



Changing Relationship between a Company and an Individual due to the Crisis

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Much attention has been paid to how the external shock of the COVID-19 pandemic is affecting the relationship between companies and workers. The aging of Japan's traditional employment system has long been an issue, but even before the Corona crisis, large companies had been working on reforming their personnel systems along with their work styles reform efforts. One example of such attempts is the introduction of "job-based" employment by Hitachi, Ltd.¹ Some believe that the COVID-19 crisis will accelerate the trend. In this article I summarize what has changed due to the crises and explore for what changes are likely in the future.



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Seniority and late promotion have been cited as problems with the Japanese conventional employment model. These two features were the key pillars of the typical relational contract for "regular" employees in Japan. The economic rationale for the seniority system was elucidated in a paper by Prof. Edward Lazear of Stanford University who viewed it as a form of deferred payment. Workers accept wages below their productivity while still young, and receive wages exceeding their productivity beginning in their later-middle age. By increasing the cost for separation from employment, it has been possible to raise employees' motivation to continue working and obtain skills specific to the company and promote labor-management cooperation that ensures the company's survival. To reinforce this incentive effect, complementary practices including employment security, promotion from within, and late promotion were adopted.

However, the benefits of the seniority system have decreased significantly due to the increasing labor cost owing to aging workforce, decreasing returns to firm-specific skills, difficulties in guaranteeing employment as a result of intensifying global competition, more recruitment of mid-career workers, and inconsistency with personnel practices of overseas subsidiaries. Many companies have been endeavoring to flatten the seniority wage curve and shift from the job skill-based pay system to the pay system based on job evaluation or performance, thereby diminishing the features of the seniority system. Nevertheless, seniority-based promotion still remains. The slow promotion cycle unique to Japan has been pointed out as a cause of the lack of leaders and female managers.

Unplanned transition to working from home that had been adopted due to the COVID-19 crisis has further revealed problems with Japan's conventional employment model. Middle-aged workers who are

¹ "Job-based" employment refers to a form of employment common in Europe and the U.S. in which job duties are clearly defined in a contract or description, and is used as a comparison to "membership-based" employment, in which job demarcations are vague and assignments are left to the employer, which is common in Japan.

unfamiliar with the ICT tools that allow for teleworking, tend to lose motivation and their productivity declines. The gap between wages and productivity may have further expanded for workers in this age group. Additionally, managerial personnel, who have traditionally prioritized face-to-face communications, may have difficulties in offering support to their subordinates, and this may also cause a loss of productivity in the organization as a whole.

I conducted a survey on working from home together with Ms. Kuroda Sachiko, professor at Waseda University, and Ms. Okudaira Hiroko, associate professor at Doshisha University. We compared productivity losses by age group before and after the issuance of the declaration of a state of emergency for all the workers from two manufacturing companies, and found that within the workers who worked from home three days or more per week, productivity losses were observed for all workers in their 30s or older compared with their 20s, but especially in their 50s (see the Figure).

Figure: Influence of Working from Home on Productivity



Meanwhile, many companies learned lessons and gained a new awareness from the COVID-19 crisis. Firstly, the introduction of ICT tools progressed rapidly and workstyle reform is being accelerated through the adoption of online communications and the simplification of paperwork. It is expected that the enhancement of the efficiency in operating procedures, automation, and reduced travel time will lead to productivity improvements.

Secondly, many workers are becoming aware of the advantages of working from home. According to the analysis of the aforementioned survey, the increased concentration while working from home improved the

productivity of respondents. Until the COVID-19 crisis began, teleworking was mostly considered as a system that allowed for managing the responsibilities of childcare and nursing care while working, but if teleworking continues into the future, an increasing number of workers will choose to work from home one or two days per week, which preceding studies in western countries have shown that many people find most appropriate.

Thirdly, the new emphasis on ICT-based business operations has greatly increased the recognition of the necessity for increased investment in human capital. Due to the expansion of working from home, the importance of the communication and coordination skills and IT literacy that are required of managerial personnel has further increased. Companies need to provide opportunities for all employees to improve their ICT skills, including those middle-aged and older, especially considering that an increasing number of employees are working until the age of 65. It is also important to raise younger employees' career consciousness and encourage them to acquire specialized knowledge in the face of a shift to "job-based" employment.



With these issues in mind, what employment model should be newly created in the post-COVID-19 era?

Firstly, if reward systems were transformed to resemble the theory in an economics textbook, i.e., a system that balanced wages with productivity, it would become easier to extend the "relational" contracts that are currently limited to "regular workers" to other employee classes. As the principle of equal pay for equal work becomes widely accepted, "relational contracts" targeting broader categories of workers covering various workstyles will appear. The status as a "regular worker" has long had a special meaning beyond the simple contractual status of being employed full-time for an indefinite term, but the implications of rights and obligations expected for regular workers may weaken in the future.

Secondly, employment security will remain a principal pillar of the employment system in Japan, because changing relational contracts would be impossible without trust in any case. However, as business restructuring is expected to accelerate further, there may be increasing cases where companies cannot fully utilize their employees' abilities internally, and companies' efforts may be limited to ensuring the maintenance of employment in a broader sense, for example by transferring employees or having them employed by another company. In order to avoid litigation risk and subsequent decreases in workers' incomes after being transferred, rules for monetary compensation for dismissal should be developed with the initiative of the national government.

Japanese companies have obtained advantages based on horizontal cooperation and transfer of knowledge supported by employees' acquisition of firm-specific human capital under commitment to ensuring long-term employment. The advantages will continue to be a source of competitiveness for Japanese companies.

Thirdly, from the perspective of prioritizing employees' career development, job assignments will shift from the traditional method of company-wide personnel assignments led by the HR department to more decentralized ones.

I've found that there are two approaches being taken. One is an attempt to expand transfers that respect the free will of individuals by actively using the job-posting system. As it can be used in conjunction with mid-career recruitment, this option is expected to be used by companies with high demand for external

hiring. The other is that managers who understand the career aspirations of their subordinates should be more involved in the transfer. There is a possibility that a new staffing method that employs matching algorithms based on reports from the individuals and their supervisors may be developed.

Lastly, a company that has abolished the seniority system and slow promotion and where employees are able to decide their own career path represents a more competitive environment under which employees are required to be independent agents. Two areas of concern here are the impact on employees' mental health and the risk of falling into an organization that lack open culture and information flows. The increase of employees working from home discussed above will also heighten these risks.

One of the solutions is a stronger company commitment to maintaining employee health. Japanese companies have a large amount of information on their employees' health conditions and history from annual medical checkups and stress check diagnoses and are therefore able to make more effective investment in health. Also, from the perspective of hiring difficulties and ESG (environmental, social, and governance) investment, more companies will work to improve employee utility through investment in health management. Another solution is to develop managers who can effectively support their subordinates by providing managers with training in coaching career development.

Under a new employment model, the roles of the human resources department also need to be changed. Most of the authority of the department, including the one to decide recruitment and assignment, should be transferred to business unit managers, while the human resource department should serve as a business partner for top management, assisting their decision making based on specialized knowledge and through data analysis. Companies and individuals will continuously seek better mechanisms for pursuing and allocating economic rents arising from long-term employment relationships, while standing on equal ground, rather than being bound by unilateral contracts centered on seniority.

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*RIETI: <http://www.rieti.go.jp/en/index.html>

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