

# Human Resource Management of Professionals in U.S. Companies

## *– Implications for Japanese Financial Firms –*

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As the Financial Big Bang unfolds, and as corporate management becomes increasingly complex, advanced, and specialized, the need for professional personnel only grows more acute. However, many companies, particularly in financial services, have great difficulty hiring, training, and compensating professionals because their personnel system retains traditional practices such as rotation and seniority.

Based on on-site interviews, this paper presents the strategies of U.S. companies that have adopted radical practices for human resource management (HRM) of professionals, and suggests directions for Japanese companies to pursue (particularly financial services companies)<sup>1</sup>

### **1. Human Resource Strategies of Professional Firms in the U.S.**

In terms of employing professional personnel, perhaps the most instructive example is the human resource model of professional firms in the U.S.<sup>2</sup> Based on the perspective that professionals represent a firm's greatest intangible asset and source of added value, these firms have a long history of building a unique human resource management model aimed to secure professionals, optimize their capabilities, and maintain the quality of work.

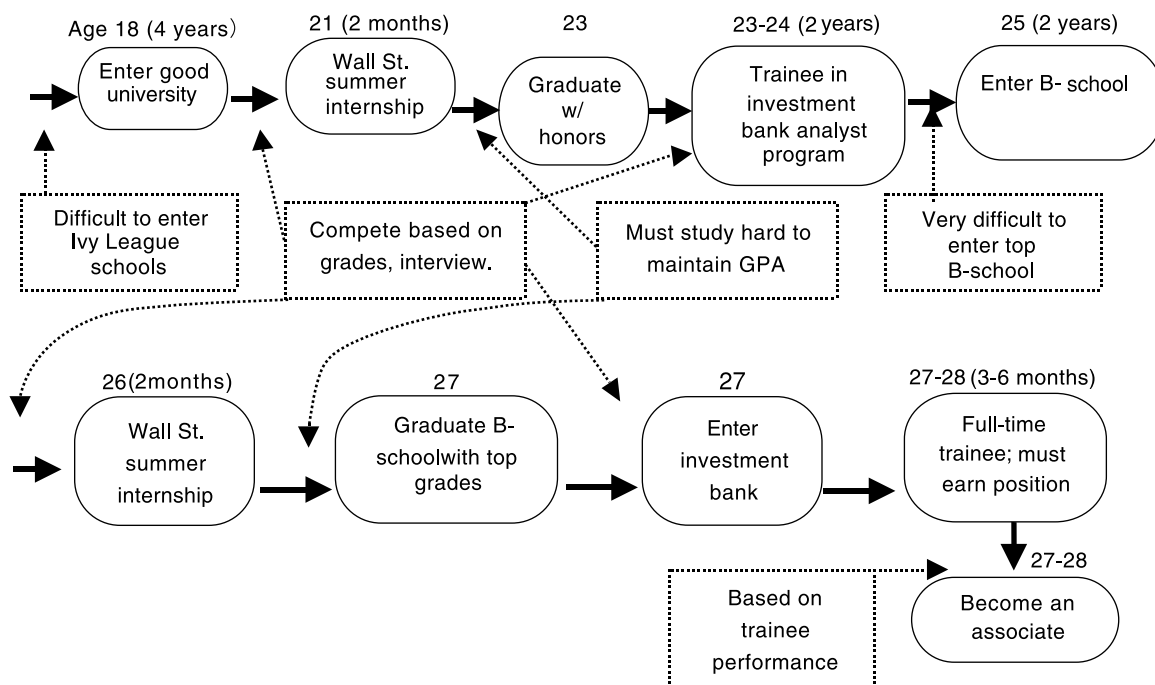
#### (1) Human Resource Strategy of U.S. Investment Banks

##### *1. The arduous road to employment at investment banks*

The long path from graduation to a position in an investment bank is tracked in Figure 1. While students with no work experience are rarely hired as regular employees, most investment banks have a two-year analyst training program. After completing the program, most people attend a reputable business school or law school, and are finally hired as regular employees upon graduation.<sup>3</sup>

As Figure 1 shows, this process is filled with difficult hurdles. Students who wish to work at an investment bank could find a permanent position elsewhere, but instead choose to expend great effort while enduring time constraints and high risk to attain higher incomes and acquire expertise. For investment banks, the hiring process is designed to efficiently generate a stable supply of candidates under age 30 with the following attributes: ( 1 ) good potential competence, analytical ability, and communication skills, ( 2 ) a certain level of experience and expertise, and ( 3 ) demonstrated ambition, stamina, risk tolerance, and leadership.

**Figure 1 Professional Career Track at Investment Banks**



## 2. Surviving the training program

For the first three to six months after hiring, companies ordinarily do not assign actual work responsibilities but instead have their employees attend a full-time training program. This training is completely unlike the training new employees of Japanese companies receive, which consists of learning social manners and basic work procedures, attending seminars on sales and other aspects of the company, and performing on-the-job ( OJT ) training. In contrast, trainees are educated by university professors and active investment bankers regarding highly specialized, leading-edge, hands-on knowledge on financial markets and corporate finance, and perform case studies and trading simulations. In the meantime, the trainees are on probation, and during the training program must sell themselves to the department they wish to enter. Depending on their performance, some are forced to quit during the training program.

### *3. Results-based evaluation and compensation*

The sales and trading department, where the gain and loss positions of each employee are tracked every day, is a typical high-risk, high-return workplace. Compensation is proportional to results, and traders and dealers voice a common aspiration to make a killing in the market and retire by age 40. However, should they perform poorly for several consecutive quarters and fail to generate revenue equivalent to three to five times their annual pay, termination can come swiftly. Layoffs are also triggered if market conditions deteriorate, or if mergers and acquisitions in the industry produce redundant departments and staff.<sup>4</sup>

With regard to corporate finance departments (underwriting securities, M&A advisories, etc.) personnel are evaluated with a relatively long time horizon, but since success in making deals (as well as their number and value) is all that really counts, evaluations are likewise completely based on results. In research departments (analysts, strategists, economists, etc.) standards of evaluation include customer evaluation surveys (of institutional investors) and ranking in *Institutional Investor* magazine. Those who survive this rigorous process are promoted to vice president and managing director.

## (2) Human Resource Strategy of Management Consulting Companies

### *1. Test of advanced business skills*

While some consulting companies affiliated with accounting firms hire new college graduates, most strategic consulting firms hire new MBA graduates. As explained below, since the average length of service is short, they hire large numbers of MBAs each year in anticipation of the high attrition rate. The competition for jobs in these firms is fierce, and candidates are selected based on criteria such as extremely rigorous case interviews (in which applicants must solve a case on the spot)

### *2. Large educational investment*

Despite the intentionally short duration of employment, the training is quite costly. In addition to the 1-month initial training (full time) there is an extremely thorough regular training regimen for each specific career path. In addition, companies emphasize knowledge management by, for example, making employee consulting records and skill data accessible on intranets.<sup>5</sup>

### *3. Up-or-out rule sustains partnership system*

Among the top strategic consulting companies with a partnership organization, practically all have adopted the up-or-out rule. Under this rule, employees who do not earn promotions within about two years are fired. In some firms, the rule is enforced so strictly that only about 10% survive after five years.<sup>6</sup> Thus consulting firms exhibit an organizational structure in which the number of personnel decreases sharply with each step up the ladder from consultant to manager and then partner, while their autonomy and incomes expand significantly. Since persons who do not contribute to corporate earnings are automatically forced to leave, the firm has very little risk of retaining unproductive personnel for very long. In addition, the intense competition to become a partner also serves to maintain the quality of personnel at high levels.

#### ( 3 ) Similarities Between Investment Banks and Consulting Firms

Many similarities can be found between the human resource strategies of investment banks and consulting firms: ( 1 ) an advanced degree ( usually an MBA ) is required, ( 2 ) both extensively hire new MBA graduates from top business schools, ( 3 ) competition in hiring is extremely fierce, ( 4 ) compensation and benefits are very large, and salaries are almost completely linked to performance, ( 5 ) time pressure and the pressure to perform are very strong, ( 6 ) the organization is designed so that professionals can focus on high value added professional responsibilities ( such as by having a separate back office and graphics department support )<sup>7</sup> ( 7 ) there is no personnel rotation because professionals are expected to develop their expertise, ( 8 ) training costs are substantial despite the intended short duration of employment, ( 9 ) managers are often professionals who have been promoted internally,<sup>8</sup> ( 10 ) poor performers are dismissed relentlessly ( the quality of personnel is maintained through constant threat of dismissal ) ( 11 ) since vacancies caused by dismissal are filled by regularly hiring new MBA graduates, the organization constantly renews itself, and ( 12 ) while the risk of dismissal is large, the work experience gained is highly valued in the job market and often leads to a new, lucrative position.

While the HRM model of professional firms has many advantages in securing, training, and using professionals, there are also many disadvantages. The extreme emphasis on earnings and efficiency can cause excessive job mobility and uncertainty, poor QWL<sup>9</sup> ( from long work hours and extreme duress ) and moral hazard risks ( inadequacy or neglect of teamwork and professional ethics, taking unwarranted risks when confronted with near certain dismissal ) Moreover, the system is not suited to nurturing managers with broad knowledge and a long-term perspective. In fact, the term “ Wall Street jobs ” has come to mean being extremely specialized and not necessarily suited for all people.

## 2. Conventional Human Resource Management at U.S. Companies

As described above, the management of professionals in professional firms is something quite extraordinary from a Japanese perspective. However, the situation is vastly different at most other U.S. companies. Their HRM ( including of professionals ) is far less characterized by the high-risk, high-return discipline of professional firms.

### ( 1 ) Hiring College Graduates

Large companies also hire new graduates from college and graduate school. But unlike Japanese companies, who regularly hire fixed numbers during a specific hiring season, they tend to keep their doors open at the entry level. And while graduates strongly desire long-term employment, they do not expect any guarantees of lifetime employment.

### ( 2 ) Unexpectedly Long Employment Term

Until the 1970s, practices such as lifetime employment ( such as IBM 's non-layoff policy ) and seniority existed in the U.S. But as layoffs became prevalent in the recessionary 1980s, workers grew cynical and adopted a lifestyle of constant job changes. Thus the perception of high job mobility may be true when compared to Japan, but we should note that ( 1 ) high job mobility is a relatively recent phenomenon of the last two decades, and ( 2 ) it mainly occurs among blue collar workers, and in fast paced environments such as Wall Street and Silicon Valley, where change is considered a fact of life. At large companies, white collar workers including professionals are usually employed for long periods.

### ( 3 ) Human Capital Development and Corporate Universities

Contrary to the stereotyped view that U.S. companies only hire fully trained personnel, they actually have surprisingly complete training and development programs. One reason is that U.S. companies as well as the society at large have a high regard for human capital. Unlike training programs at Japanese companies, which are uniform and do not take into account differences in skill level and occupation, most U.S. companies offer programs that are customized to individual needs.

Corporate universities offer the ultimate in training and development programs. In a radical departure for personnel development, companies now offer training at the university level. Presently there are 1,600 corporate universities in the U.S., established by companies in industries ranging from manufacturing to technology and retail ( Table 1 ) One of the largest

is Motorola University, which employees 400 full-time professors, has another 800 under contract, and accommodates 100,000 students annually. While Japanese companies are known for emphasizing employee education, the level of commitment of U.S. companies shows the depth of their strength.

**Table 1 Corporate Universities in the U.S.**

Arthur D. Little (consulting)	Mastercard Int'l (credit card)
AT&T (communications)	McDonnell Douglas Corp. (defense, aerospace)
Bell Atlantic Corp. (communications)	Motorola, Inc. (communications)
Anheuser-Busch, Inc. (beer)	Oracle Corp. (computer)
Charles Schwab (securities)	Sear Roebuck & Company (retail)
The Walt Disney Company (movies)	Sprint Corp. (communications)
Ford Motor Company (automobile)	Sun Microsystems (computer)
General Electric (electric)	Tennessee Valley Authority (public utility)
General Motors (automobile)	United Healthcare (medical)
McDonald's Corp. (restaurant)	Whirlpool Corp. (electric)
Harley-Davidson, Inc. (motorcycle)	Xerox Corp. (office equipment)
Intel Corporation (computer)	

Source: J.C. Meister ( 1998 ) Corporate Universities, McGraw Hill, pp. 255-265.

**Figure 2 GE University Campus**



Note: The GE Crotonville University in Ossining, New York has a lush 53-acre campus studded with many educational facilities, recreational facilities, and dormitories. Every year, 6,000 to 8,000 GE employees from around the world visit to take required courses. MBO and SWOT analysis, business screen analysis, and the six sigma method were developed here.

#### ( 4 ) Rotation Strategy of U.S. Companies

Occupational rotation does exist at U.S. companies. However, unlike the Japanese method of rotating new employees, the common pattern is for employees to develop an area of expertise first, and then to rotate only a selected few ( on the so called fast track ) For example, GE has

adopted a human resource strategy called HPI ( high performing individual ) in which selected individuals are assigned a series of challenging tasks such as managing subsidiaries or turning around unprofitable operations. This strategy allows GE to evaluate individuals while developing their managerial skills with valuable learning experiences.

**3. The Need for Innovative Management of Financial Professionals in Japan**

( 1 ) Why the Management of Professionals Varies by Industry

Here we briefly explain the reasons HRM differs between professional firms and other companies. At professional firms, which are extremely knowledge intensive, core responsibilities ( or functions that add the most value in the value chain ) are performed by professionals, whereas they are typically performed by general managers elsewhere ( Table 2 ) Professionals and general managers also differ significantly in terms of desired qualities and motivation ( Table 3 ) Moreover, compared to the extreme priority on short-term results at professional firms ( particularly investment banks ), most companies invest in real assets and evaluate personnel on a longer time horizon. Because of these differences, the overall personnel and organizational strategy takes a very different shape depending on who plays the main role ( Figure 3 )

**Table 2 Comparison of Professional Firms and Conventional Companies**

<b>Position</b>	<b>Professional firm (knowledge intensive)</b>	<b>Conventional company (labor/capital intensive)</b>
General manager (GM)	Promoted from professional position. Top management focuses on management.	Plays main role in core functions (formulation of management strategy, decision making)
Professional employee	Plays main role in core functions	Based on policies set by GM, is responsible for finance, accounting, marketing, technology, etc.
Staff member	Supports professionals	Support role/candidate for GM
Typical examples	Management consulting firm, auditing firm, law firm, investment bank, etc.	Ordinary operating company, commercial bank, etc.

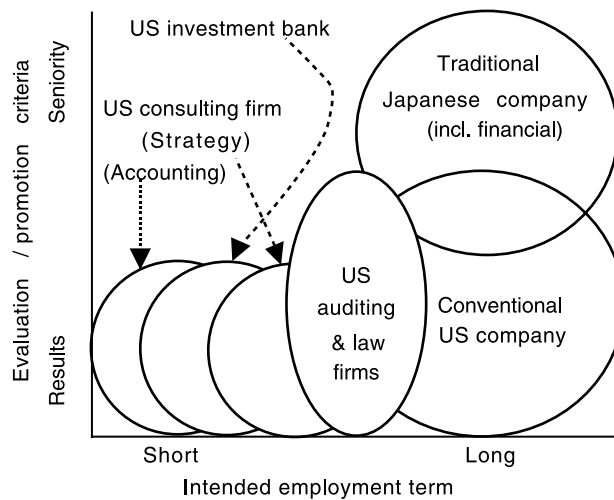
Source: NLI Research Institute

**Table 3 Comparison of Professional Position and General Manager**

	<b>Professional</b>	<b>General manager (GM)</b>
Desired qualities	Advanced skills, risk tolerance, stamina, decision making ability, initiative, creativity	Ability to make decisions from a broad, diverse perspective; management ability, good character and judgment
Motivation	Short-term financial compensation; job satisfaction and growth as professional	Promotion, evaluation within the organization, long-term potential for self expression and growth; stable employment, company loyalty
Evaluation criteria	Short-term, quantitative results	Medium to long-term qualitative and quantitative results
Term of employment	Short term	Long term

Source: NLI Research Institute

**Figure 3 Comparison of Human Resource Strategies by Industry**



Source: NLI Research

( 2 ) U.S.- Japan Comparison of the Status of Financial Professionals

In the U.S., knowledge intensive, specialized firms that manage investments such as investment banks, investment advisors, derivatives houses, hedge funds, and investment management ( investment advisors, trusts, etc. ) mostly use the HRM model of professional firms. On the other hand, retail oriented financial institutions ( commercial banks other than money center banks, insurance companies, retail securities brokers, etc. ) mostly use the conventional HRM model. Thus even in the same financial industry, companies use different HRM models depending on their specific segment.



However, this type of differentiation does not exist among financial institutions in Japan, and most companies use the conventional HRM model regardless of industry. Large securities firms, city banks, long-term credit banks, and trust banks have without exception been using the conventional HRM model to manage financial professionals, even in the investment management and financial product development divisions, which perform functions corresponding to investment banks in the west.

On the other hand, most foreign financial institutions in Japan imitate their parent company and use the professional firm model of HRM. Thus a large gap has existed in the way Japanese and foreign financial institutions manage their professional personnel.

### ( 3 ) The Growing Personnel Drain from Japanese Financial Institutions

Presently in Japan's financial sector, the flow of professionals from Japanese companies to foreign companies far exceeds the flow in the opposite direction. While Japanese professionals may feel uncomfortable about job insecurity and strict performance evaluation, they are no doubt attracted to the professional firm model of HRM because of what it offers: professional status, a promising career path, and lucrative compensation that rewards results.

Some Japanese financial institutions have responded to the personnel drain by rehauling their personnel practices. More companies are introducing professional positions, performance evaluations, and variable compensation. The new joint venture between the Industrial Bank of Japan and Nomura Securities, IBJ Nomura Financial Products ( launched in January 1999 ) has decided to introduce performance evaluations on a par with foreign firms. And while not a purely Japanese company, Nikko Solomon Smith Barney Securities, which has 700 employees transferred from Nikko Securities and Nikko Research Center, has abandoned Nikko Securities' personnel system in favor of the personnel system, organization, and business procedures of Solomon Smith Barney.

The same pattern can be seen in western financial institutions. Since the late 1980s, as financial liberalization caught on globally, major commercial banks in continental Europe responded by moving into the rapidly growing and profitable segment of investment banking. After acquiring small investment banks in the U.K. and U.S., they integrated themselves into the corporate culture and personnel systems of the investment banks. This gives credibility to the claim that the professional firm model of HRM has become a global standard for managing financial professionals.

#### ( 4 ) The Need for a New Human Resource Strategy

Now in the midst of the financial Big Bang, many Japanese financial institutions are expanding their activities in the increasingly important areas of investment management and investment banking. But while many securities subsidiaries of city banks, long-term credit banks, and trust banks are striving to expand their M&A investment banking business, their personnel systems remain largely antiquated.

Of course, city banks have less need to alter personnel systems in their retail divisions, which will continue to account for the majority of employees. But their investment banking and investment management divisions will face growing competition from foreign firms for financial professionals. In light of this, these divisions need to change how they manage professionals along the lines of the professional firm model. Specifically, city banks need to spin off these divisions from the existing organization, and adopt new human resource and organizational strategies: introduce professional positions, abolish rotation, clarify individual performance, set different salaries for different divisions, introduce performance evaluation and variable compensation, and separate the front, middle and back offices.

These innovations in the personnel system and organizational structure will undoubtedly cause a great deal of pain. But as long as the goal is to transform into an investment bank, both management and employees must become convinced of the necessity to creatively destroy existing traditions and corporate culture, and be prepared to concede some degree of job stability.

#### Notes

1. HRM refers to the management approach of aligning the personnel system with the company's strategic objectives. In this paper, professional personnel refers to white collar personnel with a high level of expertise in areas such as finance, accounting, law, management strategy, marketing, and personnel management.
2. Strictly defined, professional firms include management consulting firms, accounting firms, and law firms. However, since the latter two have a relatively conservative HRM model close to the industrial company model, in this paper we refer to management consulting companies and major investment banks ( bulge bracket firms )
3. However, since business school graduates already have several years of work experience, they are not equivalent to what are called new graduates in Japan.

4. However, since work experience at major investment banks is highly valued in the job market, they often find employment at buy-side, venture capital, proprietary finance, or boutique investment banks.
5. Knowledge management refers to the approach of systematically organizing and compiling a database of the knowledge that is scattered throughout the organization and among employees, thus creating an intangible asset that can be accumulated, managed, and shared.
6. Because work experience at a top consulting company is highly valued, those who are dismissed can frequently find lucrative positions at other firms including client companies. Since Japanese companies generally emphasize internal promotion, the infrastructure to support an up-or-out method is inadequate.
7. The graphics department specializes in preparing presentation materials, graphs and figures for reports, etc.
8. This is based on the idea that only persons with professional experience are capable of managing other professionals.
9. QWL refers to quality of work life.
10. The human capital approach regards an individual's skills and knowledge as a form of management resource or part of the social infrastructure.
11. However, this does not mean that the Japanese HRM model is inferior. While management culture theories are outside of this paper's scope, Section 2 makes clear the generality of the Japanese personnel system. With regard to the management of professionals, however, the Anglo-Saxon style is superior.