

# LECTURE 3

## GOVERNANCE THROUGH CORPORATIONS

### REFLECTIONS



# AIM OF THE LECTURE

To create an understanding of governance of local  
government operations through corporations

and

Summarize the lectures through reflecting on system  
governance

# SYSTEM GOVERNANCE FORMS

Hierarchy

Market

| <b>Hierarchy</b> | <b>Corporation</b> | <b>PPP</b>   | <b>Managed market</b> | <b>Regulated market</b> |
|------------------|--------------------|--------------|-----------------------|-------------------------|
| Producer         | Owner              | Owner        | Customer              | Customer                |
| Fiat (command)   | Strategy           | Negotiations | Adjustable contract   | Contract                |

# Sweden and it's municipalities

- 9 million inhabitants
- Nationalization of consumption (>50% of GNP directed by government), not production
- 290 municipalities
- Principle of autonomy
- Municipalities consume 30 % of GNP
- Responsibility for education, elderly care, social welfare, infrastructure and so on....
- Democratic organizations (election each 4 year)

# MUNICIPAL CORPORATIONS

- ABOUT 1280 MUNICIPAL CORPORATIONS, INCLUDING PPPs
- AT LEAST ONE CORPORATION IN EACH MUNICIPALITY
- 25% OF THE MUNICIPALITIES TURNOVER
- 45% OF THE MUNICIPALITIES CAPITAL
- 7% OF THE MUNICIPALITIES EMPLOYEES
- CONCENTRATED TO THE INDUSTRIES OF Estate, technical infrastructure (power, gas, heat, water distribution, waste & sewage)

# WHY CORPORATE FORM?

1. Agent for rationalisation of municipal operations  
(creating cost awareness)
2. Agent for competitiveness  
(making the organisation more alert to market demands)
3. Agent of privatisation  
(making it easier to transfer the company)
4. Institution  
(taken for granted, seems 'natural')

How do municipalities manage their corporations?

Popular opinion:  
They do **nothing!**

My point of departure:  
*Governance Strategy*

# GOVERNANCE STRATEGY DEFINED

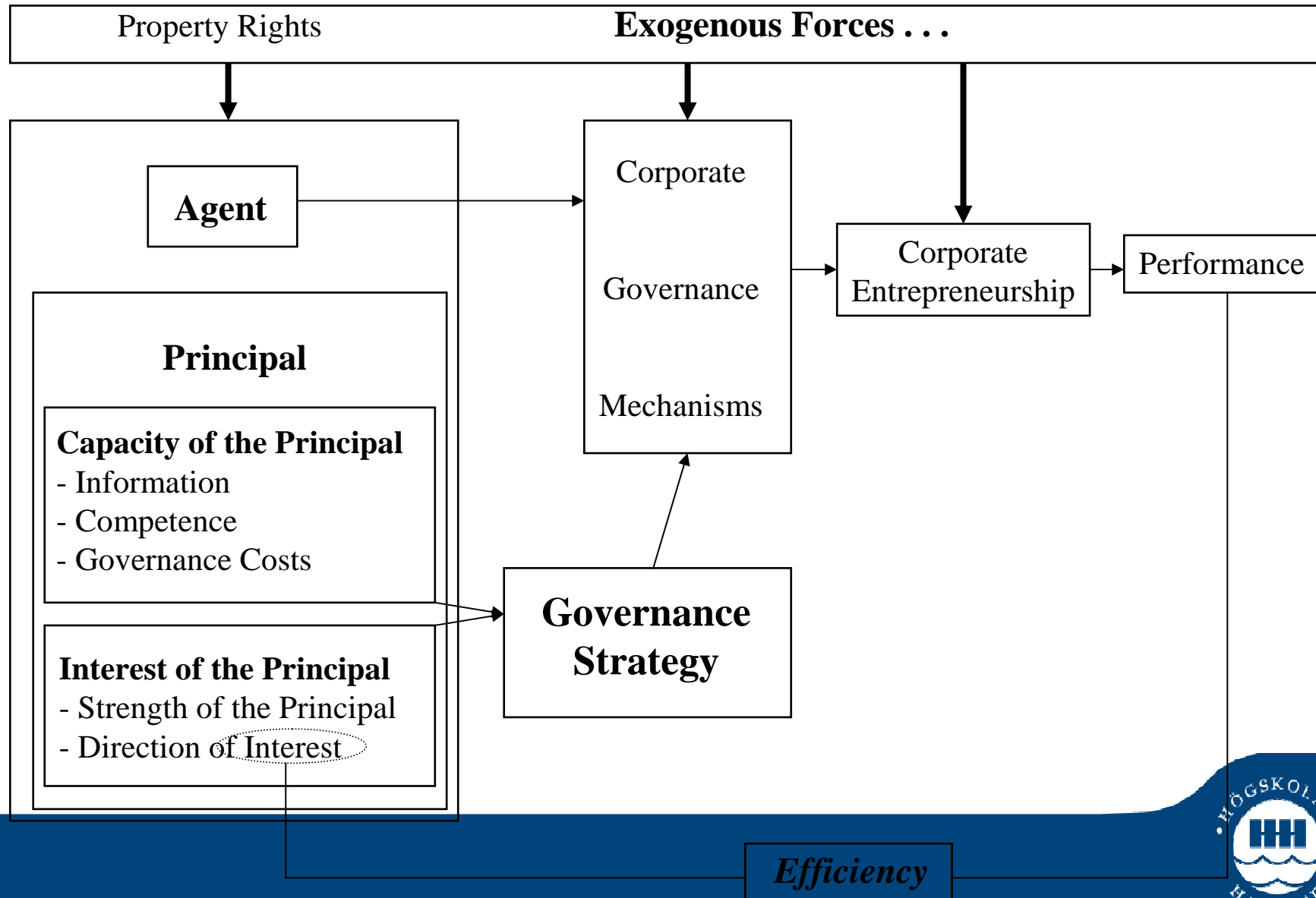
*A praxis oriented view of corporate governance*

**Designing the Individual Corporate Governance Mechanisms and  
The Mix of Corporate Governance Mechanisms**

in order to

ensure the **Fulfilment** of the **Main Stakeholders Objectives**

# GOVERNANCE STRATEGY



# Governance strategies for wholly-owned municipal corporations

| Corporate Governance Mechanism           | Strategy of Privatisation | Strategy of Competition   | Strategy of Rationalisation |
|--|---------------------------|---------------------------|-----------------------------|
| <b>Owner Capital</b>                     |                           |                           |                             |
| <i>Profit</i>                            | Strong emphasis           | Moderate emphasis         | No emphasis                 |
| <i>Risk</i>                              | Variance                  | Probability of losses     | No emphasis                 |
| <i>Size of Equity</i>                    | Strong emphasis           | Strong emphasis           | No emphasis                 |
| <i>Privatisation</i>                     | Moderate emphasis         | No emphasis               | No emphasis                 |
| <b>Debt Capital</b>                      | Preference for collateral | Preference for collateral | Preference for surety       |
| <b>Managerial Labour market</b>          |                           |                           |                             |
| <i>Recruitment source</i>                | External                  | Indifferent               | Internal                    |
| <i>Institutional Experience</i>          | Private                   | Indifferent               | Governmental                |
| <b>Organisation structure</b>            |                           |                           |                             |
| <i>Formalisation</i>                     | Vision and strong culture | Vision and strong culture | Bureaucracy                 |
| <b>Executive compensation</b>            | Bonus                     | Partly bonus              | Fix wage                    |
| <b>Board of Directors</b>                |                           |                           |                             |
| <i>Board composition: Competence</i>     | Industry dominated        | Tie                       | Politician dominated        |
| <i>Board composition: Chairman</i>       | Industry                  | Politician                | Politician                  |
| <i>Frequency of board meetings</i>       | Low                       | Low                       | High                        |
| <i>Board functional emphasis</i>         | Service                   | All functions             | Control & Decision          |
| <b>Auditor</b>                           |                           |                           |                             |
| <i>Interaction frequency</i>             | Intense                   | Medium                    | Low                         |
| <b>Product market</b>                    | No                        | specific                  | hypothesis                  |
| <b>Environment</b>                       |                           |                           |                             |
| <i>Culture</i>                           | No                        | specific                  | hypothesis                  |
| <i>Mass Media</i>                        | Negligence                | Negligence                | Negligence                  |
| <i>State legislation and Regulations</i> | No                        | specific                  | hypothesis                  |

# AN EMPIRICAL STUDY

- Empirical test on survey data 2000
- Sample of 33% of the municipal corporations
- Developed an instrument for governance strategy
- Distributed to the CEO, the Chairman and owner representative
- Response rate 47% CEO, 24% Chairman and 22% owner representative.
- Constructed the independent variable

# RESULTS

Indication on governance strategy

Capital

Part of managerial labour market

But

External recruitment of CEO in strategy of rationalisation

Primitive incentive system

The board dominated by politicians

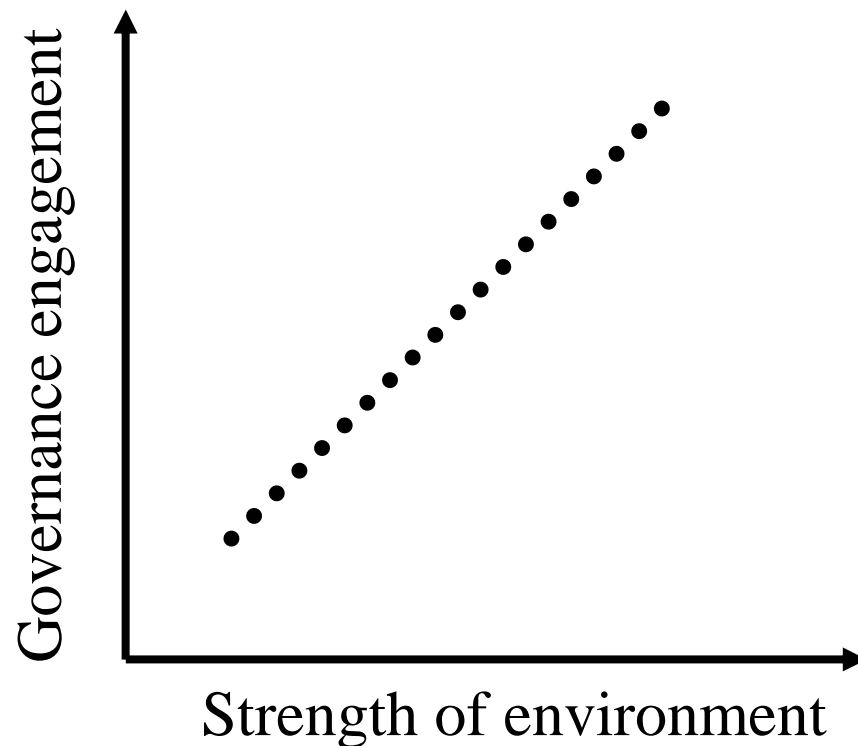
# CONCLUSIONS

- CONTROL ORIENTED GOVERNANCE STRATEGY
- BOARD MAIN ARENA

## CONSEQUENCE:

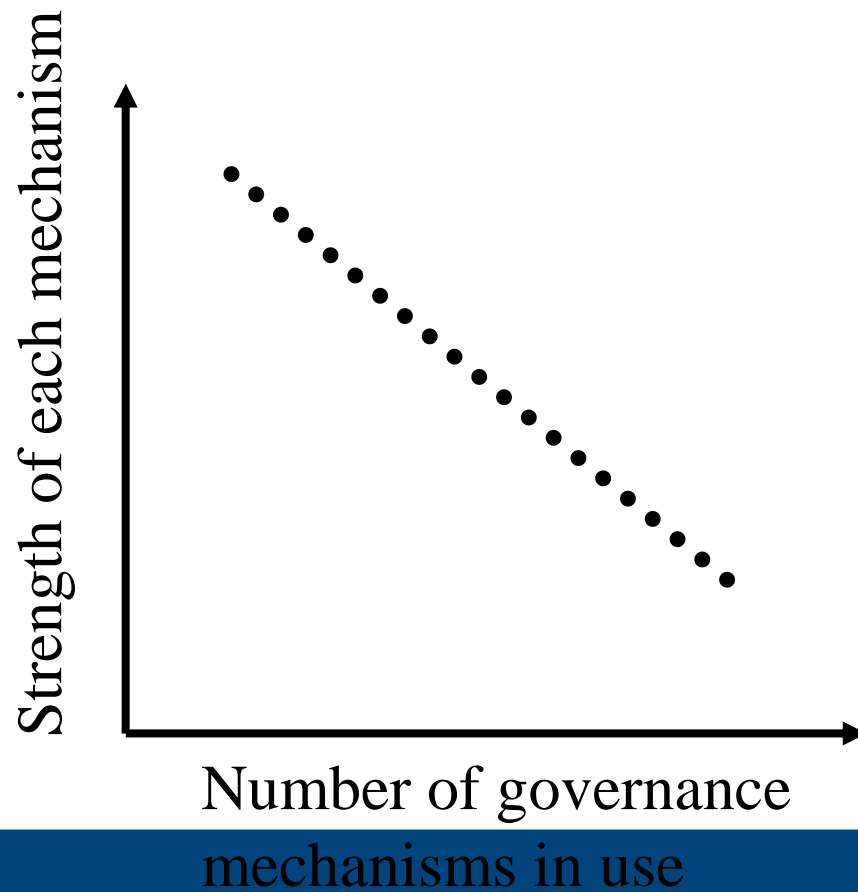
- 1.) CEO LONELINESS
- 2.) POLITICAL RISK
- 3.) DISEMPOWERMENT

# Hypothesis of the beast



- ...increasing exogenous influence puts larger demands on the governance strategy, forcing the principal to a higher level of governance engagement. Simply put, tougher environment creates tougher beasts.

# Hypothesis of the orchestra

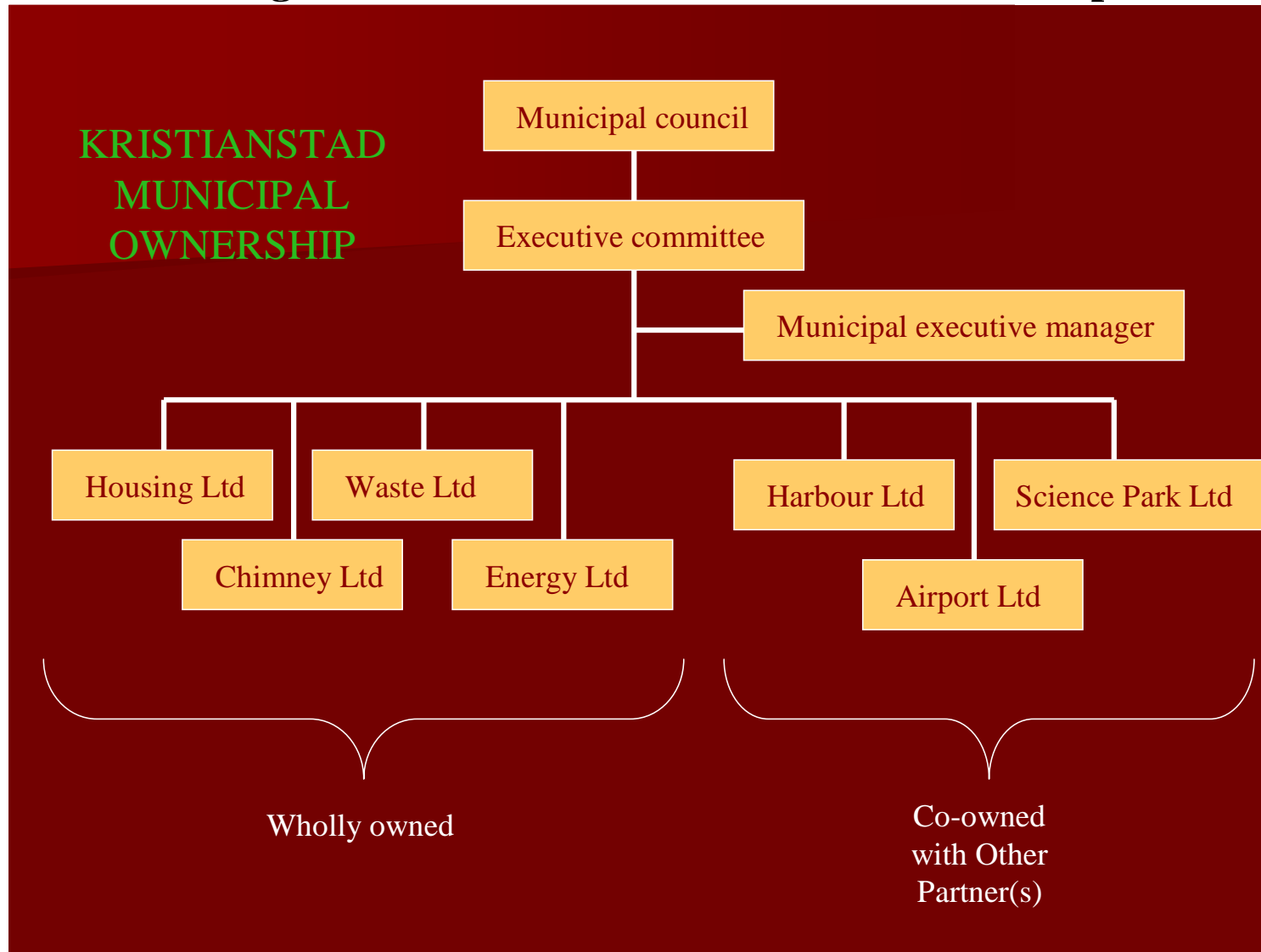


- ...if you cannot use the whole orchestra, you will have to make a louder sound with the only instruments you have available...

# Another empirical study

- Case study of one Swedish municipality and its corporations
- Evaluating the concept of governance strategy and its two hypotheses
- ...and in the future compare to PISA municipality...

# The Organizational Structure of Kristianstad Corporate Ownership



# THE EMPIRICAL INSTRUMENT FOR MAKING OBSERVATIONS

|                                   | Housing Ltd | Chimney Ltd | Waste Ltd | Energy Ltd | Harbour Ltd | Airport Ltd | Science Park Ltd |
|-----------------------------------|-------------|-------------|-----------|------------|-------------|-------------|------------------|
| <b>Capacity of the principal</b>  |             |             |           |            |             |             |                  |
| Information                       |             |             |           |            |             |             |                  |
| Competence                        |             |             |           |            |             |             |                  |
| Governance costs                  |             |             |           |            |             |             |                  |
|                                   |             |             |           |            |             |             |                  |
| <b>Interest of the principal</b>  |             |             |           |            |             |             |                  |
| Strength of the interest          |             |             |           |            |             |             |                  |
| Direction of interest             |             |             |           |            |             |             |                  |
|                                   |             |             |           |            |             |             |                  |
| <b>Governance Mechanisms</b>      |             |             |           |            |             |             |                  |
| Market for capital                |             |             |           |            |             |             |                  |
| Equity                            |             |             |           |            |             |             |                  |
| Debt                              |             |             |           |            |             |             |                  |
| Market for managerial labour      |             |             |           |            |             |             |                  |
| External                          |             |             |           |            |             |             |                  |
| Internal                          |             |             |           |            |             |             |                  |
| Executive compensation            |             |             |           |            |             |             |                  |
| Board of directors                |             |             |           |            |             |             |                  |
| Auditors                          |             |             |           |            |             |             |                  |
| Strategy                          |             |             |           |            |             |             |                  |
| Structure                         |             |             |           |            |             |             |                  |
| Product market                    |             |             |           |            |             |             |                  |
| Environment                       |             |             |           |            |             |             |                  |
|                                   |             |             |           |            |             |             |                  |
| <b>Corporate Entrepreneurship</b> |             |             |           |            |             |             |                  |

# SOME METHOD REMARKS

- Importance of operationalisation
  - Validity tests, to be sure you measure what you want
  - Reliability test, to be sure you make correct observation: Interrater reliability test
- Use multiple sources, i.e., triangulation of data: Interviews of different people, at different levels and positions, Annual reports, Internal documents, Newspapers articles, “Big ears”

# THE GOVERNANCE STRATEGY OF KRISTIANSTAD MUNICIPALITY I

- Capacity of the owner:
  - Low competence
  - higher information
  - varied governance costs
- Interest of the owner:
  - Weak, but varied

# THE GOVERNANCE STRATEGY OF KRISTIANSTAD MUNICIPALITY II

PRODUCT MARKET: Weak (monopoly)

CAPITAL: Weak (low debt-to-equity)

MARKET FOR MANAGERIAL LABOUR: Weak, but varied

COMPENSATION: Weak (coordinated with the democratic organization)

STRATEGY & STRUCTURE: Strong

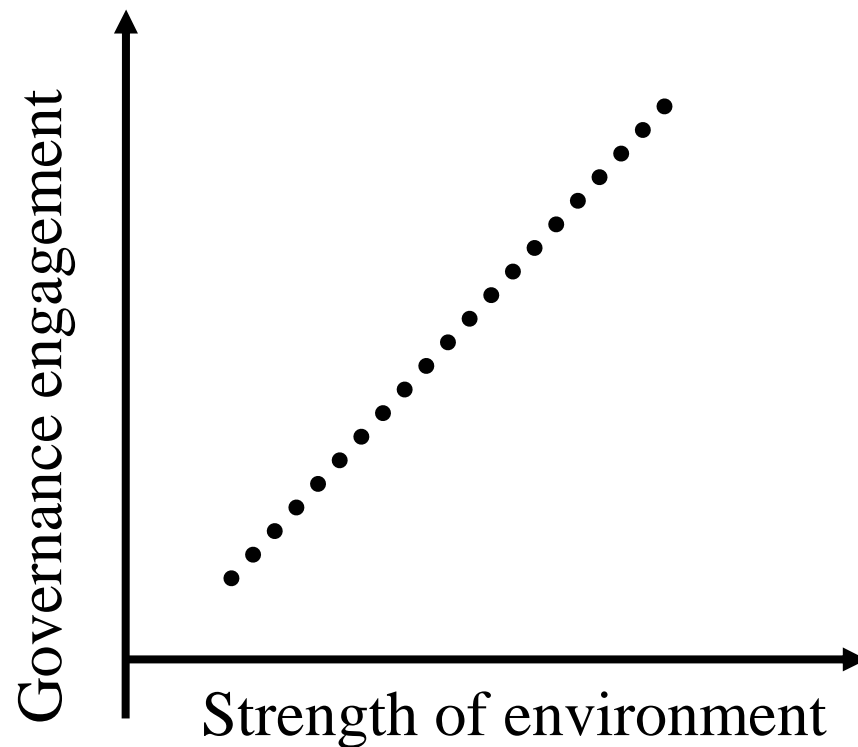
BOARD OF DIRECTORS: Weak but intermittent

AUDITORS: Weak

ENVIRONMENT: Strong due to principle of transparency

# THE GOVERNANCE STRATEGY OF KRISTIANSTAD MUNICIPALITY III

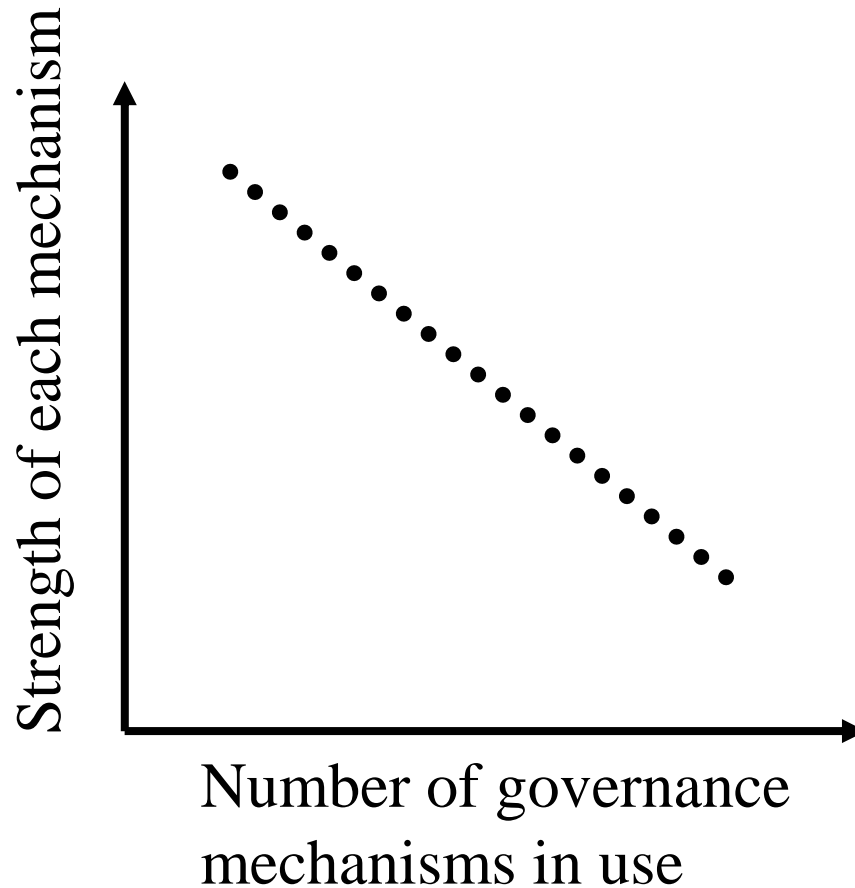
## Hypothesis of the beast



*Cannot be rejected  
for KRISTIANSTAD*

# THE GOVERNANCE STRATEGY OF KRISTIANSTAD MUNICIPALITY IV

## Hypothesis of the orchestra



*Cannot be rejected  
for KRISTIANSTAD*

# OBSERVATIONS I

- Principal with low engagement (heaven for an agent or sadness from indifference?)
- Capital of low interest (public spell?)
- External CEO market (incentives in the organization?)
- Primitive incentive system (emphasize public character?)

# OBSERVATIONS II

- Board: Random composition (functional emphasis, team characteristics?); Main mechanism (hypothesis of the orchestra), but who is the conductor?  
*Management of information...*
- Auditors (out of function?)
- Strategy, focused; Main mechanism?
- Environment: being public consumes energy
- Correlation between mechanisms and environmental pressure (hypothesis of the beast)

# THE GOVERNANCE STRATEGY OF KRISTIANSTAD MUNICIPALITY V

- Corporations constitute outsourcing without losing control of the service produced => emphasis on strategy and capacity of the board
- Financial control is not a control instrument but a signalling device
- Governance strategy not only a mean of governance, but also of creating freedom of action for the politicians (*absence of a holding company*)

# GOVERNANCE STRATEGY ... FOR WHOM?

Assuming the politician being an agent on behalf of the citizen

But, today's governance strategy more a strategy for the middle man, i.e., the politician, than for the citizen?

# SUGGESTIONS

- Financial management
- Board composition for team and functional harmony
- Principal engagement through organizational structure (A business group for coordination and governance and tax reasons?)
- Continue strategy emphasis

# MUNICIPAL CORPORATIONS IN SWEDEN

- Re-cycling of a former solution (institutional inertia).  
Path dependency or path creation
- Separation of politics from operation...
- ...but through strategy and strong CG, could be a political force



# GOVERNANCE THROUGH *CORPORATIONS*

## **Sweden**

Old system

Corporate governance:

- The board

Institutional isomorphism

Independence

+ Hierarchy (fast)

- Service uncertainty

## **Italy**

New system

Corporate governance:

- Regulation

Municipal monitoring of service

Independence

+ Focus on service

- Cost of governance

# CONCLUDING REFLECTIONS: THEORY

- **Efficiency**
  - Profit
  - Welfare
  - Democracy
- **Principal**
  - Citizen
  - Politician
- Agency theory adequate theory? Individual choice – ideology – duty

# CONCLUDING REFLECTIONS: PRAXIS

- Political pressure towards market solutions
- Corporatization implying...economizing, both as practical calculus and as weltanschauung
- Marketization => more specific specialization => increase in democracy and welfare, or domination of markets => decrease in democracy
- Marketization and corporatization => increasing market share for business administration research and teaching, at the expense of political science!