

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

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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

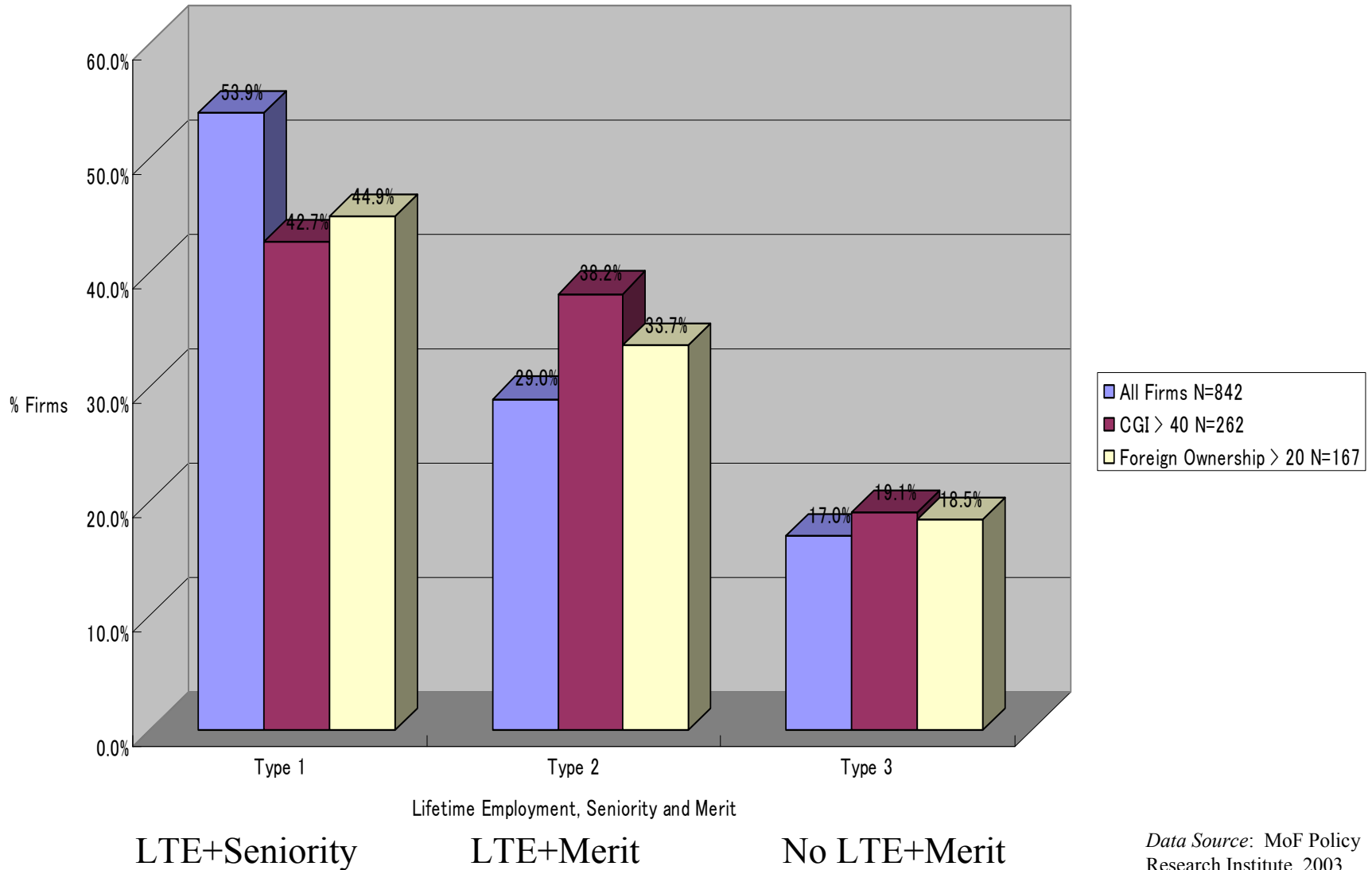
The Challenge of a Shareholder-value Model

- **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

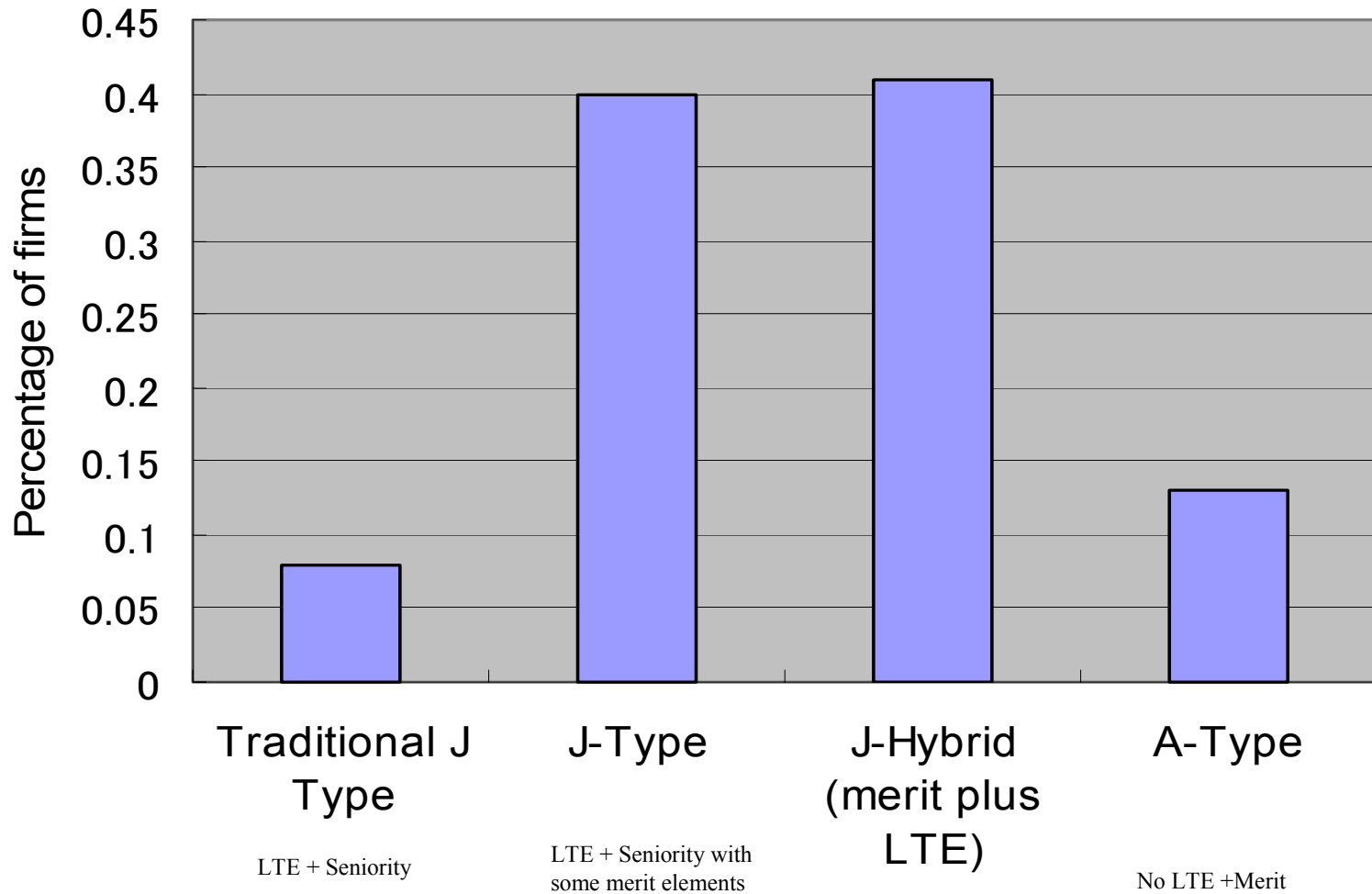
- Stability of lifetime employment norm
 - but increased corporate restructuring
- Modification of seniority-based pay
 - remains one element in more complex pay strategy, but less impact on final wage
- New forms of merit-based pay
 - but impact is uncertain
 - also a response to aging

Employment Type by Corporate Governance and Levels of Foreign Ownership



Data Source: MoF Policy Research Institute, 2003

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