ABSTRACT

I explore the missing links between globalization and greater flexibility in the Japanese labor market based on review of literature and available evidence. Understanding Japan’s responses to globalization requires a nuanced approach, which accounts for its historical trajectory and social-institutional context.

Along with globalization, Japan is experiencing a greater infusion of foreign capital, and an increasing presence of foreign firms. These foreign firms bring human resource practices that are more market-driven and less socially embedded compared to the status quo. The diverging HR practices of foreign firms have spillover effects which may destabilize the Japanese employment system in the long-run.

KEYWORDS: globalization, foreign direct investment, foreign-owned firms, human capital, labor market flexibility
INTRODUCTION

Globalization facilitates the free flow of capital, goods and services across nations. Citizens benefit from improved access to a wider variety of goods and services, lower prices, and an overall higher standard of living (International Monetary Fund, 2008). International trade allows business to expand their markets and customer base. Foreign direct investment adds to the country’s stock of capital, technology, and human capital base.

At the same time, globalization pressures countries to open up their markets, and to lower their barriers to stimulate trade and capital flows. Removal of structural impediments exposes domestic markets to increased competition from foreign multinationals. Countries must therefore seek a balance to protect its core domestic assets, whilst at the same time open up its borders so that they will not miss out on the benefits and opportunities of globalization.

The drive towards market liberalization invariably pushes employment systems towards greater flexibility for the firms and less job security for the workers. Businesses must cater to the fickle and unpredictable demands of the global market to gain competitive advantage. Responding to fluctuations in labor demand requires short-term adjustments in labor supply.

However, studies that simply connect the dots between globalization and labor market flexibility overlook the specific mechanisms that link macro-level phenomenon to micro-level behavior. How does globalization affect the behavior of firms and their workers? Why is the labor market moving towards greater flexibility?

This paper explores the missing links between globalization and declining job security in the Japanese labor market based on review of literature and available evidence. I apply the social mechanism approach, and aim for an explanation of the middle-range. I focus particularly
on the transformational mechanisms (Hedstrom & Swedberg, 1998) which link the behavior of individuals and firms (at the micro-level) to labor market flexibility at the macro-level.

The effects of globalization are not uniform across countries, and not all countries respond to globalization in the same way. Rather, countries develop solutions that are specific to their needs and available resources (Sassen, 1996). The institutional environments surrounding firms vary largely across nations. Firms develop distinct strategies to respond to globalization, which enables them to “capitalize on the institutions available for market or non-market coordination in the economy” (Hall & Soskice, 2001, p.56).

I argue that the behavior of firms and individuals are embedded in a broader social-cultural framework (Granovetter, 1985). The experiences of advanced Western nations do not necessarily set a precedent nor an exemplar for Japan. Understanding Japan’s responses to globalization requires a nuanced approach, which accounts for its historical trajectories and social-institutional context.

BACKGROUND

Globalization and the erosion of job security

It is now widely accepted that the economic integration of nations is tighter, and world markets are more interdependent now than they have been in the past (Jacoby, 2005). At the macro-level, globalization unleashes competitive forces that drive markets towards liberal, western-style capitalism (Mittelman, 1996), and employment systems to become more flexible and responsive to business-cycle fluctuations. Market liberalization forces public and private sectors to remove labor market rigidities to facilitate the unobstructed mobility of capital and labor (Brand, 2007).
Around the world, there is growing evidence that job security is eroding (International Labour Office, 2004). There is an increasing separation between the standard versus the nonstandard workforce. The core labor force is shrinking and the periphery is expanding, a phenomenon that is observed in nearly all of the OECD member states.\(^2\) In a move that signals the declining social contract and erosion of job protection (e.g. Kalleberg, 2009; Powell 2001) trade unions and collective bargaining have declined among the OECD countries since the 1970s (Brand, 2007; Katz & Darbishire, 2000; OECD, 2004). These and other global transformations point unilaterally towards an employment model characterized by declining job security.

There is greater disagreement regarding the consequences of globalization at the institutional level. One of the key controversies is the so-called convergence-divergence debate. Convergence scholars contend that business practices converge to a global norm (Pudelko et al., 2006). The pursuit of “best practice” in management is largely independent of national cultures. Divergence scholars, on the other hand, emphasize that management practices are deeply embedded in their respective national and institutional context, and remain skeptical to the cross-national convergence of management processes (Pudelko et al., 2006).

Indeed, Katz & Darbishire (2000)’s study of employment systems around the world document evidence in both directions, an outcome they refer to as “converging divergences.” They find persistent commonalities in workplace practices and labor-management relations, but at the same time, find increasing variation in employment systems within countries. The existing literature on globalization and its effects on labor markets thus underscores the important role of national cultures, social institutions, and historical trajectories.

Studies that are specific to the Japanese context forecast scenarios akin to long-term, macro-level transformations towards greater market flexibility. Murakami & Rohlen (1992)
foresee that the implicit, social exchange aspects of Japanese organizations will be eventually replaced by a more explicit model of economic exchange. Jacoby (2005) explains that the Japanese employment system is headed in the direction of greater market orientation. Westney (2001) predicts a similar transformation:

Japan’s business system is faced with one coherent and systematic model for change: the move to United States-style shareholder capitalism. The increasingly global business press, the international consulting firms, the business schools, the leading international financial services firms and investment banks all share a general model of the business system of the future: based in highly flexible labor markets with high inter-firm mobility; … with high-performing individuals rewarded handsomely for their contributions -- but only as long as they are performing at an exceptional level; with individuals responsible for their own careers and their own welfare. It is a model that makes many Japanese (and many Americans…) uneasy. (p.139)

**Framework – The macro-micro link**

What are the global forces that drive employment systems towards greater flexibility? Mills et al., (2008) outline four main macro-level factors: Internationalization of markets and decline of national borders, intensification of competition, diffusion of new information communication technologies, and rise in the importance of markets.

As I illustrate in the so-called Coleman boat diagram (Coleman, 1990) in Figure 1, if these global forces \( X_1 \) were the explanans in a statistical model with labor market flexibility
(\(X_2\)) as the explanandum, then the model will point to a positive correlation. However, with respect to its underlying mechanisms, this strictly macro-level statistical association is woefully inadequate. A mechanism is an intermediate between universal laws and descriptive narratives (Elster, 1998). The shrinking core/ expanding periphery and the erosion of the social contract both indicate a directional shift towards flexible employment but the extent to which it is linked to (or caused by) globalization is far from clear. As Boudon (1976, cited in Hedström & Swedberg, 1998) explains: “We must go beyond the statistical relationships to explore the generative mechanism responsible for them.” Hence the critical questions remain unresolved: How do these macro-level forces affect micro-level institutions? And, from the viewpoint of transformational mechanisms, how do changes at the micro-level lead to greater flexibility at the macro-level? We explore these questions with particular focus on the low-mobility context of the Japanese labor market.

**FIGURE 1 ABOUT HERE**

**LABOR MARKET FLEXIBILITY IN JAPAN**

In Japan, the labor market functions under norms and institutions that value loyalty and trust. There is an implicit understanding between workers and employers that their relationship will be long-lasting, and that benefits over the long-run will override short-term interests (Ono & Rebick, 2003). The system exemplifies what Dore (2000) and others have termed “welfare capitalism”: Corporations are managed less for the sake of shareholders, but more in the interest of protecting the welfare of their core stakeholders, namely their employees. Workers in turn are expected to reciprocate through loyalty and service to the firm. Workers who breach this
implicit contract and switch jobs are stigmatized as “social defects,” and are penalized for their actions through lower pay and reduced career opportunities (Ono, 2007; Peltokorpi, 2013).

The Japanese employment system is best understood as a cluster of interdependent and complementary institutions (Aoki, 1992). At its core is the internal labor market setup which features extensive training, seniority wages, internal promotion, job rotation, and job security, among others. These parts “fit together in fortuitous ways that are difficult to replicate piecemeal” (Jacoby, 2005, p.15). They are complementary to one another to the extent that, “the marginal returns from using one practice increase with the usage of another practice” (Moriguchi & Ono, 2006). The cluster of these interdependent human resources (HR) practices constitutes a self-enforcing equilibrium, an outcome of which is an employment model, characterized by low mobility and high trust between workers and employers. If any of the parts is removed or altered, the equilibrium is disturbed and the model becomes unstable.

The resilience and stability of the Japanese employment system have been studied extensively and monitored with great attention. Recent empirical work in this area has documented that the lifetime employment system is indeed weakening (e.g. Kawaguchi & Ueno, 2013), although this conclusion depends largely on how it is measured (Ono, 2010). The demise of lifetime employment in Japan indicates an erosion of the implicit contract between workers and employers.

Lifetime employment has never been short of criticism, and the recent debate over declining job security in Japan is hardly new.³ It is easy to criticize and to point out the weaknesses of lifetime employment. The system is simply too rigid. The implicit guarantee of job security makes it hard for employers to dismiss their workers. Firms are forced to absorb excess labor even when demand slackens. Lifetime employment is a structural impediment to
the optimal allocation of labor (Ono & Rebick, 2003). Fluidity is a drive towards greater efficiency.

How much of the erosion in the lifetime employment system is attributable to globalization? This is where the explanations become less convincing. Here again, we have two macro-level phenomena – globalization and declining job security in the Japanese labor market – that are presumably linked, but we know less about how and why. From the mechanism perspective, what is critically missing is the macro-micro connection. This paper focuses on a path that is more clearly visible: The impact of foreign direct investment on labor market flexibility in Japan. I argue that Japan’s response to globalization must be considered in light of its historical trajectories and institutional context.

**Historical context**

Japan has historically maintained an isolationist position in international commerce. From the early 1600s to the mid-1800s, Japan was completely closed off from the outside world (Kazui, 1982). International trade was virtually nonexistent. During this period of complete isolation, foreigners were forbidden to enter the country, and the Japanese were forbidden to leave under penalty of death. A limited number of Portuguese and Dutch traders were allowed into the country, “but (they) were closely confined, and the general populace had almost no contact with them” (Henderson, 1973, p.10).

This self-imposed isolation was achieved for two main reasons. First, Japan was flush with natural resources, and there was a strong nationalist sentiment that Japan was adequately self-reliant, without the need for international trade. And second, there was growing concern that the increasing influence of Western ideals and religious doctrine will undermine their
harmony and homogeneity. Indeed the foreigners, who remained almost entirely out of view, were perceived as “barbarians” who threatened the purity of the Japanese culture. The Shogunate aimed to purge these Western influences and to preserve the Japanese cultural heritage. Approximately fifty years into the self-imposed isolation, Alexander Hamilton (quoted in Goodman, 1990) observed as follows:

No Japanese dares leave his Country, and if he does, he must never return. They are so wedded to their own Customs and Opinions, and so jealous of having new or foreign Customs introduced, that they will not send Embassies to other Kings or States, or suffer their Merchants to have Commerce out of their own Dominions.

In 1853, Commodore Perry and his black ships arrived in Tokyo Bay, and demanded the inauguration of trade relations with the United States (Reischauer, 1981). He effectively forced Japan to open up its ports to U.S. trade, thereby ending the isolationist rule which had shielded Japan from outside influences for over 200 years.

Opening up the country had immediate benefits as Japan was eager to learn from the West. Indeed, as Westney (1987) and others have documented, Japan experienced one of the most remarkable social transformations in modern history as they adopted a wide range of institutions and management knowhow from the advanced Western nations.

Globalization and foreign direct investment
The volume of international trade expanded in the postwar period, and the Japanese economy flourished as they became a major trade surplus country. However, in spite of its outward expansion, Japan continued in relative isolation with respect to inward foreign direct investment (FDI).

The authorities of the American Occupation imposed major restrictions on inward FDI because they feared that it would impede the postwar reconstruction, and because it may allow foreign companies to exploit Japanese corporations that had been devastated by the war (Paprzycki & Fukao, 2008). Foreign equity of Japanese companies was limited to less than 50 percent (Henderson, 1973). Moreover, foreign firms were allowed to purchase stocks of Japanese companies, but were not allowed to participate in management.

As Japan entered the ranks of the developed economies in the 1970s, its insular position in the world economy was met with hostility from the international business community: “if (the Japanese) are to participate in global economy, Japan must surely in fact liberalize (Henderson 1973, p.34). The government was criticized for taking advantage of the postwar reconstruction measures which were only intended to be temporary (Paprzycki & Fukao, 2008). This protectionism reflected in part, a culturalist if not a nationalist ideology that Western influences would undermine the harmony and strengths of Japanese society. While the government responded by removing many of the formal barriers and restrictions to trade and investments throughout the 1970s and 1980s, other structural impediments remained in place. Even today, Japan remains relatively closed to inward foreign direct investment (FDI), at least in comparison to the major developed countries. According to 2005 statistics cited in Paprzycki & Fukao (2008), the ratio of the stock of inward FDI as percentage of GDP measured only 2.2 percent in
Japan compared to between 18 and 37.1 percent in Germany, France, and the U.K., and 13 percent in the U.S.4

Attitudes towards inward FDI began to change in the 1990s as Japan experienced a prolonged period of economic stagnation. The Japanese model of stakeholder capitalism, widely accredited for achieving the postwar economic miracle, was turned on its head and became the center of attention for why the country failed (e.g. Jacoby, 2005; Westney, 2001). The economic malaise exposed “deep-rooted structural problems that provided the impetus for further deregulation of both FDI and domestic business more generally” (Paprzycki & Fukao, 2008, p.45). The structural rigidity of the Japanese employment system came to be viewed as a source of “organizational deadweight” (Numagami et al., 2010). Its inability to adjust rapidly to market forces was viewed as a significant barrier to economic progress, and in dire need of structural reform (Olcott, 2009; Ono & Rebick, 2003). Getting Japan out of its downturn forced the business community to look West, specifically at the opposite extreme end of the management spectrum: The U.S. model of shareholder capitalism. Management experts advocated the Japanese corporations to adopt and learn from its core features: “A focus on profits, returns on investment, and shareholder interests; increasing differentiation of rewards across employees, with stock options for managers; and aggressive shedding of workers, middle-managers, and even entire lines of business” (Westney, 2001, p.106).

Against this backdrop, the Japanese government introduced a number of measures to increase foreign direct investment in Japan. Chief among them was the “Invest in Japan” initiative in the early 2000s launched by the Koizumi cabinet. The Financial Times article which featured the story referenced this rhetoric back to Commodore Perry and the need to trigger modernization (Pilling, 2004). Owing to its history of prolonged isolation, Japan still has a
culture of protectionism and self-preservation that could thwart its integration with the global economy. “Invest in Japan” was intended to (re-)open Japan’s doors to foreign direct investment.

In a reversal of its protectionist ideologies, the Ministry of Economy, Trade and Industry, which had previously played an instrumental role in tightly controlling the entry of foreign firms into Japan, “transformed itself into one of the most ardent proponents of foreign investment in Japan” (Paprzycki & Fukao, 2008, p.45). The government provided tax breaks and incentives for foreign firms to invest in Japan. The Ministry reasoned that there were significant benefits to foreign direct investment. Aside from the direct benefits of capital inflows, there are positive externalities and spillover effects to FDI, for example, transfer of technology and management knowhow. Rather than trying to protect Japan from the perils of foreign influence, it should learn from it.

These recent developments and pressures to globalize have removed many of the structural barriers to the flow of capital, and facilitated inward FDI. The cumulative stock of FDI in Japan more than tripled between 1998 and 2004 (U.S. Department of State statistics). The share of holdings by foreign investors in the Tokyo Stock Exchange also expanded, from under 10 percent in 1993, to greater than 25 percent in 2007 (Olcott, 2009). Among the workers in foreign firms, the majority are employed by U.S. firms (Japan External Trade Organization, 2004).

Emergence of the foreign firms

The increasing flows of inward FDI has given rise to a labor market for foreign-owned firms in Japan. This market represents the opposite of the Japanese status quo. It is deeply
rooted in an Anglo-American home base, and operates more closely along market principles dictated by quantity and price signals. The contrast in the HR practices between domestic and foreign firms is striking. There is more fluidity and less loyalty in the foreign firms. Workers switch jobs in response to higher pay. Employers dismiss workers with little notice when their performance is subpar (Ono, 2007).

Indeed, from the viewpoint of human resource management, Pudelko (2006) surmises that the HR systems of the U.S. and Japan are positioned at opposite ends of the spectrum (with the German system situated in between). The U.S. system features “short-term performance efficiency based on flexible market structures and profit orientation” while the Japanese system features “long-term behavioural effectiveness based on cooperative clan structures and growth orientation” (Pudelko, 2006: 137). Similarly, Jacoby (2005) refers to Japanese firms as the “embedded corporation” to describe their socially embedded features to contrast from the highly market driven nature of U.S. corporations. Indeed, international comparisons of labor statistics have consistently shown that turnover in Japan is among the lowest in the world; the U.S., on the other hand, is among the highest (Ono, 2010). Japan’s extreme position makes it easier to see how globalization and its ensuing Western “disturbances” will affect the Japanese status quo.

The cluster analogy of HR functions (Moriguchi & Ono, 2006) does not apply to the foreign firms, as there are few institutional complementarities. HR practices are less interdependent, and there is no kernel that holds them together, thus resulting in high turnover and low trust. In this system, loyalty does not pay, and is in fact, irrational. In short, workers in foreign firms act like free agents, and firms prioritize short-term profits in place of long-term relations.
In recent years, we are witnessing a “brain drain” of highly-skilled professionals who seek careers in the foreign firms in Japan. In a country with low job turnover, workers in the foreign-owned firms stand out for their seemingly unrestrained job mobility.

THE MARKET FOR FOREIGN FIRMS IN JAPAN: THE DEMAND-SIDE VIEW

Foreign firms that establish their business operations in a host country face a latecomer disadvantage (Fukao & Ito, 2003) or a “liability of foreignness” (Zaheer, 1995) arising from differences in local customs, language, and institutions. Such disadvantages are even greater when home-host country dissimilarities are large (Edman, 2016). Foreign firms generally have a shorter time span or less “patience” to achieve tangible results to catch up to their host country competitors.

Foreign firms make considerable upfront investments to establish their business operations in a host country. But less experience and less knowledge of local markets may prevent them from making long-term investments. Unfavorable market conditions, compounded by their shorter-time horizon, may compel them to cut their losses short and exit the host economy or reduce their workforce. Empirical studies have shown that foreign firms in Japan had a higher rate of exit than did their domestic counterparts during the economic downturn of the 1990s (Ahmadjian & Robinson, 2001; Fujii & Kimura, 2001).

Foreign firms are more likely to adjust employment levels in response to market fluctuations because they confront greater pressure to generate profits in the short-run. Ahmadjian & Robinson’s (2001) study of downsizing in Japan finds that the foreign ownership share of capital is positively correlated with the probability of downsizing. While lifetime
employment may be legitimate among Japanese investors, it may be less so among U.S. and European investors who are driven more by the ideal of maximizing shareholder value.

Several implications directly follow from the short-term orientation of the foreign firms. First, foreign firms are more likely to recruit midcareer professionals with previous experience (Robinson, 2003). Foreign firms do not have the patience nor the luxury of time to recruit new graduates and nurture them internally. To this end, the foreign firms resort to aggressive recruiting tactics (e.g. headhunters) to poach midcareer professionals from their domestic competitors. Second, and related to the first, foreign firms are less likely to provide training (Ono, 2007). Foreign firms prioritize high-skilled professionals with previous experience who are endowed with general (as opposed to firm-specific) human capital (see discussion in next section). These professionals are expected to be productive immediately, with minimal training. Third, there is greater turnover in the foreign firm. Foreign firms have a lower probability of survival and a higher likelihood of downsizing, as previously discussed. And fourth, foreign firms pay higher wages (Ahmadian & Robinson, 2001; Fukao & Ito, 2003; Ono, 2007; Ono & Odaki, 2011; Peltokorpi, 2013). This condition naturally follows from the theory of compensating wage differentials. Employment in the foreign firm is associated with greater risk of dismissal. Workers must be compensated for the “disutility” of working under conditions of higher risk. Conversely, it can be argued that workers in domestic firms pay an “insurance” (Hart & Holmstrom, 1987) to shield them from market risk, and to protect them from job loss.

THE SUPPLY-SIDE VIEW AND SELECTION MECHANISMS

Given the contrasting features of the domestic and foreign firms, it is unsurprising that there is systematic (or nonrandom) selection into foreign firms. As Baron, Hannan, & Burton
(2001) explain, “Employees who consider joining a firm that has a history of espousing a particular model are likely to have a good sense of what they will encounter” (p.973). If short-term employment and high turnover are the prevailing norm, foreign firms will attract workers who seek and match these attributes. Identifying the mechanism in which workers are selected into foreign firms is an important step in understanding how the increasing presence of foreign firms is linked to greater flexibility in the labor market.

The first mechanism is de facto weaker attachment. While loyalty may be the norm in the Japanese labor market, it is unrealistic to assume that all workers prescribe to and desire a lifetime career with a single employer. Workers that are attracted to the foreign firms are therefore more likely to be those that are weakly attached in the first place. Kang (1990) describes them as “mavericks,” “outsiders,” or those who “either have misplaced loyalties or could not cope with the Japanese environment.” In short, foreign firms are more likely to attract workers who are marginalized from the Japanese labor market. For example, highly-skilled professional women, who are often marginalized from the internal labor market setup of Japanese corporations, are often drawn to and recruited by foreign firms (Ono & Piper, 2004; Robinson, 2003), because they provide “relief routes” (Bozkurt, 2012) for career advancement.

The second mechanism is willingness to take on greater risk. Workers change jobs when the benefits of moving outweigh its costs. The benefits in this case are clear. As aforementioned, foreign firms on average offer significantly higher salaries to poach talented workers from the domestic firms (Ono, 2007; Ono & Odaki, 2011). The costs can be substantial if we consider the intangibles. The greatest cost is loss in job security and exposure to market risk and uncertainty. In addition, if the prevailing work norm is lifetime employment, then job movers signal a defection from the status quo (Peltokorpi, 2013). Their reputation will suffer,
making it harder for them to return to a Japanese firm in the future. As described in the Alexander Hamilton quote presented earlier, one who has departed from a Japanese firm shall never return there. In particular, workers who defect to the foreign firm will not be welcomed back by domestic firms because they have been exposed to Western influence.

Previous research in contract theory also informs us that offering short-term contracts is one way to screen high-ability types from low-ability types (Hermalin, 2002). Abler workers prefer short-term contracts because they can act on higher outside wage offers when the opportunity arises. Further, they are confident in their own abilities that they do not need the “insurance” to protect them against market risk; they forego the insurance in exchange for higher pay.

The third mechanism is the ability to compete based on general skills. From the human capital perspective, the key difference between workers in domestic versus foreign firms is that the latter are in a better position to compete on the basis of general skills. Workers in foreign firms are better endowed with general skills (Ono, 2012); for example, they have higher English skills and higher likelihood of obtaining professional degrees such as MBAs. Workers do not accumulate firm-specific skills, because the firm provides little training. The lack of firm-specific skills weakens their attachment to the firm, which further leads to greater mobility.

Empirically, Ono & Odaki (2011)’s study of wages reveals that returns to general skills are substantial in the foreign firms, but that the returns to firm-specific skills are statistically insignificant. In theory, this signifies that there is no economic rationale that restrains them from changing jobs. In contrast, the returns to firm-specific skills are sizeable in the domestic firm; workers in domestic firms could suffer a significant financial setback by quitting their jobs.
These filters are thus important selection mechanisms which channel workers into the foreign firms. Although the prevailing norm in the Japanese labor market is high-commitment and low mobility, not all workers prescribe to this norm. Workers who join foreign firms are those who have less to lose by defecting from the Japanese employment system. They are willing to forego job security for higher pay. Foreign firms reward these professionals for their general skills, and not for their loyalty to the firm.

**SPILLOVER EFFECTS OF FOREIGN DIRECT INVESTMENT**

In addition to increased foreign direct investment and greater capital flows, foreign firms bring with them intangible assets and management practices that have spillover effects to the local host economy. Organizations in the host countries, in return, respond to isomorphic pressures, often imitating other organizational forms in pursuit of optimal performance and firm survival (Dimaggio & Powell, 1983). I examine how foreign firms are transforming conventional HR practices in Japan, with particular focus on the finance sector as documented by Ono (2012).

Throughout much of the 1990s, the domestic firms continued to uphold their conventional practices of lifetime employment, seniority wages, and extensive training. However, with the emerging presence of the foreign firms, the leading brokerage firms suffered a massive exodus of their best finance professionals to the foreign competition. Ironically, the domestic firms became positioned as “academy companies” (Cappelli & Hamori, 2005) in the finance profession. They invested heavily in training their new graduates, but many were poached by the foreign firms after they completed training, or became certified in the profession. Soon it became clear that there was a one-way career transition, from the domestic to the foreign
firms, but not the other way around. The talent drain eventually became sizeable, and domestic firms were forced to counteract to protect their core human assets.

One of the drastic countermeasures to this effect was the introduction of a specialist track among the top domestic brokerage firms. Finance professionals in the specialist track are hired under one-year contracts. Compensation packages and contract renewal are based entirely on performance. The terms and conditions of the contract are designed specifically to match those offered by the foreign firms. Although the top domestic firms continue to offer the more traditional career track with job security, workers can choose the specialist track option should they desire the high-risk/ high-return work conditions of the foreign firms.

There are emerging signs that these countermeasures are starting to affect the HR practices in the finance sector. For example, the following article explains how Nomura Securities, Japan’s main brokerage firm and a well-established “academy company,” is fighting back in response to the foreign competition after their equity research rankings started to decline:

To some, Nomura’s slip reflects the same problem that equity researchers are grappling with at many of the Japanese companies they follow: a resistance to change. The country’s largest brokerage firm remained true to Japan’s seniority-based system of compensation for most of the past decade – and paid a price. Scores of young, talented analysts defected to U.S. and European banks, where the pay structure is weighted more toward merit than tenure… It wasn’t until February of last year that Nomura revamped its research compensation system to be more competitive, a move that has met with some success. The firm didn’t
lose a single analyst to a competitor last year and even managed to rehire a former analyst. (Shimizu, 2001)

FROM THE MICRO- TO THE MACRO-: THE TRANSFORMATIONAL MECHANISMS

I now examine the specific mechanisms that link individual actions at the micro-level to greater labor market flexibility at the macro-level, a mechanism which Hedstrom & Swedberg (1998) have termed, “the transformational mechanism.” From the viewpoint of institutional complementarities, “disturbances” at the firm-level could weaken the precarious equilibrium which holds the labor market institutions in their place. Like a “stress test” of institutions, these disturbances will test the resilience of the internal labor market setup.

The first mechanism is the expansion of the market for midcareer professionals. The shift in labor demand from new graduates to midcareer professionals triggers a gradual erosion of the internal labor market. The ILM presumes entry from below followed by extensive internal training and promotion. The emerging practice of hiring midcareer professionals will disturb this status quo.

The expanding market for midcareer professionals will weaken the stigma associated with job mobility in Japan, which will further lower the barriers to mobility. The practice of leaving a domestic firm, then later returning to the same firm (as described in the passage above) was unthinkable under the traditional employment system, but it is becoming more commonplace today.\(^5\)

The second mechanism is the shift from implicit to explicit contracts. The traditional lifetime employment system exemplifies an implicit contract; it is a mutual agreement between
workers and employers which presumes a long-term relationship based on trust and goodwill. Terms and conditions of employment are not clearly defined, and job functions are fuzzy and ambiguous. The specialist track, such as the one introduced at Nomura, stands at the opposite extreme of this implicit arrangement. The contract must be renewed on an annual basis, terms and conditions are explicitly specified, and job functions are clearly defined. There is little room for ambiguities.

This shift signifies the broader transformation from social exchange to economic exchange as predicted by Murakami & Rohlen (1992). The social relational aspects of employment relations, e.g. trust and reciprocity, are being replaced by explicit measures such as wages and specific terms of employment.

The third mechanism is the shift from input- to output-based reward structure. In domestic firms, the reward structure is primarily based on input. There are considerable returns to loyalty, as exemplified by seniority wages where workers are rewarded according to their tenure. In foreign firms, compensation is based on output, and driven by performance. There are no returns to tenure, and loyalty does not pay. The increasing tendency towards performance-based pay will thus replace the input-driven work culture to one that deemphasizes loyalty, which consequently raises mobility.

The fourth mechanism follows from the first three mechanisms: the shift in the demand for skills, from firm-specific to general skills. The market for midcareer professionals is essentially a market for general skills. Workers compete in a market based on a set of portable skills that are not constrained by firm boundaries. As the market for midcareer professionals expands, firms respond by providing less training which weakens worker attachment, and further reinforces mobility.
The fifth mechanism is the transition from homogeneity to heterogeneity. A key finding from the organizational demography literature is that interpersonal attachment is lower and turnover rates are higher in heterogeneous groups (e.g. Sorensen, 2000). Turnover is viewed as an outcome of weakened social integration or attachment to fellow group members.

A more fluid labor market, induced by the growing presence of midcareer professionals, is essentially a transformation from a closed to an open employment system (Sorensen & Kalleberg, 1981). The internal labor market is insular and closed to the extent that it tries to fulfill HR needs internally. By contrast, in an open system, HR needs are resolved by taking advantage of the broader external market, which will result in an organization with a more heterogeneous workforce. While the benefits of an open system are many, the transition to greater heterogeneity will at the same time disturb the harmony which was achieved in relative isolation with a homogenous workforce. The increasing heterogeneity within organizations in turn will lead to greater turnover.

In sum, these transformational mechanisms taken together will erode the internal labor market setup which remains the core of the Japanese employment system. This is not to say that it will be entirely replaced by a highly fluid and open system, as exemplified by the U.S. model. Unsurprisingly, there has been, and always will be, resistance to the greater influence of foreign capital, and to a more market-driven approach to employment relations in Japan.6

But the labor market is undoubtedly moving towards greater flexibility and less job security. In the dual labor market analogy, the core workforce of regular full-time workers is shrinking in place of an expanding periphery workforce who are exposed to greater market risk and uncertainty (Ono 2010). The mechanisms also indicate a shift away from welfare capitalism
to a U.S.-style shareholder capitalism based on profitability and accountability. Overall, these transformations point unilaterally in the direction of greater fluidity.

**DISCUSSION**

Recent labor market trends in Japan point to an overall directional shift towards greater flexibility, a movement that is consistent with globalization and its ensuing macro-level transformations. This paper has explored the links between the macro and the micro that lead to greater flexibility, and unpacked the specific mechanisms that are unique to the Japanese institutional context.

Japan is not immune to the forces of globalization. The sluggish growth of foreign direct investment in Japan is historically contingent. Given its history of extreme isolation, opening up the domestic market to foreign direct investment has been a gradual process, and investment levels remain low compared to Western counterparts. However, with the increasing realization of the benefits of FDI and the need to remain competitive in the global economy, FDI inflows are rising, and we are witnessing the increasing presence of foreign firms in Japan.

The foreign firms bring with them, human resource (HR) practices that contrast sharply from the Japanese status quo characterized by implicit long-term relationships. These diverging HR practices have spillover effects into the domestic firms, which may disturb the Japanese status quo in the long-run.

I have argued that firms and individuals are embedded in a broader social-cultural framework. Japan’s response to globalization must be considered in light of its historical trajectories and institutional context. If we remove the context, the mechanisms lose their explanatory power. The effects of globalization on labor markets are more complex than a
unidirectional convergence towards flexibility. Although there is an overall convergence towards greater market orientation, the mechanisms involved are unique to their institutional environments. Because job mobility in Japan is among the lowest in the advanced economies, Western influences are likely to move Japan towards higher mobility. On the other hand, the impact of globalization on job security in de facto high-mobility countries such as the U.S. remain unknown. The mechanisms involved there are also specific to their social-institutional context which will ultimately determine their outcome.

At the micro-level, there is growing evidence that the increasing presence of foreign firms is starting to affect the behavior of workers, especially among the younger generation. New graduates are increasingly drawn to foreign firms as they seek greater freedom and higher pay in exchange for job security and prestige of employer. These developments indicate that preferences may be changing among the younger cohort.

At the macro-level, Japan is stepping up its position to attract foreign capital as they face increasing competition from its Asian rivals, namely China, Singapore, and South Korea (Rowley, 2010). The prolonged period of protectionism has undermined Japan’s competitiveness in the Asian region. Foreign capital is either bypassing Japan, or in some cases, foreign companies are moving their regional hubs from Japan to other Asian countries. More than ever, the Japanese government is launching a number of incentives to attract foreign capital to Japanese markets.

Globalization continues to disturb the market equilibrium in the Japanese labor market, and has compelled some workers to migrate from domestic to foreign firms. They are in fact the marginal men and women of the Japanese corporation. They have broken away from custom, and are striving to survive in two conflicting cultures – one that is deeply market-driven, and the
other that is deeply social. As Park (1928) writes in his seminal paper, “Human Migration and the Marginal Man”: “It is in the mind of the marginal man – where the changes and fusions of culture are going on – that we can best study the processes of civilization and of progress” (p.893). Their struggles and experiences hold the key to understanding the progress and direction of Japanese society as a whole.

NOTES

1 It should be noted here that flexibility is a demand-side expression. From the employers’ perspective, flexibility is desirable because it allows them to adjust employment levels in response to demand fluctuations. Brand (2007) refers to labor market flexibility as “a euphemism for removing (or restricting) such labor market ‘distortions’ as trade unions and minimum wage laws and, in brief, subjecting workers to the dictates of supply and demand” (p.70). From the workers’ perspective, flexibility is undesirable because it signals an erosion of job security. Indeed flexibility from the demand-side and insecurity on the supply-side are coterminous. I shall use these expressions interchangeably depending on the discussion.

2 On average, part-time employment as percentage share of total employment, expanded from 11.6 to 16.5 percent between 1995 and 2012 across the OECD member states (OECD, 2012).


4 Estimations of gravity models which take into account factors such as economic size, geographic distance and natural endowments, reveal that Japan is indeed an outlier in inward FDI. For further discussion of why FDI in Japan remains so low, see for example, Paprzycki & Fukao (2008) and Weinstein (1996).
Returning to one’s previous domestic employer became more commonplace especially following the Lehman shock of 2008 (Ono, 2012). A large number of foreign firms withdrew or downsized considerably following the Shock, at which point many finance professionals sought shelter with their previous employers.

For example, in some extreme cases, the opposition may argue that increased competition may disturb social harmony and lead to a “high-crime society” such as the U.S. (Yashiro, 1998, cited in Olcott, 2009).

For an illustrative example which documents the importance of the historical and institutional context, see Stovel et al., (1996) who document the transformation of employment systems in a large British bank from 1890 to 1970.

Recruitment Brands Survey administered by Recruit Works Institute (various years), shows that the foreign firms are gaining more popularity and recognition as potential places to work among Japanese university graduates. An article in the Financial Times explains that Merrill Lynch Japan received over 3,500 applications for 73 job openings in 1999 (Tett & Nakamae, 1999). The president is quoted as follows: “Two years ago, if a Japanese graduate said they wanted to work at Merrill Lynch their mother would probably be shocked – what would she tell the neighbors? People had never heard of Merrill Lynch… But now we are choosing from an incredible talent pool.”
REFERENCES

deinstitutionalization of permanent employment in Japan. Administrative Science
Quarterly, 46, 622-654.

Cambridge University Press.

Baron, J. N., Hannan, M. T., & Burton, M. D. (2001). Labor pains: Change in organizational
models and employee turnover in young, high-tech Firms. American Journal of
Sociology, 106, 960-1012.

Boudon, R. (1976). Comment on Hauser’s review of education, opportunity, and social
inequality. American Journal of Sociology, 81, 1175-1187.

Bozkurt, Ö. (2012). Foreign employers as relief routes: Women, multinational corporations and

(Winter), 70-76.

32.

University Press.

collective rationality in organizational fields. American Sociological Review, 48, 147-
160.


Figure 1: Macro- and micro-level interactions: Effects of globalization on labor market flexibility