this remains unlikely. As long as the support for lifetime employment remains strong, the internal labour market and the accompanying productive logic will continue to hold a crucial role among Japanese employment practices. Much will depend on the developments during a next period of economic growth. Paradoxically, the importance of lifetime employment is confirmed during difficult economic circumstances. However, as employees have the freedom to change employment and if firms really have changed their attitude towards mid-career hiring, strong economic growth could initiate a substantial rise in labour mobility and inspire additional adaptations.

The last chapter returns to the major research questions as they were posed in the introductory chapter. Concerning the adaptation in employment practices, the increased importance of non-regular employment and the rise in performance-based pay stand out. This has had important implications for the employment at Japanese firms. However, both can also be considered an acceleration of long-term trends, as a calibration of the internal labour market to the changed circumstances. Moreover, the introduction of performance-based pay tends to be limited to more senior employees and has not changed the productive logic of Japanese employment practices for regular employees.

The second research question, concerning the impact of the changed employment situation on the competitive strength of Japanese firms, is more difficult to answer; in particular in a summarised form. Inter-industry differences further complicate the answer. However, we do indeed see signs of diminished efficiency, both in the employment practices themselves and in the combination of employment practices and the organisation of work. This makes it tempting to speak about the fading glory of Japanese employment practices. However, this conclusion could be said to do injustice to the developments in Japanese employment practices. As a matter of fact, the firms appear to have been successful in their adjustments. The flexibility in employment practices has been surprisingly large, with firms making rather substantial adjustments while also upholding the conventional employment logic based on internal labour markets and long-term employment relations. Instead of blaming the employment practices, we could also acclaim the new diversity in Japanese employment practices. Lifetime employment remains the core of Japanese employment practices but outside this core, we see a wide variety of employment practices.



## Nederlandse Samenvatting [Dutch summary]

Deze studie naar verandering in Japanse werkgelegenheidsinstituten is deels geïnspireerd door de omslag in de prestaties van de Japanse economie sinds de zogeheten ‘burst of the bubble’ aan het einde van 1989.<sup>1</sup> Wat volgde was een lange periode van beperkte en soms zelfs negatieve economische groei en dit veranderde de perceptie van Japanse economische instituten en Japanse werkgelegenheidsinstituten in het bijzonder. Niet langer worden deze instituten gezien als een van de bouwstenen van het Japanse economische succes. Het gebrek aan economische groei en verschillende structurele veranderingen zoals het verouderen van de populatie hebben geleid tot een hernieuwde discussie over de efficiëntie van deze instituten en de noodzaak voor aanpassing. Deze studie neemt positie in dit debat over verandering en bestudeert de waarschijnlijkheid, het karakter en de consequenties van veranderende Japanse werkgelegenheidsinstituten. Het analyseert de impact van de veranderende omstandigheden en de veranderingen in instituten op de prestaties van de Japanse onderneming. De twee centrale onderzoeksvragen zijn als volgt.

- (1) Hoe en in welke mate inspireren de veranderende omstandigheden aanpassingen in Japanse werkgelegenheidsinstituten?
- (2) Beïnvloeden de veranderde omstandigheden en de aanpassingen in werkgelegenheidsinstituten de concurrentiekracht van Japanse bedrijven?

Voor het beantwoorden van deze vragen is de studie verdeeld in een theoretisch, empirisch and analytisch gedeelte.

Het theoretische gedeelte bestaat uit drie hoofdstukken die samen het kader ontwikkelen voor het bespreken van institutionele verandering en haar economische implicaties. Het eerste van deze hoofdstukken bespreekt het institutionele karakter van de Japanse werkgelegenheidsinstituten door hun sociale inbedding. We zien hoe met name de institutie die bekend staat als ‘permanente werkgelegenheid’ (lifetime employment) wordt gesteund door zowel de overheid, werkgevers, werknemers als het arbeidsrecht. Bovendien blijft deze steun sterk ondanks de veranderende omstandigheden. Om de implicaties van deze steun te analyseren, presenteert het hoofdstuk verschillende theorieën van institutionele verandering. Deze tonen hoe tegenstellingen tussen functionele efficiëntie en legitimiteit een noodzakelijke

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<sup>1</sup> De studie gebruikt de Engelse term ‘employment practices’. Met enige goede wil kan deze term zowel naar de nationale instituten als naar de activiteiten van individuele bedrijven verwijzen. Wat dit betreft is ‘werkgelegenheidsinstituten’ een enigszins ongelukkige vertaling omdat het met name het nationale karakter van deze ‘werkgelegenheidspraktijken’ benadrukt.

voorwaarde zijn voor verandering. Daarnaast bespreekt het hoofdstuk hoe een belangrijke rol is weggelegd voor de onderneming als de partij die het belang ervaart van zowel efficiëntie als legitimiteit.

In overeenstemming met deze laatste conclusie bespreekt het volgende hoofdstuk verschillende theorieën van de onderneming ('theories of the firm') die het mogelijk maken het belang van werkgelegenheidsinstituten – en personeelsmanagement – voor de onderneming te analyseren. Het hoofdstuk introduceert het contractuele, capaciteiten en evolutionaire perspectief als drie belangrijke vertegenwoordigers van de theorie van de onderneming. Het evolutionaire perspectief bekleedt hierbij een bijzondere positie omdat de nadruk die het legt op verandering en heterogeniteit overeenkomt met het onderwerp van deze studie. Het hoofdstuk bespreekt ook drie belangrijke vertegenwoordigers van de perspectieven: de transactiekosten theorie van Oliver Williamson, de bedrijfsmiddelen benadering ('resource-based view') van Jay Barney en de dynamische capaciteiten benadering van David Teece, Gary Pisano en Amy Shuen. Het gebruik van deze benaderingen voor een empirische analyse is echter niet vanzelfsprekend en het hoofdstuk bespreekt de problemen die bestaan. Het beargumenteert vervolgens het idee dat elk van deze benaderingen een eigen 'logica' presenteert. Dit blijkt een manier om de verschillende operationele problemen te boven te komen en de benaderingen te combineren.

Het vierde hoofdstuk bespreekt vervolgens een tweede betekenis van het logica concept. 'Logica' verwijst ook naar de economische en institutionele implicaties van de werkgelegenheidsinstituten. Deze logica blijkt tweevoudig en kan worden beschouwd als het hart van de Japanse werkgelegenheidsinstituten en de maatstaf om verandering te evalueren. De eerste vorm van logica is de 'aanpassingslogica' die ondernemingen in staat stelt de arbeidsinput aan te passen en tegelijkertijd de 'permanente werkgelegenheid' van standaard werknemers te garanderen. Daarnaast bestaat een 'productieve logica' die beschrijft hoe de Japanse werkgelegenheidsinstituten bijdragen aan de concurrentiekracht van de Japanse onderneming. Bij het bespreken van deze productieve logica zijn de theorieën van de onderneming cruciaal. Centraal staat het belang van bedrijfsspecifieke en zogeheten 'contextuele' of 'intellectuele' vaardigheden en de manier waarop personeelsmanagement de ontwikkeling van deze vaardigheden mogelijk maakt. Het succes van deze vaardigheden is echter niet vanzelfsprekend en het hoofdstuk bespreekt verschillende contingenties voor succes.

De volgende vijf hoofdstukken presenteren de empirische resultaten van dit onderzoek. Het eerste van deze hoofdstukken bespreekt de bestaande literatuur en statistieken over de Japanse arbeidsmarkt en het personeelsbeleid van Japanse

ondernemingen. Het toont dat de werkgelegenheidsaanpassingen in de afgelopen jaren kunnen worden beschouwd als ‘traditioneel’. De aanpassingslogica regeert; ontslagen zijn relatief schaars en de steun voor ‘permanente werkgelegenheid’ blijft. Daarnaast bespreekt het hoofdstuk de veranderende omstandigheden die worden verondersteld te leiden tot aanpassingen in werkgelegenheidsinstituten. Op de korte termijn leiden deze veranderingen tot drie belangrijke problemen: (1) stijgende loonkosten, (2) een afname in mogelijkheden voor promotie en (3) de vraag naar werknemers met andere capaciteiten. Tot slot bespreekt het hoofdstuk ook vier belangrijke aanpassingen in personeelsmanagement zoals deze zijn onderkend in de afgelopen jaren: (1) het toegenomen belang van prestatiebeloning, (2) de diversificatie van werkgelegenheidstypes, (3) de toename van non-reguliere werkgelegenheid en (4) de toename in arbeidsmobiliteit.

De volgende vier hoofdstukken analyseren heterogene bedrijven in hun specifieke omstandigheden. De hoofdstukken bespreken case studies van individuele ondernemingen in vier verschillende industrieën: auto's, elektronica, constructie en detailhandel (supermarkten). Elk hoofdstuk bespreekt eerst de omstandigheden in de betreffende industrie. Wat volgt is een bespreking van elke onderneming afzonderlijk, bestaande uit een discussie van de strategieën, de economische situatie en de veranderingen in personeelsmanagement.

De hoofdstukken tonen reeds een grote verscheidenheid aan overeenkomsten en verschillen tussen de verschillende bedrijven. De interpretatie van deze resultaten volgt in de slothoofdstukken die de consequenties op het industriële en nationale niveau analyseren. Hoofdstuk tien bespreekt de industriespecifieke aanpassingen in werkgelegenheidsinstituten. Twee types werkgelegenheidslogica zijn hierbij cruciaal. Naast de conventionele productieve logica introduceert het hoofdstuk een alternatieve logica gebaseerd op het toegenomen belang van non-reguliere (part-time) werknemers. Onder druk van de veranderende omstandigheden, zoals de verschuiving van de productie- naar de service sector en de dalende marges vanwege de beperkte vraag, proberen bedrijven arbeidskosten te verminderen door reguliere door non-reguliere werknemers te vervangen. Deze trend is algemeen maar de mogelijkheden voor deze strategie verschillen tussen de industrieën in deze studie. De industrieën die de verschillende logica's hebben geïnspireerd – auto's en detailhandel – bieden de duidelijkste voorbeelden. De productieve logica blijft dominant in de auto industrie, het belang van non-reguliere werknemers is groot in de detailhandel. De andere twee industrieën bekleden een middenpositie.

Het volgende hoofdstuk keert terug naar het nationale niveau en bespreekt hoe, ondanks de verschillen tussen ondernemingen en industrieën, belangrijke overeenkomsten bestaan in de aanpassingen. Dit kan overigens geen verrassing zijn

gegeven de sterke sociale inbedding van de werkgelegenheidsinstituten. Het hoofdstuk bespreekt drie ontwikkelingen die al bekend zijn van hoofdstuk vijf: (1) het toenemende belang van prestatiebeloning, (2) de diversificatie van werkgelegenheidstypes en (3) de toename in arbeidsmobiliteit. Meest opvallend is de toename in prestatiebeloning aangezien alle bedrijven in deze studie het belang van prestaties als een evaluatiecriterium hebben versterkt in de achterliggende jaren. Tegelijkertijd tonen hun pogingen ook een zekere verscheidenheid. Alle ondernemingen beoordelen prestaties op basis van vooropgestelde doelstellingen ('management-by-objectives') maar de manier waarop en het belang naast de andere evaluatiecriteria tonen duidelijke verschillen. Bovendien proberen de bedrijven deze vernieuwingen in te bedden in de bestaande praktijken en de conventionele productieve logica blijft daarom een centrale rol bekleden. Uiteindelijk is het niet of senioriteit, of bekwaamheid, of prestaties maar eerder een combinatie van alle drie, aangepast aan de positie en functie van de werknemer.

In vergelijking zijn de andere aanpassingen minder opvallend. De case studies bevestigen het bestaan van verschillende werkgelegenheidstypes ('employment tracks') maar een groot aantal ondernemingen maakt geen onderscheid. Een mogelijke uitzondering is het door Nikkeiren voorgestelde 'multi-track' systeem en de toename van non-reguliere werkgelegenheid. Ten opzichte van de derde ontwikkeling, de toename van arbeidsmobiliteit, is het interessant om te zien hoe verschillende ondernemingen een substantieel aantal werknemers in het midden van hun carrière ('mid-career') aannemen. De negatieve houding ten opzichte van dergelijke werknemers lijkt te zijn veranderd. Daarentegen blijft deze ontwikkeling vaak wel beperkt tot werknemers in het begin van hun carrière of met specialistische kennis.

Al deze drie ontwikkelingen hebben direct betrekking op de interne arbeidsmarkt en kunnen bovendien aan elkaar worden gerelateerd. Het hoofdstuk bespreekt daarom ook de mogelijkheid van een fundamenteel nieuwe constellatie – logica – van Japanse werkgelegenheidsinstituten. Een dergelijke verandering is echter nog ver verwijderd. De huidige veranderingen lijken eerder een ijking van de interne arbeidsmarkt door een (versnelde) continuering van de lange-termijn ontwikkelingen naar een kleiner percentage reguliere werknemers en een grotere nadruk op prestatiebeloning. Dit sluit substantiële verandering niet uit maar maakt dit wel onwaarschijnlijk. Zo lang de steun voor 'permanente werkgelegenheid' aanhoudt, zal de interne arbeidsmarkt en de bijbehorende productieve logica voortduren. Veel zal wat dat betreft afhangen van de ontwikkelingen tijdens een volgende periode van substantiële economische groei. Paradoxaal wordt het belang van permanente werkgelegenheid bevestigd tijdens moeilijke economische omstandigheden. Een nieuwe periode van economische groei zal tonen of

ondernemingen en werknemers hun houding ten opzichte van arbeidsmobiliteit werkelijk hebben veranderd.

Het laatste hoofdstuk keert terug naar de centrale onderzoeksvragen. Wat betreft de aanpassingen in personeelsbeleid springen de toename in non-reguliere werkgelegenheid en prestatiebeloning het meest in het oog. Tegelijkertijd zijn dit lange-termijn ontwikkelingen van ver voor de omslag in economische omstandigheden. De tweede onderzoeksvraag, naar de impact op de concurrentiekracht van de Japanse onderneming, is minder eenvoudig te beantwoorden, met name in samenvattende vorm. We zien inderdaad tekenen van verminderde efficiëntie; zowel wat betreft de werkgelegenheidsinstituties zelf als wat betreft de combinatie van werkgelegenheidsinstituties en de organisatie van werk. Dit maakt het verleidelijk te spreken over de verminderde glans van Japanse werkgelegenheidsinstituties. Een dergelijke conclusie lijkt echter onrecht te doen aan de doorgevoerde veranderingen. De ondernemingen lijken vrij succesvol in hun aanpassingen. De flexibiliteit van het bestaande instituties blijkt verrassend groot en stelt de ondernemingen in staat belangrijke aanpassingen door te voeren zonder tegelijkertijd de conventionele logica gebaseerd op interne arbeidsmarkten en lange-termijn arbeidsrelaties aan te tasten. 'Permanente werkgelegenheid' blijft het hart van de Japanse werkgelegenheidsinstituties maar daarnaast zien wij een belangrijke variëteit in personeelsmanagement.

## **Curriculum Vitae**

Arjan Keizer has studied Economics and Philosophy at the Erasmus University in Rotterdam. During the years of this doctoral project he worked at the Rotterdam Institute of Modern Asian Studies at the Economics Faculty of the Erasmus University, where he taught on the various institutions and aspects of the economies of Asia. In addition, he spent several periods in Japan for both work experience and research, including a one-and-a-half years at Hitotsubashi University in Tokyo for the field research of this study on changing employment practices. He co-edited and contributed to a previous publication involving Japan entitled 'Mirroring Consensus: Decision-Making in Japanese-Dutch Business'. At the beginning of 2005 he joined the Bradford University School of Management where he hopes to continue his research on comparative employment practices and the theories of the firm.

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## The Changing Logic of Japanese Employment Practices

### A Firm-Level Analysis of Four Industries

In previous decades, the perception of Japan's employment practices has been strongly intertwined with its economic fortunes. From the 1970s, the employment practices came to be seen as one of the cornerstones of Japan's economic success. However, this perception changed, albeit with a substantial delay, when the economy proved incapable of returning to its former path of growth after the 'bubble' burst at the end of the 1980s. Like so many of its economic institutions, the employment practices became the subject of substantial criticism in a debate on the revitalisation of Japan's economy.

This study takes its position within this debate by discussing the likelihood, character, and economic consequences of change. Environmental changes, like the ageing of the population and the substantial decrease in economic growth, require Japanese firms to adapt their human resource management. However, the embeddedness of national practices limits the scope of firms to make these adjustments; and change is determined by the dialectics between their strategies and existing practices. The firm, as an institution, thus experiences the impact of both the embedded employment practices and the economic impact of environmental changes. Accordingly, it is at the centre of this study. Theories of the firm are used to discuss the contribution of employment practices on efficiency, capabilities, and competitive strength. Case-studies from four different industries – automobile, electronics, construction, and retailing – describe the adaptations made by individual firms. Subsequently, these findings constitute the basis for a discussion of industry-specific employment practices and provide an answer to whether developments such as the rise in performance-based pay and labour mobility have altered the logic of Japanese employment practices.

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