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Managerial transfers to reduce transaction costs among affiliated firms: Case study of Japanese railway holding companies

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ABSTRACT

We explore the impact of temporary transfer of managers on the transaction costs among unbundled business units and the important factors to consider while initiating transfers, through a case study of five Japanese railway corporations organized under a holding company structure. Our results suggest that there are very few conflicts and, thus, low transaction costs in the system, as the transferring managers engage in informal communications to align the related business units before the conflicts are actualised. However, there are cases in which other management characteristics such as human resource development programmes and organisational structures, can substitute for managerial transfers.

1. Introduction

Recently, various organisational reforms for introducing competition in network industries (public utilities) in terms of diversification, vertical separation, outsourcing, and other industrial and organisational restructuring, have attracted substantial interest. However, these organisational reforms do not necessarily yield economic benefits and may instead result in losses. This has been reported in various industries, such as water supply (e.g., Chong et al., 2006; Ruester and Zschille, 2010; Le Lannier and Porcher, 2013) and railways (e.g., Mizutani and Uranishi, 2013).

Many of the studies in this area emphasise the relevance of transaction costs. For example, as van de Velde (2015) suggests, incentive misalignments between railway operations and infrastructure management units in the European railways result in serious transaction costs between them, leading to overall system inefficiency. In fact, the railway industry in Great Britain, which pursued a radical vertical separation policy, has been suffered from inefficient management due to its inability to build cooperative relationships between train operating companies (TOCs) and infrastructure management companies (McNulty, 2011). This is due to high transaction costs that ensue following the division of the organisation, thereby leading to each company to maximise its respective profits, and not rather than those of the entire railway system. Reducing transaction costs among unbundled units is a significant challenge for reviewing the vertical separation policy and seeking cooperative relationships in the railway industry.

Japan's private corporations have developed a system to address this challenge. That is, a manager in one of the holding company firms[1] is transferred to another firm in the company for a limited period[2] so as to work with employees in the latter firm. In this paper, we discuss this aspect of the temporary transfer of managers (hereafter, "transfers"). Among the highly regulated sectors in Japan, the railway industry has rich experience with managerial transfers, since private firms dominate and, hence, its standard management system is relatively close to the private sector generally. In fact, transfers can be frequently observed in Japan's railway companies. We examine these companies as a case study of managerial transfers in network industries.

As referred to here, inter-firm transfers are different from a firm's internal transfers, or job rotation. In the former transfer type, managers move to a position in a different firm with different technologies and information there. Although job rotation inside a firm is frequently observed in other countries, inter-firm transfers are not as common. Nevertheless, in previous studies such as Inagami (2003) and Nagano (1989, 1996), transfers are considered a facilitator for inter-firm cooperation. This practice enables managers to transfer information on company policy and strategy to the affiliated firms, consequently helping them to reduce the misalignments and transaction costs between the headquarters (HQ) and affiliated firms.

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[1] Holding companies include both affiliated operating business firms and the headquarters (HQ) firms.

[2] The period of a transfer is determined on a case-by-case basis. For example, some managers are transferred for only 2 or 3 years, while others are transferred for more than 10 years.

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The purpose of this study is to examine the effects of temporary transfers of managers on transaction costs between unbundled business units in network industries and the important factors for implementing transfers. We propose transfers as a method to reduce transaction costs, especially conflicts within a company. Primarily, the discussion on public utilities leans towards inefficiency reduced by introducing market mechanisms such as competition or regulatory mechanisms such as incentive regulations, franchising, and deregulation (e.g., Amaral et al., 2009; Finger, 2014; Jamasb, 2006). We consider transfers as an organisational mechanism to reduce transaction costs between unbundled units. Our case study of Japanese railway holding companies provides implications for not only holding company systems, such as the German railways but also other sectors where business systems are vertically separated as they have common needs for coordination between the fragmented business units. Moreover, our study of horizontal misalignments could provide a new perspective to the discussion on misalignments between vertical units by revealing the pure organisational costs of separation, apart from being affected by the technical or supply chain relations between business units.

This paper comprises of four sections, after the introduction. In Section 2, we summarise the previous studies. Section 3 explains our model and describes the interviews for the case study. Section 4 discusses the results of the case study, and Section 5 concludes.

2. Literature review

2.1. Previous studies on temporary transfers

There are almost no studies on the effects of the temporary transfer of employees among affiliated firms on cooperation. Therefore, we refer to previous studies in related areas and summarise their implications and limitations as applicable to our research. Welch and Welch (1993) consider human relationships between firms as a network to manage multinational subsidiaries. They believe that bidirectional communication, from the HQ to subsidiaries and vice-versa, enhances inter-firm cooperation. The interactions are sometimes interpersonal and informal, in addition to the formal and standardised contact. Although they propose a new perspective by considering personal contact among firms for subsidiary management, their discussion is conceptual. Hence, the important factors affecting staff transfers and the possible rules consistent with the management of the entire group seem beyond the scope of their research.

Other related studies consider on job rotation within a firm. Since job rotation is typically done within a firm, the research perspective is intra-organisational. For example, Arya and Mittendorf (2004) argue that job rotation involves costs such as compensation for the employee engaged in a new task. Although their discussion on compensation can be applied to managerial transfers, their intra-organisational perspective cannot explain inter-organisational issues such as change of transferees' affiliation registers. Burke and Moore's (2000) analysis on the impact of job rotation on the fairness perceptions of non-rotating employees is also applicable to inter-organisational transfers. Our analysis goes further to include additional inter-organisational transfer issues.

Previous studies on job rotation have overlooked the impact on coordination among business units and the level of transfers. Earlier studies considered job rotation as a mechanism that facilitates the development of human resources and acquisition of skills to improve employees' productivity (e.g., Eriksson and Ortega, 2006). Moreover, they mostly investigate job rotation at the same hierarchical level (e.g., Burke and Moore, 2000), and the effect of the transfer from the upper to the lower level is not sufficiently examined. In our paper, we discuss the effects on the coordination between business units and transfers at both vertical and horizontal levels that generalises the discussion on personnel transfers.

To address these issues, we focus on transfers in a holding company in Japan, since this type of personnel transfer is very common, so knowledge and experiences have accumulated. In fact, there are some related studies in the Japanese literature on private businesses. Nagano (1989), who has conducted pioneering research in this area, describes the state of temporary transfers in manufacturing industries and categorises them into four types based on the purpose of the transfer: (1) group (inter-firm) cooperation, (2) strengthening subsidiaries, (3) employee education, and (4) employment restructuring in the parent company. The first type of transfer, which is the focus of this paper, aims to integrate the affiliated firms through the manager's direct communication. Nagano (1989) revealed that most transferees are middle-aged managers who are accustomed to the group culture, and the implicit knowledge and information. By enabling the affiliated firms to learn from them, the transfer could integrate the communication background of the firms and reduce communication costs. However, Nagano (1996) later argues that the purpose of the first type of transfer is more ambiguous than the other types. Since 'group' or inter-firm cooperation is abstractive in actual management, and its meaning depends on the context, no studies have described the impact of such transfers. In our paper, we discuss the effects of the first type of transfers that add novel implications to the literature.

Inagami (2003) considers the actual implementation of transfers. By interviewing transferees, he reveals the two methods of transfer; leaving the affiliation register in the sending firm, or transferring it to the accepting firm. In the former method, the sending firm provides the transferee's salary and welfare, while in the latter case, the accepting firm is responsible. Japanese companies have chosen these two methods, based on the situation. However, identifying environmental factors for the implementation of transfers, such as management policy for the entire group, is beyond the scope of Ingami's research interest.

So far, the role and implementation of transfers for inter-firm cooperation has not been sufficiently examined. In this paper, we explore the potential effects and identify the important factors for its operation by interviewing with managers. Moreover, our contribution is not limited to literature concerned with the transfer of personnel; we analyse transfers in the highly regulated railway industry. This approach is important in regulated network industries because constructing a cooperative system between unbundled organisations is being explored in recent years. Since the previous literature on managerial transfers mainly focuses on private firms such as manufacturers and retailers (e.g., Nagano, 1996), this is the first attempt, as far as we know, to discuss it in the context of regulated network industries. These industries face the problem of coordination of unbundled business units due to deregulation and liberalisation. In this paper, we will show how transfers work as an organisational coordination mechanism.

2.2. Transaction cost theory and definition of transaction costs

How does the temporary transfer of managers contribute to inter-firm cooperation? Although there could be several explanations for this, we specifically refer to transaction cost theory. This theory was first proposed by Coase (1937) and theoretically developed by Williamson (1967, 1983). According to this theory, firms choose the type of transaction contract and trading partner so that costs related to the transaction are minimised. Thus, the observed transaction type is the result of this transaction cost minimisation (under the condition that production costs are the same in any transaction type). Williamson (1992) further states that transaction costs are incurred due to *information asymmetry* and *opportunism* in the area of bounded rationality. Agents can have different information related to the transaction; for instance, data on the quality of partner or environmental uncertainty due to bounded rationality. Further, agents could consider opportunistic behaviours including betrayal and deception to maximise their own utilities. In these cases, agents incur additional expenditure such as searching and monitoring costs, which means higher transaction costs.

While Williamson (1983) proposes the concept of transaction costs