

Employers' money and Employees' money



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What is the objective of the firm?

- ▶ Generally, industrial relations in Japan were understood as ‘trust-based’, ‘community-like’ relationship.
- ▶ It is often said that many large Japanese firms are not managed to maximize shareholders’ wealth.
- ▶ Instead, they emphasize on the interests of other stakeholders, such as employees and group companies.
- ▶ Most directors are promoted employees.
 - ▶ Employees work hard to be promoted to higher position.
 - ▶ It is often the case that top managers are ex-union leaders.

Questionnaire Survey for managers: Objective of the firm

- ▶ Under which of the following assumptions is a large company in your country managed ? (Yoshimori, 1995)
- ▶ 1. Shareholder interest should be given the first priority
- ▶ 2. A firm exists for the interest of all stakeholders
- ▶ Shareholder interest is emphasized in the U.S. and in the U.K. , while interest of stakeholder is emphasized in Japan. France and Germany comes between.

	Stakeholder	Shareholder
UK	29.5%	70.5%
France	78%	22%
Germany	82%	17.3%
U.S.	24.4%	75.6%
Japan	97.1%	2.9%



Questionnaire survey: Lay off or dividend

- ▶ Question: Suppose a CEO must choose either to reduce dividends of to lay off a number of employees. In your country which of these alternatives would be chosen? (Yoshimori, 1995)
- ▶ Managers in the U.S. and the U.K. prefers to lay off employees to keep dividend.
- ▶ Managers in Japan are tend to choose to cut dividend to keep jobs.
- ▶ France and Germany comes between.

	To keep Jobs	To Keep Dividend
UK	10.7%	89.3%
France	60.4%	39.6%
Germany	59.1%	40.9%
U.S.	10.8%	89.2%
Japan	97.1%	2.9%



Executive compensation in Japan and the U.S.

- ▶ There are two main difference in executive compensation in Japan and the U.S. ; level of pay and pay-performance sensitivity (PPS)
- ▶ Typically, executive compensation in Japan is much lower.
- ▶ The relationship between pay and performance is much lower in Japan.



Level of Executive Pay in Japan and the U.S.

- ▶ It is well known that executive pay in the U.S. is large.
 - ▶ CEO of S&P 500 receives typically 3.7million USD in 1993 while they receive on average 14.29 million USD in 2003
 - ▶ Proportion of executive compensation to listed company's profit is more than 10% between 2000 – 2002
- ▶ Typically, executive compensation in Japan is much lower.
 - ▶ In 2005, chairman of Toyota receives 1.3 million USD and President of Cannon receives 1.2 Million USD.
 - ▶ These figures are much lower than those of GM or Xerox Corp.
 - ▶ In 2007, CEO of General Motors receive 14.415 million and CEO of Xerox receive 13.459 Million USD
- ▶ In other words, pay gap between top manager and employee is much smaller in Japan.

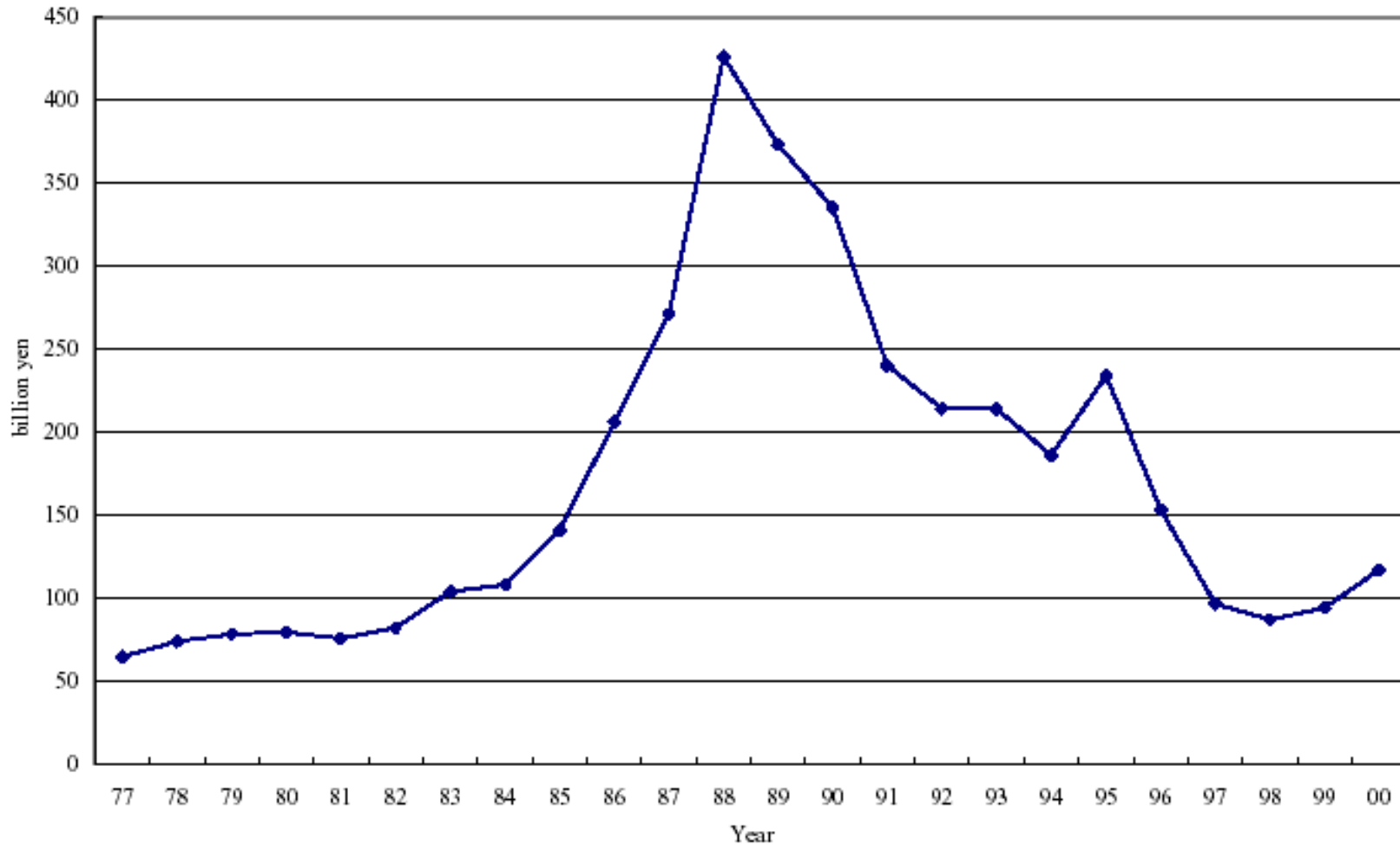


Pay-performance sensitivity

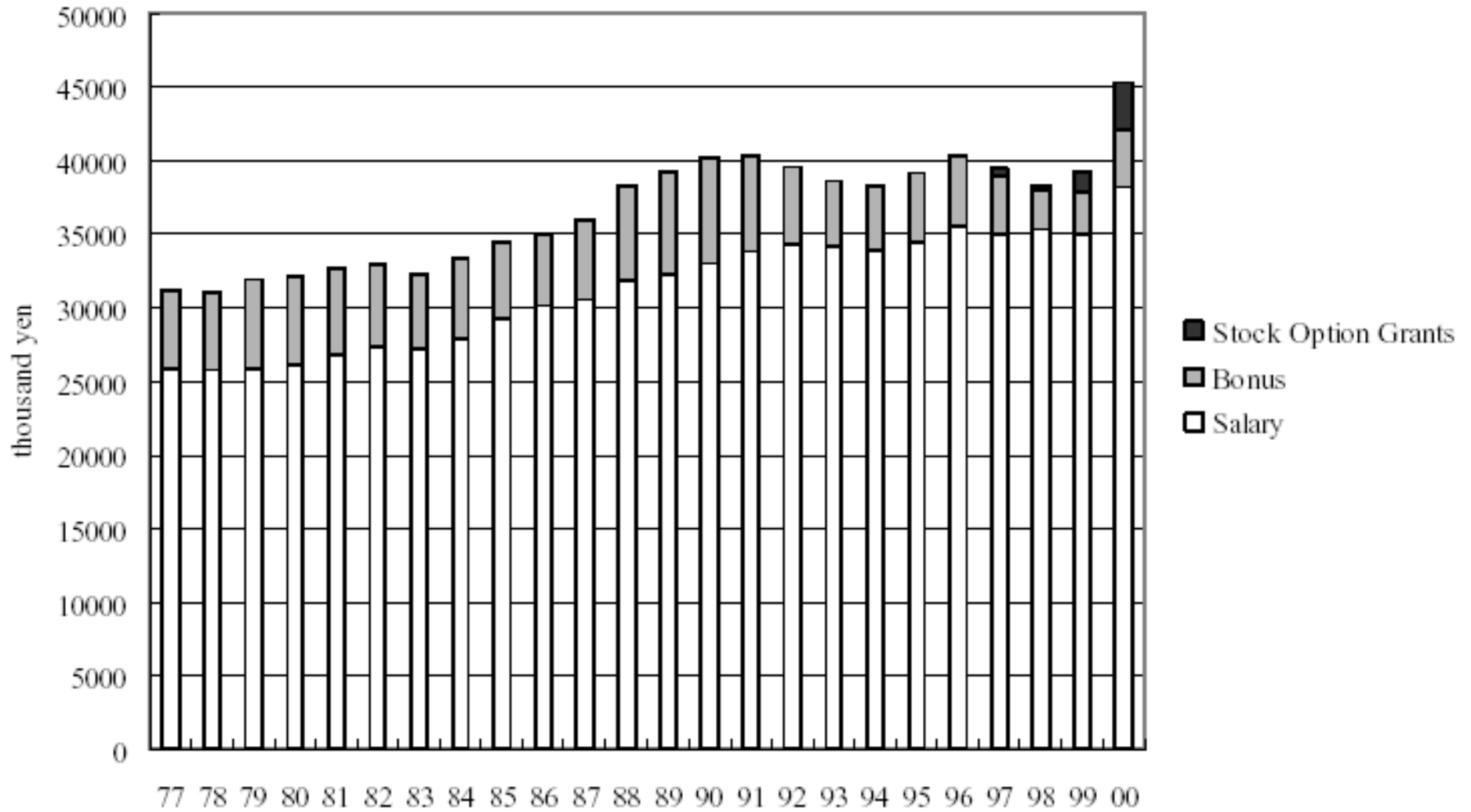
- ▶ If the relationship between CEOs pay and firm performance is large, they have incentives to maximize it.
- ▶ From the viewpoint of CEO's incentive, it is pay-performance sensitivity (PPS), not the level of pay.
- ▶ Do CEOs in Japan and the U.S. have incentive to firm performance? (Hall and Liebman, 1998, Kubo and Saito, 2008)



Firm Share Value in Japan: 77-2000



Presidents' Pay in Japan 77 - 2000



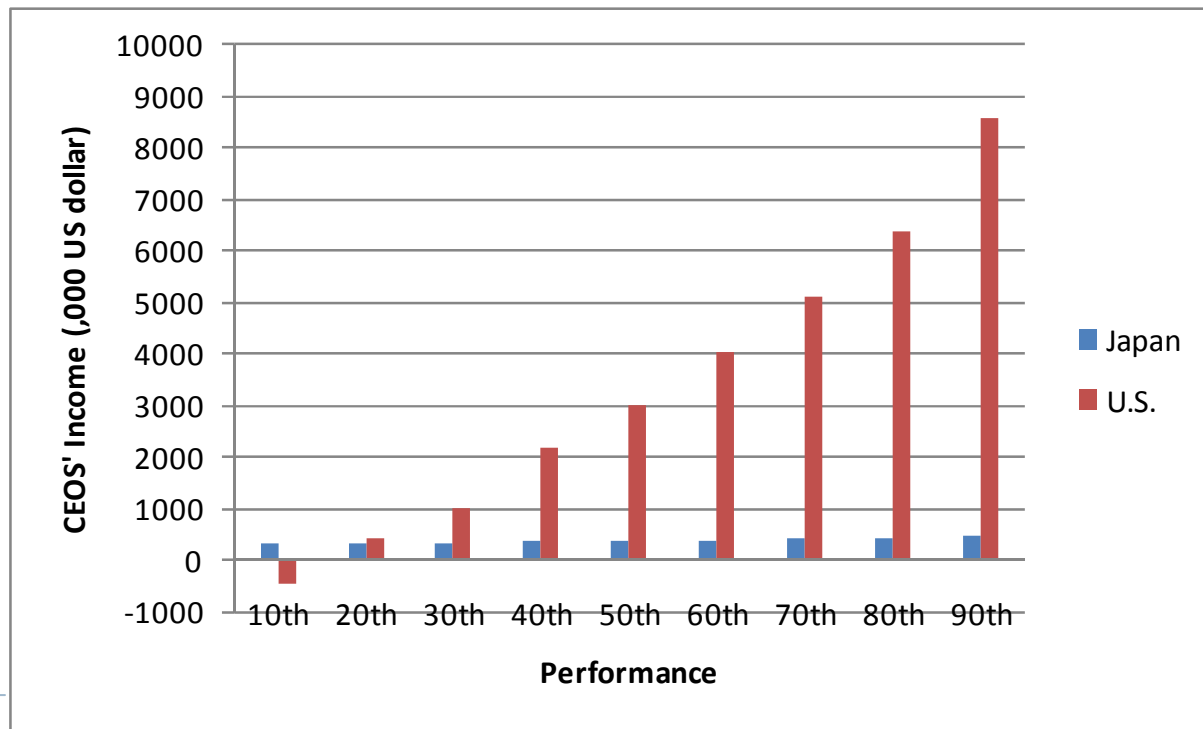
Pay-performance sensitivity in Japan and the U.S.

- ▶ Presidents in Japan have very small incentive to maximize shareholders' value.

	Japan	US
Amount for median (50 percentile) performance	372.6 thousand USD	3.026 million
Amount for good (70 percentile) performance	413.1 thousand USD	5.111 million
Amount CEO gets when firm performance improves from 50 percentile to 70	26.17 thousand	1.823 million
Source	Kubo and Saito 2008	Hall and Liebman 1998

Pay-performance sensitivity in Japan and the U.S.

- ▶ Relationship between pay and performance is much higher in the U.S. than Japan (Hall and Liebman, 1998, Kubo and Saito, 2008)



Pay-performance sensitivity in Japan and the U.S.

- ▶ In the U.S., CEO receives typically receive \$1.823m when they improves the firm performance from median to 70 percentile, in 1994.
- ▶ In Japan, president typically receive \$ 265.2 thousand for similar performance improvement in 2,000.
- ▶ Presidents in Japan have very small incentive to maximize shareholders' value.
- ▶ What is advantages and disadvantages of these two mechanisms?



What is optimal remuneration for managers and employees?

- ▶ Level of pay should reflect the contribution to the firm.
- ▶ It should provide them incentives to acquire more skills / to raise productivity.
 - ▶ It helps firms to be competitive in the product market and therefore to keep jobs and to raise their salaries.



Problems in pay practices in the U.S. and in Japan

- ▶ Compensation policy, in particular for top executives have problems in both countries.
- ▶ Pay gap between top manager and employee should reflect the difference in their contribution.
- ▶ It is difficult to justify large pay gap in the U.S.
- ▶ There is little scientific evidence on the relative importance of top manager and employee.
- ▶ On average, pay-performance sensitivity is larger in the U.S. However, there are many firms where there is no relationship, in particular in banking sector.



Bankers' pay in the U.S.

- ▶ CEOs receive large amount of money even when they achieve bad performance.

	Total compensation (thousand dollar)	Stock return
Bank of America Corporation	20,404	-19%
American International Group, Inc.(AIG)	13,930	-18%
Goldman Sachs Group, Inc. (The)	53,965	17%
Morgan Stanley	41,399	-15%
Lehman Brothers Holdings	22,030	-14%
Merrill Lynch	83,092	-42%



Many problems in executive pay in the U.S.

- ▶ Little relationship between pay and performance
- ▶ Conflict of interest of compensation consultant
- ▶ Many accounting scandals
- ▶ CEOs take excessive risk because pay reflect short term profit.



Problems in executive pay in Japan

- ▶ At the same time, it is difficult to justify low pay-performance sensitivity in Japan.
- ▶ CEOs may not work hard to improve firm performance.
- ▶ Performance of U.S. firms is better than that of Japanese firms.



Summary and Future Challenges

- ▶ CEOs in the U.S. have strong financial incentive to maximize shareholders' value.
- ▶ Inequality between top manager and employee is much smaller in Japan.
- ▶ There are many problems in executive compensation practices in the U.S.
- ▶ However, Japan's practice on executive pay, which is different from the U.S. cannot be a new model.
- ▶ More scientific evidence should be done on the contribution of employee and managers.

