

## ***Local Authority versus Local Public Utilities: A Governance Issue***

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**Abstract:** *Governance issues are fundamental in Local Public Utilities (LPUs) management. In recent decades, organisations providing Public Services in European countries are experiencing key changes in their governance system. At the same time, local authorities need to keep their control over LPU services in order to ensure coordination between different actors with different aims. Moreover, the complexities and dynamics of public service delivery require discretionary power, interaction, capacity building and trust. To this end new arrangements and new governance tools are required. The paper contributes to the overall debate on governance mechanisms in local public utilities in several ways. Firstly, we contribute to the debate on corporate governance in local public utilities by analysing the state of the art of the Italian context. The results highlight the need to strongly improve governance tools, which are at an embryonic stage. Secondly, they show that currently choice of governance tools employed is left to the initiative of each single administration and they are applied in a fragmentary and unsystematic way.*

**Keywords:** *local authorities, local public utilities, governance, the Italian case*

**JEL:** *P25; P28; Q38.*

### **Introduction**

In recent years in Europe, the management of local public utilities (LPUs) has seen innovation and rethinking after the development of New Public Management. This has in effect opened a path for a process of reform in the public sector (Brown and Potosky, 2003; Ferlie *et al.*, 1996; Hood, 1991 and 1995; OECD, 2005a). Consequently, New Public Management principles are particularly evident in LPU governance (Bognetti and Obermann, 2008; Denhardt and Denhardt, 2000; McLaughlin *et al.*, 2002; McKoy, 2009; Schwartz, 2008).

Local public utilities (LPUs) are also characterised by the rethinking of the role played by local government in the provision of services (Hodges *et al.*, 1996). The exponential growth of shared entities managing local public utilities has resulted in local authorities finding themselves at the head of authentic business

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holdings - particularly of public limited companies - delivering services to citizens. The Italian scenario sees a separation between the role of local authorities and that of the LPUs (Grossi and Reichard, 2008). The former has to meet public needs, while the latter are responsible for delivering services.

The local authority's role is no longer that of mere service provider, but that of parent company who holds shares in the public limited companies and owns public services (stockholder). It is also a stakeholder in the same entities, while continuing to maintain its institutional role representing the interests of the local population.

However, managerial autonomy without proper governance by local governments may lead to inefficiencies and inequity in providing services. So, despite this reform process, local governments need to keep their governance and to be able to choose how to provide services and to select the criteria for preserving social rights and equity principles. In Italy, the difficulties encountered in coordinating and controlling the local public administration depend partly on heterogeneity of components, both in terms of ownership structure (we find, in fact, corporations, foundations, associations, etc.) and of activities carried out and services delivered (Bognetti and Robotti, 2007; Ricci and Landi, 2009).

The research aim is to verify the state of the art of Italian local authorities' governance on their LPUs. We shall begin, therefore, with an overview of the literature on local public administration (paragraph 2) and an examination of previous studies of the Italian context (paragraph 3). The article will then present an empiric investigation carried out by administering a questionnaire to Italian municipalities (paragraph 4). The fifth paragraph illustrates the results of the research. Finally, we end with some conclusions (paragraph 6).

## **1. Public governance and LPUs**

Public governance issues are fundamental in the debate on LPUs (Moore and Hartley, 2008; Osborne, 2006). In recent decades organisations providing LPUs in European countries are experiencing key changes in their governance systems. The governance of LPUs has to be inspired by principles of social equitability, effectiveness, efficiency, risk control and environmental protection, paying attention both to the expectations of the local community and to stakeholder interests (Bosetti, 2009). As a consequence, the discussion on the coordination and steering of public actors and resources is even more important as influencing the debate on public corporate governance (Ruter *et al.*, 2005). Indissoluble relationships exist between corporate governance and governance systems over LPUs (Bosetti, 2009). Corporate governance has been defined as the system by which companies are directed and controlled (Cadbury Committee, 1992).

However, public sector governance distinguishes itself from that of the private sector by its considerable diversity of aims and management models. While corporate governance in private groups focuses mainly on company performance,

public group governance needs to include aspects related to effectiveness and equity in delivering services (Hodges *et al.*, 1996; Meneguzzo, 1999). In other words, public governance systems have to consider the relationships among different actors with different aims and needs.

In connection with the public governance approach, some authors (Bevir *et al.*, 2003; Kettl, 2000 and 2002; Lynn *et al.*, 2000; Peters and Pierre, 1998; Stoker, 2006) highlighted the importance of improving not only the internal organisational system of the LPUs but also the system of relations with their “external” actors implementing the governance tools. Differences may also be found between the attention attributed to these issues by international institutions (ANAO, 1997; OECD, 2005b) and the scientific contributions, whether theoretical or empirical ones (Gnan *et al.*, 2011). Research argues that a situation of poor corporate governance is responsible for the poor performance of such public sector enterprises throughout the world (Wong, 2004).

The failings of public governance have also been pointed out by other research focussed on public governance with particular reference to stakeholder involvement (Gnan *et al.*, 2011). It was found that public enterprises failed to increase performance because they did not fully address their corporate governance deficiencies, as governance instruments did not involve cooperation and coordination among different levels of government or among external actors, such as their public owners (local authorities).

## 2. Previous studies of the Italian context

Since the Nineties, the phenomenon of LPU outsourcing in Italy has acquired considerable materiality, both for the number of local authorities and the relevance of the economic sectors involved (Grossi and Argento, 2008).

Within the Italian context, previous studies show how the majority of local authorities continues to hold shares in corporations, although legislation is moving towards constantly “pushing” for a more competitive market, preferring sourcing by means of contracting to third parties (Calabrò *et al.*, 2011). In other words, although those LPUs of general economic interest have indeed been opened up to competition, truly competitive dynamics have only grown up in a few sectors, while public ownership continues to play a fundamental role (Napolitano, 2010).

Therefore, despite the radical reform process, local government has continued to demonstrate a will to maintain governance over supply of services, in order to be able to choose and manage services (Bognetti and Robotti, 2007). In this scenario, the debate on policy coordination and, from a strictly organisational-economic point-of-view, the models and instruments of group governance become fundamental (Ruter *et al.*, 2005). The picture that emerges from previous research shows a system of managing LPUs based principally on direct and in-house sourcing.

Moreover, Confservizi (2009) found that, in general in Italy, results from bodies dealing with the provision of LPUs were not satisfactory. On this subject, Fraquelli (2007) has also noted that the majority of public utility companies are below minimum-efficient size.

Local authority ownership of numerous shares might suggest strong governance of LPUs, however the reality, once again, is the opposite. Governance systems are found to be in an initial stage of development and instruments are mainly based on information from the balance sheet, rather than from an ad hoc reporting system (Bosetti, 2009). Instead, local authorities should develop a multidimensional information system in order to better evaluate economic, social and environmental performance of bodies delivering LPUs (Boyne, 2002).

LPUs must manage and balance various interests and values (Elefanti and Cerrato, 2009) by involving different actors. Their governance must be made up of dynamic relationships and consequently, governance tools have to be dynamic.

In other words, nowadays, the main question is not so much if LPUs are delivered by public or private companies. Rather, there is a need for management and governance functions to be properly carried out by the administrations in charge (Garlatti, 2005; Kettl, 1993; Osborne and Brown, 2005). Gnan *et al.* (2001) have underlined the need to develop adequate governance mechanisms in relations between local authority, stakeholder and internal management.

The corporate information system must collect, elaborate and supply information to support the decision-making process and disseminate the organisation's strategy with a view to delivering effective and efficient activities and services. On this point, Italy, like other European countries, is testing regulation, instruments and - above all - systems of governance that can ensure better LPU governance (Argento *et al.*, 2010; Torres and Pina, 2002).

In other words, the local authority's responsibility to citizens/users is defined, on the one hand, as a need to guarantee a suitable LPU offer, outlining priorities while satisfying requirements. On the other hand, the local authority must verify levels of effectiveness and efficiency in the delivery process, by controlling the companies chosen to supply the services (Preite, 2005). The creation of bodies distinct from the local authority has reduced the degree of accountability and decision-making usefulness of public accounts, whether budgeted or final (Grossi and Soverchia, 2011). The annual results of LPU providers are not clearly or directly reported in local authority financial statements. Suitable instruments for supplying internal and external accounting information must be acquired, to report on financial performance of the public group (Mussari *et al.*, 2005).

### 3. Method

We used qualitative methodology to pursue our research aim, by means of a semi-structured survey with multiple-choice questions. Prete and De Matteis (2006) and Preite (2009) used questionnaires - a specifically qualitative method

often used in the social science field - to carry out similar research into municipalities with at least 80 thousand inhabitants.

The questionnaire was administered as an e-mail attachment (Schutt, 2004) to a selected sample consisting of Italian local authorities with more than 20,000 inhabitants (515 entities - with a feedback of 11.65%). We decided to choose this sample, as smaller local authorities are not able to influence the governance of LPUs owing to their low percentage of shareholding.

Given the issues indicated by the literature to evaluate the local group's governance, we organised our questionnaire into three sections. Section one contains information about the main characteristics of the local authorities. The second part concerns the public group and LPUs management. The last section is the core of the survey and collects information about the governance system. It focuses on three main aspects: local public group composition, allocation criteria of services to shared entities and governance on LPUs.

In order to obtain a better response level to the questionnaire, following the first e-mail, three reminders - clearly decreasing in effectiveness - were sent in the form of further e-mails (Bruschi, 2005, p. 188).

#### **4. Discussion of results**

Table 1 shows, in absolute and percentage terms, the municipalities who replied to the questionnaire.

**Table 1. Demographic classification of municipalities who took part in the survey**

<b>Demographic classification</b>	<b>N.</b>	<b>%</b>
20,000-29,999	15	25.00
30,000-50,000	19	31.67
50,001-99,999	15	25.00
100,000-249,999	7	11.67
250,000-499,999	2	3.33
over 500,000	2	3.33
Total	60	100.00

The majority of municipalities that took part in the survey were in the 30,000-50,000 inhabitants group, following by the ones immediately before (20,000-29,999) and after (50,001-99,999) This result was probably to be expected, since the majority of municipalities to whom the questionnaire was sent belonged to these three groups. Table 2 shows the territorial distribution, in regions, to which these municipalities belong.

The questionnaire showed that the majority of municipalities (56 out of 60, or 93%) that replied were stakeholders in third parties delivering one or more LPU to the public.

**Table 2. Regional classification of municipalities who took part in the survey**

<b>Regions</b>	<b>N.</b>		<b>%</b>
Piemonte	9		15.00
Liguria	2		3.33
Lombardia	12		20.00
Valle d'Aosta	0		0.00
Trentino Alto Adige	1		1.67
Veneto	6		10.00
Friuli Venezia Giulia	2		3.33
Emilia Romagna	4		6.67
Toscana	7		11.67
Umbria	0		0.00
Marche	1		1.67
Lazio	4		6.67
Abruzzo	0		0.00
Molise	0		0.00
Campania	4		6.67
Puglia	4		6.67
Basilicata	0		0.00
Calabria	1		1.67
Sicilia	2		3.33
Sardegna	1		1.67
Total	60		100.00

For the majority of shared entities of the municipalities, their legal status was that of a public limited company. Rarely were they foundations, associations or committees. Table 3 shows local public utilities delivered by shared companies with legal status of a public limited company.

**Table 3. Shares in public limited companies**

	<b>Direct shares dire</b>		<b>Indirect shares</b>
Waste management	40		10
Water management	35		11
Social housing	9		--
Chemists	24		2
Local public transport	20		8
Other <sup>1</sup>	39		4
No reply		2	

Foundations and committees seem a somewhat marginal phenomenon, dealing with numerous services with no profit services (Table 4). 37.50% of municipalities have no shares in foundations, associations or committees.

**Table 4. Municipality shares in foundations, associations or committees**

	Foundations		Associations and Committees
Culture and sport	23		12
Social and personal services	11		5
Tourism	6		6
Other	11		10
Owens no shares	26		39

The central part of the questionnaire is dedicated to governance tools and systems. Table 5 shows replies from organisations to questions 3, 4 and 5 of the questionnaire.

**Table 5. Regulation and information between local authority and in-house organization**

Type	Yes	No	No reply
<i>Regulation of shared companies</i>	13	42	1
<i>Regulation of local authorities' representatives in shared companies</i>	30	24	2
<i>Scheduled information between local authorities and shared company</i>	45	7	4

Only 23.32% (13) of municipalities involved in the survey had approved the shared companies' regulation. More numerous were the authorities which had issued a ruling for the local authorities' representatives in shared companies (30, equal to 53.37%) and, in particular, those with scheduled information between municipality and shared entities (45, corresponding to 80.36%).

The authorities having scheduled information with in-house companies were asked to specify which company documents were involved. As might be expected, the financial statements was the main document mentioned. Indeed, almost all the municipalities (45) had information regarding financial statements and, to a lesser extent, the draft of the financial statements (25). No less than 36 municipalities requested information on company meeting minutes, 27 on the budget and 26 on the business plan. The reporting, in place with a total of 22 authorities, normally takes place every six months (14) or three months (8). It is also worth noting the request for technical reports from shared companies. Table 6 gives an overall picture of information between in-house companies and local authorities.

To further examine instruments of governance, we searched for special rights or powers for municipalities. Authorities often have a right to nominate and revoke members of company boards. Often such powers are embodied in the corporate statute or, more rarely, are the result of shareholders agreements. Table 8 gives an overall outline of the phenomenon.

**Table 6. Scheduled information for in-house organisations**

Type	No.
Business plan	26
Budget	27
Meeting minutes	36
Reports	22
Monthly	0
Quarterly	8
Six-monthly	14
Draft of the financial statements	25
Financial statements	45
Technical reports	26
Other	16
No reply	4

For services delivered by third parties the question of quality control was examined. Firstly, authorities were asked if providers had drawn up a “Service charter”, which is the main instrument of interaction between provider and user. Unfortunately, as in previous studies (Calabrò *et al.*, 2011), the result was anything but positive, for only 24 authorities had verified if such a charter existed, despite its fundamental importance in terms of governance (Table 7).

Generally, the LPU for which it is more frequently used are waste management and water management, more rarely for local public transport. The category “Other” returned a high absolute value and included very varied services (most frequently mentioned, for example, were tax collection, cemeteries, gas and public lighting).

**Table 7. Governance over “Service charters”**

Service	No.
Waste management	26
Water management	26
Social housing	6
Chemists	11
Local public transport	17
Other	14
Not carried out	24

Subsequently, information was gathered about how often the “Service charters” were updated (yearly, six-monthly etc.) and in what way. Regarding recurrence, only nine authorities replied, so it may be assumed that updates are not regularly scheduled.



Table 8 shows, for each LPU, whether the update is carried out solely by the provider or whether it is done together with the authority in question. Though the difference is slight, more frequently “Service charters” are updated by unilateral decision of the provider.

This is certainly not something positive, because this document is a guarantee for the consumer/user of the quality of the service he is using. And this, regardless of how it is managed, should always be fundamental for the municipality responsible for the service.

**Table 8. How the “Service charter” is updated**

<b>Service</b>	<b>Unilateral updating</b>		<b>Mutual updating</b>
Waste management	11		15
Water management	16		8
Social housing	3		2
Chemists	8		4
Local public transport	13		9
Other	5		13
Total	56		50
No reply		24	

Finally, authorities were asked if they monitored the level of application of criteria laid down in the “Service charter” - in other words, whether a customer satisfaction survey is conducted (Table 9). The majority of authorities (38) did not reply to the question. Customer service surveys concerned local public transport, followed by waste management and water management. Rarely did they concern services without economic materiality, such as residential public housing and chemists.

**Table 9. Monitoring of the “Service charter”**

<b>Service</b>	<b>No.</b>
Waste management	13
Water management	13
Social housing	3
Chemists	3
Local public transport	14
Other	7
Not carried out	38

Municipalities were then asked, with reference to Decree Law 118/2011 (the so-called 'harmonisation decree'), if they produce a consolidated financial statement for the municipal group. This document is considered by academics and accounting practice as the best solution to the information needs of the local authority and of its stakeholders (Preite, 2005) (Table 10).

Table 10 - The consolidated financial statement

Do you prepare a consolidated financial	No.
Yes	10
No	45
No reply	1

Unfortunately it is not a commonly used document. In fact only 10 municipalities prepare one. Those authorities that gave affirmative replies were asked for information on the consolidation area. The majority included public limited companies (7) and institutions (4) - less frequently foundations, associations and consortia. Naturally, here it was possible to give more than one reply. In general, the predominant legal status - public limited company - was also more commonly found than others in managing public services.

Lastly, those municipalities without consolidated financial statements were asked if they intended preparing one. The majority of municipalities said they intended compiling one within 2 years (16) or within 5 years (10), while only 5 intended producing one by the end of 2013. Many authorities (14) did not reply to the question.

### Conclusions

Overall, this study confirms previous research (Calabrò *et al.*, 2011) - that the majority of local authorities hold limited company shares but, although Italian legislation has been repeatedly varied in an endeavor to produce a more competitive market, the picture that emerges is the result of a public services management system focused on direct assignments and on in-house governance. This situation could potentially suggest the presence of strong governance on LPUs, however, the results are the opposite: the governance system is at an early stage and its tools are mainly focused on financial statement information instead of on a specific reporting system. Results also highlight that governance mechanisms need to be improved in order to be more accountable to citizens. They also highlight the need to develop governance mechanisms regarding the relationships between the local authority and its external (stakeholders) and internal (management) actors (Gnan *et al.*, 2011).

The governance information system has to collect, process and deliver information in order to support decision-making and disseminate the local authority's strategies into effective activities and services. Italian local authorities need to develop a multi-dimensional information system in order to better evaluate and governance the competitive, social and environmental performances of LPUs. To date, a few local authorities have a governance mechanism to control their group, but the majority are unable to manage one and consequently, to have acceptable governance over LPU organisations. As previous research highlights,

managerial autonomy of LPUs without proper governance by local governments may lead to accountability problems (Rhodes, 2006). The inability of local authorities to create a suitable governance system directly results in an inability to report properly to stakeholders on performance in general and on the performance of local public utilities in particular (Calabrò *et al.*, 2011).

According to the literature, these results could be generally attributed to the complexity of application of these management tools in public organisations, in comparison to private sector organisations (Pollit and Bouckaert, 1995), as well as to the suitability of such applications for the public sector (Murray, 2004).

The research does have some limits. One of these is linked to the continuous changes in legislation and to the uncertainty that characterizes the management of LPU issues. The paper does, however, contribute to the overall debate on governance tools and mechanisms in LPUs by highlighting the gap that to date exists between the doctrine and the results of legislation, while also aiming to develop discussion concerning further research. While the research analyses the Italian context, it could be of interest to scholars from other European countries that are experiencing the consequences of New Public Management reform, in order to identify common trends or significant differences.

The appropriate implementation of governance systems could help local authorities and LPUs to better perform their tasks. The results of this research can be considered as a starting point for further analysis concerning intentions expressed by local authorities, for example, testing the results of financial consolidated statements over the next three years.

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*Endnotes*

- <sup>1</sup> "Other" includes a variety of activities including sports facilities, building maintenance, gas, taxes, cemeteries, car parks, public lighting, public roads and social services. It proved impossible to order these activities, due to their great "fragmentation".