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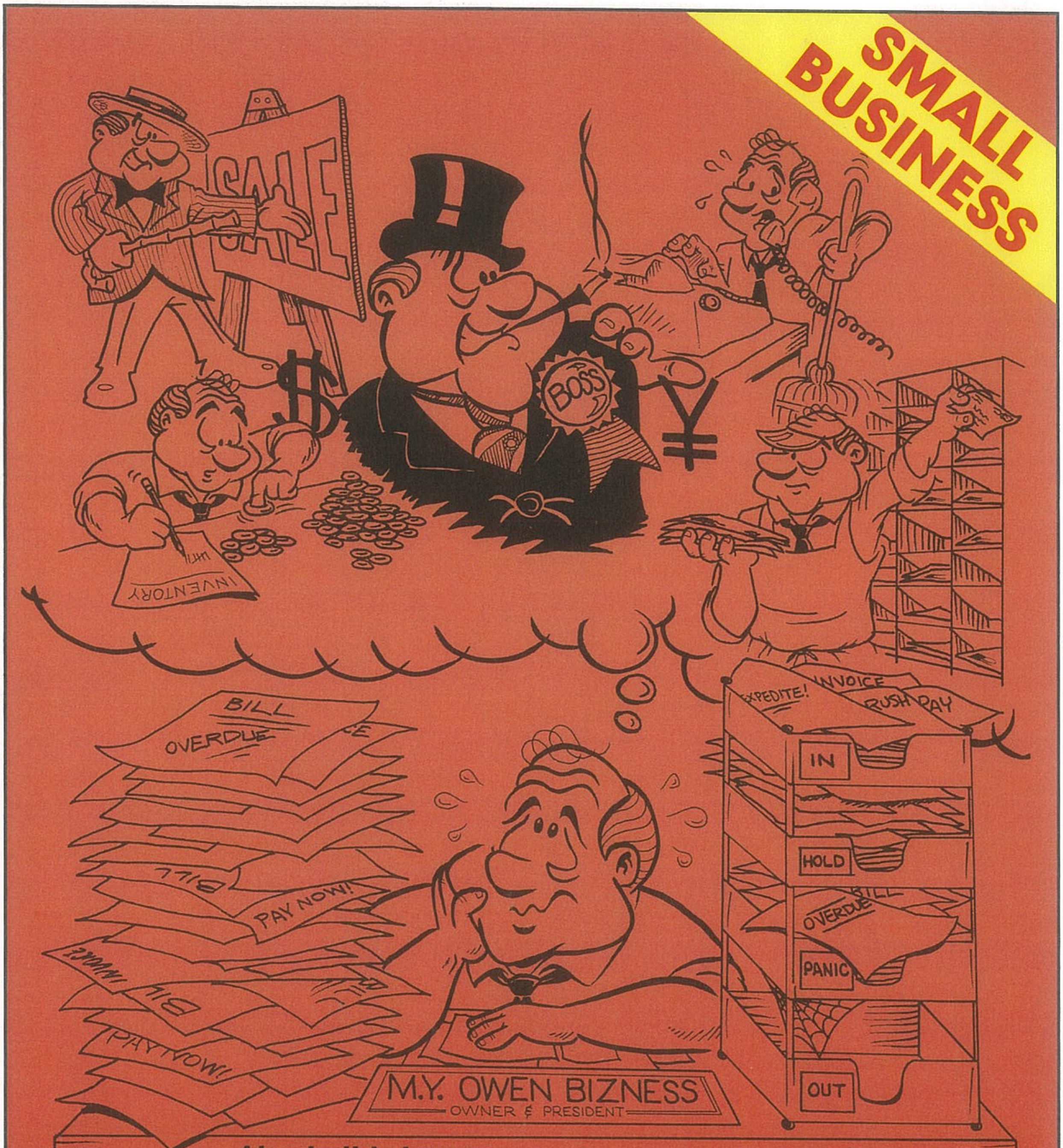
SMALL BUSINESS



Also in this Issue:

- Japanese Space Plane
- Relocation Stress

Pay Smart and Get Your Money's Worth

By
Thomas J. Nevins

*The author, already familiar to **JOURNAL** readers through his articles, seminars, and book (**Labor Pains and the Gaijin Boss**), offers interesting and practical advice and insight that goes one or two layers deeper than the usual 'how-to.' Mr. Nevins, Managing Director of Technics in Management Transfer Inc. (TMT), has created a three-hour video course with text on **Using the Strategic Tools in Six Key Areas**, from which this article is excerpted.*

What are some of the characteristics of strategically-sound compensation and pay practices in Japan?

It is only large Japanese employers (generally about 1,000 employees or more) who can realistically follow the Japanese standard model of providing salary tables based on age and years of service with the typical interplay with functional or job grades as exist in those large firms of bureaucratized career paths. The hiring and paying practices of smaller Japanese firms are not unlike those of the typical smaller multinational firm in Japan where a manager or employee may be hired at any point throughout the year when the need to fill a job with an experienced mid-career hire arises. It is virtually impossible for the small foreign or Japanese firm to recruit directly from the schools, and thus there are negotiations with individual employees, and there is the need to look and see what the individual is making in his former job. Thus it is an unrealistic goal for a smaller multinational firm in Japan (certainly one with under 500 employees) to create fixed salary tables based on age or years of service.

SIMPLICITY IS BEST

Also note that in Japan today age and service tables of even the largest Japanese employers tend to be confined within a narrow, lower and upper limit such that the salaries of top performers are free to move well above the upper limit, while the lower limit is at a bare subsistence level such that the lower limit is not forcing the firm to pay a low level, marginal employee any more than it would need to pay anyway. This aspect of the "tail not wagging the dog" is extremely important, for in today's competitive environment even for the largest Japanese firm, it would be unfortunate and strategically disadvantageous to have a compensation system which dictated the employer pay salary beyond what demand and supply of labor requires. While it is true that there is underemployment of inefficient employees in the largest firms, and while these firms also lose some of their top performers to the competition due to the inability to increase salary level, in smaller Japanese firms and in a strategically-managed multinational here, there must be less tendency to be tied to an inflexible system which does not conform to the realities of job change and the open labor market as exists in smaller Japanese firms and, of course, multinationals.

If a multinational is unionized or feels some internal pressure to create a system, there's no reason why that system should cause you to pay any more than you need to attract an unskilled and marginal employee, nor should the system prevent you from attracting a top performer at a high salary, regardless of comparatively young age or even some considerable imbalance with other employees in the firm. The other side of the equation, however, is to make it clear to the manager or employee who is being paid an unduly high salary that this salary can be frozen or even cut back should performance not meet expectations. Although this does not always have to be verbalized to the employee, the Rules of Employment and personnel system should be set up such that the employer has this kind of control over his human resources.

'JAPANIZED' VS. WESTERN PRACTICES

Another strategic question becomes whether or not the firm should adapt a so-called Japanese style compensation package. Just what does this mean? The average combined summer and winter bonus in Japan is some 5.5 months. The strategic advantages for paying this are that there can be a rather broad performance range on this bonus. It can be flexibly adjusted according to business performance. Its presence reduces the weight of pensionable income vis-a-vis the lump sum retirement benefit. And on another technical point, the social security contributions on bonus amount are only about one-third that of regular monthly cash compensation. Thus by paying bonus, there are significant savings on the employer's contribution to health, pension, unemployment, and workers' accident compensation insurances.

As for the traditional monthly allowances paid in Japan, namely the housing, family, meal, or perhaps position and work allowances, the main advantage to the employer for paying those is that their presence, once again, reduces the weight of the compensation which is calculated into the lump sum retirement benefit, thereby directly and proportionally reducing the lump sum retirement benefit liability to the employer. Furthermore, when bonus and these allowances are paid the same base-up percentage increase will of course mean a smaller increase in the cost of total annual income, as it will effect only the base salary. With the exception of the commutation allowance, which is nontaxable as income to the employee up to the tax deductible limit (which covers the commute of most employees), there are no tax implications as to whether or not these allowances are paid.

Since many firms have only paid the spouse and children allowance, or family allowance, and often housing allowance only to married male employees, especially since the April 1st, 1986 Equal Opportunity Law was passed, it will behoove companies to do some fancy footwork and to cash out those allowances into perhaps a single, nonpensionable second salary component of "dai ni kyuyo." If this is not done, female employees may request that the family allowance or what is often the larger of two housing allowances be paid to them as it has been paid to males in the past. In the case of many multinational firms here, that would create a considerable extra nonperformance-related cost, which can easily be avoided with a timely and simple adjustment in compensation practice.

KNOW YOUR SELLING POINTS

Thus Japanese and many multinationals firms have strategically limited their retirement benefit burden by paying summer and winter bonus and having an array of nonpensionable allowances. Even in firms where summer and winter bonus is not paid and various allowances do not exist, it is still possible to keep all things equal in terms of the balance of compensation design and the quality (or burden) of the lump sum retirement benefit. This can be done by designating a percentage of non-pensionable regular monthly cash compensation in your Rules of Employment. Actually if no bonus or allowances are paid at your firm, this figure could be justifiably as high as 40 or 50 percent. If you are interested, however, in trying to make your firm more competitively attractive, the figure could be higher, but certainly should be no higher than 60 percent, (assuming that the lump sum retirement table of months of pay for years of service is a typical benefit). If you are paying as much as 60 percent of one-twelfth of annual income as the calculation base for the lump sum retirement benefit, that is a factor of great advantage to employees, and you are losing out on the opportunity to strategically attract and appeal to employees if you are not aware of the built-in advantageous merits of your firm's compensation practices.

If you are paying no bonus and allowances, and a candidate complains that there is "no bonus paid at this company," chances are you are paying the same or greater annual income as a firm that pays bonus. And you should certainly make the most of the opportunity to state that "That makes your lump sum retirement benefit so much richer," or "That means that your monthly pay is comparatively stabilized and your income is secure." Basically, though, I would certainly recommend that summer and winter bonus be paid for the other reasons outlined above. Although in lieu of allowances it certainly is acceptable to define a percentage of non-pensionable regular monthly cash compensation.

The question often arises whether or not a firm should fund its lump sum retirement benefit. This would mean in the form of a tax-qualified pension, or *tekikaku nenkin.* Unless you are sure that your compensation design is properly balanced with a strategically sound lump sum retirement benefit plan, you should not go out and fund your lump sum retirement benefit. When funding has not as yet taken place, it has been possible for us to neutralize the adverse impact of redesigning compensation or the retirement benefit tables by arguing that this has been compensated by the fact that for the first time what was formerly a paper benefit is now a very real commitment funded by an outside party, with the monies safely locked away for the employees.

STRATEGICALLY SMART COMPENSATION

Philosophically, I believe that it's strategically smarter to put money into cash compensation rather than to create a rich and burdensome lump sum retirement benefit. This is because a candidate will make his decision to join a firm without seeing its Rules of Employment and without specifically having any details on the quality of the retirement benefit. Also make sure that your lump sum is designed such that there is a significant penalty between voluntary (when they quit on you) and involuntary (when they reach retirement age or you dismiss them) benefits.

Handling the pay increase each year in Japan is actually quite easy. The results of Shunto, or the Spring Wage Offensive, become quite clear by mid May. And if you are a firm following the common practice of adjusting salaries from April 1st, you need only look at the averages in the newspaper, which become clear by about May 15th. Strategically, you should think in terms of paying that average or maybe just a point or two more if you had a good year and perhaps to help attract employees to you. If you're a typical organization, however, with top performers, average performers, and some poor ones, there should be wide variance in the percentage increases at your firm. In Japan there is no legal reason why everyone should get a pay increase, and in fact, freezes and even pay cuts have become more and more common. (It helps to have Rules of Employment language which backs this up.) Even if you are unionized, there is no reason to accept the union demand that there be standard increases based on age or uniform percentage increases.

Just as there are no laws which require that you pay a lump sum retirement benefit, nor is there much in the law which talks about how you must pay your employees. There is no national minimum wage; although there are regional and industry minimums. Although in practice there is little in the way of job or hourly pay rates for salary workers in Japan, there is no law requiring that salaried workers be paid on a monthly basis. You are free to innovate in terms of commission and incentive systems and deferred incentive or compensation schemes, such as golden handcuffs are also perfectly legal. Contrary to popular belief, Japanese firms in certain sectors do much with commission schemes. Since there is a comparatively open labor market between multinational firms, an employee's destiny is not necessarily one and the same as that of the employer. Thus unlike in the large Japanese firms where employees have traditionally scurried to come out as high up on the corporate ladder as possible, it may take some creative incentive schemes to elicit the same level of effort and effectiveness from employees in your firm. ■