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Pay for Performance: Individuals, Groups and Companies

By

Yoko Sano

Abstract

The present article will first deal with the concept of pay and past changes in pay systems. Secondly it will examine the influence of organizational performance on pay level and thirdly, employee attitudes toward desirable standards of pay. Finally it will present a perspective of pay systems. Namely I suggest three components of total pay for individual employees. One of the components should be a minimum and fixed part to support one's livelihood. The second component should be linked with kinds of work which do not depend on job analysis or narrowly defined job categories. The third component should be directly linked with performance of individuals, teams, divisions, and a company. One of the problems that traditional pay systems have is the complexity of various kinds of components and allowances. The three components stated above will suffice, and other allowances and automatic annual increases should be avoided.

Key Words

internal labor markets, performance, seniority, employee satisfaction, flexible organizations

Introduction

Pay systems in Japanese organizations have faced increasing amounts of labor expenses and higher levels of wages than abroad. It is time that they should be restructured. Difficulties in supporting traditional systems have been caused not only by the aging of employees but also by growing competition in a more global market. Organizations which are not involved in competition, such as those in the public sector, should be behind, but the growing cost should be charged to taxpayers' or somebody else's account after all.

Another problem pay systems face is the internal balance of pay among individuals. An employee's satisfaction with pay is based on pay level, and more important is a referent of pay comparison. Some comparison is made with people or organizations outside the company or the agency to which an employee belongs. But other comparisons are made with other employees at the same company or agency. Employee satisfaction with pay is formed partly or primarily based on relative differences of pay in the internal organization. This is called a pay system in the present article.

Job satisfaction and work hour satisfaction have been considerably high in Japan, but wage satisfaction is still relatively low even among employees at large corporations. It suggests that Japanese employers have taken the worst strategy, that is the combination of a very high level of unit labor cost for employers and an unsatisfactory pay system for employees.

Concept of Pay

In a word, there is chaos in the usage of pay terminology, as Milkovich and Newman (1996) pointed out. For example, the term “seniority-based wages” is often referred to represent an important characteristic of work practices in Japan. The problem is there is a difference between a seniority system in the U.S. and the seniority-like system in Japan. In the U.S. “seniority” has a clear-cut definition which means “length of service” in short. On the other hand Japanese “seniority” means an informal seniority and there are neither formal rules nor regulations. In Japanese usage *nenko* wages mean pay based on length of service and age within a narrowly defined promotion track. Another characteristic of *nenko* is to relate pay to personal characteristics rather than to job or rank. Therefore *nenko* wages or pay should not be translated into “seniority.”

One of the causes of this chaos is from the confusion of principle and measurement. Principle comes from the ideology or policy from which management directs the organization. Measurement, on the contrary, is a technique to implement the policy, but it usually is difficult to find an ideal measurement and to choose the best ways among alternatives. A pay system is a result of organizational judgement and is different from general wage determination in the labor market. Every organization has its own pay system and pay systems are considerably different among different organizations.

Organizational principles usually are not unique or singular. Sometimes they correspond to a portion of pay, but other times they are mixed and melded as a comprehensive-type of pay. Table 1 shows such principles and their measurement in a chart. This is my definition and not others'. I use terms of pay systems in the present article as shown in Table 1.

These principles are summarized in ten categories: competence, job, livelihood, occupation, performance, rank, results, seniority, skills and work. The last “work” is a broader concept than “job” and it is often used in Japanese companies as a pay criteria. Most of the concepts have been developed in human resource management, and internal balance or reference among employees within an organization has been emphasized. Livelihood criteria are rather unique to Japanese organizations.

Principles are not always perfectly implemented in the real world. For example, what measurement should be used for “competence?” It has been represented by education, qualifications, experience, length of service, and most often by merit assessment. Job-based pay means pay based on job evaluation or job analysis theoretically. Livelihood has two roles to relate to pay. One is related to changes in the cost of living and the other is related to increases in household expenditures owing to rearing of children and other dependent family members. Performance, rank, results, seniority, skills and work each have criteria, but they might be more or less unsatisfactory measurements compared to principles.

Table 1. Concept of Pay – Principles and Measurement of Basic Pay –

principle		measurement
pay for (in alphabetical order)	reference emphasis	based on
competence	internal	merit assessment, school education, qualifications, experience, length of service
job	internal	job evaluation
livelihood	external	living cost, age, gender
occupation	external	occupational category, experience
performance	internal	performance appraisal
rank	internal	rank-and-function
results	internal	quantity of output
seniority	internal	length of service
skills	internal	skill category, experience, length of service
work	internal	content of work, gender

What I want to emphasize is that principles and measurement should be divided, but actually they overlap as shown in Table 1. If they are classified in accordance with either principles or measurement, it will be difficult to show the independent concepts of pay.

One example is given by a survey conducted by the Japan Ministry of Labour (MOL). In order to find importance of factors affecting pay system they presented eight categories: (1) competence to perform jobs, (2) value of jobs, (3) occupations, (4) ranks, (5) length of service, (6) age, (7) performance, (8) others (MOL, 1994). Results of the survey show 74.6% of the responding firms agreed with (6) age, 71.3% agreed with (5) length of service and 68.1% agreed with (1) competence to perform jobs. At any rate, Japanese firms place much importance on age, length of service and competence with less emphasis on job and performance. Personal characteristics are important in managing employees in Japanese organizations. Why were such factors as academic career and gender neglected in listed categories? Those eight or at least seven categories were not independent of each other.

Pay Systems in the Past

Occupational Wages

Records from the 1880s show that rewards for daily labor in farming fields were three boxes of rice (5.6 liters) for men and one box of rice (1.8 liters) for women. (For reference, day laborers' wages in 1993 were 9,970 yen for men and 6,910 yen for women in Japan.) In the modern age industries have developed and brought new kinds of work. In construction work, for example, frame workers, welders, tile workers and others were added to such traditional occupations as carpenters, plasterers and steeplejacks. The way of wage setting was based on kind and skill grade of occupation irrespective of kinds of employers.

Occupational categories became less useful as time went on, because industrial development brought about new work and required training and experience. Wages should be graded according to levels of skill. Until the 1970s Japanese manufacturers followed four classes of skill: the top level represented "supervisors," the second level

“skilled workers,” the third level “semi-skilled workers,” and the lowest level “unskilled workers.” Wages reflected these differences. It should be noted that this sort of difference exists in a region, namely, among small employers in a commuting area. (In some areas such as the U.K., payment by results was popular. This was an early style of performance pay, according to McKenna and Beech [1995] .)

In the modern era such occupational wages became the minority in the labor market. Occupational wage settings are found even today in the construction and forestry industries where a part of the workforce depends on casual workers. In a similar way some manual workers, repetitive workers and part-timers are paid on a daily or hourly basis. There, wage dispersion does not seem to be so great in one region.

In general, wages came to be paid on a daily basis and according to the amount of time spent working. Why did industrial employers not follow the occupational wage settings? Because the size of new employers' business activities became larger and larger than traditional ones. Such big business today has developed in the past several decades. Centralized public bodies were also seen in the past century. There were also a lot of small businesses, but they were assumed to grow as time went on. The policies of large organizations were, in a word, enclosure of workforce. Large employers who enjoyed economies of scale tried to keep workers attached to them for a long time.

Firm-Specific Skills

The work and skill at large plants was slightly different from that of traditional factories. The required ability for workers at large plants was to learn new ways of operation and maintenance of newly developed machinery. The required skills were for mass production and were semi-skilled and firm-specific, while traditional types of skill were more manual and standardized, and required a longer time to master. It was the human resource manager's job to control and manage a mass workforce. The new system also had to conform to a firm-specific system apart from current labor market conditions.

A firm could be assumed to be as a castle in the feudal age. The gates are not always open to outside applicants to be hired. Every castle has its own rules and regulations. Under national laws and social contracts all participants, once committed, should follow such local rules. The exterior of the castle is called “external labor markets” whereas the interior of the castle is called an “internal labor market.” The degree of internalization differs from firm to firm. More advanced internalization is found in governmental bodies, financial institutions and other large traditional corporations in Japan where they have their own unique rules of HR management.

What are the characteristics of pay systems in such advanced internal labor markets? First, each firm has its own unique pay system. The Japanese pay system is called *nenko*-based, but there are different kinds of *nenko* based systems among different firms. Second, wages in internal labor markets are not directly linked to wages in external labor markets. Third, equitable comparison is one of the important criteria to manage a pay system. It is important to have a pay difference among employees which is supported by internal forces.

Job-Based Wages

In U.S. internal labor markets, the popular way to decide the wages of a mass

workforce was job-based wages which were based on job analysis. Every job in a large operating firm was analyzed as to be measured by one single scale. The content of a job usually has four factors such as (1) required skill and knowledge, (2) manual and psychic load, (3) responsibility, and (4) unpleasantness and risk. The points for each job consisted of points for the factors above. Assessment of such factors in each job brought about the total assessment of each job in terms of points. The points were used to determine wages, and were called wages based on job evaluation. Job-based wages had two highlights. One was that they depended on the philosophy or principle of "one commodity, one price," or "equal work, equal wages" which was thought to be fair for everybody within an organization. Another highlight was that job-based wages allowed firms to have some open zone manipulated by their strategies. Some firms had to face faster development of technology and others had to face more severe market competition. Workers' skills were more or less firm-specific and they had no comparable skills in external labor markets. Imagine how much wage differentials were among, say, manufacturing industries. Key jobs were all firm-specific and almost impossible to be compared. The only jobs to compare are drivers, typists and receptionists. None of these were key jobs.

Job-based wage systems were developed in governmental organizations and large firms in the U.S. as these organizations grew larger. Occupational wage settings were no longer meaningful in such large and newly developed technological plants and managers had to develop a fair way to determine individual workers' wages. In Japan such a mass-production system which required a workforce attached to a firm started in the 1920s and 1930s, apart from the traditional subcontracting system of work in the machinery industry. As a result, employees were encouraged to stay with employers for a long time, especially in heavy manufacturing firms.

The Japanese HR System

The Japanese HR system did not adopt a job-based wage system as in the U.S. The Japanese work system has never been based on jobs. The traditional Japanese way of hiring workers was similar to taking care of boys and girls in rural areas and returning them to their parents afterwards. Examples are found in the case of apprentices at old merchants' houses. Even in large plants, the HR system was planned to take care of workers' total lives, sometimes, like family members. The way of work was also different from that in other developed countries. Like a farm family's work, there was no concept of individual work, but that of cooperative work. Farmers worked from dawn to sunset, and workers at plants were not conscious about work hours. Wages were determined totally depending on the broad characteristics of the workers. In short there has been no concept of "job" in Japan.

During World War II, wage control brought about the living wage principle. After World War II payment to afford a family was emphasized and age-based wages were added to the pay system. Not only the war controls but also rapid inflation together with the development of trade unionism resulted in the age basis. Another change after the war was the integration of laborers and clerical workers within an organization. It was backed up by the union movement and democratization. Working and wage rules were also integrated. On the other hand, since age-based wages were regarded as taking into account bread-winners' responsibilities, wage differentials between men and women held dominant. Basic pay was continuously a type of comprehensive pay

considering personal characteristics.

The Hierarchical Rank System

Major Japanese firms were interested in the pay-for-job concept following American practices in order to replace the pay-for-seniority practice and tried to introduce this in the 1950s. It was not successful because in Japanese workplaces they had no concept of job. In the few cases of their introduction, pay-for-job occupied only a part of total pay. The pay-for-job system was too costly and too rigid to replace the whole wage system. Instead Japanese firms introduced pay-for-rank: a rank-and-function-based system. Because of its flexibility and its dependency on personal characteristics it was more easily accepted by large organizations in Japan.

Not all Japanese firms have a formal pay system. According to a 1994 survey conducted by the Ministry of Labour, nearly half of the companies had such formal systems (MOL, 1994). Smaller firms were more likely to have discretionary pay for individual employees, because a formal system was expensive and of little use for them. Starting pay was often the local going rate and annual increases were added. Wages were almost always increased, but not decreased. The problem for employees was that they had no idea of their pay profiles as time went on. On the other hand, pay-for-rank was seen in large corporations and public bodies. They formed hierarchical systems based on work-role descriptions and detailed rankings.

Neither pay-for-job nor pay-for-rank had any element related to seniority. The problem was how to allocate the higher level jobs or ranks among qualified candidates if there were more people than vacancies. It is often pointed out that Japanese practices were likely to evaluate an employee's competence by taking into account his length of service. Once length of service is considered a major element, pay increases as years of service increase. As a matter of fact large organizations had no component directly related to age and/or years of service and only a small portion of total pay, if any, was related to age or tenure. They put more emphasis on the seniority factor in promotion through the ranks, and put more emphasis on seniority in the case of rank-and-file employees than in the case of managerial employees.

The pay-for-job system needed to be altered afterwards in the U.S., when organizations tried to introduce the competence factor to their pay systems. The reason was that the pay-for-job system was rigid and they had some difficulty in transferring employees. Downgrading job grades meant decreasing pay. In addition, employees with the ability to do upper-grade jobs were discouraged if there were no vacancies to which to be promoted. On the contrary, pay-for-competence encouraged employers to offer training and development programs and eased managers in transferring employees to wider areas. Firms faced a rapidly changing environment such as new technology and global competition and flexible systems were most appreciated.

On the other hand, rank-and-function-based pay has not always been successful in Japan. Complicated systems did not suitably match the changes in environment. The problem was that this pay system offered higher pay relating to high competence even if there were no positions to be filled. It meant a larger amount of labor cost while an increasing number of qualified and middle-aged employees were redundant within non-growing organizations. Rank-and-function-based pay systems had a rigid element. That is, it was assumed that the competence of employees never deteriorated. There was no case of pay decrease. Employees could always expect a pay increase or no

increase at the worst as long as they stayed in the same organization.

Most large firms today have pay systems with two parts: one is related to personal characteristics such as years of schooling, age, and length of service, and another is related to rank and function. While employees are young, the proportion of personal pay is greater, but as employees grow older, the proportion of rank-and-function-based pay becomes greater. Generally speaking, in most countries, age-wage profiles are flatter, but in Japan and even more so in Korea, the age-wage profile is steeper, especially for men, and even in low wage cases.

The Trend of Pay Systems

The rough trend of pay systems is shown in Figure 1. A formal pay system worked in sizeable organizations, and small firms did not have such a system if a boss decided each employee's pay partly referring to the going rate for the occupation. The pay system in this context mainly meant basic pay. Various kinds of allowances, bonuses, retirement pay and welfare benefits were not included although basic pay represented the principal amount. Figure 1 shows the history of pay with overlapping systems in each period.

The lower part of Figure 1 shows changes in the background situation. The labor market was internalized, industrial activities brought mass-production, mass-production required specific skills for its organization, and organizational structure needed hierarchy as industrialism developed.

Figure 1. Trend of Pay Systems

time		past		present		
pay systems		craft-related, payment by results	comprehensive pay (job-based) (in US)	rank-and-function pay	merit pay	performance pay
background conditions	labor markets	spontaneous local areas →		internal labor markets →	company group →	towards globalization markets
	industrial activities	agriculture, building, handicraft →		mass production →	information, service, global business	
	required skills	manual skill →		conceptual skill →	voluntarily, creativity, intelligent activities	
	organizational structure	home manufacturing indigenous small groups →		hierarchical bureaucracy →	flexible, flat, small organizations	

Performance and Pay

Pay level and system is various among firms and organizations. While it is frequently noted that pay differentials by size of firm are large in Japan, it should not

be overstated. Smaller and growing firms provide faster promotion to employees and as a result employees receive higher pay. Some heavy industry has had to restructure and employees' pay was not allowed to increase as fast as before. After ten years, university graduates with similar characteristics can have even twice difference of their annual pay: large traditional manufacturing companies pay half as much as international trading companies.

Firm Performance and Pay

MacKay, Boddy, Brack, Diack and Jones (1971) found that there were usually wage differentials in a local market for the same sex and occupation, according to a 1959-66 survey of British machinery plants. Such size differences are also found in times and areas with lower unemployment rates. They also found that high-wage firms pay high wages to everybody and that low-wage firms pay low wages to everybody.

MacKay et al. (1971) attributed the cause of wage differences to profitability and to the capability of transferring higher labor costs to higher product prices. Carruth and Oswald (1989) did an analysis of the past research relating to the effect of firm profit on wage level and found some positive relationships using econometric techniques.

Komiya (1989) analyzed the high wage trend at insurance companies in Japan and concluded that high wages were caused by profit sharing because the longer the employees stayed at the company, the higher their annual earnings were. He also concluded that this tendency could be found in worker-managed firms because of profit-sharing for core employees.

Efficiency wage theory can explain the general tendency toward high pay levels in financial sectors. Maintaining higher wages should attract more high quality employees. Financial institutions are especially keen to supervise their employees, but the cost of this is high. One way to lower the cost of monitoring is to pay employees more. This means that their opportunity cost (foregone earnings) is high if they are discharged owing to illegal behaviour.

Generally speaking high wage companies pay high bonuses, high severance pay and high benefits. Such large, well-known companies can attract many excellent candidates. On the other hand, there are growing numbers of small service-related import businesses, and multinational financial companies where young managerial staff are highly paid. There is also a new trend at local venture businesses which have introduced pay-for-performance systems apart from pay-for-seniority systems.

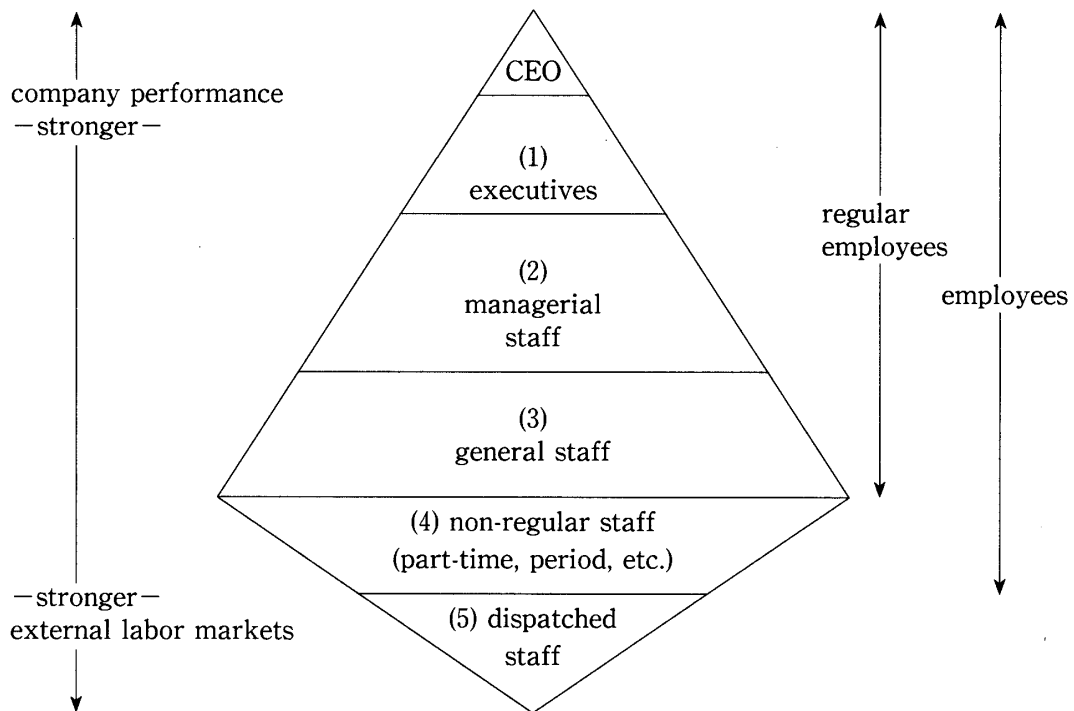
Pay-for-Seniority Similar to Pay-for-Performance on the Firm Basis

In order to encourage venture business in Japan, the stock option plan was liberalized and established at brokerage firms. This plan is popular as a reward mechanism for managerial staff in the U.S. Its aim is similar to an ESOP (employee stock ownership plan). If included, employees can earn a lot from selling their stocks at any time of higher stock prices. Employees are motivated to make efforts to achieve high performance. The stock plan enables small businesses, which cannot afford to pay employees as much as established companies pay, to attract bright and competent personnel.

Of course, employee pay is affected by a firm's ability to pay, but all employees are not affected equally. The human resources required by a firm can be classified into

five categories in terms of the type of employment contract. Those are (1) executives, (2) management staff, (3) general staff, (4) non-regular employees (part-timers and temporary staff), and (5) dispatched staff (those sent from other employers) as shown in Figure 2. Pay of dispatched staff and, to some extent, part-time staff is dependent on the external market and the firm's ability to pay has little or no impact.

Figure 2. Five Categories of Employment in an Organization



In the case of general staff, external market forces are weaker and internal market forces have some effect on their pay. Some clerical staff do the same jobs as dispatched staff do, but the regular staff are paid bonuses. Bonuses are paid partly based upon firm performance. For managerial staff, the firm's ability to pay has more influence on their compensation including bonuses. Further influence is found among executives' compensation. Their basic pay, allowances, bonus and retirement pay are greatly influenced by the performance of the firm.

Executives and managers are provided with non-monetary rewards other than pay and bonuses: private offices, assistants, cars, club memberships and expense accounts for entertaining guests. Sometimes the size of desk and type of chair are included also. Such non-pecuniary perquisites are more likely to be influenced by the ability to pay of the firm, as are other welfare benefits.

In short there is a stronger relationship between firm performance and executive and managerial pay. On the other hand, the relationship between firm performance and pay is lower for part-timers and dispatched staff. Executives and managers, therefore, receive less pay during difficult times. Furthermore, they take cuts in basic pay and decline bonuses.

It should be noted that a reward system such as stock options provides a benefit only if a firm is growing but none if it's failing. Similar reward systems are found in

pay-for-seniority systems under long-term employment systems, with risky investments such as stock purchase plans. Employers should share rewards with their long-time employees because these employees have no other alternatives on the outside. In Japanese organizations executives and managers are generally promoted from within, and they are likely to collect returns after thirty or forty years of service.

A seniority system usually lowers the quit rate of employees, because the longer an employee stays, the more he or she loses when quitting. Employee stock ownership plans and stock option plans were meant to secure future profits and to encourage employees to participate in management to some degree. Lifetime employment and pay-for-seniority have similar functions to ESOPs and stock options and to employees they mean investment. The difference is that ESOPs and stock options are formal systems, while lifetime employment and seniority are strictly informal.

Another reward system is found in such formal plans as profit sharing plans and gain profit plans, apart from paying a wage increment and bonus. These formal plans are managed to share with not only individual employees but also with team members and company members through a success-reward system. Beside the above, the following devices are found: merit pay, pay for results, gain-related pay, special bonuses, and special gifts. They are formal plans to link a firm's performance with employee pay.

Feeling against Pay for Individual Performance

Japanese organizations should be behind those abroad because they have no explicit or formal plan to link performance to pay. Even if they have either merit pay or pay for performance, it occupies only a small portion of total pay. Employees and employers both prefer stable pay to high-level but fluctuating pay. At the same time Japanese work practices prohibit tips. Tips are paid widely throughout the world in service businesses. Japanese people have been taught that tips are unethical, because work should not be done for money. This sort of thought might not encourage the development of a reward-for-success plan. Also Japanese employers developed a paternalistic way of management, and rewards in monetary form had long been discouraged in families. It should not be exaggerated that Japanese workers deny monetary aspect. They instead put emphasis on long-term rewards rather than short-term rewards.

What is performance in the Japanese context? How should performance be measured: on an individual basis or a group basis? Should performance be included in base pay to stress long-term relationships or should performance be included in results pay on a short-term basis? The content of performance varies depending on the kind of business activities and the level of functions. Examples are shown as sales, productivity, quality of product and services, input and customer satisfaction. Assessment is required at any rate.

A pay-for-performance plan means not only assessment on an individual basis but also on a group basis. What kind of groups are considered in relation to pay-for-performance? The smallest group represents a work team or a workplace. A second group represents a branch or a plant or a division if the organization has multiple establishments. A third group represents a company or a public corporation or a governmental body. A fourth group represents a company group, which includes subsidiaries with financial connections.

Finally the internalization policy of labor markets by firms is still appreciated in

Japanese major industries and businesses. It means that internal consistency of pay difference among employees backed up by ability to pay outweighs external labor market forces. It is especially true for employees with long length of service at one organization.

Employee Attitudes towards Performance and Pay

Employee reactions to assessing performance for pay were elaborately analyzed in the U.S. by Lowery, Petty and Thompson (1996). They concluded that employee attitudes were positive even with some problems needing to be improved. As a prior step to implementing pay for performance, employee attitudes towards changes were explored in Japan by Morishima (1992). He also found positive reactions to changes and negative reactions to traditional practices in general. Let me present some results of my employee attitude survey done in 1983 (Sano, 1986). Employees showed negative attitudes toward the present pay system which they viewed as valuing such factors as education, length of service and age. At the same time they showed positive attitudes toward a more work-related pay system which would value such factors as individual competence, content of work, and individual performance.

I will also present here the results from a pilot attitude survey regarding the kinds of performance and individual pay (Sano, 1988). The sample was drawn from an enterprise union organized at a representative energy firm in Japan. The number of union members was approximately 10,000 and questionnaires were randomly distributed. The number of respondents was 533 members (464 males and 69 females). Six of the working places were selected: a sales division, branch A, plant B, an outside work site, dispatched workers, the head office and all the females. Almost all of the questionnaires were returned. Usually the response rate was very high.

One point should be noted before looking at the results of the present survey. There were two major findings: one was on morale differences among workplaces and the other was on the structure of their pay systems. The employees as a whole showed a considerably high degree of morale and they were vitalized by working. Members at outside work sites showed some dissatisfaction with their working conditions, but it was cancelled out by job satisfaction and by satisfaction with the company. Female employees showed some different reactions from males: they had no persistent dissatisfaction in general, but they showed weak commitment to their work and were not motivated as much as were males. Dispatched employees (to subsidiary companies) were proud of their work and highly motivated, but their responses showed that unfortunately they were not provided with satisfying work.

Another Point

A quantitative analysis of their pay system showed that pay was determined on the basis of seniority just the same as the results of an analysis of aggregate data from across Japan. They assumed that age-pay profiles were significantly explained by age and length-of-service holding gender and education constant. Gender and academic career explain a significant part of the difference among profiles. That is, pay progression was faster for males and for those with higher education. The pay characteristics of the present company are very similar to the average found in Japanese industry, except for slightly faster promotion. Pay differentials were ex-

plained quite well by the four factors of gender, education, length of service, and age. This means that their pay system is quite representative of those found in Japan.

Questions on performance and pay were given as follows:

1. Do you agree or disagree that your pay is affected by performance?

2. Do you agree or disagree that your pay should be affected by performance?

Please choose "yes" or "no" to each statement from "a" to "e". The first question refers to the present situation and the second question refers to the desirable situation.

The present situation:

- My pay is affected by my performance.
- My pay is affected by my work group's performance.
- My pay is affected by my division's performance.
- My pay is affected by my company's performance.
- My pay is affected by my company group's performance.

The desirable situation:

- My pay should be more affected by my performance.
- My pay should be more affected by my work group's performance.
- My pay should be more affected by my division's performance.
- My pay should be more affected by my company's performance.
- My pay should be more affected by my company group's performance.

As stated before the number of respondents was 533 at six workplaces. Some question remains regarding the randomness of data gathering. The results are shown in Table 2.

**Table 2. Employees' Attitudes towards Pay for Performance:
Perception of Present Practice and of Desirable Practice**

Questions: ① Do you agree that your pay is affected by performance?

② Do you agree that your pay should be affected by performance? (%)

work place	number of respondents	individual		work-group-wide		division-wide		company-wide		company-group-wide		
		① is affected	② should be	① is affected	② should be	① is affected	② should be	① is affected	② should be	① is affected	② should be	
men	sales division	148	34	82	23	80	23	75	63	87	45	70
	branch A	69	26	87	22	84	16	75	63	76	32	71
	plant B	74	34	79	19	68	32	71	74	89	42	75
	outside work site	60	37	88	32	85	29	90	64	90	37	79
	dispatched staff	28	18	67	25	74	30	81	57	89	30	75
	main office	85	33	84	22	68	24	65	71	77	33	69
women	69	16	76	21	78	25	70	78	88	47	61	

Figures: $\frac{\text{respondents with "agree"}}{\text{total respondents}} \times 100$

Source: "Attitudes Survey on Working Hours," 1988 (533 respondents).

The present situation always shows a lower percentage of the effect of performance on individual pay. Generally speaking their pay is most affected by company-wide performance. On the other hand, they want their pay to be more affected by their individual performance and by their work group performance. As a whole the employees at this time want stronger relationships with performance from any category. It means they want to take more risk rather than depending on the stable seniority basis. Differences among people in various work places did not look to be so wide as differences among performance of different categories.

The difference between perception of the present situation and the desirable situation was largest in the cases of individual, work group, and division performance. The least difference was shown in the case of company-wide performance. It should be noted that employees actually did their work as a team and on an organizational basis. They sometimes considered it difficult to assess individual performance fairly.

At any rate the employees of the present company regarded themselves as belonging to a prestigious company in the local area and they were satisfied with the level of their pay. It should also be emphasized that they were not satisfied with their pay system and desired more emphasis on competence (potential), content of work, and performance.

In conclusion, employees of the present company were of the opinion that their pay was affected by company-wide performance, but they wanted more emphasis of the company-wide performance on their pay. This would introduce a more changeable and variable pay plan. They also wanted to have more emphasis of individual performance on their pay which was achieved far less than the case of company-wide performance. This implied wide differences among individuals. They also showed a preference for more emphasis on work group performance and on division-wide performance in determining their pay. Such a large company as 10,000 employees should be far from a face-to-face group, even though their commitment to the company had been high enough to create new activities and ideas.

The Future of Japanese Pay Systems

From the viewpoint of pay system trends Japanese organizations will introduce systems based more on competence, achievement and performance than on rank and function. This means human resources management policies will be changed depending on changes in the business environment. As shown in Figure 1, the traditional type of internal labor markets with hierarchy and mass production will be directed to localization and decentralization. It will be caused by such changes as the splitting of large organizations, globalization of activities and introduction of holding companies. Required qualifications for human resources will be creativity and voluntarism caused by the information-oriented and service-oriented activities of business. The structure of organizations will be flatter, smaller and more flexible in the future.

The traditional pay principles of seniority and a comprehensive basis of pay will lose their usefulness and the rank-and-function pay system will represent only the skill hierarchy of the past. On the other hand, the pay-for-job basis is considered to be too rigid and its disadvantages bring about enormous extra cost. What kind of pay system can solve the problem?

The conditions which future pay systems should be equipped with are: (1) flexible

enough matching to various kinds of jobs and work, (2) short-term oriented rather than long-term oriented, (3) a clear-cut definition of pay to divide into two parts, fixed livelihood and pay for performance, and (4) formal contracts between employees and employers. Above all, pay systems should be (5) easily explained by employers to employees. In Japan it is sometimes pointed out that not only employees but also their superiors do not know about the amount of subordinates' pay.

In summary, any pay system in an organization of considerable size should have the following three parts: the first component representing livelihood or minimum wage requirement, the second component representing the content of work, function and occupation (the job-related part) but broad categories will be desirable rather than traditional job analysis. The categories will be, for example, "sales" or "software." This part is related to specific areas like job-related pay and could be reduced owing to transfers to any lowly ranked work areas. It might be close to allowance pay. The third component should correspond to pay for performance and achievement of an individual, a work team, and a company. Pay linked with performance in monetary terms should be variable over time. It resembles profit sharing and should be given in the form of a bonus payment.

As a result annual pay would consist of three payments: livelihood related to a minimum base pay, work-related pay and performance-related pay. Factors to determine pay such as gender, education, length of service and age are all based on personal characteristics and are sometimes regarded as discriminatory in the U.S. and elsewhere. Therefore, livelihood-related pay should not include automatic annual increases and should be equal for all employees notwithstanding dependent family members. Allowance systems which caused the present pay system to be so complicated should be reconsidered. Most importantly performance-related pay programs should be developed not only for individuals but also for groups, divisions and the company as a whole. The problem remains with the proportion of the above three components. It will reflect the situation and the policies of each organization.

Let me introduce an example of a company named Plaza Create in Nagoya which introduced a new pay system recently. It is a nationwide DPE (development, printing, and enlargement) company with nearly 200 regular employees. A young CEO decided to change the traditional pay system to a new one: monthly salary is related only to an employee's age and one year of age equals 10,000 yen a month till 45 years old after which a flat rate of 450,000 yen is paid. The new plan includes neither annual increases nor any allowance in addition to the basic salary every month. However, a bonus is paid twice a year after a careful assessment of individuals is done. The reason why the new CEO introduced such a revolutionary plan was that employees should be evaluated so as to constantly develop their ability to the maximum. But such careful assessment requires time and expense. Twice a year should be reasonable. It should be underlined that the new plan did not account for gender, education and length of service which are as deeply rooted in the Japanese HRM system as is age.

The plan was accepted by the employees partly because the salary level of 10,000 yen per year of age meant a relatively high level for most employees. On the other hand the employer needs to raise each employee's salary 120,000 yen automatically every year until the age of 45. The new pay plan without considering employees' career and personal characteristics represents a new vision.

It will be necessary to keep in mind that the trend direct to small, flexible, global

and local to manage pay systems successfully in the future. It will also be required to manage human resources in order to develop initiatives, creativity and an information orientation. Participation in management by employees will be encouraged. Partnership relations in small groups will introduce sharing of their performance outcomes. Simple systems will be encouraged. Sharing in a small group often means flat sharing without time-consuming assessment and evaluation. Allocation of work will attract more attention both in an organization and in a market.

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