

SUCCESS STORIES **JAPAN**

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A SPECIALIST OFFERS ADVICE

The Most Common Employee and Work Rules Questions Answered

By Thomas J. Nevins, President, TMT Inc. (Part One)

Longtime SSJ expert contributor Thomas J. Nevins is back with answers for many of Japan P&L managers' most commonly-asked questions in areas such as hiring, compensation, work rules, benefits, retirement, terminations, vacation policy and employee law generally. Below is Part One of what we expect will be several parts.

It might be interesting to first try and answer these questions for yourself, and then compare them to my answers. If our companies ever work together, this comparison may be of reference to better understand our assumptions, mind-set, and from where we respectively are coming.

Some of these questions are clear-cut. With others, my answers will seem to differ from a traditional, stereotyped, textbook answer. It may be easier for many Japanese lawyers, your Japanese top management, or your personnel manager, to more readily endorse this textbook answer. Except for simple, clear-cut issues of statutory regulation, it can rarely be unequivocally said that something is 'legal', or 'illegal' in Japan. The word is often and understandably loosely used, when more complete and precise communications are not possible. Most of the most important issues that come up are always subject to interpretation, with very wide, deep swaths of gray.

With personnel issues and labor relations in Japan, sometimes what is thought to be easy, risk-free implementation ends up being too costly and damaging to your people and your business. The risk assessment is fundamentally flawed, and a lack of knowledge and experience of other possibilities and a better way, results in bad judgment and poor results. Some creativity, better strategy and tactics, more explanation, apology and time

spent in properly communicating with all staff are elements that are often missing. A sincere, careful, and heartfelt communication process with the necessary content will also result in smoother, faster implementation, more effective results, happier people, and higher morale at the company.

When designing and changing compensation and benefits at your company, remember these questions were meant to demystify some of the HR misconceptions and myths floating around us. There are misinterpretations of confusing and sometimes contradictory legal/professional advice, or sometimes stereotyped thinking and positions among personnel managers and even in Japan's corporate boardrooms. It has been going on for a long, long time. There are better ways to grow sales, increase profits and achieve greater success in Japan. Read on and you'll see what I mean.

1. Is it legally required or just local practice to stipulate annual income amount in employment contracts?

It is neither legally required, nor is it local practice to stipulate annual income amounts in employment contracts, or offer letters. Virtually all major Japanese companies in the past, and still today, merely stipulate the monthly salary amount. Generally the number of months of summer and winter bonus payable is not mentioned in the contract, although 'last year's average bonus', or 'X months in principle', may be in an advertisement for the position, or may be mentioned in the job application interview. The number of months paid is also not mentioned in the Rules of Employ-

ment (ROE). Some foreign-capitalized firms, and perhaps your firm, may be an exception to this, because expatriate bosses were not plugged-in, and Japanese employees may have preferred to have nothing at risk. Nowadays we often hear about *nenposei*, or annual pay, with no 'old-fashioned' summer and winter bonus. Japanese job applicants may understandably prefer it. Annualized income figures are in the employment contracts of most foreign-capitalized firms. And when we put on our head-hunting hats, yes, it is important to have it to attract, reassure candidates. However, your contract language can be subtly worded such that you could still have flexibility and a performance pay basis. (See next question)

2. Do Japanese and most foreign companies have a performance range or variable payment of summer and winter bonus by both company results and individual evaluation?

It is true, although about 25 percent of foreign firms essentially fix the number of months bonus in the offer letters, and about 5 percent go as far as making the unusual and unnecessary commitment of stipulating in their ROE that X number of months will be paid. Then at about 15 percent of foreign firms they may not do either of the above, but in reality, have been consistently paying a uniform number of months of bonus in practice. Although conservative legal interpretations would say this sets up a *kanko*, or 'custom' as in Anglo-Saxon law, breaking from a custom or even a written practice is not impossible given the proper implementation. Over the years I have heard a number

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FROM THE EDITORS

US AAA DOWNGRADE MEANS MORE INFLOWS TO JAPAN

With many new subscribers coming to us over the past year, we take time to reiterate our mission.

SSJ is one of a very, very few remaining independent business information services focused exclusively on Japan, published in English, and consumed by a worldwide readership of senior executives. With Japan continuing to be ignored by corporations and investors who don't generally understand or appreciate the immense opportunities that exist here for those who enjoy taking 'the road less traveled', our mission is to highlight just those Japan-related business opportunities for you — our subscribers — so that you can benefit from being among the relatively few who know about them.

We also like to give full voice to the view that Japan remains an enormous 'emerging' market. Its wealth, its vast technology, its very stable business environment, continue to be relatively unappreciated even by its own citizenry.

We have long felt the Western business model to be ineffective in Asia, particularly in Japan. The past few years validates our view.

Now more than ever, as we state in our house ad on the last page of this publication each issue, Japan represents "the single largest profit opportunity most companies will encounter during the next decade." We are more confident in this view now than when we started iterating it almost a decade ago.

As for us, although we do not have unlimited resources, we do have Ivy League affiliations; proprietary databases of executives and companies; and many very well-placed company sources.

Yet we continue to rely on you to share with us your Japan stories, insights, news scoops, and viewpoints. And to ignore those who snicker at us all because they still don't understand the opportunities.

The Most Common Questions Answered

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of expat bosses say (even if the commitment wasn't in writing), 'since we pay uniformly, anyway, why not put the bonus into annual income, and just divide by 12?' An understandable reaction, but instead I try and swing them in the other direction of taking advantage of one thing that is helpful when it comes to managing personnel issues, or de-hiring, or getting staff to quit. With the typical Japanese-style summer and winter 'bonus' being 5 or 6 months worth of monthly pay (IBM traditionally paid 8 months), and when you can say 'don't expect much, or even any bonus', you have a powerful tool at your disposal. Any Japanese Labor Standards Office (LSO), or court of law will allow that 'bonus' is up for grabs. This means the proper application of Japanese pay practices, at least to handle exceptional problem people, places 30 to 40 percent of pay at performance risk.

3. Is it legally not possible to reduce a person's pay level in Japan, unless the person agrees, and even if the person is assigned to a different job?

This is definitely not true, although most attorneys and professionals say it is. They go on and say, 'that would make labor management too easy!' Well, that's my job, and I don't make any money when cases go to court. In fact, I often lose money. If I believed the above statement was true, I would not have been much help to my clients over the last 30 years. I would also not have been able to bring value-added over the other advice, or advisers, in the market. In this country, where it is so hard to terminate people at a reasonable cost should they decide to contest the termination, I cannot overstate how critical this issue is. So much of my

books, my life and my work pivot in a fundamental way around this issue. Here I will only make a few statements. I have never gone to the LSO with a client, and not had these key government authorities agree that it was all right for us to reduce pay as long as we were above the level of the minimum wage (varies by prefecture. Tokyo is highest at 821 yen per hour, and Okinawa and Miyazaki lowest at 629 yen per hour as of May, 2011). For those who would say 'ah, but it's different if it goes to court'. Yes, these are gray zones, but in order to get a greedy employee who wants a huge severance package to become more reasonable, we have never had a judge not say, 'how about continuing to work there but at that lower pay level they are offering?' And once, at each succeeding court session we got permission from the judge in advance to move a man who had been making 16 million yen per year, down to 150,000 yen per month. The judge also agreed we wouldn't have to pay bonus, so for quite a few months until the severance demand came down we had this person at only a 1.8 million yen annualized rate. Of course it helps if you have the right language in your employment contracts, ROE, and the right salary system. Those are some of the things we work on when we say we give clients a stronger foundation. At the macro level, Japanese industry has always done more with pay-cut cost savings and rationalizations than we are accustomed to in the West, and many other countries.

4. Is it legally required to pay commutation allowance at actual cost up to the maximum tax deductible limit?

It's false. People get confused because almost everyone pays it. The practice, really, as silly as it

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is (and probably illegal in most other countries), is so predominant that any kind of a major or normal (not TMT!) employer is stuck with paying this one. Up until April 1, 1989, it was only 26,500 yen. This we could live with. It had only very gradually gone up over tens of years. Then overnight this maximum tax-deductible amount almost doubled to 50,000 yen, then 60,000, 75,000, and as of this writing (May, 2011) it is 100,000 yen, or about \$1,000 per month. Most of us were/are sitting here with ROE saying we will pay at cost up to the maximum amount determined by the tax agency as non-taxable income to the employee. So someone can live very far away, in a nice piece of purchased real estate, or be able to pay a lower outlying area rent level, be tired because of his/her long commute, use that as an excuse to kick-off early, and it can cost the employer a fortune up to this 100,000 yen per month. In addition to it being an increasing cost, that some bureaucrat who bought a place far away stuck us with, it is a fairness issue among employees. A number of companies and many clients who have passed through TMT have created a reasonable cap that covers 90 percent of the employees. You could automatically have it increase by 1 or 2 percent per year.

5. Will the Labor Standards Office (LSO) allow you to reduce a person's pay as long as you are above the level of the minimum wage?

I already answered this in #3 above. This one is so clear-cut, such a no-brainer, slam-dunk, that it is amazing so many in the know say that you cannot reduce someone's pay unless they agree. It would be nice if they would agree. But you're asking for your

cake, and wanting to eat it too, if you ask someone to sign an agreement to a pay-reduction. What if they don't sign? Rather than implementing and slipping the pay-reduction through, you have placed an unnecessary boulder on the path. I do need to say that people have a tendency to go to the LSO, or Labor Relations Commission (LRC) and come back with the answer or result they want. One can ask questions as one wants, and accept answers that don't need to be accepted. In the same sense we could say that when I represent my client's interests, and we have such a challenge before us, when I am the one at the counter of the LSO, or at the table of the LRC, I always come back with the answers and results that we aim for. Of course, as always, the civil proceeding in court is not as clear-cut. However, if you know how to handle it, there is no way that a *karishobun* or temporary restraining order (TRO) would stop you from unilaterally implementing the pay-cut. In the few times when our work has led to making-pay-whole-type lawsuits, a TRO to restore pay level has never been ordered. Instead you enter the murky waters of the Japanese court system and inefficient legal process. And that is pretty much equally satisfying or unsatisfying for both the employer and employee.

6. When greatly reducing someone's pay, it is safer, fairer, and tactically smart to indicate a small extra severance package might be available if the person wants to take that route?

I don't like to reduce people's pay. None of us do. It is definitely a bummer. It should only be done out of overwhelming ne-

cessity, when there are very good reasons including internal inequities, and usually only for exceptional situations to handle a troublesome employee, or someone you know won't be reasonable about accepting a reasonable severance package. So, I guess we are 'greatly reducing someone's pay' for such a reason. Obviously, if he is an overpaid non-contributor, or troublesome person, what you really want is for the person to leave your employ. But because termination is not the only tool in our pocket (incidentally, firing is the only direction most attorneys will recommend), the severance package can be modest. This is because you have to pay through the nose for the luxury of termination in this country. We are also offering the severance package so that we don't actually have to implement the pay-cut. This way there is no risk of being in court on pay-cut litigation, although you would still be in a much better/stronger position than being in court with termination litigation. I will get a call from a client who has had termination litigation going on for 2 or 3 years, and I will end it within about a week, by inviting the plaintiff to return to work with a deep pay-cut. The judge then can jawbone the plaintiff to take a reasonable severance package. When your intention is to have a good-enough person stay with you but at the lower salary, sincerely tell him that, but you still will have a sounder legal foundation if you at least offered 'consideration' in return for the pay reduction. The severance package option helps you out by serving as that consideration.

Thomas J. Nevins is founder and chief consultant at Tokyo-based TMT and Glasford International Japan (www.tmt-aba.com). His views are his own.