
Performance Evaluation of Microprofit Center and Blurred Link with Compensation: Literature Review of Japanese Performance Evaluation System

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1. Introduction

Since the "relevance lost" (Johnson and Kaplan, 1987) of management accounting studies, management accounting researchers have been interested in regaining the lost ground. Management accounting control (MAC) researchers after Robert Anthony claim the concept of management accounting should be enlarged. Otley et al. (1995) reviews MAC studies and points out the necessary shift the concept of MAC from closed approach, which excludes an idea of organization environment, to open approach, which takes organizational environment into account (Otley et al., 1995).

Otley suggests that MAC as presented by Anthony is the control of lower managers by middle managers with management accounting information. Some researchers point out that an overemphasis of management accounting as a control tool could lead to dysfunction and prevent cooperation among employees (Johnson, 1992; Roberts, 1991, 1996; Roberts & Scapens, 1985). The concept of MAC should be modified to empower lower managers by giving them authorities of self-control and decision making (Otley, 1994). In order to solve the problem of accounting control, new ideas of control are suggested. These include employees empowerment, sense of accountability to promote cooperative activities among employees, and continuous improvement (Otley, 1994).

Recently, microprofit center (MPC) draws interests of researchers as a way to facilitate employee empowerment. In MPC system, a unit that originally was a cost center is treated as a profit center by calculating sales and profits. It is reported that companies that introduced MPC system achieved revitalization and productivity improvement (Cooper, 1995; Kaplan & Cooper, 1998; Tani, 1997; Tani & Miya, 1998). MPCs have different characteristics from profit centers as divisions in a multi-divisional organization. A division is usually a larger unit than a MPC and is assumed to have a hierarchical organizational structure with its manager at the top.

One of procedures to control divisions is the performance evaluation of its managers. Implementing performance evaluation makes certain that managers' conduct is in alignment with and contributes to the corporate goals. It also prevents them from opportunistic behaviors. Performance evaluation studies have a premise that performance should be linked to rewards. Western researchers since Anthony (1965) have focused on the link between monetary payments and performance.

Most MPCs are small in size and are built on the experience of factory shop floor teamwork. Viewing a MPC as a team is more appropriate than just a profit center. Performance evaluation studies for teams also refer to the importance of link between team performance and payment (Campion et al., 1993; Cohen, 1993; Hackman, 1987, Kirkman & Rosen, 1999).

However, in Japanese MPCs, performance and payment are not directly linked. The blurred link between performance and payment in the MPCs could be attributed to obscure distinction between authority and responsibility and frequent job rotation in Japanese companies.

If performance and payment are not linked, an important question is what is likely to revitalize employees when the MPC system is introduced? The purpose of this paper is to clarify the nature of MPC system as a team and its effects on performance evaluation, compensation and motivation of its members.

The paper is organized as follows. First, I discuss characteristics of MPCs. Second, I review team studies and show that a MPC has common characteristics with a team. In addition, I show that studies concerning team and payment indicate that team-based payment and skill based payment have deep impact on team performance. Third, I show that typical Japanese companies have not linked performance to payment directly. Finally, I discuss the impact of MPCs on cost reduction and employee motivation in the absence of direct link between performance and payment.

2. MPCs Studies

MPCs as Profit Centers.

The concept of "profit center" is built on "responsibility accounting" and "controllability discipline". The main idea is that responsibility should be aligned with controllable costs. If lower level managers are to assume profit responsibilities, they should be given authorities over costs and sales. There needs to be decentralization if a unit becomes a profit center.

Most of MPCs are just a small unit of manufacturing process or occasionally a unit of

sales division. Thus, authority of decision making for MPCs is highly restricted. Nevertheless, a MPC is treated as a profit center. This is one of differences from ordinary profit centers.

Cooper (1995) suggests that the characteristic of small size of the MPCs has effects on its performance. Kaplan & Cooper (1998) describe MPCs as "teams" or "work teams". The word "team" is used in reference to quality control circles. In many MPCs, they had experiences of Total Quality Management (TQM). That is, a MPC has a characteristic of "team". The concept of team is a pivotal MPC characteristic.

Type of MPCs by Structure

MPCs are introduced mainly into shop floor in manufacturing companies. MPCs can be classified into two organizational types: functional unit and functional units by products.

Functional unit type of MPC constitutes a part of the manufacturing process (e.g., soy source manufacturer and brewery (Cooper 1995)). Each of the manufacturing process (e.g., bottling, packaging etc.) is seen as a MPC. These MPCs do not sell directly to the market as each MPC sells to the next process MPC.

Functional units by products type of MPC are organized by products within the manufacturing department (Castellano et al., 1998; Deguchi et al., 1996; Hendrics et al., 1992; Tani & Miya, 1998). This configuration is also called "line company system"(Tani & Miya, 1998), which means each production line is like a company. Introduction of this type of MPC often leads to the reorganization of the manufacturing process. At the electric wire plant (Deguchi et al., 1996), the MPC system promoted reorganization from units by processes (wire stretching, tin plating and wires twisting) to units by products (thick electric wires company, middle and thin electric wire company). Although this type of MPC could not set market prices, this reorganization had a profound impact on the way of operations were performed.

Additionally, in Kyocera, MPCs named *Amoeba* include both types of MPCs (Miya, Tani & Kagono, 1999). But they have different features concerning pricing with other MPCs. As each *Amoeba* could potentially sell to the market, it is called "real microprofit centers"(Cooper, 1995). In *Amoeba*, the price is decided through negotiations with other *Amoebas*, reflecting the market.

Characteristics of Japanese MPCs are rather different from other countries such as US companies. In US companies, MPC performance is linked to monetary incentives as bonuses or non-monetary incentives as a new canteen, etc. But almost no Japanese companies link MPC performance with monetary incentives. Due to these differences, the focus of this paper is on Japanese MPCs. After reviewing the following team and payment studies, it becomes harder to understand why MPCs have effects though it does not link

with monetary incentives.

3. Team

Robins (1997) defined "team" as a number of people who generate positive synergy through individual effort and cooperation and bring better results than the mere accumulation of individual or group. "Group" is defined as a number of people who gather to accomplish certain purposes, to influence and to depend on each other. Teams are also described as "one type among various kinds of employee involvement (Manz & Sims, Jr., 1993). The difference between "team" and "group" is synergy among people.

Typology of Team

Robins (1997) distinguished three types of teams: problem solving team, self-management team and cross-functional team.

In problem solving teams (parallel team (Cohen, 1993), team for advice and involvement (Sunstrom, 1990), suggestion involvement (Redford Jr., 1993)), people share ideas for improvement of operation procedures and make suggestions. A quality circle activity is an example of this type of teams.

Quality control circles consist of 8-10 employees and one supervisor. They gather regularly and discuss causes of quality problems and make suggestions for solutions. Distinctive features of this type are its temporary nature, supplementary role next to main organizational roles and vague borders. But the potential of this kind of team is limited to conveying suggestions and has no authority and responsibility for results.

Self-management team is also called work team (Cohen, 1993), self designed team (Banker, et al., 1996), team for production and service (Sunstrom, 1990), and high involvement culture (Manz & Sims Jr., 1993). The degree of authority given to this kind of team is rather different. In this type, authority for daily operations of production and service is transferred from the supervisors to the employees. This type of team is responsible for deciding the speed of operations, the allocation of workload, the coordination of resting time and the inspection of procedures. In the case of more empowered teams, the teams themselves are responsible for choosing members and evaluating individual performance. Formalities of organizational structure and regular formation are features of this type of team. The high degree of job satisfaction and performance improvement are the benefits of this configuration. On the other hand, absenteeism and resignations tend to increase in certain cases. These phenomena imply a certain degree of difficulty in the introduction of this type of teams.

Cross functional team (Robins, 1997) is also called project team. Members of the same hierarchical level but from different functions constitute these teams, which deal with certain issues. This type of team has temporary nature. The product development team for Boeing 777, new product development team, and target costing team are representatives of this type. The advantages of this scheme are that "people from various intra or inter-organization functions share and exchange information, provide new ideas for development or problem solving and coordinate complicated project" (Robins, 1997).

Given the above characteristics of teams, a MPC can be explained as follows. A MPC is based on a formal unit in the organization and its daily work for production and service is operated through it. A MPC leader is given more authority than before. He is allowed to make small changes in the procedures and he is even concerned with the inventory management. In the *Amoeba*, the leader has authority over the organization design including creating or dissolving the teams. He can also decide the transfer of members between the various *Amoebas*.

But in almost all cases, the degree of decision making for MPC leaders is restricted to daily operations and procedures. In Japanese companies, the decision making concerning personnel issues such as selection, payment, evaluation rests on the central human resource department. Based on the team typology, the degree of autonomy of MPCs is higher than the problem solving type, but not as high as self-managing type.

Team Payment

According to management accounting textbooks, performance should be linked to rewards. It is said that if a team's task and payment are interdependent and that appropriate information is given, cooperative activities among members and team performance will increase (Wageman & Baker, 1997). Management accounting researchers have not specify a practical way to successfully and efficiently create this link especially in team setting (Otley, 1999). But in management studies, Wageman and Baker' s (1997) experiment demonstrated that when task and payment are interdependent, there is a positive effect in team performance. Specifically, they clarified that task interdependence promoted cooperative action among team members, and moreover payment interdependence is inevitable for the overall productivity. In addition to payment interdependence, relevant information adds up to team performance, such as quality information (Ittner & Larcker, 1995) or customer information (Sim & Killough, 1998).

In order to draw out employees' efforts and team cooperation, evaluation and payment should be seen holistically based on team performance, but not on individual performance (Cohen, 1993).

Team-based payment system also facilitates the introduction of new management

accounting tools to teams. Activity-based costing (ABC) focuses on reducing non-value-added activity. The introduction of ABC has often been problematic to the units deemed as non-value-added. Drake et al. (1999) indicated that teams that introduced ABC in conjunction with team-based payment had higher productivity than teams with volume-based accounting system and individual-based payment.

Not only team-based payment, but also skill-based payment is also recommended for teams. Skill-based payment encourages less-skilled workers to obtain new skills and make full use of it (Cohen, 1993; Murray et al., 1998). Payment can become a powerful tool to influence the recipients.

However, utilizing a team performance or skill-based system of reward is not a panacea, problems can always appear. Though wide range of experimental research shows that team-based payment is positively related to the performance, there are potential limitations of these studies. Research methods of these studies are almost all experimental using university students as a unit of analysis or large volume questionnaire surveys.

Ezzamel & Wilmott (1998) revealed in the case of British clothing manufacturer that conflicts resulted from the team-based bonus system. Lack of coordinators for the teams caused conflict among less-skilled and skilled workers. The point is that free riders existed in teams and no coordinators can manage the situations.

At the same time, skill-based payment also have a problem invoking insecurity among skilled workers who are threatened by potentially being caught up by younger workers (Manz & Sims Jr., 1993). For them the necessary knowledge already exists and therefore a skill-based payment system does not constitute an adequate incentive. A further raise in payment is doubtful due to the fact that their existing skills cannot be further increased.

Though several problems are indicated for team payment issues, Western researchers take it for granted that team performance should be linked with team-based monetary incentives in some way.

4. Performance Evaluation System in Japan

In MPCs in Japanese companies, performance and payment including monthly payment and bonuses are not directly linked. But it is not unusual for Japanese companies. Payment systems are often different depending on countries.

Many Japanese companies do not tend to link performance directly with each employee's payment, and this system has worked well until recently. The fact that this system has worked well is attributable to Japanese personnel evaluation system and promotion system.

Japanese Companies' Personnel Evaluation System

Management control system in Japanese companies directs the control of performance measurement to the accounting department and that of individual evaluation and payment to the human resource department. Due to this separation a direct link between performance measurement and performance evaluation including payment cannot be established. Consequently, on an individual level any changes in the human resource system have deeper effect than accounting system. According to Yokota (1998), any changes in human resource management system influenced individual understanding and attitude towards management accounting information.

In Japanese companies, individual payments are set depending on the grading system called *shokuno shikaku* in Japanese, and this payment system links both to organizational hierarchy and payment. Organizational hierarchy means not only organizational positions, but ranks, which are in-house qualifications of job and ability. Employees, who are posited in certain ranks, compete with each other for certain positions. Even if he cannot get a higher position, his payment will rise if his rank rises.

This system distinguishes employees according to their ranks in the organization and it reflects on their promotion and their rewards. At the time of promotion to a higher positions or higher ranks, personnel evaluation is performed.

Personnel evaluation in Japanese companies includes the following characteristics. First, it is applied to both blue-collar and white-collar permanent workers. Second, various evaluating factors are included. Finally, it is implemented repeatedly on the long time basis (Kumazawa, 1987, 1989).

The first characteristic is also called 'white-collarization' (Koike, 1988, pp.53) of blue-collar workers. Such phenomenon is not observed in western companies. As far as the third characteristic is concerned, personnel evaluation is performed regularly at the time of bonus decision, promotion and moving up hierarchical ranks. Usually evaluation for promotion happens once a year. Evaluation for bonus is reviewed once every six months.

With respect to the second characteristic, the personnel evaluation factors include three elements: performance evaluation, attitude evaluation and task ability evaluation. Performance evaluation focuses on task achievement. Attitude evaluation is concerned with individual attitude towards the work. Finally, evaluation on the task performing ability focuses on his potential ability to respond effectively to his duties.

Among three factors, performance evaluation is one of the factors which are hard to deal with. Partly because the external environment always influences performance, each unit performance cannot be evaluated with a set of uniform criteria. And it is difficult to measure the performance of lower employees compared with managers, because they have limited authorities and responsibilities for the performance. Thus, especially for lower level

employees, performance evaluation is just considered supplemental for other factors, and it is not linked to salaries and bonuses. This makes the connection of performance and payment rather vague.

Japanese Companies' Promotion System

In Japanese companies, promotion is carried out mainly by internal selection. So a starting point is different between employees who entered the company just after his graduation from school and employees who are transferred from other companies. The first group enjoys more advantages than the latter. Until recently, employees who experienced change of companies tend to be promoted a bit slower than pure-blooded employees. In addition, promotion selection in Japanese companies is done exclusively among co-workers who entered into the company in the same year. Consequently, the competition is severe.

Usually, the waiting time for the first promotion is longer for the employees of the Japanese companies compared to their counterparts in the West. The length of the selection process is usually followed and translated into patience for promotion. In this prolonged selection process, employees experience a few job rotations and get personnel evaluation from a number of superiors. Personnel evaluation, which emphasizes on the employees' effort, attitude, and potential talents, ensures that they will maintain a sustained efforts preparing for the first selection to a higher hierarchical position.

This selection process is very different from those of western companies examined. In many western companies, employees, who are thought to have higher potential, are distinguished from the others at an early stage of their careers and they are trained as candidates for a future top management position.

As for Japanese blue-collared workers, one of the most critical occupational requirements is their aptitude for production operation or *Chiteki-jukuren* in Japanese (Koike, 1999). *Chiteki-jukuren* includes workers' abilities to respond swiftly and effectively to unusual problems and changes in operations. It is thought that this quality constitutes essential elements underlying the operational productivity in Japanese companies. This quality is reflected in their formal ranks in the organizational hierarchy and their rewards. This payment system shares common features with the skill based payment system. One of reasons for employees' tendency to work for a company for a long time is that certain number of years of service is required to acquire some skills. The higher skilled employees receive respectively the higher payments. This can be a strong incentive for employees to obtain new skills and have positive attitude toward jobs.

To respond quickly to accidents and changes, not only individual skills but also teamwork among employees is needed. Repetitive personnel evaluation, which puts emphasis on this quality, encourages employees to develop their skills and teamwork.

As mentioned above, Japanese promotion system has several key features including internal promotion, prolonged promotion and skill-based promotion. These features could encourage especially blue-collared workers, who are main participants for MPCs, to work enthusiastically as a team with other employees and maintain a higher standard of personal effort for a long term basis (Kumazawa, 1997)¹⁾.

5. How the Rewards are Paid at MPCs

MPC studies show that most of MPCs have very limited authorities. They cannot select and evaluate their MPC members by themselves. This means, personnel evaluation and performance measurement are divided in MPCs as with many Japanese performance evaluation systems. At MPCs, though profit performances are measured, evaluation and incentive are not aligned with performance. Those issues are dealt with by the central human resource management department just as before. These conditions in Japanese companies would lead to blurred link between MPC performance and payment.

Instead of short term monetary incentives, a MPC has intrinsic rewards and long term pay off. This could be the reason why MPC works (Figure 1).

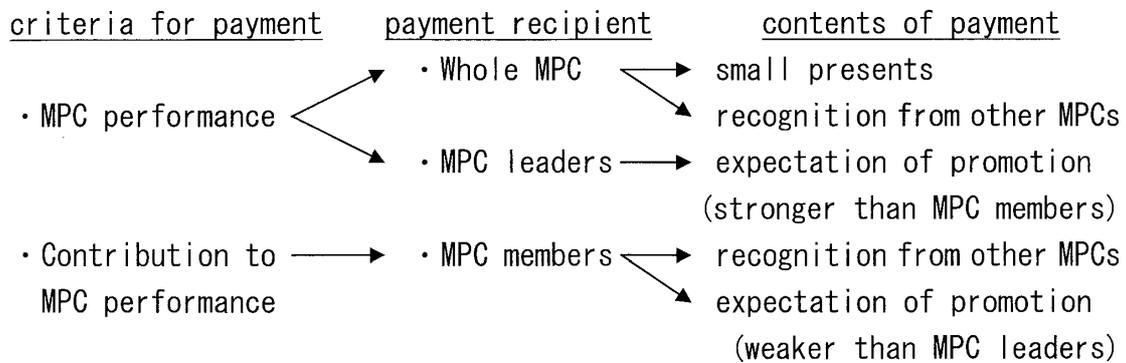
The MPCs that show high profit results receive recognition from other MPCs and publicly commended. At Kyocera, *Amoebas* that attained the yearly target are publicly commended and small presents are given to all *Amoebas* members.

In addition, MPC results and each member's efforts poured into MPC are taken into consideration at the evaluation times. It might be reflected in promotions and bonuses in the long run. The expectation of members themselves would be one of incentives for MPC members.

As to MPC leaders, influence of MPC results on their career would be bigger than other MPC members. If the MPC show favorable results, the possibility of promotion for MPC leaders increases. Then, it is implicitly recognized that MPC leaders who attained good results are assured speedy promotion.

1) However, this personnel evaluation system is sometimes criticized for making the employees stereotypical and depriving them of any initiative and creativity (Kumazawa, 1989). The criteria for personnel evaluation emphasize elements which the company requires its employees to comply with. In this system, information about the desirable attitude towards the job and the way of thinking are communicated repetitively. If employees do not meet these criteria, the company would judge them to have low potentials, resulting in lower payment than other employees.

Figure 1
MPC and payment



6. Summery and Conclusions

The issues of incentive system including a link with individual pay have been neglected in the MAC studies. But the explicit reference to and discussion of incentive system is inevitable considering its powerful influence.

This paper explains blurred link between MPC performance with monetary payment from Japanese evaluation and promotion studies. Diversified evaluations, prolonged promotion selection and skill-based payment promote especially blue-collar workers' positive attitude toward teamwork and draw out their long term efforts for MPC.

However there might be some limitation for MPC system to work. Above mentioned Japanese personnel evaluation system and promotion system have existed against the background of long term employment. Because of this, MPC members can expect that their efforts for MPC could pay off in the long run, if not immediately in monetary terms. But these days, Japanese companies are no longer offering long term employment for its employees. Because of this, MPC members' belief in long term pay off cannot be maintained. These environmental changes might threaten MPC effects in the future.

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Abstract

In recent years, some Japanese firms have moved towards a microprofit center (MPC) system. A MPC is usually an operational unit that used to be a cost center but is instead treated as a profit center. The size of a MPC is usually very small. It has been reported that the introduction of a MPC is effective in revitalizing the corporate operations and increasing productivity. The paper aims to clarify the nature of MPC system as a team and the reason why MPC system is effective though its performance and compensation are not directly linked.

MPC system is operated in the context of Japanese companies' evaluation system which characteristics are diversified evaluation, prolonged promotion selection and skill-based payment in the long time employment background. This context allows MPC members to believe that their efforts for MPC performance would pay off in the future. Consequently this expectation of MPC members encourage cost reduction and an increase in employees' motivation even though MPC performance is not linked with immediate monetary incentives.

Lastly this paper points out potential limitation of Japanese MPC system. Japanese MPC is built on Japanese companies' long term employment premises, but recently many Japanese companies no longer maintain this employment condition. Because of this, if Japanese companies' employment condition change drastically in the future, MPC system might be threatened with the change.