

The Changing Role of Employees in Japanese Corporate Governance: Participation, Adjustment and Distributional Conflict

Gregory Jackson

King's College London

October 20, 2004

Prepared for RIETI Symposium

‘Corporate Governance in Japan: Converging to
Any Specific Model?’

The Issues

- To what extent are Japanese-style employment practices changing?
- To what extent are these changes related to corporate governance (e.g. greater influence of shareholders, corporate restructuring, etc.)?
- Under what conditions are systems of CG and HRM complementary?

Data Sources

- METI Dataset
 - Survey on the Corporate System and Employment
 - October 2003
 - N=252 (12% response rate)
- RIETI Dataset
 - Survey on Labor Management and Corporate Governance in Japan
 - May 2004
 - N=131 (5% response rate)
- Company case studies
 - Interviews with investor relations, personnel and enterprise unions

I. Characteristics of J-Type HRM

- Long-term Employment
- Seniority-related Pay Schemes
- Firm-specific Training

Supported by industrial relations institutions

- Enterprise-based Unions
 - Cooperation
 - Homogeneous internal labor market
- Employee Participation
 - Labor-Management Council
 - Quality circles, etc.
- Labor law
 - Strong barriers to dismissal
- Weak welfare state
 - Internalization of welfare functions with the enterprise or enterprise group

Complementarities between HRM and CG in Japan

- Firm-specific investments
 - Main bank and stable shareholding protect investments in firm-specific skills
 - Firm-specific skills and cooperation increase productivity that benefits long-term investors
- Decision Rights
 - Information sharing
 - “Democratization” of insider control

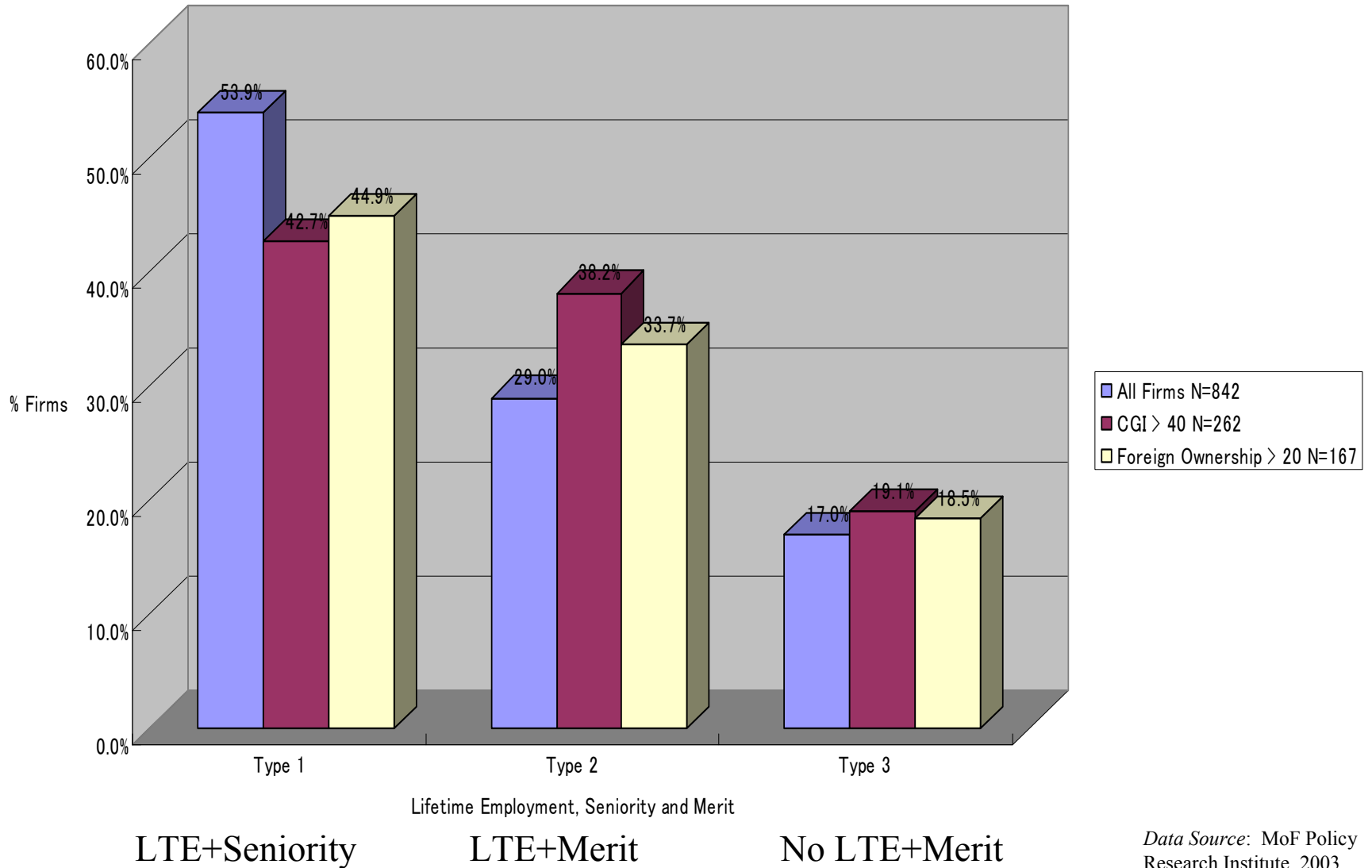
The Challenge of a Shareholder-value Model

- **Corporate Competencies:**
 - conflict with employees over the definition of core business units and diversification strategies used to stabilize employment. Divestment raises issues of finding good buyers who honor existing employment agreements.
- **Equity-oriented performance targets:**
 - ending cross-subsidization creates conflicts over performance criteria, time horizons, and disciplining poor performance. Business independence may weaken employee solidarity and increase individual market risks and rewards.
- **Performance-oriented pay:**
 - issues of balancing individual and group incentives, defining criteria, and contingent pay risks. Managerial stock options raise issues of income inequality and short-termism.
- **Disclosure and market-oriented accounting:**
 - limits buffering risks through internal reserves and favors higher distribution of profits to shareholders, but may may also increase transparency for employee representatives.

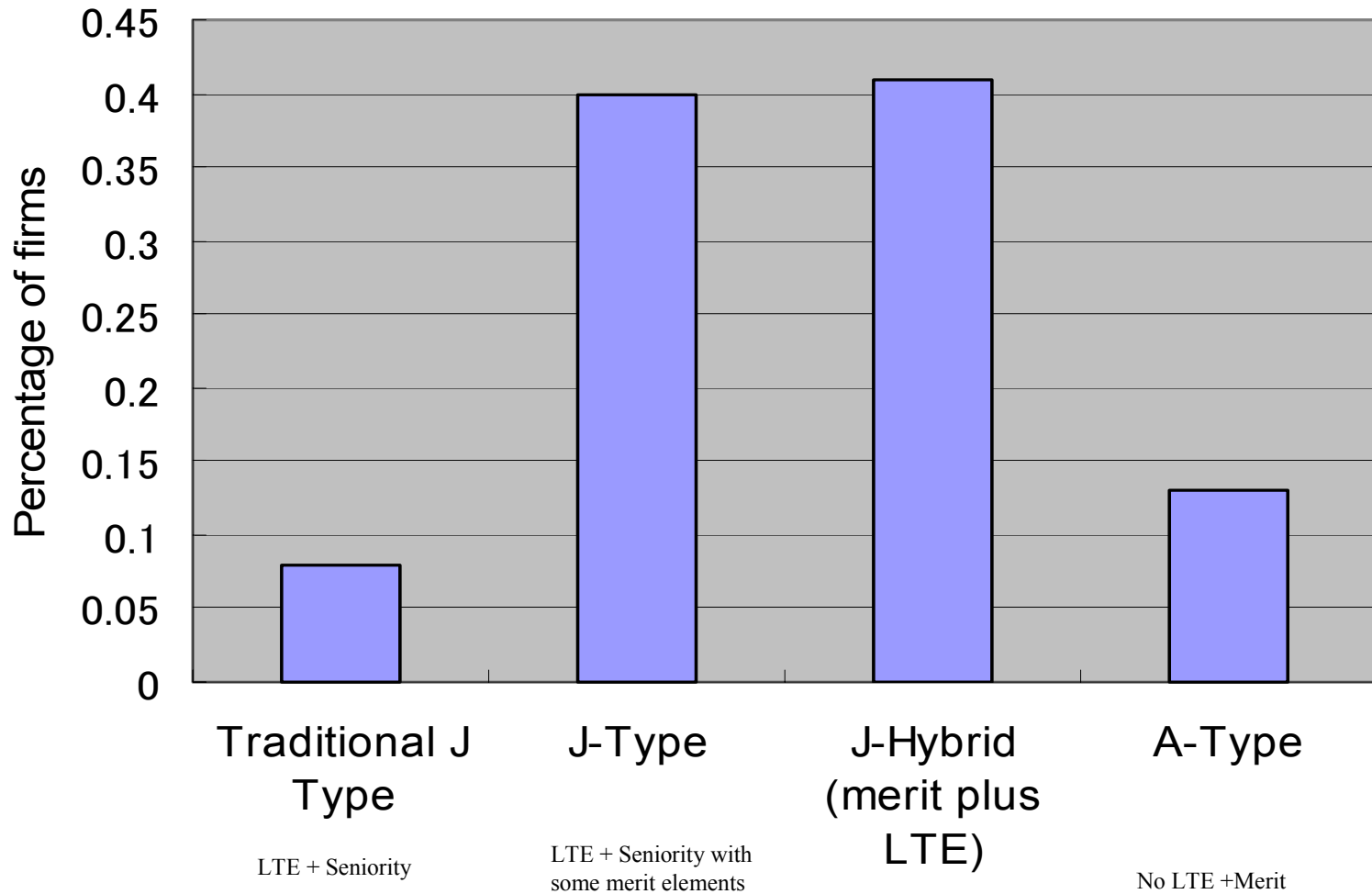
II. Current Situation of HRM in Japan

- Stability of lifetime employment norm
 - but increased corporate restructuring
- Modification of seniority-based pay
 - remains one element in more complex pay strategy, but less impact on final wage
- New forms of merit-based pay
 - but impact is uncertain
 - also a response to aging

Employment Type by Corporate Governance and Levels of Foreign Ownership



Type of Employment System, 2003



III. Emerging Employment Patterns

- Labour Force Surveys
 - No shift in job retention rates btw. 1980s vs. 1990s (T.Kato)
 - Average tenure of male employees increased from 12.7 years in 1991 to 13.6 in 2001 (JIL)
 - Job tenures stable across different age groups
- Elasticity of employment unchanged – 1985-91, 1991-97, 1997-2001 (JIL)
 - Faster adjustment 91-97, then very slow

The Impact of CG on Commitment to Lifetime Employment: Probit Model

LTEdummy		Coef.	Std Error	P
-----+-----				
Employees		-6.54E-07	0.0000176	0.97
Ratio of Foreign Ownership		-0.009	0.00	0.03
Stock Options		-0.567	0.23	0.01
Equity-linked Performance Measure		0.010	0.30	0.98
Manufacture		2.381	0.91	0.01
Utilities		1.109	0.79	0.16
Transport & Telecom		1.678	0.76	0.03
Retail		1.834	0.90	0.04
Finance		1.840	0.79	0.02
Real Estate		1.365	0.87	0.12
Services		1.644	0.98	0.09
Other		1.234	0.79	0.12
_cons		-0.288	0.73	0.69
	N		=	227
	LR	chi2(12)	=	25.22
	Prob >	chi2	=	0.0138
	Log	likelihood	=	-93.0808
	Pseudo	R2	=	0.1193

Table 3 Rates of corporate downsizing for selected countries, 1991-2001

Country	10% cut 2001	10% cut 1991	Average annual rate 1991-2001	Cumulative likelihood for each firm
Australia	.099	.057	.093	.301
Canada	.094	.212	.096	.312
France	.083	.079	.069**	.306
Germany	.093	.099	.101	.402
Italy	.147	.088	.096	.413
Japan	.059	.020	.041**	.213
Korea	.140	.104	.153**	.548
Netherlands	.070	.077	.065*	.351
Sweden	.154	.276	.095	.384
Switzerland	.131	.096	.091	.426
UK	.179	.164	.129**	.473
US	.206	.092	.106**	.445
Dispersed	--	--	.105**	--
Concentrated	--	--	.082**	--

Notes: Refers to all listed corporations with over 2,000 employees, Thompson Worldscope Database.

Source: Jackson, Gregory (2004) 'Toward a Comparative Analysis of Corporate Governance and Labour Management' in H.Gospel and A.Pendleton *Corporate Governance and Labour Management in Comparison*, Oxford University Press.

Employment Adjustment

- 81% of firms express commitment to LTE, but core is shrinking...
 - Largest 1% of firms employed nearly 23,000 people in 1993, but just 17,400 people on average in 2002 (own calculations from DBJ database)
- RIETI Survey (2004)
 - 36% of survey firms implemented employment adjustment policy over the period of 2000-2003
 - Average reduction 530 employees (15% of workforce)
- „benevolent“ adjustment:
 - 54% of exits through early retirement, 29% hiring freeze
 - 5% transfer, 5% spin-offs
 - only 4% of exits through lay-offs

Impact of CG on adjustment

- Foreign ownership increases downsizing in 1990s (see Ahmadjian)
 - but also diffusion process driven by social norms
- Bank relationship decreases downsizing (see Abe, Miyajima/Arikawa)
- But...direct impact of foreign ownership seems less in 2000-2003...
- No evidence for impact on method of adjustment (e.g. likelihood of lay-off)
 - A-type firms may buffer more through temporary staff

Probit Estimation: The Impact of HRM and CG on Downsizing, 2003

down10	Coef.	Std.	P	down10	Coef.	Std.	P
-----+-----				-----+-----			
roa2000	-0.01	0.01	0.34	roa2000	-0.04	0.03	0.23
Employees	0.00	0.00	0.01	employe~2000	0.00	0.00	0.01
LTEdummy	-0.82	0.31	0.01	LTEdummy	-0.66	0.35	0.05
Performance Pay	0.14	0.10	0.17	Performance Pay	0.10	0.11	0.39
Seniority Pay	-0.07	0.11	0.49	Seniority Pay	-0.14	0.12	0.25
Job related Pay	-0.10	0.10	0.35	Job related Pay	-0.07	0.11	0.57
Ratio of Non-regular Employees	0.00	0.00	0.56	nonregular	0.00	0.01	0.85
Average age	0.20	0.04	0.00	Average Age	0.20	0.04	0.00
_cons	-7.61	1.41	0.00	Ratio of Foreign Owners	-0.01	0.01	0.54
				Stock Options Dummy	0.44	0.28	0.11
				Ration of Inhouse Executives	0.00	0.00	0.82
				_cons	-7.47	1.79	0.00
N	198			N	177		
LR	chi2(8)	=	61.83	LR	chi2(12)	=	64.39
Prob > Chi2		=	0	Prob > Chi2		=	0
Log	likelihood	=	-101.84	Log	likelihood	=	-87.3976
Pseudo	R2	=	0.2329	Pseudo	R2	=	0.2692

Limits to Benevolent Adjustment?

- exhaustion of transfer system
 - case of NTT (Sako and Jackson)
 - consolidated accounting
- social closure of the firm to young recruits
- restructuring and scope of internal labor market
- CG as a distributional constraint?
 - few firms have reduced wages, but no wage growth
 - DBJ Data of listed firms:
 - increasing labor share of value-added (1992-2001)
 - lower VA shares to banks, state and shareholders
 - foreign ownership associated with rising dividends

Pay Systems

- LTE positively correlated with seniority, but no correlation with merit pay
- Seniority is not disappearing, but just one element in more complex pay strategy
- Different meanings of merit...
 - Variable pay based on individual performance
 - Variable pay based on company performance
 - Job-related elements
 - Low correlation between “merit” and particular practices

Elements of Pay Schemes and LTE

	Seniority Based	Job/Rank Based	Individual PRP	PRP % employees	PRP % Managers	Firm PRP
No LTE Firms	1.4	2.8	3.7	0.27	0.41	3.2
LTE	1.8	3.0	3.8	0.37	0.54	3.3
High LTE	2.0	3.2	4.1	0.37	0.59	3.5
All Firms	1.6	2.9	3.7	0.32	0.48	3.3

Notes: Numbers indicate the average importance of each pay element on a 5-point Likert Scale. 1=Not important 2=A little important 3= Important 4=Very Important 5=Extremely Important. No LTE indicators LTE score of 1-2, whereas high is LTE = 4 or 5.

Sources: RIETI Survey, 2004, N=136

Determinants of Pay Systems

- Dependent variable
 - Factor analysis of different pay elements
 - PRP Factor / Seniority Factor / Job Factor
- Independent variables
 - Foreign ownership
 - Stock options (dummy)
 - % of in-house executives
 - Strategy (e.g. diversification)
 - Corporate Structure
 - Equity-related Performance measures
 - Controls: industry, size, average age of employees

Main results

- Performance-related pay
 - No impact of governance factors!
 - Different result than in Germany
 - Japan already has some link to firm performance
- Seniority
 - Foreign ownership (-)
 - In-house executives (+)
- Job/Rank
 - No impact

Determinates of Employment Types

- 4 Types ranging from J \leftrightarrow A
 - In-house executives (-)
 - Stock options (+)
 - Equity based performance index (+)
 - No significant result for foreign ownership
- Degree of external pressure may be less important than style of insider control!

IV. Employee Participation

- Still high union presence in large firms, but changing role
- Changing boundaries of the firm
 - Heterogeneity of employee interests
 - Problematic access to strategic decision makers
 - Shift toward co-management (e.g. supporting spin-offs)
- Boundary of the union
 - NTT example
 - Sako Chapter

Unions and CG Reform

- Political role limited
 - No strong opposition
 - Amended spin-off legislation
- Supportive role in companies
 - ‘Transparency coalition’
 - If market pressure high, participation increases degree of reform (Miyajima chapter)

V. Complementarities?

- Not simple causal model
 - CG \rightarrow Employment
 - Employment \rightarrow CG
- Compatibility vs. Complementarity
 - Japanese style-employment compatible with a range of CG
 - Complementarities implies a narrower concept
 - $f(\text{CG}_a + E_b + \text{industry}_c) = \text{performance}_d$
 - Methodological challenge
- Cross-national evidence (Jackson RIETI DP 2004)
 - Countries with strong market-oriented CG do not have strong relational employment (CG constraint)
 - But very large scope for variation at intermediate levels
 - Different impact of legal vs. market variables

Stability and Contribution to Governance

- Stable hybrid?
 - Will reducing seniority-related wage components weaken incentives for long-term employment?
 - Distributional struggle
 - Market for corporate control
- Accountability
 - Shareholder activism for labor via ESOPs?
 - Internal governance function

Conclusions

- Continued stakeholder orientation depends very much on the character of internal governance
- Importance of social norms
 - Legal change has been slow