

Convergence to Anglo-Saxon Human Resource Management Practices? – Recent Occupational Pension Reforms in Japan

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Outline of Today's Lecture

- Background: Convergence/non-convergence debate in business studies
- Overview: Japan's traditional compensation practices
- What are occupational pensions?
- Why do companies offer occupational pensions?
- How have traditional pension schemes changed since the early 2000s and what explains these changes?
- Outlook: Future Challenges
- Conclusions

The Convergence School

- Increasing global competition forces companies to adopt best practices that are universally valid and applicable
- This development contributes to a cross-national convergence of business and management practices
- Erosion of institutional differences among different national economies with more market-oriented institutions

(Sources: Streeck and Thelen 2005; Lane 1995; Kerr *et al.* 1962)

The Non-Convergence School

- Stresses the embeddedness of national management methods in their cultural and institutional context
- The Comparative Capitalism literature elucidates the institutional foundations of diverse national ‘varieties’ of business organization
- Existing complementarities among institutional elements of national economies are considered to thwart international convergence

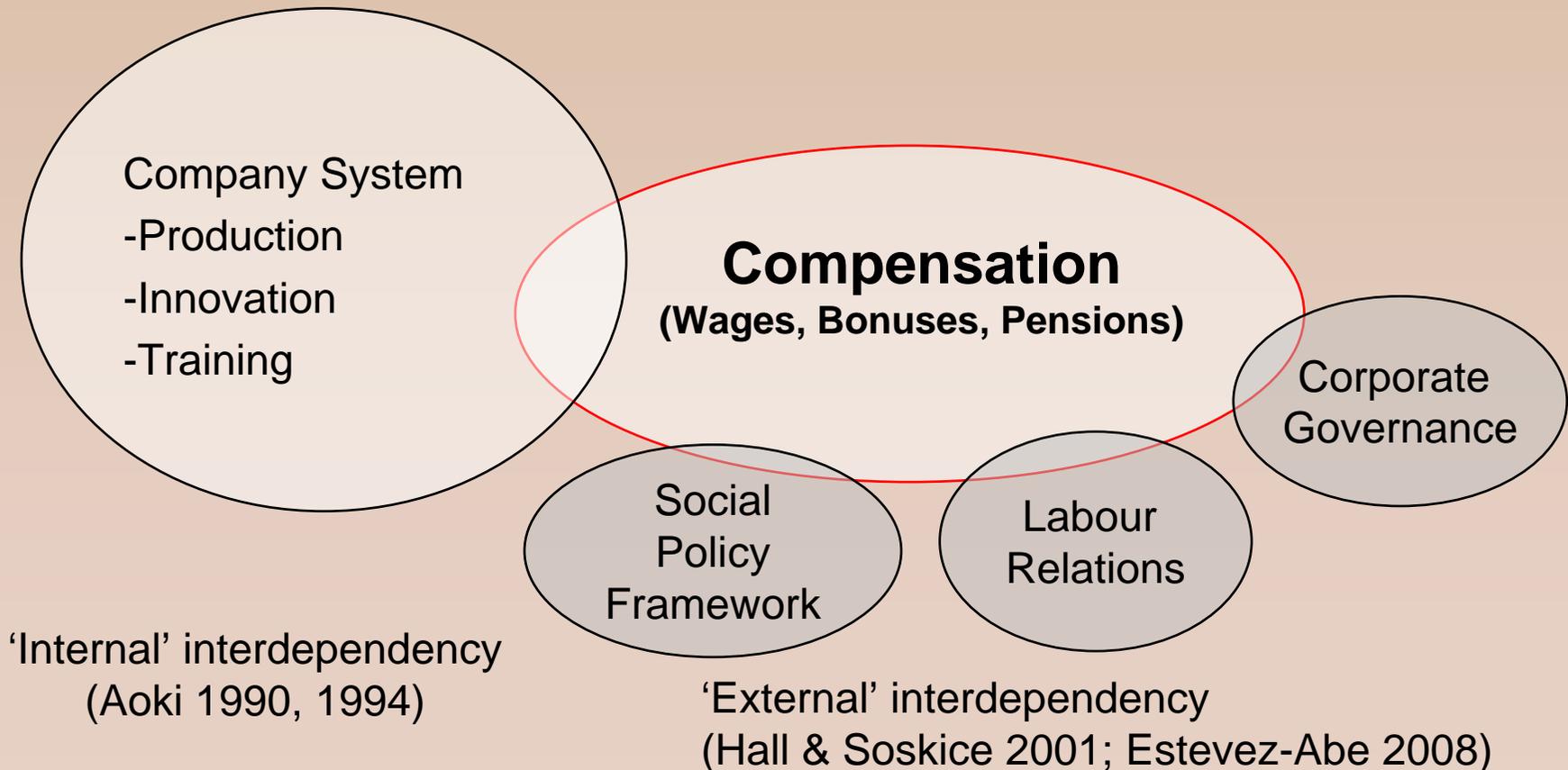
(Sources: Degg and Jackson 2007; Hall and Soskice 2001; Whitely 1999; Hollingsworth and Boyer 1997)

‘The Japanese Model’

- Japan has been characterized as a *coordinated market economy* as opposed to *liberal market economies* such as the US and UK
- The academic literature has highlighted the special nature and embeddedness of Japan’s business and employment practices
- However, recent research has established that Japanese firms’ practices have changed considerably since the 1990s
- For example, main bank relationships, corporate finance patterns and inter-firm relationships have undergone considerable transformations
- These changes have raised the question whether Japanese firms are adopting practices that are predominant in liberal market economies or whether new models may be emerging

(Sources: Vogel 2006; Aoki, Jackson, Miyajima 2007; Inagami and Whittaker 2005)

The Embeddedness of Compensation Practices



Stylized Facts: The "Old" Wage Regimes (1)

- Complex compensation systems with numerous wage components
- However, in practice strong seniority-orientation

Typical wage components in the private sector

Base Pay (<i>kihonkyû</i>) -Age Pay (<i>nenreikyû</i>) -Skill Pay (<i>shokunôkyû</i>) -Performance Pay (<i>seisekikyû</i>)	Standard Pay <i>(kijunnai chingin)</i>
Family pay (<i>kazokukyû</i>)	
Work-site allowance (<i>gengyôteate</i>)	
Overtime Pay (<i>jikangai warimashikin</i>)	Non-Standard Pay <i>(kijungai chingin)</i>
Allowances (<i>teate</i>)	

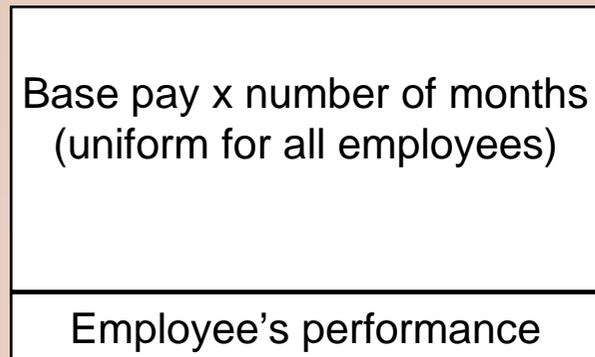
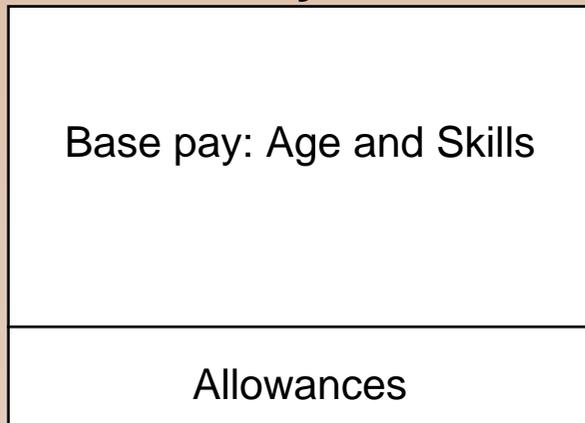
Stylized Facts: The "Old" Wage Regimes (2)

- **Bonuses**
 - Bi-Annual
 - Defined Number of Months' Worth of Base Pay
 - Weak Link to Performance
- **Lump-Sum Benefits and Pensions**
 - Mostly Defined Benefit Type: Linked to Tenure and Pre-Retirement Pay

Example of Recent Changes to Wage and Bonus Systems

Basic Wage and Bonus Concept for Managerial Staff at Canon Inc. (adopted in 2001)

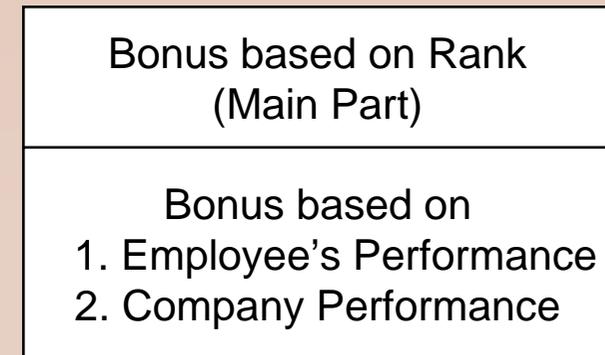
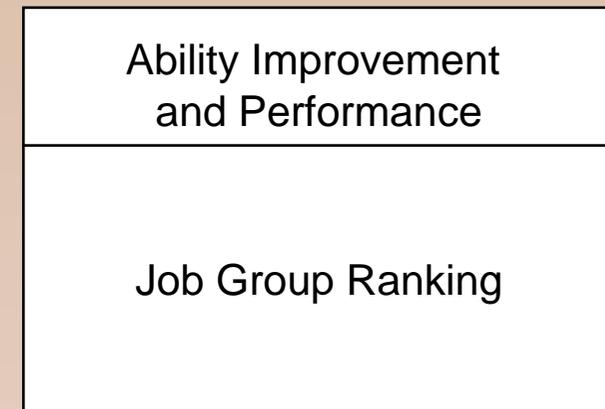
Old system



↑
Monthly
wage
↓

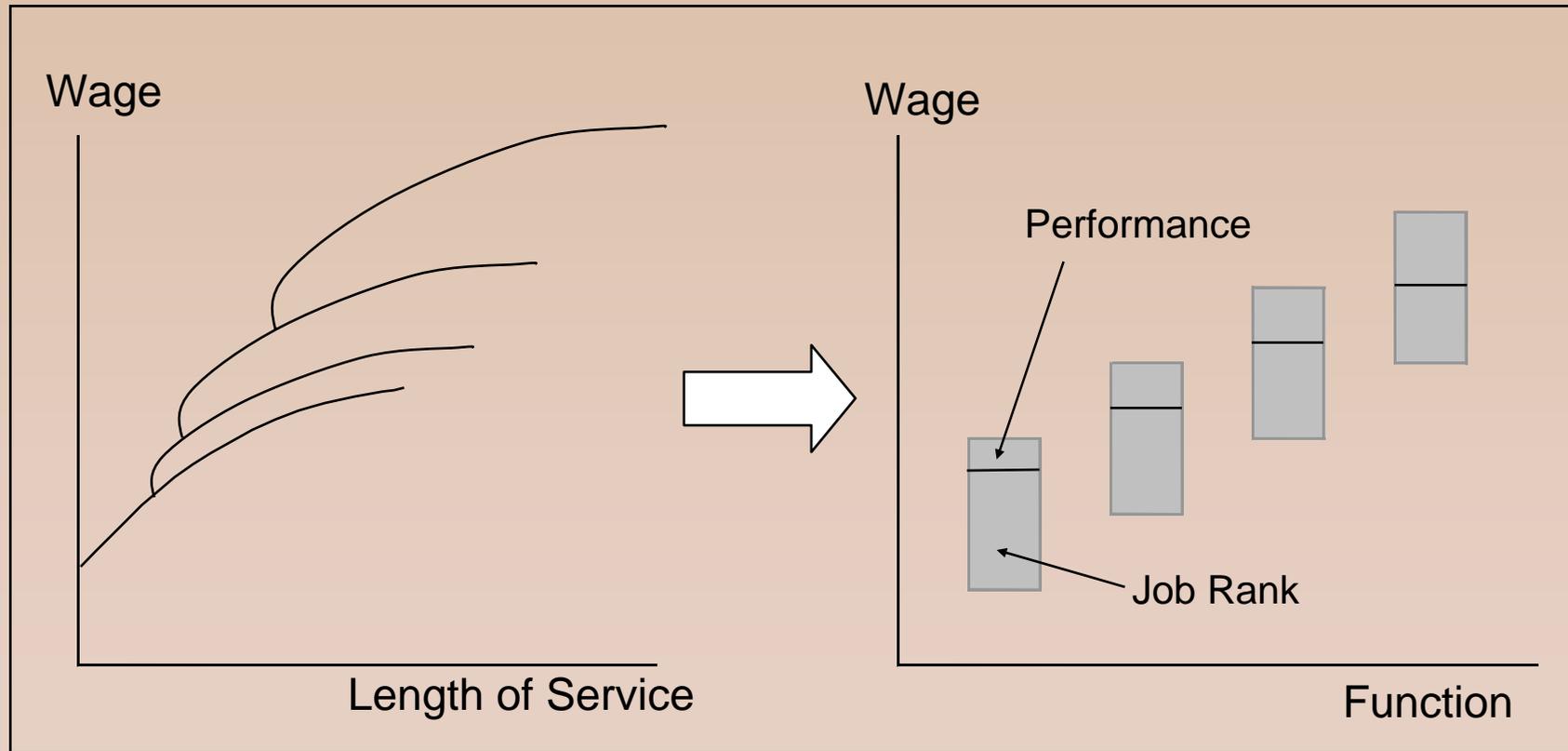
↑
Bonuses
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New system



Recent Changes: An Overview

Stylized Picture of Recent Changes in Wage Regimes



Why do companies offer corporate pension plans?

- Corporate pensions are a tool in human capital management to influence recruitment, retention and retirement of workers
- Historically, corporate pensions have been used as a means to preserve industrial peace vis-à-vis trade unions
- Government regulation can have a major influence on employers' motivation to provide retirement benefit schemes
- The likelihood of employer provision of occupational pensions is linked to the size of a business establishment
- The general economic and ideological environment is known to influence corporate pension provision



Corporate pensions fulfil a double role as an incentive tool of companies and as a benefit component within the public-private pension mix

Occupational Pension Basics

- **Defined benefit plan (DB):** Employer makes a promise of an eventual pension benefit that is determined by a pre-specified pension formula that typically reflects a worker's age, pay, and/or service levels → investment risk shouldered by the employer
- **Defined contribution plan (DC):** Employer makes periodic contribution payments into an account that is established for each participating employee. Final benefits are a reflection of the total of all contributions and any investment gains or losses → investment risk shouldered by the employee
- **Cash-balance plan (CB):** Legally DB plans that are designed to look like a DC plan → investment risk shouldered by the employer, but the risk is limited due to flexible interest rates

Stylized Facts: The "Old" Pension Regimes (1)

- Up to the early 2000s, corporate pensions mainly of the DB type with a seniority-oriented incentive structure
- Government regulation favoured strongly DB benefits over DC benefits
- Basically three types of voluntary DB-type retirement benefits:
 - Book-Reserve Plans (BRPs)
 - Tax-Qualified Pension Plans (TQPPs)
 - Employee Pension Funds (EPFs)

Companies Providing Retirement Benefits by Company Size

Number of employees and year	Percentage of firms paying retirement benefits			Percentage of firms paying no retirement benefits			Percentage of firms paying only a lump sum (among those firms with retirement benefits)			Percentage of firms paying both a lump sum and an annuity (among those firms with retirement benefits)		
	1997	2003	2008	1997	2003	2008	1997	2003	2008	1997	2003	2008
Over 1,000	99.5	97.1	95.2	0.5	2.9	4.8	9.5	10.7	19.3	67.4	67.9	56.7
300-999	97.7	95.7	92.2	2.3	4.3	7.8	17.2	21.7	30.7	50.1	48.7	45.6
100-299	95.9	89.5	88.0	4.1	10.5	12.0	33.8	31.1	41.1	40.0	39.1	41.2
30-99	85.7	84.7	81.7	14.3	15.3	18.3	48.1	45.8	63.0	22.1	23.5	27.1

Types of Retirement Benefit Plans Offered (in Percent)

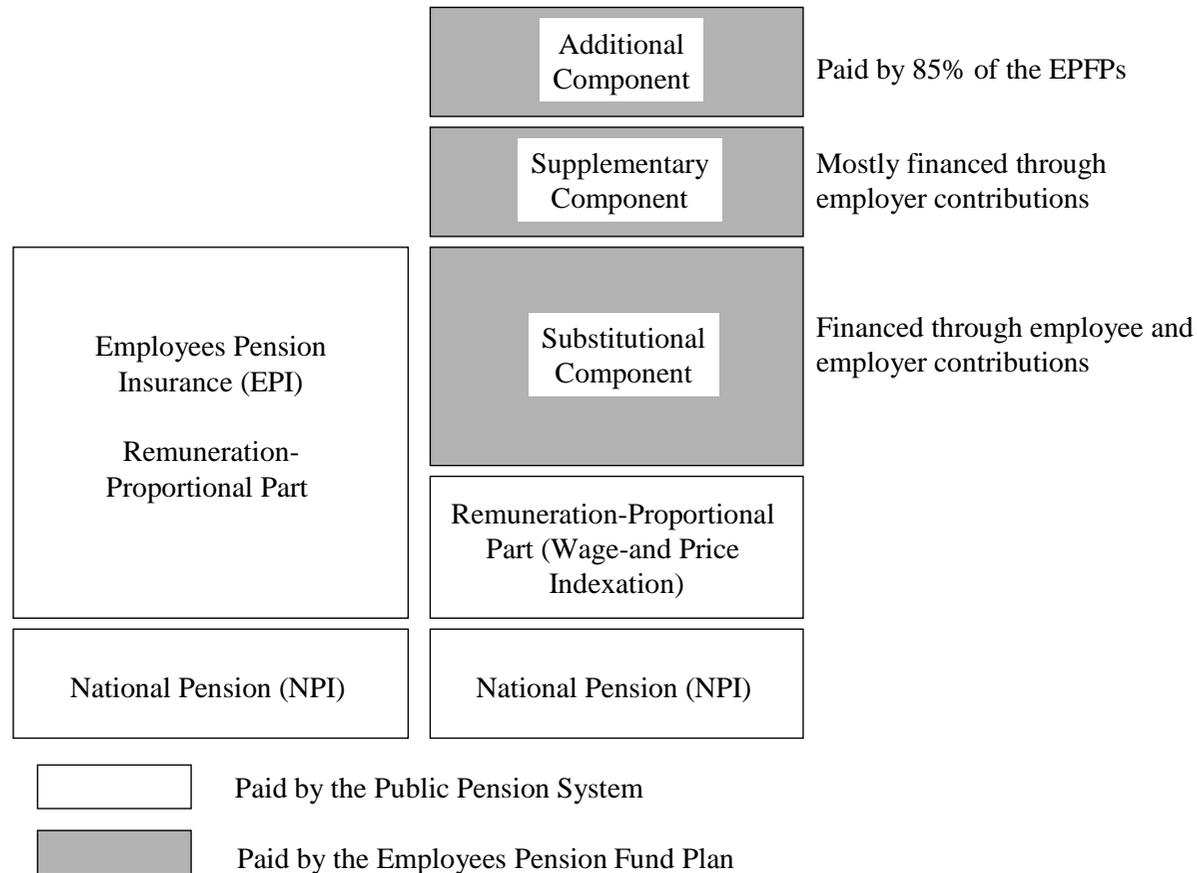
Number of employees and year	Companies with a retirement benefit plan (excluding firms that offer lump sum payments only)		Form of retirement benefit (multiple answers)				
			EPF	TQPP	DB plan (including cash balance plans)	Corporate DC Plan	Others
Total	(44.7)	100.0	35.9	49.5	11.7	15.9	2.1
Over 1,000	(80.7)	100.0	12.7	34.1	45.2	35.0	4.5
300-999	(69.3)	100.0	27.2	54.9	22.4	20.3	1.8
100-299	(58.9)	100.0	31.8	57.9	12.1	17.6	1.4
30-99	(37.0)	100.0	41.1	45.7	7.4	13.0	2.4
1997	(52.5)	100.0	43.8	74.9	x	x	6.0
2003	(53.5)	100.0	46.5	65.8	0.0	1.8	2.7
2008*	(46.9)	100.0	35.6	50.1	12.9	15.8	2.2

Notes: x = not applicable; Up until 2007 the survey covered only regular employees *in head offices* of private enterprises with more than 30 employees. Since 2008 it has widened its coverage to include all regular employees of private enterprises with more than 30 employees. *However, the numbers for 2008 below show only regular employees *in head offices* of private enterprises with more than 30 employees so that the numbers are comparable over time.

Source: Kōsei-rōdōshō 1997, 2003, 2008

Stylized Facts: The "Old" Pension Regimes (2)

The Quasi-Public Nature of Employee Pension Funds (EPF)

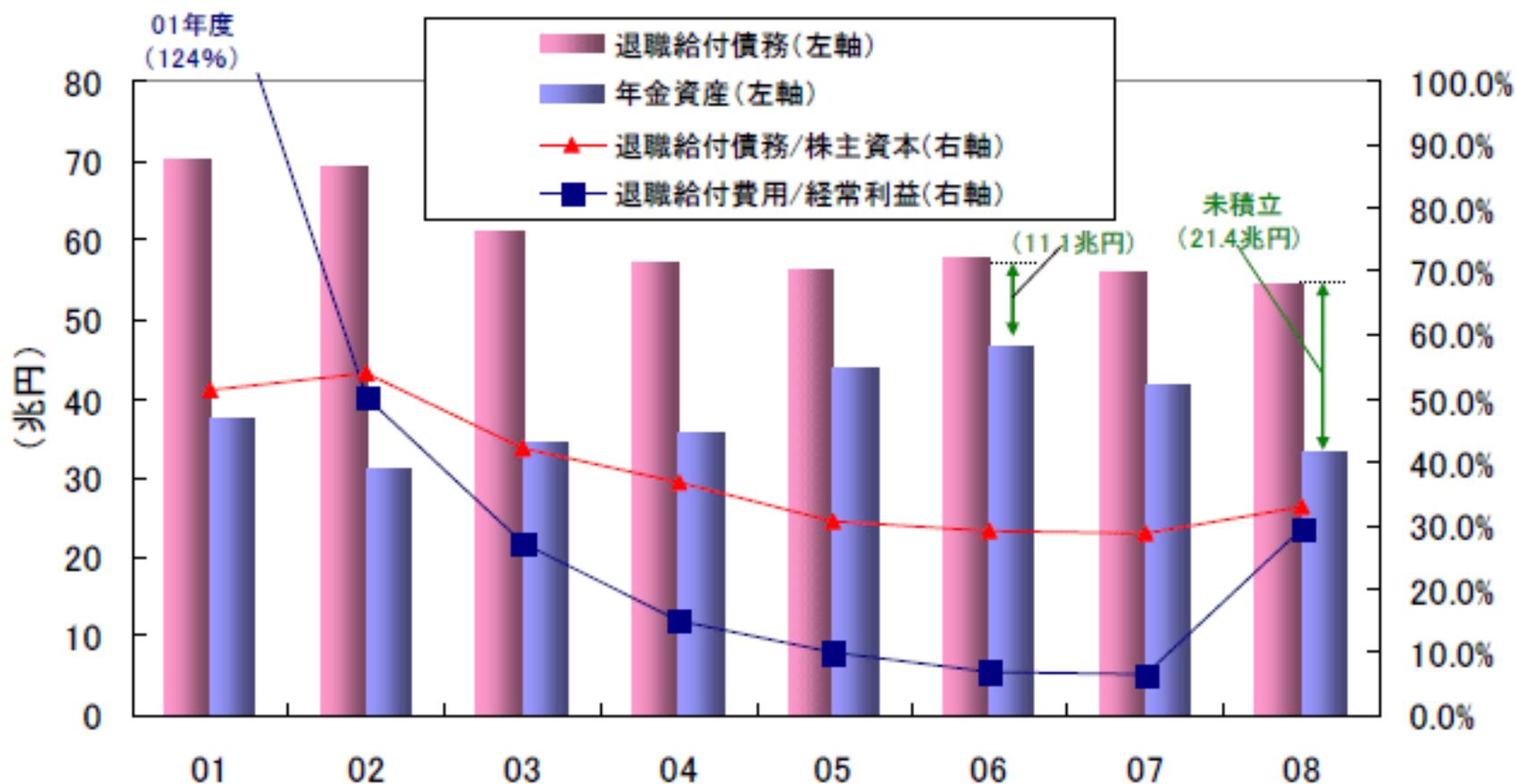


Challenges to the “Old” Pension Regimes

- The depressed stock market and declining interest rates over the 1990s contributed to a rapid increase in underfunding of the prevailing DB plans
- New accounting standards that were introduced in April 2000 made these unfunded pension liabilities for the first time visible on companies’ balance sheets
- Cost-automatism due to an increasing number of older workers
- Plan sponsors began to reconsider the design of their plans and lobbied for new DC options

The Problem of Unfunded Pension Liabilities

主要上場企業における退職給付債務・費用等の状況推移
(一次集計ベース)

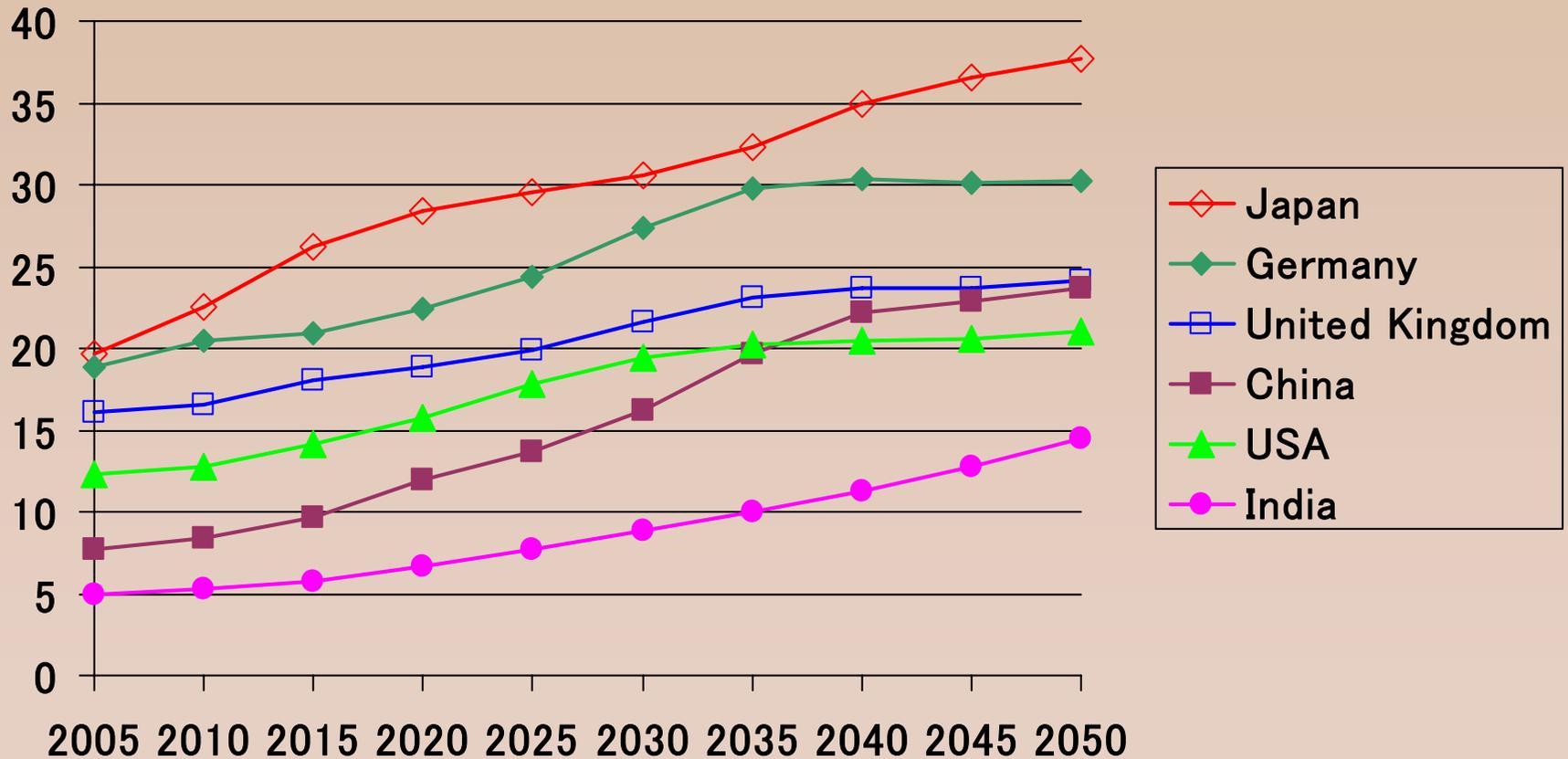


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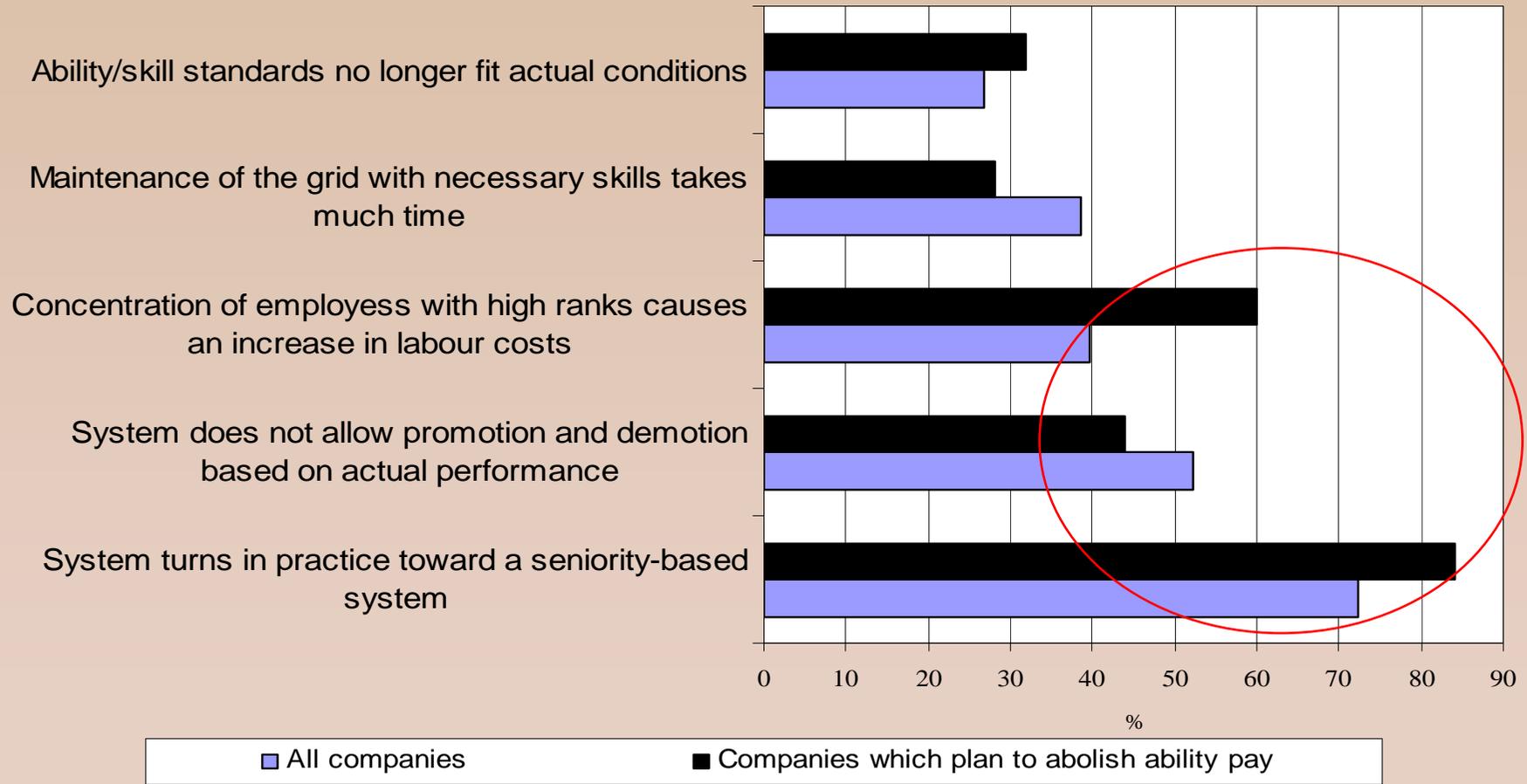
注: 09年3月時点の日経300対象銘柄のうちデータの連続性等の条件を満たす278社のデータ集計値

The Ageing Problem

Population aged 65 or over (%)



Problems of the Skill-grading System



Notes: N=317; up to three possible answers

Key Legal Changes in 2001/2002

- Legislation in 2001/2002 introduced several new options for company pension plans:
 - Option for EPFs to return their assets related to the contracted out portion of the public EPI back to the government
 - Introduction of DC and CB plans and other type of new DB plans
 - Elimination of TQPPs until 2012

Methodology

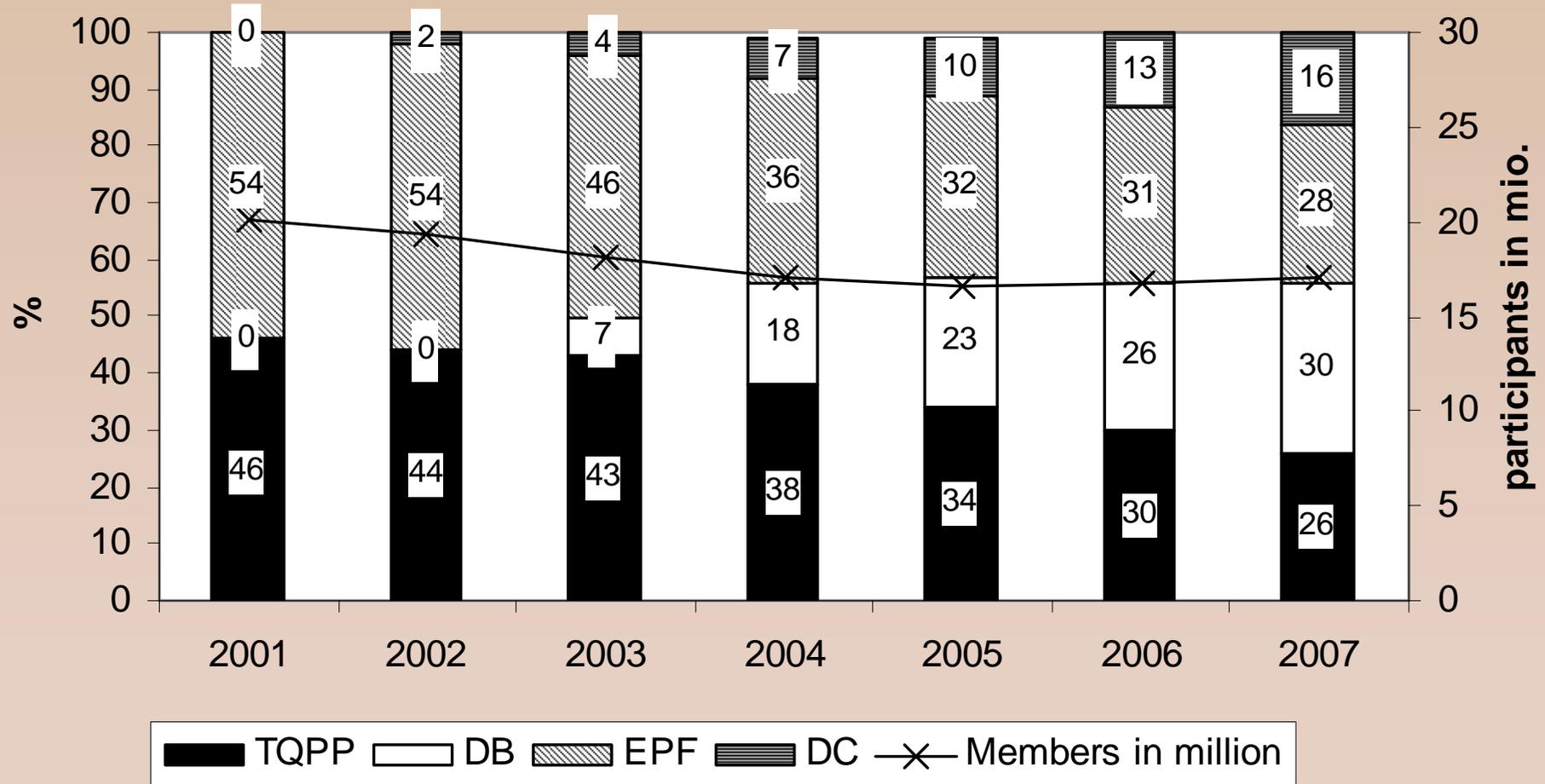
- Qualitative approach
- Changes since the early 2000s
- Sources
 - Japanese secondary sources
 - Semi-structured interviews with 60 informants between April 2009-November 2011 (human resource managers of large and medium-sized Japanese companies, labour union representatives, officials of governmental and semi-governmental institutions, actuaries, pension and human resource management experts from research and academic institutions)

Key Findings (1)

- The number of pension plan participants declined from 20.1 million in 2001 to 17 million in 2007
- The number of EPFs and TQPPS declined substantially, but these systems were largely compensated for by new DB and DC pension plans
- Medium and large-sized companies have largely replaced EPFs with multi-layered retirement benefit systems that offer a combination of DB (usually 75-90% of total benefits) and DC benefits (usually 10-25% of total benefits) → example Panasonic

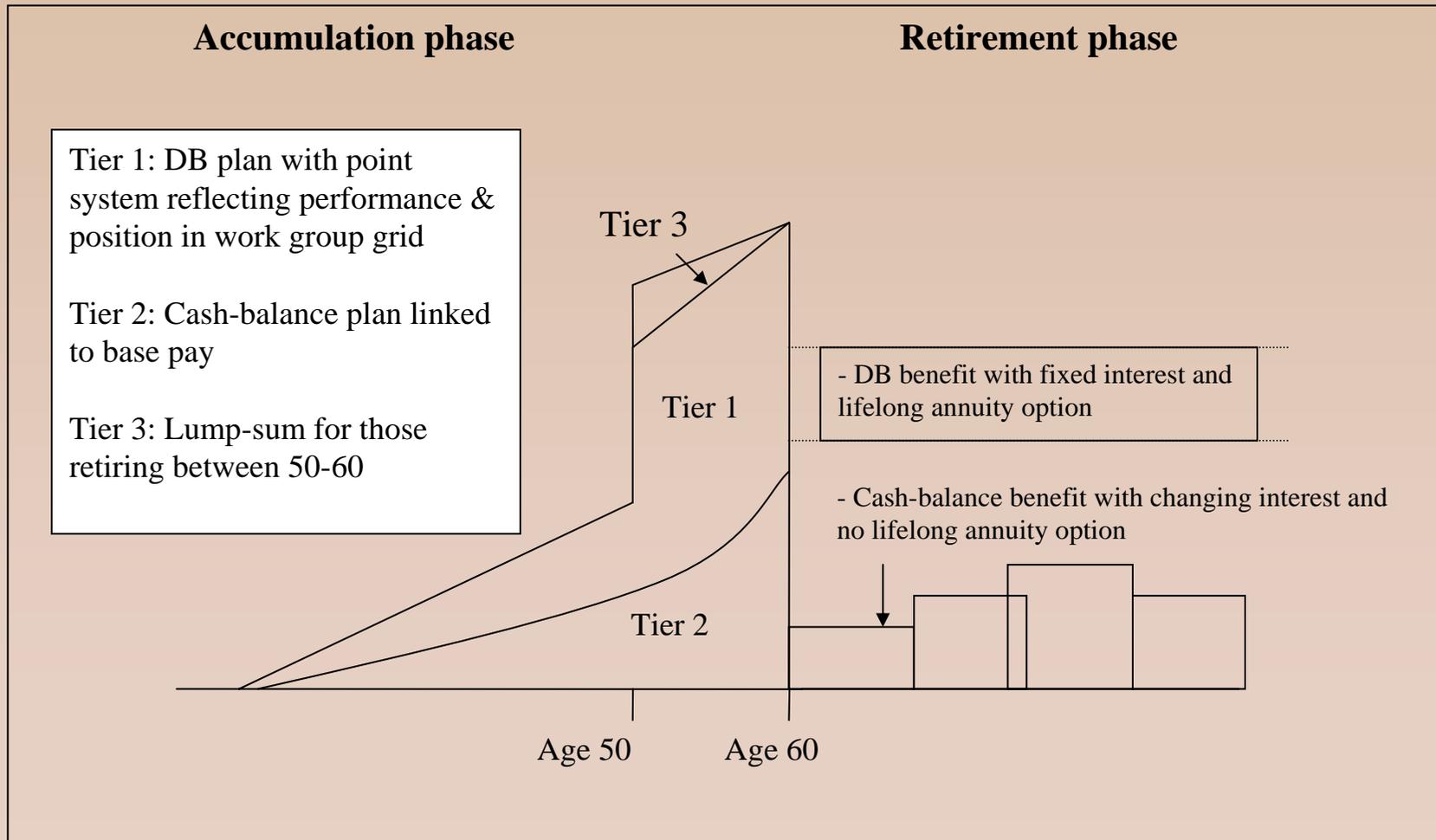
Changes since 2001

Occupational Pension Plan Participants (Relative and Absolute Numbers)



Typical Example of Changes

Panasonic's new retirement benefit system (since 2002)



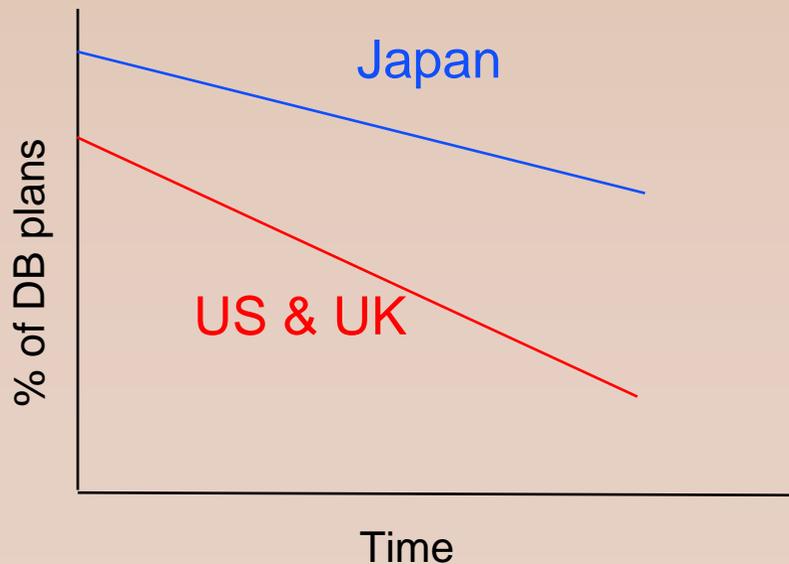
Key Findings (2)

- Compared with the dramatic decline of DB plans in liberal market economies such as the United States and the United Kingdom, DB plans continue to play an important role in Japan
- Does the decline of Japanese DB plans qualify as convergence?
- Convergence in the strictest sense requires that the developments of a variable in different countries point towards a common end point so that we can witness a consistent decline of variance over time

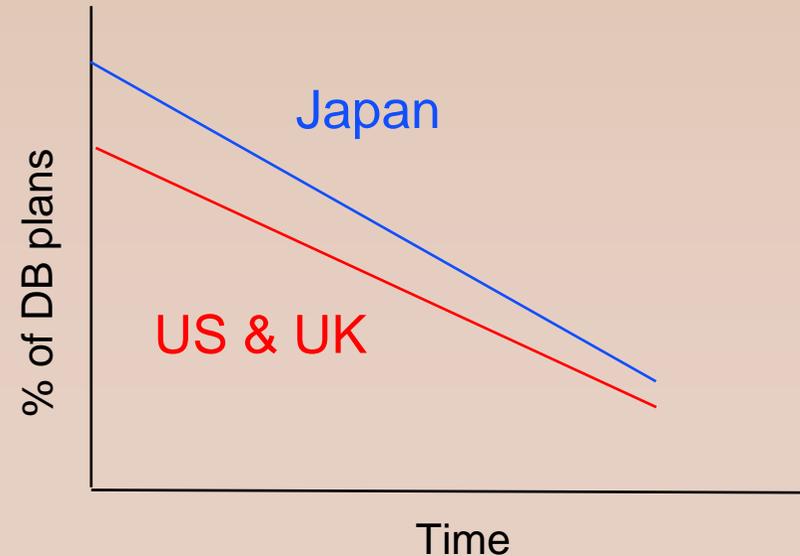
Key Findings (3)

- There is a similar trend with regards to the decline of DB plans, but not necessarily convergence
- Moreover, there is evidence for greater *within*-country variance

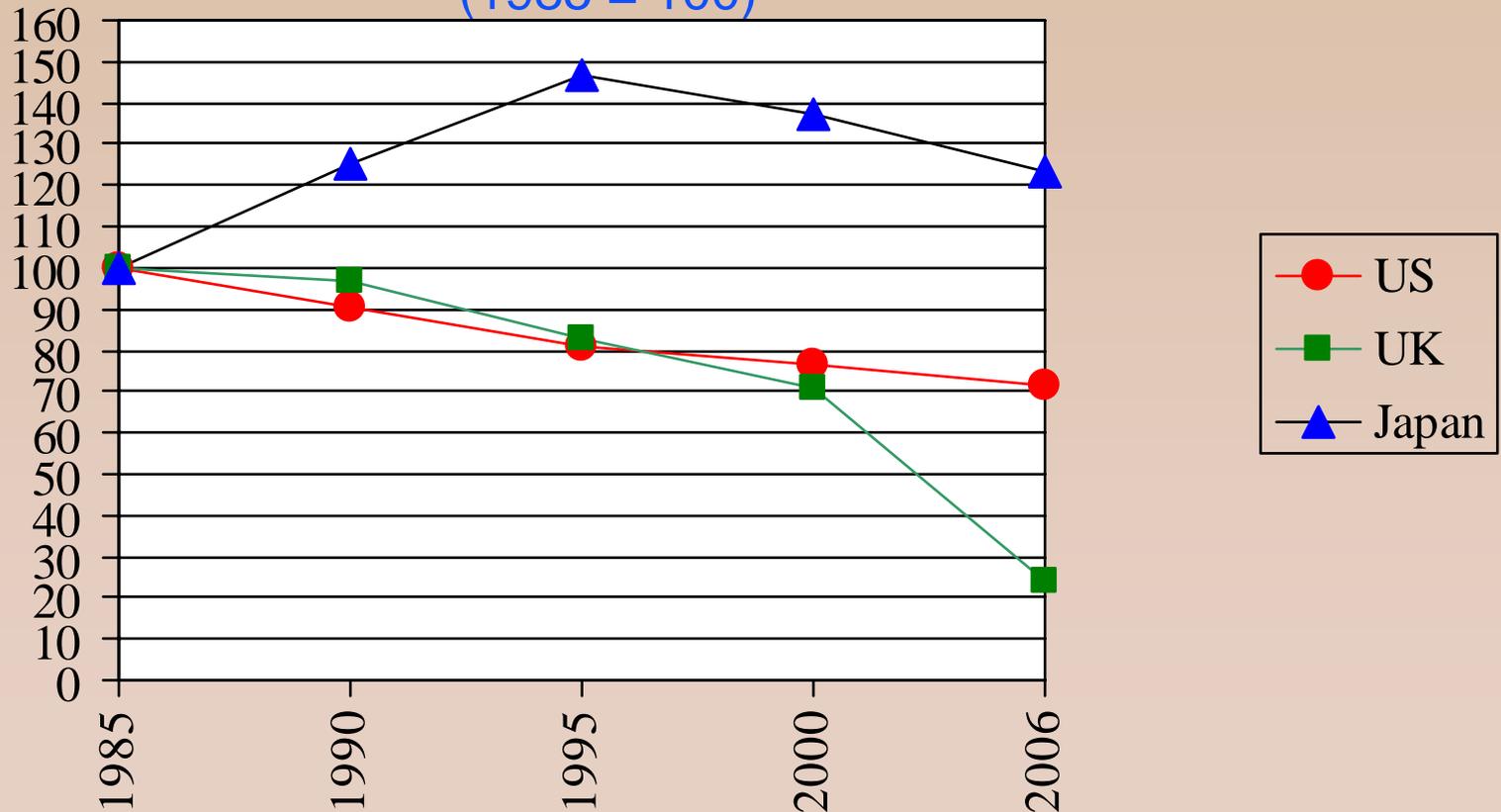
Similar trend



Convergence



Development in the Number of Participants of Private Sector DB Pension Schemes (1985 = 100)



Sources: Author's calculations based on Kigyō Nenkin Kenkyūkai 2008b; Office for National Statistics 2008; Employee Benefit Research Institute 2007

Key Findings (4)

- What explains the particular nature of the recent changes in Japan?
 - Role of government regulation
 - Role of the labour unions
 - Role of HR departments

Key Findings (5)

- **Role of Government Regulation**
 - Some observers (Huh & McLellan 2007) have claimed that the resilience of DB plans in Japan is the result of low tax-advantaged contribution ceilings
 - However, I would challenge the view that this is true for the majority of Japanese companies
 - For example, only 29% (2007) of DC plans paid contributions up to the maximum tax-advantaged contribution ceilings
 - Informants stated that the contribution ceilings would pose only problems for older employees

Key Findings (6)

- **Role of Government Regulation**

- More important than the tax ceilings seems to be another regulatory requirement: If a company wants to transfer not only future but also accrued past benefit obligations from DB plans to DC plans, it has to first fully fund those obligations
- Given the difficult financial state of many DB plans, many companies have therefore limited their transfers mainly to future benefit obligations



Government regulation explains to some extent the resilience of DB plans

Key Findings (7)

- **Role of the Labour Unions**

- Changes in occupational pensions that involve transfers from the old DB to the new DC systems have to be agreed by a high proportion of the participants and the enterprise unions
- Depending on the extent of such transfers between 2/3 and 3/4 of the participants as well as the labour unions representing more than 1/3 of the participants have to agree
- The Japanese Trade Union Federation advises its members to oppose the introduction of DC-type plans
- However, in practice Japanese enterprise unions have usually been cooperative and have agreed to the introduction of DC pensions



The labour unions have not played an active role securing DB pensions

Key Findings (8)

- **Role of HR Departments**

- HR managers have been careful not to alienate their core workers by simply retrenching pension benefits
- As part of a careful reform approach, employers have reduced their direct costs and risks by partially introducing DC benefits and by tying the existing DB benefits closer to employees' performance indicators
- This approach reflects a general trend in Japanese wage systems, where seniority factors have also been partially replaced by performance factors
- The overall moderate nature of these reforms is confirmed by the fact that companies have rarely reduced overall contribution levels

Key Findings (10)

- **Role of HR Departments**
 - Further cost reductions have been realized by an increase in the proportion of non-regular workers that are not covered under any pension schemes
 - The percentage of non-regular workers in the Japanese labour force has increased substantially from 20.1% in 1994 to 33.2% in 2006 (JILPT 2009)

Key Findings (9)

- **Role of HR Departments**

- Companies are increasingly using point systems where employees accumulate yearly a certain number of points which reflect their performance, employees' abilities, the number of years of employment, or a combination of those factors
- A more subtle link to performance exists through the way how companies have changed the make-up of base pay, which is the basis for the calculation of retirement benefits

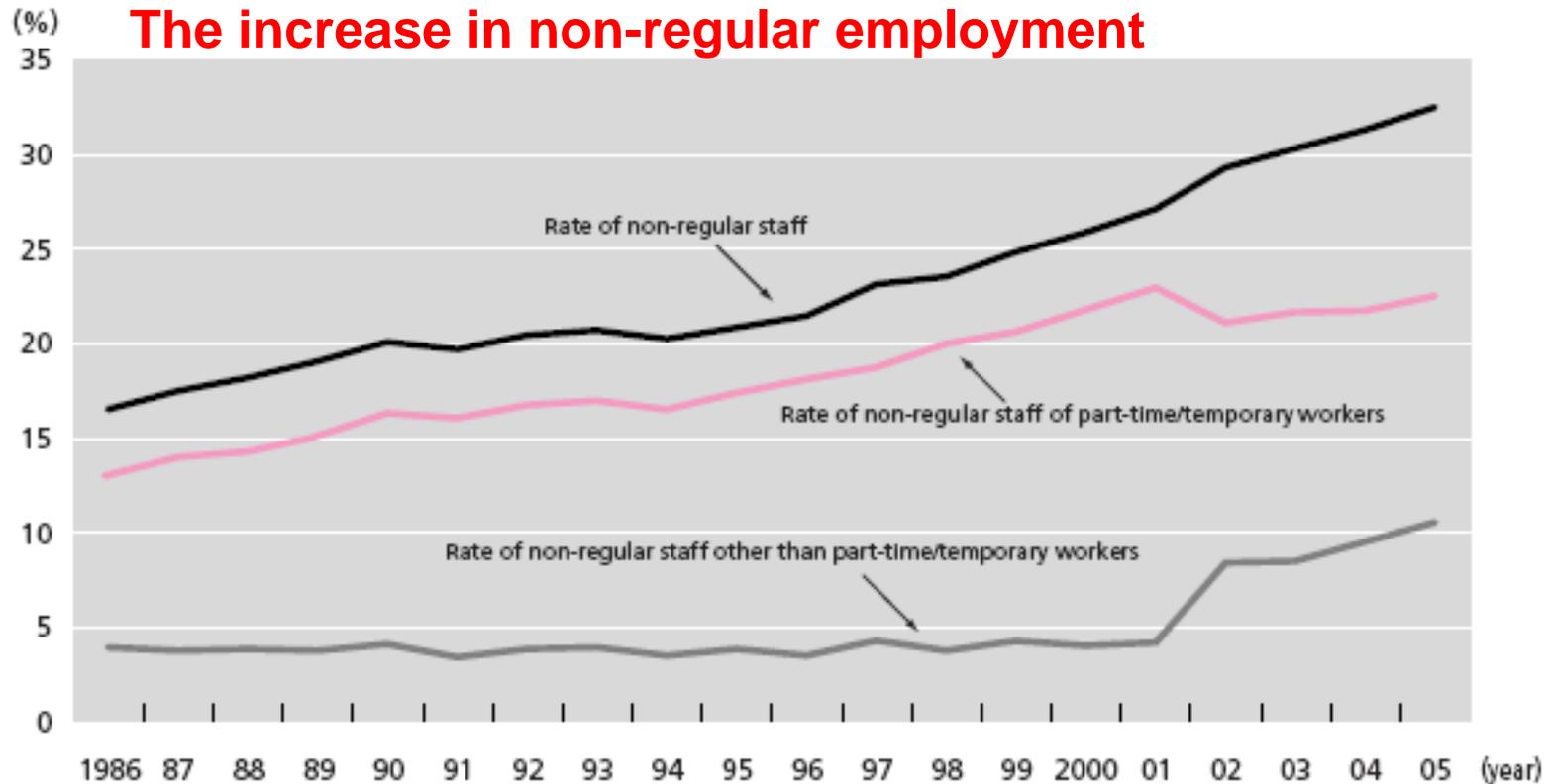


Human resource management factors play an important role for the resilience of DB benefits

Corporate Pension Plans Offered in Addition to DC Plans (in %)

	Less than 99 employees	100-299 employees	300-999 employees	Over 1000 employees
EPF	13.4	21.4	15.4	9.3
TQPP	2.5	4.5	8.2	7.3
DB-plan	8.2	15.4	25.1	47.0
EPF/DB-plan	0.2	0.6	2.1	2.6
EPF/TQPP	0.8	1.4	2.3	1.9
TQPP/DB-plan	0.2	0.2	0.5	0.9
Mutual Aid Ass. for School Teachers	0.04	0.05	0.2	0.0
NONE	74.7	56.3	46.3	31.0
Number of corporations with DC plans	5,089	2,024	1,104	645

Future Challenges (1)



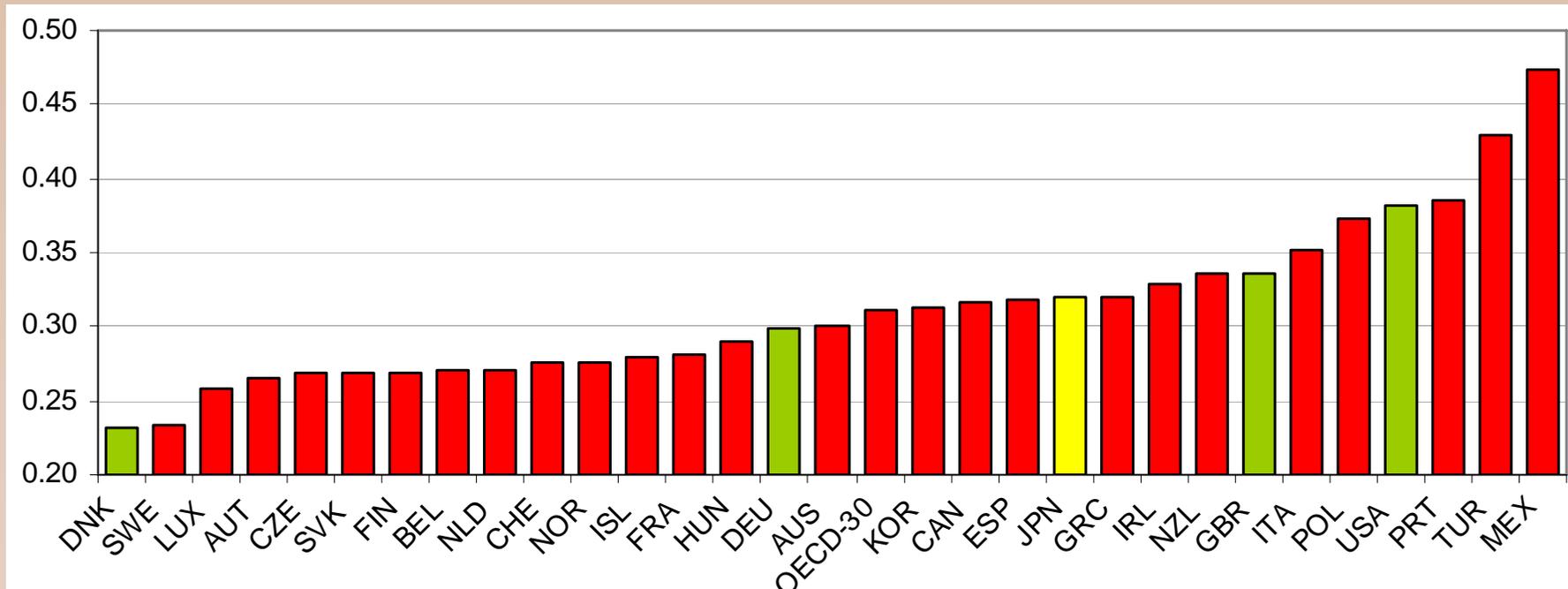
Sources: *Special Survey of Labour Force Survey (February survey) (1986-2001)* and *Labour Force Survey (Detailed Tabulation) (2002-2005)*, Statistics Bureau, Ministry of Internal Affairs and Communications

Notes: 1) Rate includes employees other than directors.

2) A reason for the drop in the rate of part-time workers in 2002 is that the survey questionnaire for the "Labour Force Survey (Detailed Tabulation)" was different from that of the prior "Special Survey of Labour Force Survey," and therefore, that some people who responded until 2001 that they were part-time workers may have answered in 2002 that they were, contract employees or entrusted employees.

Future Challenges (2)

Gini coefficients of income inequality in OECD countries, mid-2000s

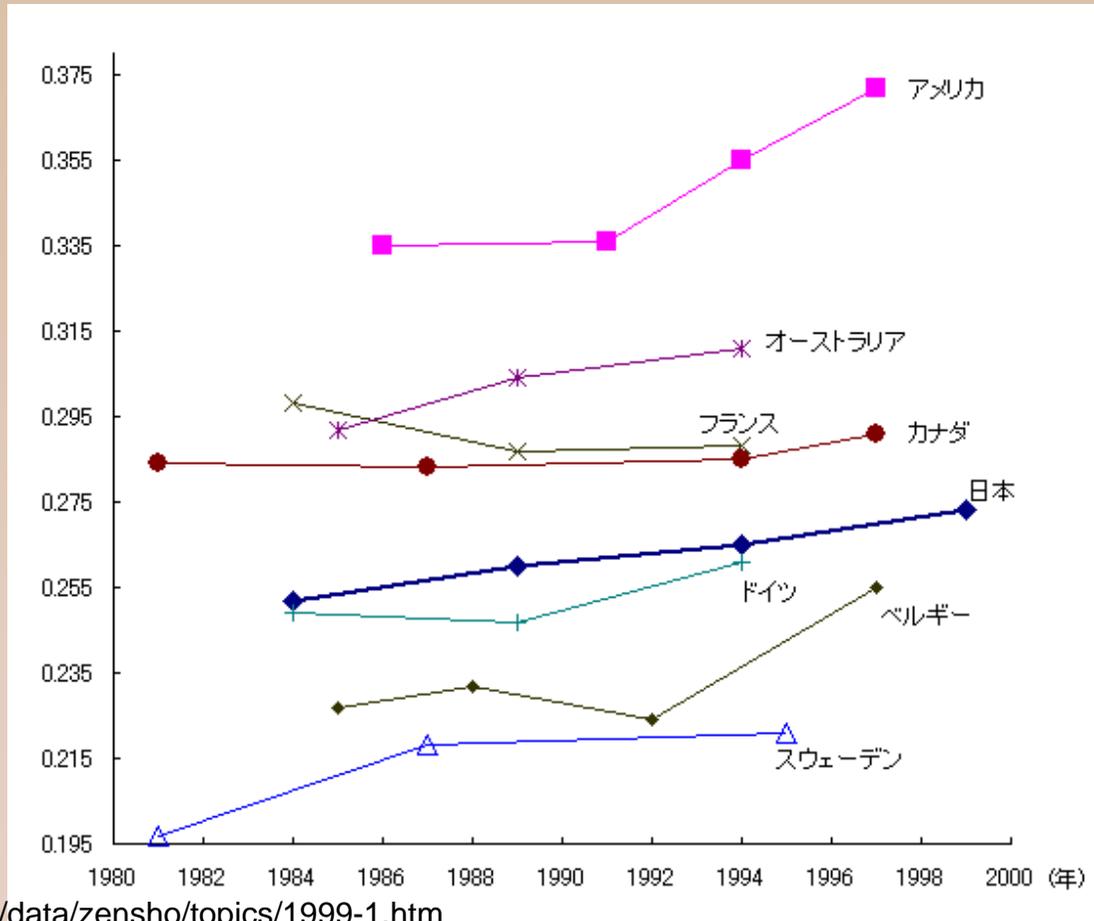


Note: Countries are ranked, from left to right, in increasing order in the Gini coefficient. The income concept used is that of disposable household income in cash, adjusted for household size with an elasticity of 0.5.

Source: OECD

Future Challenges (3)

Development of Gini coefficients of income inequality since the 1980s



<http://www.stat.go.jp/data/zensho/topics/1999-1.htm>

日本(平成11年).....平成11年全国消費実態調査より

日本(平成6年以前)...経済企画庁経済研究所 経済分析政策研究の視点シリーズ11(1997年11月)より

日本以外.....ルクセンブルク所得研究(LIS)プロジェクトより

各国で調査された調査票のデータを収集し各種経済分析を行っているグループ

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Conclusion

- The structure of corporate pension benefits has changed fundamentally since the early 2000s
- The resilience of DB pensions is mainly due to human resource management factors and government regulation and less due to labor union influence
- The new corporate pension mix seeks to transfer some benefit risks to regular workers, but maintains a comprehensive benefit package for those workers at the expense of a growing number of non-regular workers
- These developments are not indicative of a convergence to practices in liberal market economies
- (Perceived) constraints have shaped the institutional innovation of the newly evolving multi-layered retirement systems