



**University of Rome “Tor Vergata”**  
**Faculty of Economics**

*PhD in Public Management and Governance (XXII)*

**GOVERNANCE STRUCTURES AND MECHANISMS  
IN PUBLIC SERVICE ORGANIZATIONS:  
THEORIES, EVIDENCE AND FUTURE DIRECTIONS**

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# Table of contents

<b>Introduction</b>	I	
<b>– Chapter 1 –</b>		
GOVERNANCE STRUCTURES AND MECHANISMS IN PUBLIC SERVICE ORGANIZATION: A REVIEW AND RESEARCH AGENDA		
<b>1.1</b>	Introduction and motivation	1
<b>1.2</b>	The theoretical debate on governance structures and mechanisms in PSOs	5
<b>1.3</b>	Methods	9
1.3.1	Selection of papers	9
1.3.2	Content analysis	12
1.3.3	Type of articles	13
1.3.4	Use of theories	13
1.3.5	Research setting	13
1.3.6	Source of data	14
1.3.7	Governance structures and mechanisms in PSOs	14
<b>1.4</b>	Empirical results	15
1.4.1	The growing attention to the research on governance structures and mechanisms in PSOs	15
1.4.2	Interactions of theories, settings, and data sources	15
1.4.3	Time evolution	20
<b>1.5</b>	Discussion and findings	22
<b>1.6</b>	Conclusions and future research directions	30
<b>1.7</b>	References	31
<b>– Chapter 2 –</b>		
CONFLICTS OF INTEREST AND GOVERNANCE MECHANISMS IN ITALIAN LOCAL PUBLIC UTILITIES		
<b>2.1</b>	Foreword	38
<b>2.2</b>	The governance system of LPUs: a principal-agent perspective	40
2.2.1	The agency relationships between the citizens and the main shareholder	42
2.2.2	The principal-principal conflict	44
2.2.3	The role of the board of directors as the main governance mechanism	45
<b>2.3</b>	Research design	47
<b>2.4</b>	Results	50

2.4.1	The accountability to citizens	51
2.4.2	The ownership structure and the board composition	54
2.4.3	The board independence	55
<b>2.5</b>	Discussion and findings	56
<b>2.6</b>	Conclusions and future research directions	62
<b>2.7</b>	References	64
Appendix: The legislative evolution of local public services in Italy		69

### – Chapter 3 –

#### PARTIAL PRIVATIZATION PROCESSES AND ACCOUNTABILITY ISSUES: EVIDENCE FROM ITALY AND NORWAY

<b>3.1</b>	Introduction	74
<b>3.2</b>	The privatization process in different perspectives: New Public Management, New Public Service, New Public Governance	76
<b>3.3</b>	Privatization, public service providers, corruption and conflict of interest	79
<b>3.4</b>	Methods	82
<b>3.5</b>	Privatization in Italy and in Norway: a historical overview	87
3.5.1	The Italian case	87
3.5.2	The case of Norway	89
3.5.3	Privatization in Italy and in Norway: different drivers but same final status	92
3.5.4	The ethical structure	93
<b>3.6</b>	Discussion and Findings	97
<b>3.7</b>	Conclusion and future research directions	101
<b>3.8</b>	References	104

### – Chapter 4 –

#### DOES THE BOARD OF DIRECTORS CONTRIBUTE TO THE INNOVATION OF STATE-OWNED COMPANIES?

<b>4.1</b>	Introduction	108
<b>4.2</b>	Why is innovation important for SOCs?	110
4.2.1	The types of innovation in SOCs	111
4.2.2	The Norwegian context and the role of SOCs	114
<b>4.3</b>	Governance mechanisms and innovation in SOCs: the role of the board of directors	116
4.3.1	Board composition and board working style	117
<b>4.4</b>	Methods	120
4.4.1	The sample	120

4.4.2	Measures	122
4.4.3	The multiple linear regressions analysis	124
<b>4.5</b>	<b>Results</b>	<b>125</b>
<b>4.6</b>	<b>Discussion and Findings</b>	<b>128</b>
<b>4.7</b>	<b>Conclusions and future research directions</b>	<b>133</b>
<b>4.8</b>	<b>References</b>	<b>135</b>
<b>Conclusions</b>		<b>140</b>

## **Figures**

### **– Chapter 1 –**

Figure 1 – The research on governance structure and mechanisms of PSOs 16

### **– Chapter 2 –**

Figure 1 – The agency relationships in LPUs 43

### **– Chapter 4 –**

Figure 1 – The research model and the main hypotheses 120

## **Tables**

### **– Chapter 1 –**

Table 1 – Summary of the selection criteria	16
Table 2 – Overview of journals including publications per time period and impact factor	17
Table 3 – Interactions of theories, settings, and data sources	18
Table 4 – The evolution of the literature on governance structures and mechanisms in PSOs	21

### **– Chapter 2 –**

Table 1 – The LPUs listed in the Italian Stock Exchange	48
Table 2 – The content analysis of the service charters (principles)	51
Table 3 – The content analysis of the service charters (implementation actions)	52
Table 4 – The Ownership structure of LPUs	53
Table 5 – The board composition	54
Table 6 – The content analysis of the CVs	55

### **– Chapter 3 –**

Table 1 – Companies owned by the MEF in Italy	84
Table 2 – Companies with sectoral policy objectives in Norway	86

### **– Chapter 4 –**

Table 1 – Companies in the sample	122
Table 2 – Factor analysis of innovation measures	123
Table 3 – Summary Statistics	125
Table 4 – The correlation matrix (88 observations)	127
Table 5 – Multiple linear regressions (88 observations)	128

## Introduction

Public services play a central role in the well-being, sustainability and growth of communities, cities and nations. However, globally, public services have emerged from a period of considerable criticism. This period of challenge to public services was generated by the rise of neo-liberal ideologies in the 1980s and 1990s (Hartely et al., 2008). During this period market solutions were implemented instead of State provisions. Privatizations and disinvestments played a central role in that process (Cafferata, 1993) taken place on the grounds that management is underpinned by certain general principles and practices (New Public Management) which can be applied across a range of businesses, organizations and sectors (Pollit and Bouckaert, 2004).

The current situation is characterized by new forms of relationships between State and society. The role of both government and public services are considered fundamental in order to create stable social and economic conditions by actively involving citizens and community organizations. Therefore, the inter-relationships between the public, the private and the voluntary sectors in the design and provision of public services are increased (Ferlie et al., 2005).

In recent years, two seem to be the key questions: *how are public service organizations governed? And, are we asking the right questions?* These questions arise from the fact that nowadays, the public sector has differences among countries and many actors are producing and providing public services through different modes of governance. Actually, it is possible that public private partnerships (hereafter denoted as PPPs) (Klijn, 2008), outsourcing, state owned companies, municipal corporations (Grossi and Mussari, 2009; Grossi e Reichard, 2008), third sector and voluntary organizations, citizens, etc. might coexist. However, many issues may arise, for example, from the use of PPPs, co-production with civil society organizations, and other new governance arrangements. These developments open up questions about the extent to which such new organizational forms deliver benefits of innovation, efficiency and responsiveness, as well as their impact on processes of steering and accountability in a democratic context. Even if this fragmented reality gives more challenges to the provision and

## Introduction

production of public services and goods to citizens however it raises many accountability problems due to the overlapping of roles and responsibility (Skelcher, 2010). This is the major concern of a networked public sector (Rhodes, 2007) and therefore analyses of public service organizations' (hereafter PSOs) governance systems are needed.

Managing those complex inter-relationships can be harnessed to improve a range of public services by examining them through different theoretical perspectives (e.g. network theories, agency theory, resource and knowledge based theories, political power theories, innovation and change theories, performance and management theories, governance theories, etc.). By using this approach it will be possible to definitely advance both theory and practice, beyond the traditional model of Public Administration (hereafter denoted as PA) and New Public Management (hereafter denoted as NPM), by considering the existence of networked forms of governance, thus arriving at the acceptance of the New Public Governance (hereafter denoted as NPG) as the steering theoretical framework (Osborne, 2006; 2009).

These aspects are in line with the new awareness of the social, economic, and cultural contribution of public services, public organizations and government has resulted in a significant period of reform and experimentation (Hinna et al., 2006). Besides, at the heart of these initiatives is the idea that improvements to the ways in which public services can be governed, managed and delivered will produce improved outcomes for citizens (Brandson and Pestoff, 2006; Pestoff, 2009).

The purpose of this thesis, therefore, is a new understanding of public service organizations' (hereafter denoted as PSOs) governance and management. This is done by using a multidisciplinary approach to explore governance structures and mechanisms, management, innovation, and performance of PSOs. Moreover, the study fills the gap of quantitative analysis to be tested and explored for their meanings and contextual influences by undertaking case studies, and for case studies to generate propositions to be tested with large datasets. Finally, questions of when, how and why

governance structures and mechanisms matter to public service performance and accountability, are addressed.

The role of governing bodies and internal governance mechanisms seems to be especially important for understanding the dynamics and the processes that in turn affect the overall value creation capacity of PSOs. In this respect, it is important to underline that PSOs primarily aim to produce not profit or market positioning but “public value” (Moore, 1995; 2005; Bozeman, 2009). Public value means what is added to the public sphere and this may be social or economic, or it may be political, environmental or even more broadly about the quality of life. Indeed, a public value perspective requires examining the impact of public services on “customers” and “users” but also the impact on them as “citizens”.

Only by taking into account all these issues and the inherent complexity of the analyzed phenomenon, through this study it becomes possible to investigate the governance structures and mechanisms of PSOs from different angles and “regimes”, with emphasis on differences among national contexts, theoretical frameworks, and methods of analysis.

The first chapter is a systematic literature review on governance structures and mechanisms in PSOs. The other chapters are empirical (with qualitative and quantitative methodology of analysis) and are based on different research settings. In particular chapter two is based on the Italian context and the analysis is on 10 listed local public utilities (hereafter denoted as LPU). The third chapter makes a cross country comparison of the Italian and the Norwegian privatization processes, mainly focusing on the impact of these processes on public service providers. The last chapter is based on Norwegian data (collected from 2003 to 2006) on 88 state owned companies (hereafter denoted as SOCs) mainly operating in the service sector.

The first chapter – *“Governance structures and mechanisms in public service organizations: a review and research agenda”* – comprises a systematic literature review on the topic of governance in the public services domain. Indeed, issues related to

## Introduction

governance structures and mechanisms are receiving increasing attention worldwide. However, there are often overlaps, misuse and superficiality when using the term *governance*. Particularly, the governance term is monopolizing and inhibiting the debate on Public Administration and Management (hereafter denoted as PAM).

The research questions addressed in the chapter are: *which are the governance structures and mechanisms used for managing PSOs? Why there is a need for a systematic literature review? How to cope with the gaps? How to contribute to the on-going debate? And, which are the possible future research directions?* Therefore, the aim is to assess the state of the art on governance structures and mechanisms in PSOs analysing past, present and future evolutions. We use the argument advanced in Osborne's article (2006) that PAM has actually passed through three dominant modes [Public Administration, New Public Management and New Public Governance]. Drawing on that classification the chapter analyses quantitatively 184 published journal articles, from 1970 to 2009 by showing the relationships among theories, research settings, sources of data, countries of analysis, governance structures and mechanisms, etc. Moving from what is already done in previous studies, the chapter identifies critical areas that need an insightful introspection in order to suggest useful future research directions.

Chapter two – “*Conflicts of interest and governance mechanisms in Italian Local Public Utilities*” – analyses the situation of the Italian listed LPUs. The focus is thus on local public services and on the involvement of various actors in their governance system. Through the lens of agency theory, the chapter examines the conflicts of interest that may arise among the different actors (citizens, Local governments, private shareholders, service providers, etc.) involved in the governance of LPUs. The overall research questions are: *which is the governance system adopted by the Italian LPUs? Is it possible to catch, whether and to what extent potential conflicts of interest arise among different actors [citizens, LGs, private shareholders and service providers]? If yes, is it possible to prevent and mitigate such governance problems?* This chapter summarizes the main results of the multiple case study analysis on 10 Italian listed LPUs identifying different and co-existing situations of conflict of interest among multiple principals and agents. Although governance mechanisms (e.g., the board of directors) have different roles and functions and may prevent and mitigate such conflicts, our findings suggest

that there are a number of problematic issues. First, the effects of ownership structure on board composition and functioning. Second, higher numbers of independent directors do not mean “actual” board independence. Third, the Service Charter as a tool for promoting transparency, accountability and public participation is not yet well implemented. The study contributes to the debate on LPUs suggesting possible developments of agency theory by including forms of citizens’ participation and engagement (co-production).

The third chapter – “*Partial privatization processes and accountability issues: evidences from Italy and Norway*” – highlights how in the last decades the privatization process has characterized and changed the public sector in many European countries. However, often it ended up with public service providers (organized in the form of joint stock companies) still owned by the State (partial privatizations). The main research questions are: *what motivates partial privatizations? And, what are the consequences of partial privatizations for the accountability of public service providers? Are there differences or common patterns when comparing the situation of different countries?* By discussing the partial privatizations from different theoretical perspectives – New Public Management (NPM), New Public Service (NPS), and New Public Governance (NPG) – the chapter shows some main problematic issues related to corruption, conflicts of interest and the lack of accountability. While in the NPM the privatization process aims at improving public service providers’ efficiency, if analysed from the NPS perspective it seems to create ethical problems. Moreover, NPG, as co-production, networks and cooperation, offers valid alternatives to privatization focusing more on citizens’ public value and interest. Through a case study analysis the chapter describes the Italian and the Norwegian privatization processes. The results show the *stop and go* characteristic of the Italian process, the *reluctance* of the Norwegian government to privatize and the existence, in both countries, of situations in which the Ministries are still the major owners of service providers. Moreover, although the role of Ministerial governance has different development in the analysed countries a common pattern exists in relation to ethical and accountability problems. To investigate those issues a content analysis of codes of ethics has been conducted on the public service providers owned by the Italian and the Norwegian

## Introduction

governments. Finally, we discuss networked modes of governance and the implementation of accountability as reasonable alternatives to the lacks generated by these partial privatization processes.

In the fourth chapter – “*Does the board of directors contribute to the innovation of State owned companies?*” – the focus is on the influence of internal governance mechanisms on the innovation of Norwegian SOCs mainly operating in the service sector. The chapter shows that in the broader public services arena, there have been a limited number of studies on innovation in public services (Osborne and Brown, 2005), and that recently an increasing attention has been given to them. Actually, in the wake of the global financial crisis of 2008-2009 many industrialized States worldwide have increased their stakes in corporations, characterizing even more the organization type of SOCs. Therefore, the idea of governments as value-creating institution is increasing and the focus on its main drivers is emerging. Moreover, there has been a great deal of both scholarly and professional interest in “innovation” believing that it is essential to the improvement and effectiveness of the public sector. This chapter seeks to add knowledge on the governance mechanisms in SOCs (and in a more extended view also in other government owned companies) influencing their innovation capacity. In this investigation interesting contribution are given especially by answering the following research questions: *is innovation a valuable feature of governance and a useful concept in SOCs? Does the board of directors contribute to the innovation of SOCs?* Drawing on the innovation literature, the agency and the resource-based theories, the analysis is on a sample of 88 Norwegian SOCs mainly operating in the service sector. The results show that some aspects of board composition, board working-style and board members’ knowledge and competences influence significantly the type of innovations. Implications for the theory and the practice and future research directions are discussed.

As shown in this brief description, the analysis is mainly focused on two specific contexts: the Italian and the Norwegian one. This choice allows to make cross countries comparisons and to understand how historical evolutions, political contexts, traditions, and national conditions influence theories, research settings, findings and finally knowledge building. In fact, the Italian context has been mainly characterized by reforms

processes that lead now to situations in which nationally and locally there are private law companies (Saraceno, 1988) operating in the production and provision of public services in a context still characterized by low level of competition, despite the continuous European intervention to the creation of a competitive market also for public services. To the contrary, the Norwegian context is characterized by an active role of the State which exercises most of the high value activities for the entire community (Christensen, 2003). Even if the two context are characterized by a high intervention of the State in the economy (with different degrees and tools), substantially, as it is better shown in chapter three and four, they have different patterns and evolving perspectives. However, similarities exist between them and accountability concerns emerge in both the national contexts. Thus, what seems clear is that in the entire context characterized by PSOs there are more stakeholders with a variety of interests (Borgonovi, 2005), and they become even more present and exercising their right to “voice”. The boundaries between PSOs, contexts, and citizens are even more permeable and Public Management studies should thus be oriented in managing this complexity.

### **More about the overall thesis**

Many parts of the thesis have been realized during a research stay at BI Norwegian School of Management, Oslo – Norway. Professor Morten Huse has been the supervisor of the overall activities during the visiting period at BI.

The thesis is developed following the European PhD Label guidelines. The idea of a European Doctorate (European PhD or Doctor Europaeus/ Europaea) originated from an informal initiative in 1991 of the former Confederation of European Union Rectors’ Conferences concerning requirements for the awarding of a “Doctor Europaeus”. In order to get this title the thesis has been developed according to the following guidelines:

1. At least two professors from two higher education institutions of two European countries, other than the one where the thesis is defended, have given their review of the manuscript;
2. At least one member of the jury comes from a higher education institution in another European country, other than the one, where the thesis is defended;
3. A part of the defence takes place in one of the official languages, other than the one(s) of the country, where the thesis is defended;

## Introduction

4. The thesis must partly have been prepared as a result of a research period of six months spent in another European Country.

The thesis fulfils all these requirements. Two international scholars have reviewed the thesis. Particularly, prof. Morten Huse (BI Norwegian School of Management - Norway) which is president of the European Academy of Management and prof. Victor Pestoff (Institute for Civil Society Studies, Ersta Skondal University College – Sweden) leading scholar in New Public Governance and Co-production. Professor Morten Huse is also one member of the jury coming from a higher education institution other than Italy. The defence is completely in English language. Finally, it has been partially prepared during a research stay (six months) in Oslo (Norway) at BI Norwegian School of Management at the Department of Innovation and Economic Organization.

### **More about the chapters**

Previous versions of these chapters have been presented to several National and International Conferences. Moreover, previous versions of these chapters are already published or in publication. Especially, chapter one has been submitted to the international journal *Public Management Review*.

A previous version of chapter two was awarded as best paper during the IV National Workshop of “Azienda Pubblica” held at the University of Rome “Tre” (25<sup>th</sup> – 26<sup>th</sup> of March, 2010) – Italy. This chapter is currently under review at Azienda Pubblica (an Italian journal). Another version of this chapter has been accepted for the XXXIII Annual Conference of AIDEA (Italian Academy of Management) that will be held in Milan (21<sup>st</sup> – 22<sup>nd</sup> of October, 2010) at Bocconi University – Italy.

A previous version of chapter three was presented to the “International Workshop on Social Audit, Social Accounting and Accountability”, arranged by the “International Research Society for Public Management” (IRSPM) and by the Third Sector Study Group of European Group for Public Administration (EGPA), at Charles University of Prague (the 15<sup>th</sup> – 16<sup>th</sup> of May, 2008). Another version of this chapter, focusing only on the Italian context will be published (2010) in S. P. Osborne and A. Ball (eds.), *Social Accounting and Public Management: Accountability for the Public Good*, Routledge, London. The current version of chapter three has been accepted for publication in V.

Pestoff, T. Brandsen and B. Verschuere (eds), *New Public Governance, the Third Sector and Co-Production*, Routledge, London.

Chapter four has been submitted to the international journal *Public Money and Management*.

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## – Chapter 1 –

### GOVERNANCE STRUCTURES AND MECHANISMS IN PUBLIC SERVICE ORGANIZATIONS: A REVIEW AND RESEARCH AGENDA

#### **Abstract**

Issues related to governance structures and mechanisms in public service organizations are receiving increasing attention worldwide. However, there are often overlaps, misuse and superficiality when using the term *governance*. Particularly, the governance term is monopolizing and inhibiting the debate on Public Administration and Management. The aim of this systematic literature review is to assess the state of the art on governance structures and mechanisms in public service organizations analysing past, present and future evolutions. We use the argument advanced in Osborne's article (2006) that Public Administration and Management has actually passed through three dominant modes [Public Administration, New Public Management and New Public Governance]. Drawing on that classification the chapter analyses quantitatively 184 published journal articles, from 1970 to 2009 by showing the relationships among theories, research settings, sources of data, countries of analysis, governance structures and mechanisms, etc. Moving from what is already done in previous studies, the study identifies critical areas that need an insightful introspection in order to suggest useful future research directions.

**Keywords:** Governance structures; governance mechanisms; public service organizations; systematic literature review

#### **1.1 Introduction and motivation**

Public service organizations (hereafter denoted as PSOs) at all levels have come under increasing pressure from deregulation and the continuous comparison with the private sector. They have made considerable efforts to improve their efficiency, to reduce costs by downsizing and rationalization, by introducing new managerial concepts and tools and by being more responsive to citizens or customers (Pollitt, 2009). Indeed, they are facing competition and an increasing demand for privatization for many reasons (Boyne, 2003) especially because they suffer from long lasting fiscal stress (Stiglitz,

2002. All those different influences are forcing PSOs to adapt to the new challenges and conditions (Reichard, 2006). One particular aspect has been to be more open to external market pressures and to accept market mechanisms and competitive arrangements as a challenge, which in an increasingly competitive environment might contribute to their survival (Reichard, 2006).

In the past 10 years, serious challenge to the ideal of Public Administration (hereafter denoted as PA) has been mounted by critics and reformers who favour market, network, or mixed-economy models (Considine and Lewis, 2003). Indeed, theories of democratic government traditionally have relied on a model of organization in which officials act impartially, accept clear lines of accountability and supervision, and define their day-by-day activities through rules, procedures, and confined discretion. However, recently networked forms of governance are seen as particularly well suited to meet the challenges of increased differentiation compared to the centralized, slow and rigid hierarchies as well as to the anarchy of the market (Esmark, 2009). There is also an emerging idea highlighting that PSOs are once more seen as interesting and important sites of study and not merely as a residual category to be considered after the analysis of the private sector has been exhausted (Ferlie et al., 2003). All those aspects are associated with an increasing and larger cultural contest over the importance of terms such as “public interest”, “public value” that in this new century need to be better understood (Alford and Hughes, 2008; Perry, 2007). Thus, the aspects of locally accessible and accountable public services seem to become fundamental (Jorgensen and Bozeman, 2007; Bozeman, 2009).

The main issues are related to the evolution of different ways of public services provision during the years (Cafferata, 1995; 2008). Indeed, PSOs have experienced and are experiencing many changes in how to govern complex public services production and/or provision. The citizens become more and more informed and the ICT development completely changes the way we understand public services (Torres et al., 2005). Therefore, the investigation of the governance structures and mechanisms helps to be aware of the current national and international patterns and to carry out possible future directions in the area. By assessing the relevant literature on the topic it will be

possible to develop knowledge building in order to understand drivers, causes and effects of PSOs' strategic choices (Boyne and Walker, 2004).

We use the argument that Public Administration and Management (hereafter denoted as PAM) has actually passed through three dominant modes – a longer, pre-eminent one of PA, from the late nineteenth century through to the late 1970s/early 1980s; a second mode, of the New Public Management (hereafter denoted as NPM), through to the start of the twenty-first century; and an emergent third one, of the New Public Governance (hereafter denoted as NPG), since then (Osborne, 2006). This three-stage model is a simplification; certainly elements of each stage can often coexist with each other or overlap (Osborne, 2006). Actually, many network systems often operate in the shadow of, or in spite of, the dominant mode of hierarchy, for example, while both PA and NPM contain strong, if differentiated, elements of hierarchy (Klijn, 2008). Drawing on this classification the chapter quantitatively analyses 184 published articles (from 1970 to 2009). The aim of this systematic literature review is to tease out the *status quo* of governance structures and mechanisms in PSOs. This will assist and promote analyses and discussions of the conceptual and practical development of PAM also outlining further research developments.

Stemming from this framework we would like to answer the following research questions: *which are the governance structures and mechanisms used for managing PSOs? Why there is a need for a systematic literature review? How to cope with the gaps? How to contribute to the on-going debate? And, which are the possible future research directions?*

In order to answer these questions a sample of published journal articles on this topic was identified using an adapted version of the approach developed by David and Han (2004) and Newbert (2007). This method differs from the traditional narrative review by being more systematic and explicit in the selection of published journal articles and by employing quantitative evaluations. Synthesizing existing evidence in this way can be a powerful tool for build up knowledge, and can be as important as conducting new research (Light and Pillemer, 1984).

The database *Econlit*, *Web of science* (ISI)<sup>1</sup>, *ABI Inform* and *Elsevier Science Direct* are selected in order to search for all scholarly articles containing simultaneously the keywords [**"public servic\*<sup>2</sup>" and govern\***] or [**"public servic\*" and privat\* or state or municipal\* or partnership or utilit\* or ppp\* or network\* or local or co-product\* or citizen\* or partecipat\* or democra\***] in the title or in the abstract. The time period is from 1970 to 2009. Essentially, from all the published journal articles a representative sample of 184 analyzing governance structures and mechanisms in PSOs has been extracted.

The main results from the systematic review highlight existing patterns among the theories, the research settings, the sources of data, the governance structures and mechanisms, etc.

The contribution of the paper is threefold.

First, it helps overcoming the implicit limit of much PAM research that has been small scale, undertheorized and has been focused on application rather than theory building (Ferlie et al., 2003). By assessing the relevant literature on the evolution of governance structures and mechanisms in PSOs it is possible to be aware of the *status quo* and the future research directions.

Second, it quantitatively shows that the analyzed articles are classifiable following Osborne's (2006) arguments. Actually, these findings are in line with the discussion on the emergence of the NPG and on the shift to Public Management.

Third, by discussing the way research questions, theories, settings, and sources of data interact, the chapter clearly highlights the relationships between those elements and governance structures and mechanisms evolution in PSOs. Moreover, the role of the national context is important as it is also shown by the recent tendency of most empirical studies to be drawn on multiple contexts non-including UK and/or US. There is also an increasing use of surveys in respect to the studies on NPM mainly using archival data.

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<sup>1</sup> The keywords are searched in the title and in the "topic" instead of the abstract. Moreover, we included journals directly linked to social science (in particular with PA).

<sup>2</sup> The asterisk at the end of the word accounts for variations in this root word. For example, by using *servic\**, the results will be all verses containing the word *servic* and its derivatives such as *services*, *servicing*, etc.

The rest of the paper is organized as follows: in the next section the debate on governance structures and mechanisms in PSOs is presented. In section three, the systematic literature review is described. The main results from the statistical analyses are presented in section four. In the fifth section the results were discussed and the main findings highlighted. Concluding remarks and future research directions are presented in the last section.

## **1.2 The theoretical debate on governance structures and mechanisms in PSOs**

When approaching the debate on the importance of public services and PSOs, the application of organization and management theories and the design of organizational research need to be contextualized and take into account social, economic and political factors to be directly relevant to the specific institutional context (Pettigrew, 2005).

PSOs are critical to national competitiveness in creating the necessary conditions and infrastructure (Hartley et al., 2008), in leading and governing local communities and managing complex interrelationships between the State, the market and the civil society (Benington, 2000). The scale of PSOs is also important. Indeed, public services account for over a third of GDP (gross domestic product) in OECD countries (Pettigrew, 2005). However, the management of PSOs is often distinct from other type of organizations, because it operates in a complex policy and political environment, under the formal control of politicians, and is subject to a high degree of scrutiny and accountability (Ferlie et al., 2003). Indeed, PSOs do not aim to make profit but public value for citizens and communities (Bozeman, 2009), as well as balancing competing stakeholder interests (Moore, 1995). Therefore, there is a different relationship between ideas, practices and organizations in the public and private sectors (Moore and Hartley, 2008). That is probably due to the fact that the purpose, drivers, catalysts and key actors are different between sectors (Hartley, 2005; O'Toole et al., 2005).

The general tone of specialist opinion in most parts of the world is now agnostic on what are the best organizational arrangements for PSOs (Osborne, 2009; Skelcher, 2010). There is much agreement that monopolistic provision entirely through state

agencies is unfeasible, undesirable, or simply rather old fashioned (Joshi and Moore, 2004). However, there is little consensus on alternatives. That is why the NPM agenda of privatization and contracting out of public service delivery still has a great deal of support, and even sceptics see in it many elements and ideas of value (Hood et al., 2008). Whatever, it has now been sufficiently road tested that some major flaws and contradictions have become evident (Joshi and Moore, 2004). Anyone now suggests that the dominant language is of pragmatism, pluralism, and adaptation to specific circumstances (Pollitt, 2009; Rhodes, 2007).

Social science literature identifies three pure routes to governance – *hierarchy*, *markets* and *networks* (Thompson et al., 1991) providing a useful starting point for the analysis of the recent history of public service delivery. This point of view is also better explained in Osborne (2006) who clearly identifies the core distinction and time evolution from PA, to NPM and to NPG at the end.

Up to the end of the 1970s hierarchy was the dominant route to the delivery of public services, with intra-agency co-ordination achieved through the distinctive features of bureaucracy, vertical integration, clearly spheres of authority, command-and-control leadership, the emphasis on rules, routines and procedures (Ranade and Hudson, 2003)<sup>3</sup>. In the 1980s and 1990s the perceived failings of bureaucracy led to a renewed emphasis on markets and competition in the delivery of public services. Conservative governments privatized large parts of the public sector, and exposed what was left to market disciplines through quasi-markets, compulsory competitive tendering, market testing and so on (Snape and Taylor, 2004). Large multi-functional bureaucracies were broken-up into a network of specialised agencies contracting for services with a variety of public, private and voluntary providers. However, in the public sector, the introduction of competition proved to be a problematic exercise for many reasons (Ranade and Hudson, 2003; Robinson, 2007) and always co-existed with strong hierarchical controls downwards from the central government, notably in setting and

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<sup>3</sup> However, it seems important to underline that since the end of the 1970s, alternatives to internal government production of public services have assumed increasing prominence. The most important of these has been contracting out, but a less travelled road has been co-production: the involvement of citizens, volunteers and clients in producing public services as well as consuming them (Alford, 1998).

regulating the performance targets expected from actors in the market (Ranade and Hudson, 2003).

The result was that the break-up of bureaucracies introduced more actors into the policy arena, making co-ordination and a holistic approach to service delivery more difficult rather than less (Hudson and Lowe, 2004). Strategically this fragmentation also made the whole system more difficult to steer in any coherent direction. It was argued that competition and the contract culture had promoted self-interested behaviour rather than the public interest (Bozeman, 2009), and low trust relationships rather than high trust (Ranade and Hudson, 2003).

Hence, by the late 1990s, and partly as a response to these issues, the emphasis changed to networked governance and partnerships as the dominant mode of coordination (Klijn, 2008; Osborne, 2006; 2009; Pestoff, 2009; Ranade and Hudson, 2003).

Giving more complexity to the debate, it is also important to underline that it is difficult (but, could be useful) to distinguish between public services and public sector because of the uncertainty of the boundaries of these concepts (Meier, 2007). What are public services? It is easy to think about some examples: in many countries, law enforcement, refuse collection, utilities outcomes, and primary education would be regarded as public services. Health services may be included, too, but patterns of provision differ. Public services are not necessarily financed and delivered by the public sector, although the public sector is likely to be involved in some way (Grout and Stevens, 2003). We define a public service as any service provided for large numbers of citizens, in which there is a potential significant market failure (broadly interpreted to include equity as well as efficiency) justifying government involvement in production, finance, or regulation (Grout and Stevens, 2003).

The public sector comprises the economic activities controlled by the government, many of which are public services. A particular concern is that PSOs, not subject to the discipline of the competitive market, may lack incentives to control costs or provide quality of service and respond to the needs of consumers (citizens). PSOs may also have multiple and non-financial objectives reflected by the inclusion of all aspects of performance within the definitions (Hodges et al., 1996). The current developments in the study of PSOs, is timely given the recent and current high-level political, policy and

scholarly interest across a large number of countries in strategies of public management reform (Ferlie et al., 2003).

As seen in the picture outlined by Osborne (2006), new modes of governing are evolving with a high degree of autonomy from the State, the so-called governing without government (Rhodes, 2007). However, there are those arguing that it is more appropriate to speak of a shifting than a shrinking role of the State (Kooiman, 1999). The role of the State is transforming from being based on constitutional power towards functioning as a facilitator and cooperative partner (Hysing, 2009; Lundqvist, 2001; Sorensen, 2006; Pierre, 2009).

Governance and government can be regarded as two poles on a continuum along which the role of the State varies from direct State intervention, that is, State governing through authoritative allocation of values to society, to extensive societal autonomy, that is, self-organized and self-governing private and voluntary actors and networks capable of resisting government interference (Rhodes, 1997; Treib et al., 2007). Nevertheless, the major problem with any framework to deliver public services is that those delivering the services can have far better information than the government (Grout and Stevens, 2003). This disparity allows them to pursue goals that may not fully coincide with society's objectives. It is essential to understand how to design activities to elicit correct information from agents responsible for delivery, and to put in place structures so that the incentives facing the agents coincide with society's objectives (Lane, 2005). Of course, this is far from easy!

What seems clear is that the NPM has become perceived as limited and one-dimensional in its ability to capture and contribute to the management and governance of public services and of PSOs – whether situated in the public, private or voluntary sector – in an increasingly plural and pluralist world (Rhodes, 1997; 2007).

Before describing and showing the methods and main results of the systematic literature review, the central tenets and the on-going debate of governance structures and mechanisms in PSOs have been first briefly outlined.

The chapter clearly keeps in mind that PSOs are not like private sector organizations, and for that reason they should not be treated like business entities. So basically theorizing on the public sector management, its services and its organizations should not take business science's functional areas as a mirror image at all (Kooiman, 1996). Moreover, public sector "corporate governance" distinguishes itself from its private sector counterpart by the considerable diversity of objectives and management structures in the former. There is a need to address performance as well as conformance issues in public sector governance (Hodges et al., 1996). The main open issue is that the structural changes that have characterized the public sector, as the private sector, have been accompanied by cases which have increased public concern over the governance and accountability of PSOs (Hodges et al., 1996; Mulgan, 2006; Poulsen, 2009).

### **1.3 Methods**

#### **1.3.1 Selection of papers**

The systematic literature review differs from the traditional narrative one by being more systematic and explicit in the selection of published journal articles. It also employs quantitative methods of evaluation. Synthesizing existing evidence in this way can be a powerful tool in building up knowledge, and can be as important as conducting new research (Cooper, 1989; David and Han, 2004; Light and Pillemer, 1984;). The aim is to identify a representative sample of published journal articles (papers) and to test statistically the core tenets of governance structure and mechanisms in PSOs.

In order to assess the research, the sample was identified using an adapted version of the approach developed by David and Han (2004) and by Newbert (2007). This approach was chosen as it represents a more objective approach thereby mitigating some of the bias result when samples are selected via purely subjective criteria (Newbert, 2007).

Systematic reviews in the social sciences are relatively new (Rashman et al., 2009; Greenhalgh et al., 2004; Pittaway et al., 2004). The method was first developed in the medical sciences as part of the search for a better evidence base for policy-making and for clinical practice (Tranfield et al., 2003). They have been used in a range of health, social care and educational fields in order to synthesize research in an orderly and transparent way (Boaz et al., 1999; Davies et al., 2000). The chapter adopts some main

elements of the orthodox methodology of systematic review. These include a commitment to make the literature review replicable, scientific and transparent (Tranfield et al. 2003), and establishing a number of steps to frame the enquiry and present the results. Moreover, the emphasis is on the quantitative analysis of articles useful to the elucidation of concepts and frameworks, but also to provide conceptual clarity and the identification of areas where knowledge is still lacking.

Here below follows an adapted version [from David and Han (2004) and Newbert (2007)] showing the main criteria been used:

1. Search for published journal articles only. The time frame is 1970-2009.
2. The database *Econlit*, *Web of Science* (ISI), *ABI Inform* and *Elsevier Science Direct* were selected in order to search for all published journal articles (papers) containing simultaneously the keywords ["public servic\*" and govern\*] or ["public servic\*" and privat\* or state or municipal\* or partnership or utilit\* or ppp\* or network\* or local or co-product\* or citizen\* or participat\* or democra\*] in the title or in the abstract. This approach enabled us to identify a set of articles directly referring to the debate on governance structures and mechanisms in PSOs. This procedure resulted in 3,809 hits in total.
3. Deletion of duplicate articles (18.0%) found in many databases<sup>4</sup>.
4. Eliminate substantively irrelevant articles (17.0%) by only selecting articles that appear in journals in which multiple articles appear.
5. Ensure substantive and empirical relevance by reading all remaining abstracts for substantive context [i.e., aligned with the core tenets of the research questions]. In this step the 51.0% of the selected papers were deleted.
6. Further ensure substantive and empirical relevance by reading all remaining articles (563 articles – 15.0%) in their entirety for substantive context (i.e., the articles referring to governance structures and mechanisms).
7. Consolidate results from the electronic sources by including only the articles (184) relevant for the research questions.

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<sup>4</sup> In this step EndNote automatically identifies the duplicates.

184 articles (5.0%) turned out to be relevant to the examination. In sum, the final sample consists of 184 articles published in 33 journals from 1984 (first included paper) to 2009. The large difference between the number of hits (3,809) and the number of included articles (184) is due to several factors. For example, by using four databases the 18.0% of the articles duplicate and have been deleted from the original sample. Moreover, another 17.0% has been deleted following the criterion four (substantive). Finally, in the *Web of Science* (ISI) database we used different research criteria that lead to a wider number of selected articles. As appeared in the list of criteria, several choices needed to be done.

The first was to include only published journal articles, thereby excluding book chapters or unpublished work. Journal articles have been through a review process that acts as a screen for quality, allowing us to distil studies meeting a certain level of conceptual and methodological rigor. Actually, restricting a review to published studies may enhance quality control having most refereed journals reasonably strict requirements for publication and thus leading to a better technical product (Light and Pillemer, 1984). Furthermore, many electronic abstracting services cover only journals, making other sources much more difficult to locate systematically. Excluding unpublished work may lead to an overestimation of effects due to bias towards publishing significant results. However, some scholars shown that the results of published and unpublished studies were “essentially identical” and that there exists “no problem of availability bias” when including only published works (Hunter and Schmidt, 1990). In addition, it is argued that relying on published results is appropriate when the published research contains several dozen, or in some cases several hundred, relevant works (Cooper, 1989). In such an instance it is likely that while the published research may overestimate the magnitude of the relation, it probably will not incorrectly identify relation direction. Because, as we will explain below, we are not concerned with establishing the direction of effects, we are less concerned about the (possibly negligible) bias introduced by sampling only from published studies.

The second choice was to use different databases (four) in order to have a complete source of articles from which build the final sample. To our knowledge this is the first systematic literature review that uses four different sources.

The third choice was to use more keywords for the research. In particular basing on the existing knowledge on the phenomena of governance structures and mechanisms in PSOs and focusing on the on-going debate the aim is to identify and cluster different approaches and developments in this area.

The fourth choice was to use the EndNote software in order to manage electronically the selected articles. Through this software it has been possible to automatically delete the duplicates in an early stage on the review process. This is also an advancement in comparison to previous systematic review of the literature (David and Han, 2004; Newbert, 2007).

### **1.3.2 Content analysis**

In order to analyze the evolving nature of studies on governance structures and mechanisms in PSOs, two researchers independently analyzed and coded the set of 184 articles (Coffey and Atkinson, 1996; Krippendorff, 2005; Pugliese et al., 2009). The two researchers were asked to codify all basic elements of an article: (a) the type; (b) main research topic; (c) use of theories; (d) research setting; (e) source of data; and (f) the type of governance structures [hierarchy, market (contracting-out, municipal corporations), network (PPPs, co-production, third sector involvement)]. The coding scheme was pre-tested on two sub-samples of 30 articles after which the researchers came to an agreement about the final set of items to be used in the classification for each category (Pugliese et al., 2009). A review was then conducted on the whole set of articles (D'Aveni and Mac-Millan, 1994). At the end of the coding procedure, the two sets of data were matched. There appeared to be a high degree of overlap in the responses – only 43 out of 716 items were coded differently by the two researchers. Inter-rater reliability scores were calculated, and the percent age of agreement (89.3 %) and Cohen's Kappa (.89) were both above the acceptance threshold (Cohen, 1960; Dewey, 1983). A final meeting was arranged to discuss the inconsistencies in the responses. To reconcile the disagreements, the articles were re-read and recoded (Pugliese et al., 2009).

### **1.3.3 Type of articles**

The 184 articles were differentiated according to their nature – “conceptual” versus “empirical” (Pugliese et al., 2009). Papers were coded as “conceptual” when they sought to advance or refine theory and were solely based on deductive reasoning without any empirical metrics. The articles were labelled “empirical” if authors applied inductive logics, described their methods in a separate section, and argued on the strength of data obtained from qualitative research methods (i.e., interviews, participant observation, and anecdotes) and/or quantitative methods (i.e., archival data and surveys).

### **1.3.4 Use of theories**

To examine the theoretical development of the field, we mapped the theories to which each article explicitly referred. Basing on the contribution of Osborne (2006) we decided to create a variable capturing whether a paper referred to:

1. Political studies (PA)
2. Neo-classical economics and rational/public choice theory (NPM)
3. Organizational sociology and network theory (NPG)

### **1.3.5 Research Setting**

Institutional contexts widely vary between nations and have a profound impact on local governance structures and practices (Pollitt and Bouckaert, 2004). Therefore, an important dimension of the analysis is added by examining the empirical setting in which research on governance structures and mechanisms in PSOs has been conducted. As most empirical articles in our sample are based on UK and US data, we decided to use the following categorizations (Pugliese et al., 2009):

1. Articles using exclusively data drawn from the UK
2. Articles using exclusively data drawn from the US
3. Articles using data based on multiple setting (including also UK and/or US)
4. Articles using data based on multiple setting (non including neither UK nor US)

### 1.3.6 Source of data

To provide insights in the use of different data sources, we coded the empirical articles with the following six categories (Pugliese et al., 2009):

1. Interviews
2. Anecdotal evidence
3. Archival data
4. Survey data
5. Direct observations
6. Multiple sources (combinations of the above-mentioned sources)<sup>5</sup>

### 1.3.7 Governance structures and mechanisms in PSOs

When analysing the different governance structures and mechanisms in PSOs, the main issues are related to the evolution of different ways of public services production/provision during the years (Cafferata, 1993). Therefore, the investigation of the governance structures and mechanisms helps to be aware of the current national and international patterns and to carry out possible future research directions in the area.

Drawing from Osborne (2006) that suggest that PAM has actually passed through three dominant modes PA, NPM, and NPG, we use this three-stage model as a simplification (knowing that elements of each stage can often coexist with each other or overlap). The first group includes the *hierarchy* as a qualifying aspect of the governance structure of PSOs. The second group investigates the *market* as a qualifying aspect of the governance structure of PSOs. Particularly, we identify *contracting-out* (Brown et al., 2006; Hood, 1997; Yang et al., 2009) and *Municipal corporations* (Grossi and Mussari, 2009; Grossi and Reichard, 2008) as ways to improve efficiency and effectiveness in PSOs. The third group encompasses research that explores *networked* forms of governance in PSOs. This group includes the articles referring directly to the *network* (Klijn, 2008; Klijn et al., 1995) structure as the main mechanisms used for public service production and provision. Moreover, there are *public-private partnerships* (PPPs) (Fischbacher and Beaumont, 2003; Hood and McGarvey, 2002; Klijn and Teisman, 2003; Warner and Hefetz, 2008), *co-production* considering the importance of citizens engagement and

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<sup>5</sup> This category included articles using combinations of interviews and survey data, interviews and archival data, and survey data and archival data.

involvement in the governance of public services (Alford, 1998; Bovaird, 2007; Brandsen and Pestoff, 2006; Pestoff, 2009), and finally the involvement of *Not for profit and voluntary organizations* (Chew and Osborne, 2009; Considine, 2003; Osborne, 1998; Osborne et al, 2008).

## **1.4 Empirical results**

### **1.4.1 The growing attention to the research on governance structures and mechanisms in PSOs**

This section provides a brief overview of the main results from the systematic literature review using tables, matrix and other explanatory tools. The aim is to give more clarity to the overall picture as resulting from the analysis. Table 1 shows for each step (from step 1 to 6) the number of articles returned from the systematic review process. The final sample is of 184 published articles.

In recent years, many scholars have debated the various governance structures and mechanisms in PSOs (Hartley et al., 2008). Figure 1 illustrates the historical development of the number of published articles on this topic in the PAM literature. As depicted, the first paper was published in 1984, and in the following decades the number of published articles steadily increased. Studies on governance structure and mechanisms were published irregularly during the early years prior to the '90s. Since then, the marked increase in the average number of articles on the topic reflecting the growing attention of scholars.

Finally, it is noteworthy that in the period 2001–2009 (Table 2) most papers were published in top journals on PAM, such as *Public Administration* (29), *Public Money and Management* (28), *Australian Journal of Public Administration* (15), *Public Administration Review* (14), *Public Management Review* (12), and *Journal of Public Administration Research and Theory* (10).

### **1.4.2 Interactions of theories, settings, and data sources**

Table 3 provides an overview of the articles that have contributed to the growing attention on governance structure and mechanisms of PSOs. The papers are overwhelmingly empirical (N = 132; 72 per cent).

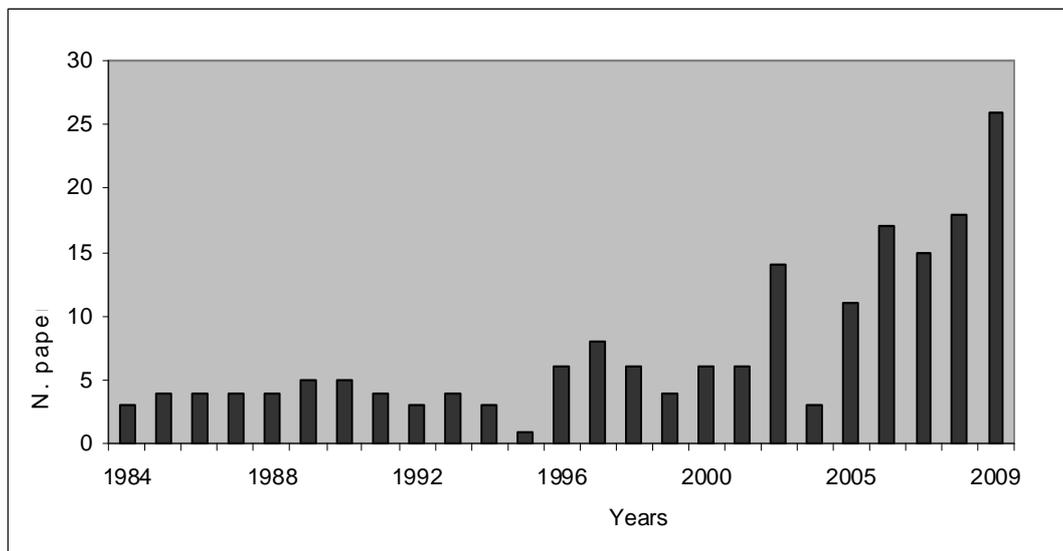
## Governance Structures And Mechanisms In Public Service Organizations

Table 1 – Summary of the selection criteria<sup>6</sup>

Filter type	Description	Database				Total	
		Econlit	Web of Science (ISI)	Elsevier Science Direct	ABI Inform		
<b>1</b>	Substantive	All articles with ["public servic*" and govern*] or ["public servic*" and privat* or state or municipal* or partnership or utilit* or ppp* or network* or local or co-product* or citizen* or participat* or democra*] in title or abstract	815	1976	490	528	<b>3809</b>
<b>2</b>	Duplicates	Deletion of duplicate articles found in both databases	668				<b>3141</b>
<b>3</b>	Substantive	Eliminate substantively irrelevant articles by only selecting articles that appear in journals in which multiple articles appear	635				<b>2506</b>
<b>4</b>	Substantive	Eliminate abstracts read that are not relevant for the research question	1943				<b>563</b>
<b>5</b>	Substantive	Eliminate full articles read not relevant for the research questions	379				<b>184</b>
<b>6</b>	Substantive	Final number of articles included in the review	<b>184</b>				

Source – Our elaboration

Figure 1 – The research on governance structure and mechanisms of PSOs



Source – Our elaboration

<sup>6</sup> The selection filters used herein are based on and adapted version from those developed and used by David and Han (2004) in their review of the TCE literature and on Newbert (2007) in his review of the RBV literature.

Table 2 – Overview of journals including publications per time period and impact factor

	Journal	On-line starting from	Impact Factor	1980-1991	1992-2000	2001-2010	Overall
1	<i>Public Administration</i>	1923	1.269	4	3	22	<b>29</b>
2	<i>Public Money and Management</i>	1981	0.438	2	10	16	<b>28</b>
3	<i>Australian Journal of Public Admin.</i>	1937	0.59	4	7	4	<b>15</b>
4	<i>Public Administration Review</i>	2000	1.503	0	1	13	<b>14</b>
5	<i>Public Management Review</i>	1999	0.93	0	1	11	<b>12</b>
6	<i>J. of Public Admin. Res. and Theory</i>	1991	1.509	0	2	8	<b>10</b>
7	<i>Government Information Quarterly</i>	1984	1.91	3	2	2	<b>7</b>
8	<i>Intern.l Review of Admin. Sciences</i>	1957	0.71	3	1	3	<b>7</b>
9	<i>Administration and Society</i>	1969	0.941	3	1	2	<b>6</b>
10	<i>American Review of Public Admin.</i>	1967	0.633	2	2	2	<b>6</b>
11	<i>Policy and Politics</i>	1973	0	3	0	3	<b>6</b>
12	<i>Annals of Public &amp; Coop. Economics</i>	1925	0	0	1	4	<b>5</b>
13	<i>Local Government Studies</i>	1975	0.514	1	2	3	<b>6</b>
14	<i>Gov.: An Int. J. of Pol., Adm., Instit.</i>	1988	1.137	1	2	1	<b>4</b>
15	<i>Journal of Urban Affairs</i>	1979	1.271	3	1	0	<b>4</b>
16	<i>Public Choice</i>	1966	0.698	3	1	0	<b>4</b>
17	<i>Journal of Management Studies</i>	1964	2.558	1	1	1	<b>3</b>
18	<i>Australian Jour. of Political Science</i>	1970	0.461	0	1	1	<b>2</b>
19	<i>Accoun., Auditing and Account. Jour.</i>	1988	0	0	0	1	<b>1</b>
20	<i>British Journal of Management</i>	1990	1.839	0	0	1	<b>1</b>
21	<i>Inter. Journal of Public Administr.</i>	1979	0	0	0	1	<b>1</b>
22	<i>International Journal of Public Policy</i>	1986	0	0	0	1	<b>1</b>
23	<i>Intern. J.l of Public Sector Manag.</i>	1988	0	0	1	0	<b>1</b>
24	<i>Intern. Journal of Social Welfare</i>	1992	0.631	0	1	0	<b>1</b>
25	<i>Intern. Review of Applied Economics</i>	1987	0	0	0	1	<b>1</b>
26	<i>Organization Studies</i>	1980	1.857	0	0	1	<b>1</b>
27	<i>Oxford Review of Economic Policy</i>	1985	0.642	0	0	1	<b>1</b>
28	<i>Policy Studies</i>	1980	0	0	0	1	<b>1</b>
29	<i>Political Research Quarterly</i>	1948	0.75	0	0	1	<b>1</b>
30	<i>Public Budgeting and Finance</i>	1981	0	0	0	1	<b>1</b>
31	<i>Public Organization Review</i>	2001	0	0	0	1	<b>1</b>
32	<i>Social Policy and Administration</i>	1967	0	0	0	1	<b>1</b>
33	<i>Urban Affairs Review</i>	1965	0.186	0	0	2	<b>2</b>
				<b>33</b>	<b>41</b>	<b>110</b>	<b>184</b>

Source – Our elaboration

## Governance Structures And Mechanisms In Public Service Organizations

Table 3 – Interactions of theories, settings, and data sources\*\*

	Empirical papers (n=132; 72%)					Theoretical papers (n=52;28%)	Overall (n=184)
	UK context (n=31; 24%)	US context (n=23; 17%)	Multiple context (with UK and/or US) (n=34; 26%)	Non-UK and non-US context (n=44; 33%)	Total		
<b>Use of Theories*:</b>							
Political studies (PA)	10 (32%)	8 (35%)	0 (0%)	7 (16%)	25 (19%)	11 (21%)	36 (19%)
Neo-classical economics and rational/public choice theory (NPM)	17 (55%)	8 (35%)	30 (88%)	19 (43%)	74 (56%)	18 (35%)	92 (50%)
Organizational sociology and network theory (NPG)	4 (13%)	7 (30%)	4 (12%)	18 (41%)	33 (25%)	23 (44%)	56 (31%)
<b>Total</b>	<b>31 (100%)</b>	<b>23 (100%)</b>	<b>34 (100%)</b>	<b>44 (100%)</b>	<b>132 (100%)</b>	<b>52 (100%)</b>	<b>184 (100%)</b>
<b>Source of Data*:</b>							
Interviews	2 (6%)	3 (13%)	4 (12%)	3 (7%)	12 (10%)	-	12 (10%)
Anecdotal Evidence	0 (0%)	0 (0%)	0 (0%)	0 (0%)	0 (0%)	-	0 (0%)
Archival Data	2 (6%)	7 (31%)	3 (9%)	14 (32%)	26 (20%)	-	26 (20%)
Survey	5 (17%)	5 (21%)	7 (20%)	6 (14%)	23 (17%)	-	23 (17%)
Direct Observations	1 (3%)	1 (4%)	0 (0%)	1 (2%)	3 (2%)	-	3 (2%)
Multiple Sources	21 (68%)	7 (31%)	20 (59%)	20 (45%)	68 (51%)	-	68 (51%)
<b>Total</b>	<b>31(100%)</b>	<b>23 (100%)</b>	<b>34 (100%)</b>	<b>44 (100%)</b>	<b>132 (100%)</b>	<b>-</b>	<b>132 (100%)</b>
<b>Gover. Struc. and Mechanisms*:</b>							
Hierarchy	8 (26%)	4 (17%)	1 (3%)	2 (4%)	15 (11%)	7 (13%)	22 (12%)
Network	7 (23%)	3 (13%)	6 (18%)	10 (23%)	26 (20%)	8 (15%)	34 (19%)
Co-production	2 (6%)	0 (0%)	2 (6%)	3 (7%)	7 (5%)	16 (31%)	23 (13%)
PPPs	2 (6%)	2 (9%)	3 (9%)	3 (7%)	10 (7%)	2 (4%)	12 (6%)
Not For Profit and Volunteers	5 (16%)	3 (13%)	2 (6%)	2 (4%)	12 (10%)	0 (0%)	12 (6%)
Contracting-out	3 (10%)	7 (31%)	9 (26%)	9 (21%)	28 (21%)	9 (17%)	37 (20%)
Municipal Corporations	4 (13%)	4 (17%)	9 (26%)	7 (16%)	24 (18%)	7 (14%)	31 (17%)
Combinations of more	0 (0%)	0 (0%)	2 (6%)	8 (18%)	10 (8%)	3 (6%)	13 (7%)
<b>Total</b>	<b>31 (100%)</b>	<b>23 (100%)</b>	<b>34 (100%)</b>	<b>44 (100%)</b>	<b>132 (100%)</b>	<b>52 (100%)</b>	<b>184 (100%)</b>

\* Differences between different research settings are statistically significant at the 0.05-level (two-tailed).

\*\* Statistical tests show that the relationships between the use of theories and the different governance structures and mechanisms and the research setting are all significant at the 0.05-level (two-tailed).

The majority of studies are conducted in multiple setting non including UK or US (N = 44; 33 per cent). Most empirical studies have been also conducted in UK (N = 31; 24 per cent) and US (N = 23; 17 per cent). However, there are many studies done in multiple setting including also UK and/or US (N = 34; 26 per cent).

With regard to the main theoretical framework, neo-classical economics and rational/public choice theory (NPM) are the prevailing lens of analysis (N = 74; 56 per cent). Organizational sociology and network theory (NPG) are also increasingly used (N = 33; 25 per cent) and the use of political studies are even more reduced in the years (N = 25; 19 per cent). The sources of data are quite diverse, although the use of multiple sources (N = 68; 51 per cent) and archival data (N = 26; 20 per cent) is most common. Finally, the largest groups of governance structures and mechanisms that are used in the analysed articles are *network* (N = 34; 19 per cent) and *contracting-out* (N = 37; 20 per cent), followed by *municipal corporations* (N = 31; 17 per cent), while the smallest group is that of *not for profit and voluntary organizations* (N = 12; 6 per cent). Furthermore, Table 3 illustrates how theories, settings, and data sources interact. Most notable are the key differences between empirical studies that have been conducted in a multiple setting including UK and US context and those conducted in a multiple setting non including UK and US. In the first group scholars have published most on *contracting-out* (N = 9; 26 per cent) and *municipal corporations* (N = 9; 26 per cent). In contrast studies conducted in multiple setting non including UK and US focused more on *network* (N = 10; 23 per cent). Furthermore, the studies from the first group focused more on neo-classical economics and rational/public choice theory (NPM) while the others referred more on organizational sociology and network theory (NPG).

Theoretical articles differ from empirical articles. They generally address the practice and question the desirability on the one hand of *co-production* and *network* and on the other hand also of *contracting-out* and *municipal corporations*. Most of these articles are grounded on the NPG theoretical debate (N = 23; 44 per cent). We tested the abovementioned interactions among theories, settings, and data sources for statistical significance. Several cross tabulations reveal that the relationships between the use of theories, research setting, and the various governance structures and mechanisms are indeed statistically significant at the .05 level.

### 1.4.3 Time evolution

In order to observe an evolutionary pattern in previous research, three periods are identified (Pugliese et al., 2009) and each article is assigned to one of them according to the publication year (Table 4).

Although the three periods are not homogeneous in terms of time-length, we clustered them in accordance with two criteria.

First, we observed changes in the slope of the curve with a cumulative number of articles published over time (Table 4). We considered a cut-off for a new period if (1) there was a sharp increase in the number of publications in a given year; and (2) this number was significantly higher than the average during the previous years. Second, we identified a new period if relevant and highly influential articles (or groups of articles) came out during a given year or the year before (Pugliese et al., 2009). Major changes in a field of study often occur thanks to breakthroughs and innovative articles that suggest new theoretical approaches and/or methods and set a new agenda for future research (Kuhn, 1962). We checked for robustness by examining whether our findings would change if we slightly changed our cut-off points (Pugliese et al., 2009).

The first group covers the period from the 1980 to 1991 in which the interest in studies on governance structures and mechanisms of PSOs seems to be infrequent and more concentrated on the evolution from the traditional paradigm of PA to the affirmation of the NPM (Osborne, 2006). Indeed, in the public sector most of the internal pressure has derived from inefficient bureaucratic structures and mechanisms. Local government has been operating traditionally along the principles and concepts of the *old public administration*, leading to costly leadership structures, to slow production and delivery processes, to ineffective systems of steering and supervision. Even more, the influence of the politicians (e.g. local councillors) on the administrative apparatus has been declining (Reichard, 2006).

Table 4 – The evolution of the literature on governance structures and mechanisms in PSOs

	1980-1990	1991-2000	2001-2009	Overall
<b>Summary:</b>				
Number of articles	29	45	110	184
Average number of articles per year	2,64	4,50	12,22	19,36
<b>Type of Article:</b>				
Conceptual	7 (24%)	17 (38%)	28 (25%)	52 (28%)
Empirical	22 (76%)	28 (62%)	82 (75%)	132 (72%)
<b>Total</b>	<b>29 (100%)</b>	<b>45 (100%)</b>	<b>110 (100%)</b>	<b>184 (100%)</b>
<b>Main Research Topic*:</b>				
1. Efficiency (Privatization, etc.)	21 (73%)	10 (22%)	17 (16%)	48 (26%)
2. Governance	1 (3%)	7 (16%)	48 (43%)	56 (30%)
3. E-government	0 (0%)	0 (0%)	4 (4%)	4 (2%)
4. Innovation	0 (0%)	6 (13%)	10 (9%)	16 (9%)
5. Accountability	0 (0%)	6 (13%)	12 (11%)	18 (10%)
6. Public Services Quality	0 (0%)	9 (20%)	9 (8%)	18 (10%)
7. Public Value and Interest	7 (24%)	5 (11%)	7 (6%)	19 (10%)
8. Ethics	0 (0%)	2 (5)	3 (3%)	5 (3%)
<b>Total</b>	<b>29 (100%)</b>	<b>45 (100%)</b>	<b>110 (100%)</b>	<b>184 (100%)</b>
<b>Use of Theories*:</b>				
Political studies (PA)	28 (97%)	8 (18%)	0 (0%)	36 (19%)
Neo-classical economics and rational/public choice theory (NPM)	0 (0%)	28 (62%)	64 (58%)	92 (50%)
Organizational sociology and network theory (NPG)	1 (3%)	9 (20%)	46 (42%)	56 (31%)
<b>Total</b>	<b>29</b>	<b>45</b>	<b>110</b>	<b>184 (100%)</b>
<b>Research Setting*:</b>				
UK context	9 (41%)	6 (21%)	16 (20%)	31 (24%)
US context	7 (32%)	5 (18%)	11 (13%)	23 (17%)
Multiple context (including UK and/or US)	0 (0%)	13 (46%)	21 (26%)	34 (26%)
Non-UK and non-US context	6 (27%)	4 (15%)	34 (41%)	44 (33%)
<b>Total</b>	<b>22 (100%)</b>	<b>28 (100%)</b>	<b>82 (100%)</b>	<b>132 (100%)</b>
<b>Source of Data:</b>				
Interviews	1 (5%)	3 (11%)	8 (10%)	12 (10%)
Anecdotal Evidence	0 (0%)	0 (0%)	0 (0%)	0 (0%)
Archival Data	10 (45%)	2 (7%)	14 (17%)	26 (20%)
Survey	0 (0%)	7 (25%)	16 (19%)	23 (17%)
Direct Observations	0 (0%)	1 (4%)	2 (3%)	3 (2%)
Multiple Sources	11 (50%)	15 (53%)	42 (51%)	68 (51%)
<b>Total</b>	<b>22 (100%)</b>	<b>28 (100%)</b>	<b>82 (100%)</b>	<b>132 (100%)</b>
<b>Governance Structures and Mechanisms*:</b>				
Hierarchy	17 (59%)	4 (9%)	1 (3%)	22 (12%)
Network	1 (3%)	5 (11%)	28 (25%)	34 (19%)
Co-production	1(3%)	2 (4%)	20 (18%)	23 (13%)
PPPs	0 (0%)	3 (7%)	9 (8%)	12 (6%)
Not For Profit and Volunteers	0 (0%)	3 (7%)	9 (8%)	12 (6%)
Contracting-out	9 (32%)	12 (27%)	16 (14%)	37 (20%)
Municipal Corporations	0 (0%)	14 (31%)	17 (15%)	31 (17%)
Combinations of more	1(3%)	2 (4%)	10 (9%)	13 (7%)
<b>Total</b>	<b>29 (100%)</b>	<b>45 (100%)</b>	<b>110 (100%)</b>	<b>184 (100%)</b>

\* Differences between the three time period are statistically significant at the 0.05-level (two-tailed).

In the period from 1992 to 2000, 41 articles were published. They focus on the experiences that NPM has produced worldwide discussing its content, tools and evolutions. By the end of the 90s questions regarding the effectiveness of this approach emerged even stronger suggesting different national effects and results. The public choice theory and new institutional economics provided the necessary theoretical and ideological framework to push market mechanisms and competitive concepts into the public sector (Pollitt and Bouckaert, 2004).

The third period is from 2001 to 2009. The articles in this time period provided input to a new strand of research, and most of the literature in the following years sought to analyze which governance structures and mechanisms are used in PSOs (Hartley et al., 2008, Osborne, 2009). In 2008 and 2009, great interest around *networked governance* is particularly clear, as 44 articles were published in the two years. These researchers had a significant impact on the PAM field influencing the debate around the delivery of public services and questioning if we are asking the right questions (Osborne, 2009). In the following sections, we will discuss the distinctive characteristics of the articles published during each period and seeing the main theoretical and practical implications of our systematic literature review.

### 1.5 Discussion and findings

Over the last three decades, the interest in research on the governance structures and mechanisms in PSOs has grown significantly (see Figure 1). Scholars and practitioners have extensively discussed the potential contribution that new organizational modes may have in the production and provision of public services. What seems clear from this systematic literature review is that the three-stage model identified by Osborne (Osborne, 2006, 2009) can be used as a lens of analysis to catch the development of public services studies. In fact, Osborne's (2006) discussion on the emergence of a NPG, explains that the field of PM study has matured from a focus on mechanical PA to that of PM, taking an active interest in the functioning of the administration and to developing and changing administrative practices. PA theory was followed by more recent theories of NPM which feature cross-over in managerial approaches and advancements from the private sector.

Osborne (2006) contends that this has now matured into what could be termed the NPG, taking into consideration an approach to the outward effects of PAM.

The literature review assesses systematically 184 published articles testing statically the existence of significant relationships among use of theories, research settings, sources of data, main research topics and governance structures and mechanisms of PSOs (Tables 3 and 4). This was done by identifying three time periods from 1980 to 1990 (Period 1), from 1991 to 2000 (Period 2), and from 2001 to 2009 (Period 3). The periods were useful in order to see the increase of published articles from one period to the other and to understand some changing aspects.

It seems interesting to discuss some main issues. Referring to the types of article (Table 4) it is possible to see that empirical articles had a relevant increase from Period 2 to Period 3 (in the last we had 54 more articles) while the increase of theoretical articles from one period to another has been moderated. It is also important to underline that among the empirical papers there are many quantitative analyses (especially regression analyses). However, the prevailing methodology is the case study analysis. This is justified by the need for more evidences based on local contexts and on the exploration of the actors involved at various levels in the governance system of PSOs.

One result suggests that in the analysed articles there is a relationship between the research focus and the identified periods. Period 1 is characterized by the focus on efficiency, cost savings, and improvement of effectiveness (73.0%), issues mainly related to the passage from the old bureaucratic State to new managerial logic coming from the private sector (NPM) and aiming at improving public services (Osborne, 2006). Many articles also referred to the *privatization* process as a way to improve public services quality and effectiveness. Period 2 is characterized by an increasing attention on *contracting-out* (27.0%), *innovation* (13.0%), *accountability* (13.0%) and *public service quality* (20.0%) issues accompanied also by an emerging focus on *governance* (16.0%) (Table 4). However, the customer focus of the contracting movement has lead to the rejection of certain tenets of democratic governance, including citizenship, civic engagement, and broad conceptions of the public interest (DeLeon and Denhardt, 2000).

Moreover, increased complexity of contract service delivery creates coordination problems (O'Toole, 1996) and accountability problems are rampant (Brown and Potoski, 2003) leading to Period 3 in which the main attention is on *governance* issues (43.0%) and *accountability*.

The review provides insights on previous research contributions illustrating the way in which the literature evolved, highlighting implications for both scholars and practitioners, and suggesting avenues for future research. The results highlight two important trends in the literature on governance structures and mechanisms of PSOs.

First, our findings illustrate that research on governance structures and mechanisms of PSOs developed from *market* solutions in the production/provision of public services to the use of *networked* forms of governance. Especially citizens engagement and involvement (Bovaird, 2007) in the decision-making processes (Klijn and Koppenjan, 2000) and in the production/provision of public services (Pestoff, 2009) is increasing (even if most studies and experiences make particularly reference to UK context). This suggests that the dominant theoretical paradigm is the NPG (Osborne, 2009).

Second, our results highlight that research questions, theories, settings, and sources of data interact and influence our insights about the relationships between those elements and the evolution of the governance structures and mechanisms of PSOs. Most empirical studies analyze multiple contexts non-including UK and/or US. There is also an increasing use of surveys thus changing radically the source of data in comparison with studies basing on NPM which used more archival data.

This study has several scholarly implications and highlights avenues for future research. First, the results reveal the need to understand the role of context at multiple levels as most of the contemporary wisdom originates from UK and US samples; and the new tendency is to have even more comparative studies not necessarily including the above mentioned contexts (Table 3). Actually, the impact of the national setting (e.g., the legal system, culture, and economic conditions) and the public service characteristics on the governance structures and mechanisms of PSOs is not yet fully understood (Hartley et al., 2008). For example, only few studies focus on the emerging role of the *third sector*

*and voluntary organizations.* Particular attention is given to their involvement in the innovation processes of public services (Chew and Osborne, 2009; Considine, 2003; Osborne, 1998; Osborne et al., 2008).

The majority of studies (50.0%) use NPM theories but the time period reveals that from 2001-2009 there is an increasing and now consolidated interest in networked governance (31.0%). However, there are some main issues related to this development that is already more consolidated rather than completely new. The first concern is related with the patterns between governance structures and the context of analysis.

In the European area there are many varieties of governance structure and mechanisms (Lourdes and Vicente, 2003) of PSOs, continuously changing along different contexts. This is also partially due to the activities of the EU Commission to open markets for public services, to reduce public monopolies and to increase competition and pressure at the local level. The EU deregulation and liberalization programmes in different sectors of public infrastructure (e.g. energy, telecommunication, public transport, etc.) have had a particular impact on local governments and on their utilities. Similarly, the national governments have introduced competitive elements in the sector of social or health care services by offering consumer choice to citizens and by reducing market entry barriers to private for-profit competitors (Reichard, 2006).

Here below we discuss different patterns and experiences emerging from the systematic review.

It seems that in UK the attention is on governance through *public-private partnerships* and/or *public-public partnerships* (Alexander and Nank, 2009; Fischbacher and Beaumont, 2003; Hood and McGarvey, 2002; Klijn and Teisman, 2003; Warner and Hefetz, 2008). PPP activities have been of significance also at various levels. They are relevant in two different variants: as contractual PPPs which can be found primarily in the fields of project financing or as institutional PPPs involving both the government and private actors (Richter et al., 2006). Despite the lack of empirical underpinning, partnerships in public service delivery tend to be regarded very favourably, a “self-

evident virtue” (Hudson et al., 1999), often with little attention paid to the difficulties and costs of partnership working. It seems important to highlight that for some partnerships, it may be difficult to evaluate costs, for others it may be that costs outweigh benefits, performance can be highly variable, and some authors argue that partnerships should not be seen as necessarily positive (Wilkinson and Craig, 2002). Moreover, critics point to the tension between the increased central control of government (Clarke and Glendinning, 2002) (e.g. through centralised policies, and increased statutory targets and performance indicators), and the decentralised approach of partnerships for local governance. Particularly, it is suggested that the pluralism implied by partnerships needs to be tempered with understanding central interventions (Skelcher et al., 2004). Therefore, the predominant discourse of partnership in UK suggests inclusion of multiple stakeholders but conceals considerable variation in the structure and practice of accountability (Skelcher et al., 2005). In UK, increasing is also the role of the third sector and of voluntary and community organizations (Kelly, 2007; Osborne et al., 2008).

Instead, the Netherlands are characterized by extremely widely forms of *networked governance* (Kickert, 1997; 2003; Klijn, 2008; Klijn and Skelcher, 2007; Skelcher, 2010; Stone and Sandfort, 2009). Here, the focus is on the auto-determination of the network that is able to manage itself without any State intervention or steering role (Rhodes, 2002; 2007).

The European Mediterranean area (Italy, Spain, France, Germany, Greece, etc.) are mainly characterized by *municipal corporations* (Grossi and Reichard, 2008) and *mixed enterprises* (Bognetti and Robotti, 2007; Cox, 2008) involved in the production/provision of public services. There is also an increasing focus on forms of contracting-out (Yang et al., 2009). For example this is not a new development in German local government. Indeed, in that country social and health care services, in particular, have long since been contracted-out to not for profit organizations (NPOs). However, this happened not in a competitive framework but under corporatist conditions (Reichard, 2006).

The phenomenon of *corporatization* (Grossi and Reichard, 2008) in the domain of public services has many accountability issues due to the presence of multiple principals and agents (Lane, 2000; 2005; Skelcher, 2010) involved in the governance systems of PSOs. These countries are characterized by a high involvement of the State in the governance system of PSOs [as a results of partial privatization processes (Bel and Fageda, 2010)]. The State is involved directly (by Ministries) or through local governments (Municipality, Province, Region). In recent years, Municipalities have extended their efforts to transfer the production and delivery of services to private for-profit and not-for-profit suppliers. Municipalities are withdrawing from direct service provision and are concentrating more on their role as the ensuring and guaranteeing institution (Reichard, 2006). Supported by the decentralization doctrine of NPM, many Municipalities increased the managerial discretion and the autonomy of their service providing units. They introduced cost or result centres and delegated competencies to those centres. Furthermore, Municipalities separated their utilities more and more from the core administration (Pollitt and Talbot, 2004). They established corporate holding structures and transformed their local enterprises into companies with their own, private-law based legal status (corporatization) (Reichard, 2006). In those countries questions on *public corporate governance* and on internal governance mechanisms become essential (Ruter et al., 2005).

The role of the State significantly changes in Northern countries (Norway, Sweden, Denmark and Finland) even if with differences among them. The presence of *State owned companies* (SOCs) is dominant in the public service sector and other sectors as well (Christensen, 2003). What seems interesting is the changing role that the State has in some of these countries. This is due to the fact that an atmosphere of mutual trust and collaboration has historically characterized some of these countries (Christensen, 2003). This made possible forms of citizens' engagement and involvement (*co-production*) in the production and/or provision of public sector (Pestoff, 2009) and the continuous and increasing role of the *third sector and of voluntary organizations* (Collin and Vagnoni, 2002). Moreover, some scholars writing from a Scandinavian perspective see also the development of network governance and public-private partnerships as having the potential to revitalize liberal democracy and provide new channels for citizen

participation (Sorensen, 2002; Andersen, 2004). A participatory State depends upon both its citizens and front-line staff becoming involved in making some choices about policy and social services. Similar to the market model, a participatory model would also give citizens more choice and direct control over the providers of various goods and services. But the manner in which these choices would be exercised in a participatory State would be much more overtly political (Pestoff, 2006).

Quite different is the situation of Eastern European transition (Gerxhani, 2003) countries (Romania, Slovenia, Hungary, Poland, Bulgaria, etc.) more focused on efficiency and effectiveness issues in PSOs. The study on privatization processes are dominating and suggest aspects connected with results and negative and positive effects (Bel and Fageda, 2010). However, there are some studies that focus on the innovative capacities of third sectors organizations in the production/provision of public services (Osborne et al., 2005; Osborne and Kaposvari, 1998).

The focus on the privatization process is also similar in developing countries (Indonesia, China, India, etc.) where the focus is mainly on the role of SOCs and privatization processes (Hefetz and Warner, 2004; Painter and Mok, 2008). Various issues concerning corruption are often associated to these processes (Stiglitz, 2002). The same pattern is also characterizing some American Latin countries (Checchi et al., 2009).

The attention is on various issues in the US context. Public-private partnerships seems to be increasingly considered (Warner and Hefetz, 2008) even if there is also a focus on the role of Municipalities in the production/provision of certain public services (Brown and Potoski, 2003; Joassart-Marcelli and Musso, 2005; Moore et al., 2005; Woods, 2009). The topic of local governance is in vogue with a special focus on accountability, public value and interests (Alford and Hughes, 2008; Perry, 2007).

The contexts of New Zealand and Australia seem to be focused particularly on accountability issues (Barrett, 1997; Chapman and Duncan, 2007; Gregory and Hicks, 1999; Lonti and Gregory, 2007; Mulgan, 2006) and ethical behaviours (Kakabadse et al.,

2003; Kinchin, 2007) of public servants. The role of the conflict of interest is also particularly highlighted (Bowman et al., 2001)

Even if networked forms of governance are increasing worldwide, the major concern is associated with the overlapping of functions and the shared responsibilities that often characterize the various actors involved in the governance system of PSOs. That is a big problem, and, following some scholars, in these situations the role of government becomes even more important as a coordinating and steering actor (Rhodes, 1997; 2007). Furthermore, the growing number of studies that identify co-production as an interesting and promising governance mechanism of PSOs for grating the public value and interest, may stimulate more dynamic theories and promote research designs explicitly investigating the changing contributions of citizens and community involvement in the production/provision of public services.

In sum, multi-level approaches and international comparative studies on PSOs may contribute to the development and understanding of interactions between macro, meso, and micro dynamics and how these forces jointly shape the relationship between theories and governance structures and mechanisms (Considine, 2002; Farrell, 2009; Skelcher, 2010). The results from this study, however, highlight the number and variety of theoretical perspectives and inconclusiveness of some empirical findings. More recently, scholars emphasized the need to go beyond structuralism and to examine PSOs trying to understand their internal governance mechanisms and the relationships with the context and the actors (Bourgon, 2008; Ferlie et al., 2003; Pierre, 2009; Yapp and Skelcher, 2007).

Finally, it is important to highlight that although useful up to a point, our chronological account, which superimposes changing governance structures and mechanisms on different historical epochs, over-simplifies the real position. Rather than superseding each other as the dominant operating mode hierarchy, markets, and networks have been overlaid on each other and co-exist in complex sets of relationships in different settings (Ranade and Hudson, 2003).

### 1.6 Conclusion and future research directions

Through a systematic literature review the chapter assesses the contribution of 184 published articles by highlighting and analysing issues, theories, research settings, sources of data, evidences and suggesting future research directions. What has especially emerged is that worldwide there are different and co-existing experiences of governance structures and mechanism of PSOs. Nevertheless, there are also hybrid model of governance characterized by the co-existence and interaction of hierarchical, market-based and network (collaborative) frameworks (Ranade and Hudson, 2003; Osborne, 2009). Moreover, different governance structures and mechanisms introduce distinct problems, for the theory and practice, of public accountability (Skelcher, 2007). Indeed, the creation of “hybrid organizations (and other novel institutional arrangements) in the public sector needs to be accompanied by a reconsideration of our notions of accountability” (Skelcher, 2007). From this systematic literature review it emerges that for many public services there are good reasons for trying to achieve local access for the population and building in opportunities for citizen and/or consumer involvement and accountability. Indeed, this is an essential component of the public service *ethos* and mission (Rhodes, 2002). In this direction, co-production or citizen involvement in the provision of public services could prove highly relevant proposals for democratic and welfare State reforms. Co-production provides a missing piece of the puzzle for reforming democracy and the welfare State. It contributes a view and understanding of conditions at the micro level or the site of production of welfare services (Pestoff, 2006).

Due to the lack of accountability and the increasing interest on public value and interest (Bozeman, 2009) the role of coordination and collaboration becomes essential for future improvements and developments of public services worldwide. Indeed, lines of accountability are less clear, public organizations relate to several political principals rather than one elected official, and there can be a mix of representative, delegate, and direct democracy around the core policy-making process.

Moreover, a glass ceiling for the participation of citizen exist and the concepts of co-production and co-governance (Brandsen and Pestoff, 2006) may be useful to crash this

glass ceiling. As emerged in this study, *co-production* refers to the delivery of a public service by citizens and non for profit and voluntary organizations, acting as arm's length from the State. *Co-governance* is active co-involvement in the internal public sector policy development and implementation processes jointly between the non for profit and voluntary organizations, citizens, and the State (Brandsen and Pestoff, 2006; Osborne and McLaughlin, 2004). Admittedly, there is overlap between the two types of interaction and the distinctions can become quite blurred. However, what this theoretical distinction allows us to do is to consider discrete moments in the nature of and rationale behind these inter-organizational network interactions and suggesting a way to improve accountability in the governance of PSOs.

These findings can contribute to the development of a democratic governance policy, both at the macro and micro-levels, as well as to a new paradigm of participative democracy (Pestoff, 2008) and empowered citizenship (Fung, 2004).

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## Governance Structures And Mechanisms In Public Service Organizations

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## – Chapter 2 –

### CONFLICTS OF INTEREST AND GOVERNANCE MECHANISMS IN ITALIAN LOCAL PUBLIC UTILITIES

#### **Abstract**

Through the lens of agency theory, the paper examines the conflicts of interest that may arise among the different actors (citizens, Local Governments, private shareholders, service providers) involved in the governance of Local Public Utilities (LPUs). This chapter summarizes the main results of the multiple case study analysis on 10 Italian listed LPUs identifying different and co-existing situations of conflict of interest through multiple principals and agents. Although governance mechanisms (e.g., the board of directors) have different roles and functions and may prevent and mitigate such conflicts, our findings suggest that there are several problematic issues. First, the effects of ownership structure on board composition and functioning. Second, higher numbers of independent directors do not mean “actual” board independence. Third, the Service Charter as a tool for promoting transparency, accountability and public participation is not yet well implemented. The chapter contributes to the debate on LPUs suggesting possible developments of agency theory by including forms of citizens’ participation and engagement (co-production).

**Keywords** – Local public utilities; conflicts of interest; governance mechanisms; board of directors; independence; service charters

#### **2.1 Foreword**

In Italy, as well as in other European countries, the last decades have been characterized by public services organizations (PSOs) experiencing structural changes in their governance structures (Osborne and Brown, 2005). Particularly, in the 1990s the transformation from government-owned enterprises (*aziende speciali*) to joint-stock companies (JSC) has significantly modified the ownership structure and the governance mechanisms of the Italian LPUs (Grossi and Mussari, 2004; Grossi, 2007; Ricci and Landi, 2009). This situation was due to internal and external factors<sup>1</sup>:

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<sup>1</sup> A legislative appendix summarizing the major legislation relating to the Italian LPUs is provided at the end of the article.

- strong push from legislative reforms (Garlatti, 2001; Grossi, 2001; Valotti, 2006) based on the assumption of the private sector solutions supremacy on large bureaucratic entities (Grossi and Reichard, 2008);
- political parties look carefully at the financial results of LPUs considering the previous inefficiency of the public sector (Bognetti and Robotti, 2007);
- European directives introduced reforms for local authorities liberalising the sector and building up competitive markets (Garlatti, 2001).

However, despite the deep reform process, the Local Governments (LGs) want to preserve the control over the supply of services and want to be able to choose the way and the model to provide public services (Bognetti and Robotti, 2007). Therefore, issues on the coordination and steering of many actors and resources become important thus influencing the debate on “public corporate governance” (Ruter et al., 2005).

Hodges et al. (1996) point out that “public sector corporate governance distinguishes itself from its private sector counterpart by the considerable diversity of objectives and management structures in the former”. Indeed, corporate governance in private firms focuses mainly on the board of directors and firm performance, while governance in public sector organizations needs to include also aspects related to the presence of other several interests (Meneguzzo, 1999). Hence, the identification of stakeholders’ interests (citizens, shareholders, managers, etc.) is crucial for designing appropriate governance systems in LPUs (Grossi and Reichard, 2008). To deal with this complexity, questions on why and for whom create “public value” become more and more important (Bozeman, 2008).

Drawing from agency theory (Fama and Jensen, 1983; Jensen and Meckling, 1976), the chapter discusses governance mechanisms in LPUs. The main research questions are: *which is the governance system adopted by the Italian LPUs? Is it possible to catch, whether and to what extent potential conflicts of interest arise among different actors [citizens, LGs, private shareholders and service providers]? If yes, is it possible to prevent and mitigate such governance problems?* This chapter summarizes the main results of the multiple case study analysis (Yin, 2003) on 10 Italian listed LPUs identifying different and co-existing situations of conflict of interest among multiple

principals and agents. The investigation of governance mechanisms focuses on three main aspects: the ownership structure, the board composition and independence, and the role of citizens (service charters) in LPUs.

The results from the case study analysis are utilized to inductively suggest the existence of controversial problems in the governance systems of LPUs. First, the ownership structure analysis shows the existence of a *principal-principal conflict* (Dharwadkar et al., 2000) affecting the correct functioning of their governance systems. The board of directors does not seem to be a useful political arena to solve these conflicts, especially for the absence of actual board independence. Therefore, it is difficult to answer the question: *how “independent” are the independent directors?*

Hence, other governance mechanisms need to be improved in order to be more accountable with the citizens (main users of LPUs outcomes). In this direction, service charters, in order to protect the “public interest”, seem to be useful. However, the results from the content analysis of the service charters suggest that further implementation are needed.

The chapter contributes to the research on understanding governance mechanisms in LPUs, and more in general in PSOs, in several ways.

First, we contribute to the debate on corporate governance in LPUs (Hodges et al., 1996) by using the agency theory to identify the conflicts of interest arising from the co-existence of many principals and agents. Moreover, the article shows how agency theory prescriptions (the board of directors as a conflict resolution arena) do not fit with the gap of accountability characterizing LPUs. The implementation and diffusion of the service charters could be a starting point in order to cover this gap of accountability. Nevertheless, forms of citizens’ participation and engagement (co-production) would be the best solution (Pestoff, 2009).

Second, we explicitly fill the gap in the literature suggesting the need for studies on governance mechanisms in LPUs (Grossi and Reichard, 2008; Farrell, 2005). We add new evidences to the general trend of Public Administration and Management (PAM) research that moves from the old bureaucratic model of Public Administration (PA) to

the New Public Management (NPM); nowadays it is characterized by the pluralistic world of the New Public Governance (NPG) (Osborne, 2006), especially by showing the limits of agency theory prescriptions and alleviating accountability problems through the use of co-production (Pestoff, 2009).

The rest of the chapter is organized as follows. Section two is focused on the debate on governance mechanisms in LPU leading to the formulation of some propositions. The research design and methods are presented in section three. The results from the case study analysis and the main findings are subsequently discussed in section four and five. Conclusions and for future research directions are then presented.

## **2.2 The governance system of LPUs: a principal-agent perspective**

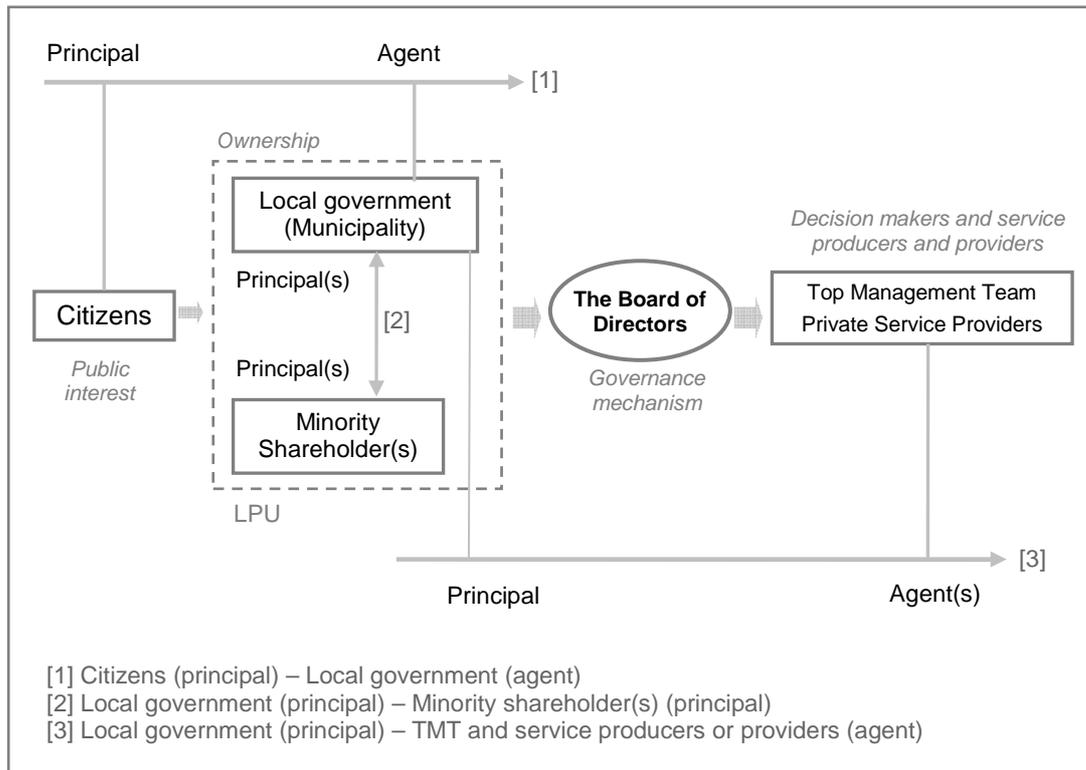
In the public sector, the relevance of corporate governance can be traced back to the application of the New Public Management (Hood, 1995) during the 1980s and 1990s. Corporate governance issues are extremely complex (Mulazzani, 2009) especially in the context of LPUs. LGs can choose from a range of different methods to produce and/or provide local public services to citizens (Collin, 2007; Cristofoli and Zerbini, 2002). They can, for example, produce and/or provide *in-house* or outsourced local public services. One of the alternatives is also to produce and/or provide local public services through firms owned by the Municipality (Grossi and Reichard, 2008).

In many European countries (e.g., Italy, Germany, etc.), the preferred way for managing public services is to use private-law form (joint stock companies, etc.) of firms (Cafferata, 1993) even if the main owners are still the LGs (Grossi and Reichard, 2008). If LPUs are governed through private forms, the discussion about boards and governance in those types of companies has some parallel with that of private firms (Clatworthy et al., 2000). However, and this is different if compared with the private sector, governing a LPU requires managing the balance between several purposes, interests, values involving the Government, the market and the society (Elefanti and Cerrato, 2009). In fact, the governance of LPUs can be understood in terms of dynamics relationships among these different actors. What is particularly relevant is that LPUs are

expected to achieve efficiency, and at the same time serve social or policy objectives and to be accountable to the public.

One of the most common concerns with LPUs is that managerial autonomy from political intervention is a necessary condition for public sector enterprises in order to achieve managerial efficiency and commercial goals (Yeung, 2005). However, managerial autonomy without proper control by the LGs may lead to democratic accountability problems (Rhodes, 2006). In this context, the agency theory might help us identifying the various agency relationships in LPUs. Indeed, in these PSOs it is possible to identify some main categories of actors that, at different levels, participate to the governance process: the citizens, the Local Governments (Municipalities), the private investors (minority shareholders), the governing entities (the board of directors and the top management team) and other public service producers and/or providers. Different agency relationships may exist (and co-exist) among these actors, also regulated by contractual agreements and code prescriptions. Figure 1 shows the various agency relationships among the above mentioned actors, in a simplified way.

Figure 1 – The agency relationships in LPUs



Source – Our elaboration

Considering these complex agency relationships, it seems important to investigate governance mechanisms in LPUs being conscious that there is a need for translation of corporate governance logics by considering the specificities of PSOs, and by being careful to the public value and interest (Bozeman, 2007; Borgonovi, 1996).

### 2.2.1 The agency relationships between the citizens and the main shareholder

In a LPU the most important agency relationship is that between the citizens and the majority shareholder (Municipality). This relationship has to be continuously monitored. Indeed, citizens' interests are particularly important in organizations controlled by the LGs and operating in the provision of public services. The relationships and the delegation mechanisms between the citizens (principal) and the LG (agent) may be investigated through the lens of the agency theory (Lane, 2000).

In a democratic view, citizens are principals in the sense that LGs, as agents, act as the representatives of the public interest. The question is whether agents are motivated by rational self-interest rather than by public interest (Batley, 2004). In these cases a conflict of interest arises between citizens and LGs because the actions of the agent are

inconsistent with the notion of maximizing the principals' interest (Lane, 2005). Since the degree of separation between the citizens (principals) and LGs (agents) is very high, the risk of opportunistic behavior from agents is particularly strong. Hence, the likelihood of the principal effectively controlling the agent depends on how much information the principal has about the performance of the agent (Batley and Larbi, 2004). Therefore, actions to keep citizens informed on the decision-making process, on service quality and standards, on price policy, etc., help the principal to exercise an effective monitoring or ex-post evaluation on the public service provision realized and/or coordinated by the LGs (and the service providers).

One of the most important tools generally used to render public services more responsive to direct users are the *Service Charters* (Torres, 2005; Borgonovi, 2002; Grossi and Mussari, 2004). The service charters are generally understood as a managerial tool designed to offer consumer guarantees to the quality of public services. Charter initiatives were pioneered in the UK in 1991, in the wake of a broader privatization program (Walsh, 1994). In Italy, the service charter (*Carta dei servizi*) was launched in 1993 after a study tour in Great Britain (Lo Schiavo, 2000).

The service charter basically means that public structures are accountable for quality standards and have to put into practice a control and evaluation system in order to improve the quality of public services (Lo Schiavo, 2000). They are based on the idea of extending the market logic of consumer sovereignty to public services provision (Walsh, 1994). Moreover, service charters could be useful tools for the citizens if LPUs take actions in order to implement the main principles. Indeed, if implemented among citizens, they might partially alleviate the conflicts of interest associated to the information asymmetry between the citizens and the LGs. These considerations lead us to the following proposition:

*Proposition 1 – The degree of citizens' control (as principal) over the local government (Municipality as the agent) depends on the level of transparency and accountability in LPUs. Particularly, service charters represent a useful tool, but further implementation and evaluation are needed in order to improve citizens' involvement in public services.*

### 2.2.2 The principal-principal conflict

The arguments in agency theory are related to large corporations with dispersed ownership and with the most well-known problem of corporate governance: the conflict of interest between managers and shareholders (Berle and Means, 1932; Jensen and Meckling, 1976). In LPUs it is also possible to identify the classical agency relationship between the main shareholders (LGs) and the managers or the other service producers/providers (Figure 1).

In many European countries, both listed and non-listed firms have an individual, a family or the State as dominant shareholder (La Porta et al., 1999; Shleifer and Vishny, 1997). These countries are characterized by high ownership concentration and the governance mechanisms aim at reducing also the conflict of interest between the controlling shareholder and the minority shareholders (Shleifer and Vishny, 1997). This conflict generates a new agency problem, because the interest of the controlling shareholder is not always perfectly aligned with that of minorities, especially in cases of high degree of separation between the ownership and the control (Claessens et al., 2002). In particular, there has been research pointing to the *principal-principal conflict* (Dharwadkar et al., 2000). Briefly, the principal-principal problem refers to the appropriation of value from minority shareholders by majority shareholders, often by influencing board level decisions (Young et al., 2008).

The Italian listed LPUs, as well the majority of the Italian firms, are characterized by concentrated ownership (Di Pietra et al., 2008). The LG is the dominant shareholder and the private owners (Figure 1) are minority shareholders (Argento et al., 2010). From this consideration we can formulate the second proposition:

*Proposition 2 – The Italian listed LPUs are characterized by situations of conflicts of interest between majority shareholders (LG) and minority shareholders (principal-principal conflict).*

### **2.2.3 The role of the board of directors as the main governance mechanism**

As previously shown, agency theory is the dominant paradigm for corporate governance studies. However, it might be applicable in LPUs to understand the agency relationships among the various actors involved in the production and/or provision of public services (Lane, 2005). In an agency theory perspective, the main task of the board of directors is controlling or monitoring, in order to solve agency problems (Fama and Jensen, 1983; Jensen and Meckling, 1976). How is that translatable also for LPUs?

In proposition 2, we have identified the situation of conflicts of interest between majority shareholders (LGs) and minority shareholders (principal-principal conflict). Certainly, in LPUs minority shareholders are connected with the possibility of expropriation by large shareholders who frequently control boards' decisions through directors appointed by them. Given that the board of directors is the main decision-making arena, it seems important to understand when this governance mechanism is effective. This is important because the board as a negotiation arena (Ravasi and Zattoni, 2006) has to represent and balance the various interests involved in the governance system of LPUs. For example, one way to detect potential expropriations which may damage the minority shareholders' interests is examining the board of directors' structure and composition. Indeed, the controlling shareholder exerts direct pressure on the boardroom; therefore, LGs' representatives with political authority can enhance their interests at the expense of a subgroup of owners who do not have similar levels of influence (Collin, 2007).

The root cause of minority shareholders' oppression in this context, therefore, is the ability of large shareholders to directly influence the board of directors by appointing directors that represent their own strategic interests rather than the narrowly defined financial (minority shareholders) and non-financial (citizens) interests of all stakeholders (Su et al., 2008). This situation is solved in favour of the LGs since the directors interpret their fiduciary duty in light of the controlling shareholder's interests, rather than the interests of all shareholders, including the minorities. Moreover, majority shareholders may appoint directors who are sympathetic to the State's political and

strategic objectives (Collin, 2007). These reflections lead us to the formulation of the following proposition:

*Proposition 3 – In LPUs the ownership structure characteristics affects the board of directors' composition.*

In this general debate, the board of directors is seen as a governance mechanism that alleviates various agency problems and the issue of board independence has important implications for the board effectiveness. The board of directors as a negotiation arena (Ravasi e Zattoni, 2006) has to protect the various interests involved in the governance system of LPUs. However, board independence in LPUs should be wider than in private firms, especially for the delicate nature of the interests involved. Even if independent directors respect the requirements of corporate governance guidelines in order to be considered “independent”, their relationships with politicians are particularly interesting in LPUs and has to be monitored. Besides, independent directors who are affiliated to politicians may have difficulties in performing their tasks (Judge and Zeithaml, 1992). Thus, they may be affiliated to the controlling shareholder (Dahya et al., 2008) giving prevalence to the controller's interest and damaging the interests of the citizens and of the minority shareholders.

Following, agency theory considers the board of directors as the most important mechanism to monitor the firm's management. In addition, we have shown (Figure 1) that it may be useful in order to detect and solve the other agency conflicts in LPUs. Therefore, in LPUs the disclosure of directors' characteristics and attributes (Dalton et al., 1998) becomes critical [e.g., publishing their curriculum vitae (CVs) on the website]. Increasing the disclosure on these elements reduces the information asymmetry (Linck et al., 2008) and gives to the citizens and to the minorities the opportunity to understand if directors were appointed for their professional background and experiences or for other reasons (political).

Conventionally, research has treated board independence as a solution to agency problems (Dalton et al., 1999). Companies with more independent directors traditionally should have less agency problems (Peng, 2004) even if the recent corporate scandals

have suggested that “actual” board independence is particularly difficult to be realized (Shen, 2005). Also in LPUs, the question of *how “independent” are the independent directors* is critical, especially if we take into account that the majority of board members are usually appointed by the public owner (Collin, 2007) proportionally to LGs’ participation in the equity (Grossi, 2007; Grossi and Reichard, 2008). This appointment process may generate several problems to the credibility of independent directors’ independence. Indeed, the major concern is that even if independent directors are considered as genuine independent (Shen, 2005) in accordance to corporate governance code guidelines, they may be affiliated to the politicians, thus influencing negatively the board of directors’ effectiveness. Based on this reasoning we suggest the following proposition:

*Proposition 4 – Higher numbers of independent directors do not mean actual board independence and the resolution of agency conflicts in LPUs.*

### **2.3 Research design**

The chapter is drawn from an in-depth qualitative multiple case study (Yin, 2003). This methodology was used for three main reasons. First, the case study analysis is particularly suitable for answering “how” and “why” questions, and it is ideal for generating and building theory in an area where little data or theory exists (Yin, 2003). Second, it has noted that considering every organization has unique attributes, researchers should adopt approaches that enable them to develop insights into the patterns of values and assumptions that characterize the culture of a given group of analysis (Howard, 1998; Schein, 1990), in our case of Italian listed LPUs. Finally, the case study analysis is widely used in studying PSOs (e.g. Grossi and Reichard, 2008; Grossi, 2007; Elefanti and Cerrato, 2009) because of the suitability of this methodology to understand dynamics and peculiarities that are proper of these organizations. The selection criteria are fundamental. We selected 10 Italian LPUs. It is important to clarify that in the Italian Stock Exchange there were 17 companies included in the “utilities sector” in 2008. However, our focus is on the public utilities mainly operating at the

local territorial level<sup>2</sup>. Hence, we decided to select only the cases in which the LG (the Municipality) hold shares, thus excluding the companies operating at a national level. In 3 cases the central government (through the Ministry of Economy and Finance) holds shares and in 4 cases the shares are owned by private shareholders. For this reason we included 10 LPUs (Table 1) operating in sectors having “industrial importance” (water, gas, electricity, environmental hygiene, local transportation).

Table 1 – The LPUs listed in the Italian Stock Exchange

	<b>Controlling Shareholder</b>	<b>National/LPU</b>
A2A	Municipalities of Brescia and Milano	LPU
Acea	Municipality of Rome	LPU
Acegas-Aps	Municipalities of Trieste and Padova	LPU
Acque Potabili	Municipalities of Torino and Genova	LPU
ACSM Agam	Municipalities of Como and Monza	LPU
Ascopiave	93 different Municipalities	LPU
Edison	Municipalities of Brescia and Milano	LPU
Enia	Municipalities of Reggio Emilia, Piacenza, Parma and other minor Municipalities	LPU
Hera	189 different Municipalities	LPU
Iride	Municipalities of Genova and Torino	LPU
Enel	MEF	National
Snam Rete Gas	MEF	National
Terna	MEF	National
Actelios	Private owners	National
Erg Renew	Private owners	National
Ergycapital	Private owners	National
Ternienergia	Private owners	National

Source – Our elaboration

A number of interrelated sources were collected and analysed: annual reports, corporate governance codes, corporate statutes, candidate lists for board of directors, board members’ curriculum vitae and service charters.

We developed the multiple case study analysis along three main directions:

<sup>2</sup> The Legislative Decree No. 267 of 18 August 2000, defines local public services having the aims to produce goods and activities in order to achieve social purposes and to promote the economic and social development of local communities.

1. Collection of annual reports, corporate governance codes, corporate statutes and candidates list from the companies' websites (year 2008) in order to analyse the ownership structure and the board composition.
2. The analysis of the board of directors' independence. Keeping into consideration our goal, we analysed corporate governance codes and corporate statutes in order to understand the nomination process of directors. We collected the curriculum vitae (CV) of the independent directors currently available on the corporate website.
3. The content analysis of service charters, seen as a managerial tool designed to get public services more responsive to the direct users by seeking to transform the culture of service delivery, focusing on users' needs and offering to consumers guarantees on the quality of public services (Torres, 2005).

The 90.0% of LPUs adopted a traditional governance system characterized by the subdivision of duties to three corporate bodies: the shareholders' board, the board of directors and the board of auditors. Only one LPU has adopted the dualistic system of governance, characterized by the presence (beyond the shareholders' board) of a management board and a supervision board.

The analysis of the CVs and of the service charters was done through the content analysis methodology (Krippendorff, 1980). This methodology has been widely used in literature, particularly in corporate social disclosure studies (Guthrie and Parker, 1990). Content analysis objectively and quantitatively examines written or oral communications in order to make inferences about values, meanings or understandings being conveyed (Riffe et al., 1998; Holst, 1981).

A coding scheme was identified in order to analyse the documents (CVs and service charters). The coding scheme was pre-tested on two sub-samples of CVs and service charters; after this step, two researchers came to an agreement about the final set of items to be used in the classification for each category (Pugliese et al., 2009). Therefore, the items were defined as precisely as possible (Ingram and Frazier, 1990). Following previous studies using the content analysis (Ingram and Frazier, 1990), two researchers

independently were asked to score the items (ranging from 1 to 5) in each document (the CVs and the service charters) through the identified coding scheme. The final score is the summary of the score provided by the two researchers. Any instance of disagreement was discussed between the two researchers in order to be resolved (Ryan and Ng, 2000). However, the agreement between the two researchers grew and discussions were no longer needed.

Four dimensions were analyzed in the CVs: demographic aspects, education, previous employment experiences, and politics involvements. Moreover, we provide (as indicated previously) availability scores (ranging from 1 to 5) (Has it been easy to find the CV?) and the exhaustiveness ones (the length of pages and the degree of information detail) of CVs.

CVs are a useful source of data. Actually, several studies have used CVs data to different aims. The data available from CVs were also used in previous studies (Gaughan and Bozeman, 2002). However, if the CV provides a useful source of data, several methodological issues exist. For example, CVs are usually characterized by: not standardized formats; variation in length (short and long formats) and information ordering; truncation and missing of important information<sup>3</sup> (Dietz et al., 2000).

Four dimensions were identified for the analysis of the service charters: general principles (equality of users' rights, fairness of public service producers, continuity and regularity in services' provision, citizens participation, right of choice for users of public services and complaints and redress mechanisms), services quality standards, implementation, and evaluation according with previous survey on service charters in Italy (Lo Schiavo, 2000).

## **2.4 Results**

In this section, the main results from the multiple case study are presented in three parts. First, the evidences emerging from the content analysis of the service charters are

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<sup>3</sup> To solve this methodological problem we use information from the website to complement CVs information according to previous research.

shown. Second, the analysis of the relationships between ownership structure and board composition in LPUs are presented. Finally, the results of the content analysis of the CVs are presented revealing interesting issues on board independence on LPUs.

#### 2.4.1 The accountability to citizens

This section presents the results from the content analysis of the service charters.

The service charters are agreements between the producer (LPUs) and the consumers (citizens) of the public services (Mussari, 2001). According with previous studies on service charters (Lo Schiavo, 2000; Torres, 2005) the aim of the content analysis is to verify whether and to what extent LPUs put the right emphasis on the six main principles and on the implementation actions. The six principles and the related scores are presented in Table 2. In Table 3 we provide the results about the scoring assigned to the implementation actions undertaken by LPUs. Each item was scored on a 5-point scale from 1, "strongly disagree" to 5, "strongly agree".

As indicated in Table 2, the equality of users' rights was scored 2.5 on average. The fairness of public service producers was scored 2.5 on average. The continuity and regularity in services provision 2.5 and the right of choice for users of public services was scored 1.7. Citizens' participation was scored 2.2 and efficiency and effectiveness were scored 2.1.

Table 2 – The content analysis of the service charters (principles)

<b>General Principles</b>						
	Equality of users' rights	Fairness of PS producers	Continuity and regularity in the provision	Right of choice for users of PS	Participation	Efficiency /effectiven.
A2A	2	1	2	1.5	2	2
Acea	3	2	3	2	3	3
Acegas-Aps	2	3	2	2	2	2
Acque Potabili	2	4	3	1	2	2
ACSM Agam	1.5	2	2	1	1	2
Ascopiave	2	2	1	2	2	1
Edison	3	3	2	2	1	2
Enia	3	2	2.5	1	3	2
Hera	3	4	3	3	4	4
Iride	3	2	2	1	2	1
<b>Average score</b>	<b>2.5</b>	<b>2.5</b>	<b>2.3</b>	<b>1.7</b>	<b>2.2</b>	<b>2.1</b>

Source – Our elaboration

Table 2 shows that the six principles are introduced more to comply with formal requirements rather than giving accurate information on the service charters. Indeed, these principles are often fairly related to the specific reality of LPUs.

We also checked for implementation actions that try to operationalize and communicate what is indicated in the service charters. In particular, the focus was on five items (Torres, 2005): service standards, consultative mechanisms, information to citizens, complaints and redress mechanisms (Table 3).

Service standards were scored 3.6 on average. The consultative mechanisms were on average scored 2.5 while the information to citizens was scored 2.7. Complaints and redress mechanisms were scored 2.4 on average. Therefore, the implementation actions seem to be not very well implemented.

Table 3 – The content analysis of the service charters (implementation actions)

	<b>Tools</b>			
	Service standards	Consultative mechanisms	Information to citizens	Complaints and redress mechanisms
A2A	3	2	2	2
Acea	4	3	2	1
Acegas-Aps	4	2	3	2
Acque Potabili	3	2	2	3
ACSM Agam	4	2	3	3
Ascopiave	3	3	3	4
Edison	3	2	3	3
Enia	4	2	3	2
Hera	4	4	4	3
Iride	4	3	2	1
<b>Average score</b>	<b>3.6</b>	<b>2.5</b>	<b>2.7</b>	<b>2.4</b>

Source – Our elaboration

Finally, we looked at the availability and the exhaustiveness of the service charters. The availability has been evaluated considering if it has been easy to find the service charters. The availability has been judged with a score of 2.4. This result is affected by the fact that only few LPUs (4) made available the service charters on the websites. The rest of the service charters were searched by the web through different search engines.

The exhaustiveness has been judged with a score of 2.7. It is strictly linked to the length of service charters that is in average 24.2 pages (from a minimum of 7 pages to a maximum of 42 pages).

#### 2.4.2 The ownership structure and the board composition

As indicated in Table 4, in all the analysed LPUs resulted the majority ownership by the LGs (Municipalities have at least the 50.0% of shares in equity). On average, the participation of the LGs in the equity was of the 62.6%<sup>4</sup> in 2008. The value of the quota of floating capital on the market is on average equal to 25.9% of the total capital (Table 4).

Table 4 – The Ownership structure of LPUs

	% Local Government(s)	% Private shareholder(s)	% Market	Owned by at least two local governments	Shareholders Agreement
A2A	55.0%	7.5%	37.5%	Yes	Yes
Acea	51.0%	21.5%	27.5%	No	No
Acegas-Aps	63.0%	9.0%	28.0%	Yes	No
Acque Potabili	61.0%	10.0%	29.0%	Yes	Yes
ACSM Agam	76.0%	-	24.0%	Yes	Yes
Ascopiave	60.0%	-	40.0%	Yes	No
Edison	80.8%	10.4%	8.8%	Yes	Yes
Enia	62.0%	2.4%	35.6%	Yes	Yes
Hera	59.0%	41.0%	0.0%	Yes	Yes
Iride	58.1%	12.9%	29.1%	Yes	Yes
<b>Average</b>	<b>62.6%</b>	<b>14.3%</b>	<b>25.9%</b>	-	-

Source – Our elaboration

The minority ownership is on average 14.3% (Table 4). The main minority shareholder has on average the 6.0% of the equity. It is important to underline that corporate statutes impose maximum private shareholding limits for all entities that are different from LGs. In 8 LPUs, the statutes bind the majority ownership in favour of Municipalities. Therefore, the ownership structure of LPUs is substantially derived from statute items.

<sup>4</sup> In some cases the participation in equity is held indirectly, through corporations controlled by LGs.

## Conflicts of Interest and Governance Mechanisms in Italian Local Public Utilities

In the majority of cases (9) the LGs hold shares jointly. This happens when Municipalities are located in the same province or in territorially contiguous provinces. Besides, joint ownership is often guaranteed by agreements among the Municipalities. For what concerns the board of directors' composition, the board size is on average of 11 directors (Table 5). The 72.6% of the directors were appointed by the major shareholder through a statutory attribution of direct powers of nomination reflecting the provisions of the article 2449 of the Italian Civil Code indicating that if the State or a public entity holds shares in a joint stock company (JSC), they have the right to appoint one or more directors directly, regardless of the size of its share holding, thus violating the principle that all shareholders are entitled to equal treatment<sup>5</sup>.

Table 5 – The board composition

	N° of directors	% of directors appointed from the major shareholder	Executive directors	Non executive directors	Independent members	Outsider ratio	CEO duality
A2A	15	80.0%	0	15	15	100.0%	No
Acea	9	55.6%	2	7	7	77.8%	No
Acegas-Aps	12	66.7%	2	10	9	75.0%	No
Acque Potabili	9	88.9%	4	5	3	33.3%	No
ACSM Agam	9	66.7%	4	5	5	55.6%	No
Ascopiave	5	80.0%	2	3	2	40.0%	No
Edison	13	69.2%	1	12	3	23.1%	No
Enia	11	72.7%	6	5	7	63.6%	Si
Hera	18	55.6%	2	16	16	88.9%	No
Iride	11	90.9%	2	9	8	72.7%	No
<b>Average</b>	<b>11.2</b>	<b>72.6%</b>	<b>2.5</b>	<b>8.7</b>	<b>7.5</b>	<b>63.0%</b>	-

Source – Our elaboration

The rest of the directors are appointed by the election system “*voto di lista*”. According to this election system, directors are appointed by the shareholders' meeting on the basis of lists presented by the shareholders<sup>6</sup>.

<sup>5</sup> In 2008 the Italian Legislator issued a Law (34/2008) in order to solve this problem and to limit the power of direct nomination by the public shareholder. However, this Law is actually subject of various criticism and the chapter does not catch its effects because the analysis is on 2008 data.

<sup>6</sup> Only those shareholders who, alone or together with other shareholders, represent at least 1.0% of the shares with voting rights at ordinary shareholders' meetings shall be entitled to present lists. Within each

### 2.4.3 The board independence

Board members' independence has been analysed and the results are now presented. The outsider ratio [the number of independent directors on the total number of directors (Daily and Dalton, 1992)] is on average 63.0%. This means that in LPUs the boards of directors have a relatively high number of independent directors. Basing on the theoretical discussion on actual board independence, we analysed the CVs of the independent directors by doing a content analysis. 8 LPUs made available the CVs on the company website (Table 6). In the analyzed LPUs, the total number of independent directors was 75. We collected 63 CVs directly available from the company website.

Table 6 – The content analysis of the CVs

	General information				CV exhaustiveness and availability		
	CVs containing inform. on education	Directors with previous experiences	Directors with previous experience in utilities	Directors with political involv.	Lenght in pages	Exhaust.	Availab.
A2A	13	15	13	4	1.8	2.8	2.0
Ace Gas APS	5	7	4	6	2.1	2.7	2.0
Acque Potabili	3	3	3	0	0.3	1.5	4.0
Ascopiave	1	2	0	0	0.8	2.3	5.0
Edison	2	3	3	1	1.0	3.0	5.0
Enia	6	6	3	1	1.5	3.3	4.0
Hera	15	13	10	6	1.2	2.8	5.0
Iride	9	9	7	5	0.8	1.8	5.0
<b>Average score</b>	<b>54</b>	<b>56</b>	<b>43</b>	<b>23</b>	<b>1.2</b>	<b>2.6</b>	<b>4.7</b>

Source – Our elaboration

Among the 75 independent directors, 59 are male. On average, their age is 59. In 54 CVs there were information on the educational background of the directors. In 47 CVs it was specifically reported that *the director has a university degree* (only 2 directors have also a PhD), while 7 directors have a high school degree. At least 56 directors have had one prior position as director in another company. Among them, 43 have had a prior position in a LPU. It was indicated that in only 23 CVs the director had some

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list, candidates must be ranked progressively. The list obtaining a majority of votes will elect a certain percentage of the directors. The remaining directors will be drawn from the other lists.

involvement in the political field. Among these, 15 directors are currently involved in political activities (in most cases at local level).

We assigned on average the score of 4.7 to the availability of the CVs. Therefore, many LPUs made available the CVs in the website or in the corporate governance report. We assigned on average the score of 2.6 to the exhaustiveness of the CVs. The degree of exhaustiveness is not particularly high. The length was on average 1.2 pages (in some CVs there were only few sentences, in others the maximum number of pages was 4).

## **2.5 Discussion and findings**

Despite the large emphasis on efficiency and on private sector logics (NPM) that has characterized the last decades, in Italy the Municipalities are the main shareholders of LPUs (Grossi, 2007; Grossi and Mussari, 2009). Therefore, studies on the governance systems of LPUs have to consider especially the role of Municipalities.

The case study analysis shows that in the Italian LPUs there are many and different interests. The Municipalities have the fundamental role to balance these opposite needs and interests (Kickert et al., 1997). The appropriate implementations of governance systems may help LPUs and the LGs performing this task (Walsh, 1994; Grossi, 2007).

A broad principal-agent framework (Fama and Jensen 1983; Jensen and Meckling 1976) has been adopted to examine the governance system in LPUs by showing various agency co-existing relationships (Figure 1). In section two, the theoretical debate on LPUs has led us to the formulation of four propositions.

The role of citizens in the governance of LPUs is central. Indeed, citizens are at the same time customers, clients, resident, principals and owners (Schachter, 1997). Moreover, the public interest (Bozeman, 2009) is particularly important in LPUs, because the competitors are often few and in some cases none. Therefore, the market is not able to eliminate inefficiencies generated by bad management, as in the private sector.

As indicated in **proposition 1**, drawing on agency theory the citizens are the main principal and the LGs the agents delegated to grant the public interest (Lane, 2000). The degree of citizens' control on the LGs depends on the level of transparency and accountability in LPUs. To be more competitive and to offer a service that would be perceived by the customer/client/resident/citizen as better, it is required a higher level of involvement during the process of delivering the service (Testa and Ugolini, 2001). This is because the behaviour of the client significantly influences the level of quality (Gronroos, 1994). Moreover, the customer/client/resident/citizen is going to be the one that judges the quality of the service received. Therefore, communication between the company and its clients becomes important (Pellicano, 1992). The customer/client/resident/citizen must be provided with the information that is considered by him to be necessary and will enable him to participate in the service delivery process (Baccarini, 1995). Service charters represent a useful tool to this purpose (Mussari 2001; Bertocchi, 2008), but further implementation and evaluation are needed in order to improve the quality of public services. Service charters list the rights that citizens can expect from public institutions and introduce the priority of putting citizens or users first (Torres, 2006). Effectiveness of service charters as a *voice* mechanism depends on transparency and openness of performance reporting and complaint mechanisms (McGuire, 2001).

The results from the content analysis of the service charters show some critical issues. We found that in all the analysed Italian LPUs, although the service charter respects the formal and legal requirements, it often does not represent an effective instrument to ensure and/or improve public service quality. They are only seen as way to accomplish the legal requirements without the protection of citizens' interests (Lo Schiavo, 2000; Mussari, 2001; Bertocchi, 2008). So, service charters are not an NPM strategy intended to change the culture of public service delivery to focus on the needs of the users, identified as "clients" or "customers" (McGuire, 2001). The results also suggest that in many service charters there is a lack of important specificities especially connected to the general principles of reference. In particular, the six principles [equality of users' rights, fairness of public service producers, continuity and regularity in services' provision, citizens participation, right of choice for users of public services and

complaints and redress mechanisms (Torres, 2005)] are covered in the charters, while detailed descriptions on goal achievements are completely missing. Besides, very little attention has been devoted to implementation features. Indeed, it emerges that service charters are still ignored by the wide majority of citizens. This is also in line with previous results going in the same direction (Mussari, 2001; Lo Schiavo, 2000). Therefore, the objectives to make service providers more responsive to users by guaranteeing specific standards for service delivery, providing a substitute for competition and a benchmark for measuring service quality are not accomplished in the Italian listed LPUs.

The formulation of proposition 1 seems to be in line with the evidences of the case study analysis, suggesting that LGs need to regain citizens trust by providing more transparency, accountability and openness (Torres, 2004). Moreover, the citizens claim the right to receive a certain level of performance of LPUs, thus exercising an “indirect” type of control over them (Grossi, 2007). The challenge is to make the citizens more involved and engaged with local public services (Brown, 2007). Indeed, significant improvements of quality in public services can derive from directly involvement of citizens [e.g., through the use of citizen surveys (Dalehite, 2008)]. More interestingly, Brandsen and Pestoff (2008) emphasize the importance of *co-production* in public services “primarily related to the involvement of citizens or clients in the production or provision of public services”. Thus it will be possible to create a circular link between services planning, provision and performance, and citizen feedback, based on a two-way communication (Cassia and Magno, 2009). Co-production implies benefits for citizens providing them with knowledge about public issues, with the opportunity to influence the agenda (Askim and Hanseen, 2008) and consequently service improvements. Finally, co-production is an alternative theoretical framework for the investigation of LPUs, it makes adjustments and advancements to the intrinsic limits of the agency theory and gives more possibilities to improve controlling and monitoring tasks through an active involvement of citizens.

In **proposition 2** we suggested that in the Italian listed LPUs [context characterized by concentrated ownership and by the dominant role of the State (La Porta et al., 1999)]

there are conflicts of interest between majority shareholders and minority shareholders [principal-principal conflict (Young et al, 2008)]. The results from the analysis suggest that there are situations in the ownership structures that may generate conflicts between majority (LGs) and minority (private owners) shareholders (Dharwadkar et al., 2000). Indeed, considering the analyzed cases, in 2008 the LGs hold on average approximately the 62.6% while minority shareholders have on average the 14.3% [(the main minority shareholder has on average the 6.0% of the equity (Table 4)].

This situation suggests that having the minority shareholders small percentage of shares in the LPUs, the interests of the LGs are not perfectly aligned with that of minorities (Claessens et al, 2002). Hence, the LGs have strong power over the strategic directions. There are conflicting purposes and influences, so there is a need for control and autonomy requiring a continuous search for balance (Grossi, 2007).

In the discussion of proposition 2 it is important to highlight which is the role of private shareholders in LPUs. They are mainly motivated by the pursuit of profit even if not focused on the public value (Bozeman, 2009). This might be risky if the main interest to protect is that of the citizens (Lane, 2005). However, the minorities have strategic importance to correct the inefficiency of the public sector logics thus ensuring efficiency in the production/provision of public services. By their side, LGs are supposed to pursue the public interest and avoid opportunistic behaviours by the private owners who may be oriented only to the profit maximization (Bognetti and Robotti, 2007). So, there are good reasons to the LGs control (Wettenhall, 1985).

Moreover, problematic aspect arises when the LGs are moved by the desire to maintain a strong control on LPUs in order to protect not only the public interest but primarily their political power (Zajac and Westphal, 1996). Indeed, decisions regarding the quantity, quality, choice and equitable provision of public services are ultimately political decisions because the board of directors of LPUs includes members directly or indirectly involved with the government (Kilpatrick and Lapsley, 1996). In these cases (as discussed better in the other propositions) it is important to avoid that the composition of the board may be one-sided, dominated by politicians (Collin, 2007).

The role of LGs is in reality more complex. In fact, it becomes even more critical in the emerging pluralistic model of public services production/provision through *networked forms of governance* [public-private partnership; public-public partnership; not for profit and voluntary organizations involvement; citizens' involvement; private actors' involvement, etc. (Rhodes, 2007)]. In these situations the role of the LGs is to steer all the actors involved at various level in the governance system of LPUs. The interests of minority shareholders are than considered in a wider perspectives being related to that of all the other stakeholders (Freeman and McVea, 2001). Coordination actions and monitoring mechanisms (ex-ante and ex-post) are of course useful for LGs in order to perform these tasks (Judge and Zeithaml, 1992). Introducing these elements of innovativeness (Moore and Hartley, 2008) in the governance system of LPUs may partially alleviate the problematic arising from the principal-principal conflict.

**Proposition 3** is discussed indicating that ownership structure characteristics affect the composition of the board of directors. The results from the multiple case studies analysis support our proposition suggesting that LGs exert pressures by the direct appointment of board members. Indeed, the 72.6% of the directors were appointed by the major shareholder through a statutory attribution of direct powers of nomination reflecting the provisions of the article 2449 of the Italian Civil Code (Table 5). Therefore, if the State or a public body holds shares in a JSC, they have the right to appoint one or more directors directly, considering the size of their share holding. This statement is in contrast with one of the OECD principles contemplating that non-controlling shareholders are entitled to equal consideration with other shareholders and that the board should not favor one category of shareholders over the others (OECD, 1999). Moreover, the European Court of Justice's decision on 2007, represents the last stage of a long debate on the articles 2449 of the Italian Civil Code. The decision reaffirms that such provisions in a JSC unfairly restrict shareholders' ability to participate effectively in the management of a company, discouraging overseas investors from acquiring shares in a company which is partly owned by the State.

Even in cases of jointly ownership by the LGs, as indicated from our results (Table 4), their appointment power is guaranteed by agreements among the Municipalities. Thus,

the power of the controlling shareholders, strengthened by agreements among the Municipalities, is an appropriate vehicle for keeping shares out of the hands of undesirable investors (Hand et al., 1982, Volpin, 2001) highlighting the low protection of minority shareholders (La Porta et al., 1999) in LPUs. Hence, the power of direct nomination of the LGs effectively nullifies the board's ability to oversee the controlling shareholders (Young et al., 2008). LGs can appoint the directors who are sympathetic to their political and strategic objectives (Claessens et al., 2002). Particularly, the directors who are appointed by the LGs interpret their fiduciary duty in light of the controlling shareholder's interests, rather than the interests of all the others (minorities, citizens, etc.) stakeholders (Collin, 2007). Unlike a private shareholder, the LGs might acquire a right to exercise a degree of influence over the management of LPUs beyond that to which its shareholding status would otherwise entitle it. The essential idea should be to appoint directors who would be expected to pursue strategies which are in the public interest rather than strategies which focus exclusively on the controlling shareholders interest (Bishop and Thompson, 1992).

Issues related to board independence are thus critical and they are discussed in **Proposition 4**. In order to verify the board of directors' actual independence, the CVs of independent board members were analysed.

The results from the content analysis show some main concerns in relation to the formal attributes that the independent directors should have in order to be appointed in LPUs. Particularly, Table 6 shows that information on the educational background, previous experiences and absence of directors' political affiliation are not well disclosed. This is partially due to the fact that the exhaustiveness and availability of CVs do not follow high quality standards. This information gap arises doubt on the actual independence of independent directors. Therefore, the question on how "independent" are independent directors is even more on fashion.

Following the agency theory, independent directors may serve to primarily monitoring the management (Pearce and Zahra, 2007; Zahra and Pearce, 1989) in order to protect shareholders from management's conflict of interest (Fama and Jensen, 1983). However, our theoretical discussion has underlined that in LPUs there are multiple principals and agents that might be in several situations of conflict of interests thus

suggesting that a wider concept of independence should be considered in these types of organizations. Hence, in LPUs the independence of board members from the management is not enough. In fact, even if the independent directors are independent from the management, we are not certain that they are independent from the controlling shareholders as well (Mallin, 2002). Indeed, following the corporate governance code guidelines, they may be considered as genuine independent even if they are affiliated to the politicians. This is particularly evident in LPUs characterized by strong political input and appointment of politically affiliated individuals *versus* a lack of professionalism. Thus, in order to make the board an effective governance mechanism to protect all the interests involved in LPUs there is a need for independence – *double independence* – both from the management and the controlling shareholders (Huse, 2007). Moreover, more transparent and competence based selection processes that includes appraisals of board members which will ensure that the ultimate selection criteria is “competency based”, may give the chance for more coherent future appointments (OECD, 1999). The new requirements established by the Law 34/2008 seem to be in line with these expectations providing many elements of innovation in the appointment process that go towards more transparency and accountability. Of course this is a future challenge and a central prerequisite to empower boards in LPUs by structuring them in a way that effectively enables objective and independent judgements.

## **2.6 Conclusions and future research directions**

This chapter examines how in LPUs questions regarding the ownership structure, the board composition and independence, and the role of service charters may be challenging.

We use the agency theory (Fama and Jensen, 1983; Jensen and Meckling, 1976) to investigate the complex co-existence of agency relationships in the governance system of LPUs. Along this theoretical debate we formulate four propositions discussed through a multiple case study analysis on 10 Italian listed LPUs.

This study contributes in several ways to the research on LPUs governance systems, and PSOs.

First, we contribute to the debate on corporate governance in PSOs (Hodges et al., 1996) and, in particular, in LPUs by using the agency theory as the starting point to identify the conflicts of interest arising from the co-presence of different principals and agents. However, we also show how the agency theory prescriptions (the board of directors as a conflict resolution arena) are often not a useful tool to fill the lack of accountability of LPUs. Service charters represent a good starting point to cope with. However, the best solution would be the direct involvement of citizens in the provision of public services and in the decision-making process, as ways of co-production (Pestoff, 2009).

Second, we explicitly fill this gap in the literature that shows the need for more studies on governance mechanisms in LPUs (Grossi and Reichard, 2008; Farrell, 2005). By having this purpose, we add new evidence to the general trend of Public Administration and Management (PAM) research that moves from the old bureaucratic model of Public Administration (PA) to the New Public Management (NPM), and nowadays is characterized by the pluralistic world of the New Public Governance (NPG) (Osborne, 2006).

Moreover, our study provides new and insightful findings for the practice and the local administrators. Indeed, by understanding the paradox of corporate governance in PSOs (the role of ownership structure, board composition and independence, service charters) and suggesting new theoretical perspectives it will be possible to improve public services provision, keeping more attention on the public value and interests. This allows us to overcome the intrinsic limits of agency theory which allow us to catch only a one-dimensional view of behaviour, ignoring the co-operative aspects of social life (Dilulio, 1994) as better indicated in the co-production concept.

Although various studies try to understand governance mechanisms in LPUs, there is a need for future research on the processes and dynamics of governing bodies. The challenges to focus on internal governance mechanisms when studying LPUs is given by the limited presence of competition in the national and international arena that stops in a certain way the possibility of the market to correct public sector inefficiencies.

Therefore, trying to solve the paradox of corporate governance in LPU could give interesting perspectives for public services improvement.

## 2.7 References

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## **Appendix**

### **The legislative evolution of local public services in Italy**

The Italian system of local public utilities has undergone an important reform process starting from 1990. This legislative appendix summarizes the various legislative reforms starting from 1990 until 2009.

#### **1 Laws 142 of 8 June 1990: “Regulation of the local authorities”**

The Law 142/1990 represented a remarkable change regarding the management of LPUs. References are in articles 22 (local public services) and 23 (special undertakings and institutions). In particular, art. 22 stated that “Municipalities and Provinces may use the following forms for local public services”:

- a) public management, where, owing to the small size or the characteristics of the service, it is not an expedient to create an institution or an undertaking;
- b) concessions to third parties, where there are technical, economic or social reasons;
- c) special undertakings (*aziende speciali*), for the management of multiservice with economic and commercial interest;
- d) institutions, for the provision of social services not having any commercial interest;
- e) joint stocks mixed enterprises with a public majority, where participation by other public or private persons appears useful owing to the nature of the service to be provided.

Therefore, the Law 142 did not allow, in the case of local public services, joint stock companies with private majority, but only mixed enterprises with public majority.

#### **2 Law 498 of 23 December 1992: “Urgent acts on public finance”**

The article 12 of Law 498 of 23 December 1992, introduced the possibility of joint stock companies without the restriction of public majority. In particular it is established that local entities may “create *ad hoc* joint stock companies for the provision of public services” without the restriction of public majority.

**3 Law 127 of 15 May 1997: “Measures to stabilize public finances”**

An other important reform is represented by Law 127/1997 the (Bassanini Law). This law introduced a simplified process for the transformation of the former municipal companies into joint-stock companies, through which the transformation becomes immediately effective after the unilateral act by which the local body which assigns the assets of the former municipal firm to the new company.

The benefit connected to the simplification of the transformation process entails the obligation for the local body to transfer its holding, entirely or partly, in the two years following the setting up of the new company.

**4 Legislative Decree No. 267 of 18 August 2000: “Consolidated Act on Local Authorities”**

The Consolidated Act contained, in articles 112-116 of the Title V “Services and local public interventions”, the rules which replaced and innovated what had been provided under the previous laws and by other pieces of legislation approved in the 90s. The relevant article are: 113, 115 and 116.

Art. 113 contemplates the possibility to provide local public services through joint stock companies or through limited liability companies with a public majority set up or participated by the Authorities responsible for the public service, where participation by various public or private subjects appears expedient owing to the nature or territorial extent of the service. Moreover, the article 113 underlines what had been provided under Law 498, allowed the management of public services through joint stock companies without the restriction of the public majority holding according to art. 116.

Art. 115 establishes the procedure for the transformation of the special undertakings into joint stock companies.

**5 Law 448 of 28 December 2001: “2002 Financial Law”**

The article 35 of the Law 448/2001 introduced significant modifications at the discipline of local public services categories according to whether they are of industrial interest or not. The industrial interest services are regulated by the renewed art. 113 which entirely reforms the version included in the Consolidated Act. The non industrial interest services are regulated by the new article 113 bis.

The new art. 113 “Management of networks and provision of local public services of industrial interest”, contains the principle of non-transferability by the local public entities of ownership to the plants, networks and other capital assets for the provision of local public services and the

possibility to separate the management of the aforesaid assets from the management for the provision of the services.

As for the forms of management, art. 113 provides that the local public authorities can transfer the ownership of the assets to joint stock companies of which they hold the majority. Then the management of the assets should be separated from that of the services. For the operation of the networks and plants, the local authorities can utilize: a) subjects created for this purpose, in the form of joint-stock companies with the majority of the shares held by the local authorities, eventually associated with other local authorities to which such activities may be directly entrusted; b) suitable enterprises, to be identified through a public tender procedure, whilst paragraph 5 (which disciplines the forms for the provision of the service) states that the management must be carried out in competitive conditions granting the service to joint-stock companies identified through public tendering procedures.

The majority participation in the companies, owners of the assets, cannot be sold. Instead, when public participations are in companies providing services, participations may be transferred totally or partially.

**6 Law 326 of 24 November 2003: “Conversion in Law of the Law Decree 269/2003”; and Law 350 of 24 December 2003: “2004 Financial Law”**

The Law Decree No. 269 of 30 September 2003 (then converted with amendments into Law 326 of 24 November 2003) and the Law 350 of 24 December 2003 introduced substantial modifications to articles 113 and 113 bis of the Consolidated Act, already modified by art. 35 of the 2002 Financial Law. Here below some main changes:

- 1) The expression “industrial interest” has been abandoned and, following the trends in the European Union, of the “economic interest” has been adopted. Services of economic interest governed by art. 113 do not include local transportation and the distribution of electricity and natural gas, which are regulated by specific legislation.
- 2) Secondly, it has been stated that the companies owning networks and other capital assets must be entirely publicly held.
- 3) Local Municipalities may use, for the separate management of networks and plants, their own joint-stock companies to which they may directly assign the activity, but, also in this case, it has been established that the company must be entirely publicly held and that the public authorities owning the capital must exercise the control over the company similar to the one exercised over their own services. Moreover,

the company must carry out the most important part of its activities with the public body or bodies which control it (so-called in-house provision).

- 4) For the provision of public services of economic interest, three possibilities are identified: a) awarding the service to joint-stock companies identified through public tender procedures; b) awarding the service to mixed capital public-private companies in which the private shareholder is selected through a public tender procedure; c) awarding the service to a company having an entirely public capital, on condition that the public body or bodies owning the capital exercise over the company a control similar to that exercised over their own services and that the company performs the most important part of its activities with the public authority or authorities which control it (in house provision).

#### **7 Law No. 133 of 6 August 2008: “Conversion in Law of the Law Decree 112/2008”**

The article 23-bis of the Law Decree 112/2008 has changed the expectations and the management of local public services of economic interest in order to promote the principles of competition. It states that the holder of the management of a public service can be an entrepreneur or a company and not only a company, as indicated in the article 113 of the Legislative Decree 267/2000. Moreover, it states that the management must be carried out only through public tendering procedures, eliminating other possible procedures (e.g., direct entrusting). The importance of the law is demonstrated by the fact that its provisions shall apply to all local public services prevailing over any conflicting industry-related disciplines.

#### **8 Law No. 166 of 20 November 2009: “Conversion in Law of the Law decree 135/2009”**

The last regulatory action concerning local public services is the Law 166/2009. The Law modifies the article 23-bis of the Law 133/2008. From the possibility to entrust the management of local public services by an entrepreneur or a company, the law adds the possibility to entrust the management with a mixed enterprises (public-private) through the public tendering procedure.

Entrusting to the mixed-enterprise needs to accomplish two requirements:

- 1) the private partner is selected through a public procedure, also called "tender double-object", referring to the person and the activity that become both object of the competition;
- 2) the extent of private participation is not lower than 40.0% of the capital.

## – Chapter 3 –

### PARTIAL PRIVATIZATION PROCESSES, PUBLIC SERVICE PROVIDERS AND ACCOUNTABILITY ISSUES: EVIDENCES FROM ITALY AND NORWAY

#### **Abstract**

In the last decades the privatization process has characterized and changed the public sector in many European countries. However, often it ended up with public service providers (organized in the form of joint stock companies) still owned by the State (partial privatizations). By discussing these partial privatizations from different theoretical perspectives – New Public Management (NPM), New Public Service (NPS), and New Public Governance (NPG) – the chapter highlights some main problematic issues related to corruption, conflicts of interest and the lack of accountability. While in the NPM the privatization process aims at improving efficiency of public service providers, if analysed from the NPS perspective it seems to create ethical problems. Moreover, NPG, as co-production, networks and cooperation, offers valid alternatives to privatization focusing more on citizens' public value and interest. Through a case study analysis we describe the Italian and the Norwegian privatization processes. The results show the *stop and go* characteristic of the Italian process and the *reluctance* of the Norwegian government to privatize and the existence, in both countries, of situations in which the Ministries are still the major owners of service providers. Moreover, although the role of Ministerial governance has different development in the analysed countries a common pattern exists in relation to ethical and accountability problems. To investigate those issues a content analysis of codes of ethics has been conducted on the public service providers owned by the Italian and the Norwegian governments. Finally, we discuss networked modes of governance and the implementation of accountability as reasonable alternatives to the lacks and problematics generated by these partial privatization processes.

**Keywords** : Privatization · accountability · ethics · codes of ethics · NPM · NPS · NPG · Italy · Norway.

### **3.1 Introduction and motivation**

Market reforms such as privatization, often aim at improving economic efficiency by reducing the role of the State and increasing the degree of private sector competition. These reforms are expected to have a positive effect on the local economy (Boubakri and Cosset, 1998; Meggison and Netter, 2001). However, the measure of the success of privatization is often very narrow (Kikeri and Nellis, 2001). In fact, in many cases concerns have been raised about the privatization processes, in terms of conflict of interests, lack of accountability and corruption. Moreover, in many countries (e.g. Italy and Norway), public service providers are still controlled by the State therefore outlining situations of partial privatization.

The chapter emphasises attributes, limits and open-debates related to the privatization process. Actually, ethical issues arising from conflicts of interest, lack of accountability and corruption of public officials may be a reason for the failure of privatizations. As result of partial privatization processes, it may be possible to find ethical concerns and lack of accountability in the governance systems in which public service providers operate (Bjorvatn and Soreide, 2005). Therefore, there is an urgent need for understanding and improve accountability (Paul, 1992).

In addition, and trying to cope with these issues, the Organization for Economic Co-operation and Development (OECD) has played an important role in developing guidance and recommendations for member countries on managing ethical issues in the public sector (OECD, 2000).

Stemming from this debate this study looks at whether privatizing public sector activities might improve or detract from New Public Management (NPM) reforms. It starts thus by noting that privatization is an important part of market reform programs, which are expected to improve economic efficiency by reducing the role of the State in the economy. Yet, some countries in Europe have only recently begun to privatize or have stopped the process without realizing effective market competition, so they may be considered as examples of partial privatization. The primary aim of this chapter is to show the impact of privatization on the accountability system for providers of public services. The primary research questions are: *what are the main reasons and motivations for partial privatization? How it can be related to different regime*

*perspectives, like NPM, NPS and NPG, and how are these different perspectives related to accountability systems of public service providers? Are there differences or common patterns when comparing the situation of different countries?*

In order to catch the institutional, social and political differences between Italy and Norway, a historical approach has been adopted for the analysis of their privatization processes. An additional dimension of analysis is given by the exploration of the ownership stakes that both the Italian and the Norwegian governments still have in providers mainly operating in the domain of public services and goods. Moreover, the chapter investigates the consequences of the privatization processes on public service providers accountability system by analysing the content of the codes of ethics adopted. This is done in order to catch if they address issues on conflicts of interests, unethical behaviours, and accountability and if effective implementation and communication actions to citizens exist. Finally, it is clearly highlighted that differences and common patterns exist between the analyzed national contexts.

The chapter makes several contributions to the debate on privatization, accountability and governance systems of public service providers. First, it is clearly showed how in the debate on public service providers accountability, themes such as conflicts of interests, and unethical behaviours are considered critical to the successful definition and implementation of their governance systems.

Second, it is shown that valid alternatives to privatization exists (Pestoff, 1992; 2008). Indeed, NPS and NPG may able to solve, in part, some of the ethical issues related to conflicts of interest and corruption, due to greater citizen participation in public service delivery. However, it is important to remember that given different perspectives on privatization, like NPM, NPS and NPG, the power of governing bodies are also changing. This gives rise to questions about the capacity of accountability systems to keep up with these developments.

Third, the findings suggest the *stop and go* characteristic of the Italian process, the *reluctance* of the Norwegian government to privatize and the existence, in both countries, of situations in which the Ministries are still the major owners of service providers. Moreover, although the role of Ministerial governance has different

development in the analysed countries a common pattern exists in relation to ethical and accountability problems.

Fourth, from the analysis of the historical background of the two countries the chapter emphasises that while in Italy the privatization process has been a way of reducing inefficiencies in the public sector (Bognetti and Robotti, 2007; Cassese, 1996) and adapting to the competitive pressures emerging in the international market (Saraceno, 1981; Cafferata, 1995), Norway has not been characterized to any strong Public management reform path, reflecting also a healthy economic situation and a well-functioning public apparatus (Christensen and Lægheid, 2009).

Finally, the findings from the the content analysis of the code of ethics of both the Italian and the Norwegian service providers highlight that although the contestual and historical differences in which the privatization process has developed a clear lack of accountability, of implementation actions on the codes of ethics, and of transparency resulted from both the analyzed countries.

The rest of the chapter is organized as follows: in section two, the main characteristics of privatization along different theoretical perspectives (NPM, NPS, NPG) are discussed. In section three the focus is on corruption and conflicts of interest in relation to privatization. The methods are described in section four. Section five summarizes the main results. Discussion, findings and future research directions are presented in the last sections.

### **3.2 The privatization process in different perspectives: New Public Management, New Public Service, New Public Governance**

The privatization process is aimed at shifting, functions and responsibilities, in whole and in part, from the government to the private sector (US General Accounting Office, 1997). It regards the changing of State industries in manufacturing, public utilities, transport and telecommunications (Millward, 1995). These changes have been most apparent in Europe, although experience has been patchy: telecommunications has largely been privatized; railways are sometimes State owned, sometimes privately-owned and sometimes in mixed ownership; many countries still have State-owned industries (McLaughlin et al., 2002).

It is often common refer to privatization as a mechanism or a tool of the NPM perspective; but it is not appropriate and correct. The NPM is a set of approaches to Public management reforms and it seems possible to look at the privatization process as a mechanism used during the NPM for realizing public sector reforms. However, there are several distinctions between NPM and privatization. First, privatization is the older term, entered the dictionary around 1968. This makes the terms about fifteen years senior of NPM.

Second, the NPM seems to have more management strategy trappings than privatization (Bozeman, 2007). Indeed, privatization is about moving public performance and functions to the private sector, but NPM includes many other trappings such as, for example, viewing the client as a customer. It is perhaps accurate to say that privatization is a broad tool kit, whereas NPM is, as advertised, an approach to management reform. But it would be a mistake to make any hard-and-fast claims about specifics boundaries between NPM and privatization (Bozeman, 2007). The privatization process is a fundamental tool to be used for re-organizing the national States. Indeed, it turned the so called State-owned firms in more market-oriented entities.

NPM is a paradigmatic break from the traditional model of Public Administration (Hood, 1991). Public sector reforms have been a common experience across the world despite its different forms (Pollit and Bouckaert, 2004). During this era several countries became exemplars of NPM (e. g. New Zealand and Australia).

More recently, however, cracks have appeared and the need of new way of thinking on public management practice has begun to be addressed to the weaknesses of NPM. There are many studies that try to overcome to those weakness, in particular the *public value approach* is attracting considerable interest (Bozeman, 2002; Hartley, 2005; Hefetz and Warner, 2004; Smith *et al.*, 2004; Stoker, 2006). A new paradigm on government activity, policy making and service delivery may emerge bringing with it important implications for public managers. In this new light also the privatization process assumes a new shape. Authors start to look at negative effects of the privatization processes that often results in partial processes with no improvement of public service values for citizens. They try to address the main lacks of these partial processes to the existence of corruption and ethical problems that might arise from

conflicts of interests among various actors. These arguments come from authors that highly contested the concept (Groot and Budding, 2008). Indeed, in recent years, it seems that the apprehension for the potentially negative impact of privatization on the ethics of public officials has been strengthened by highly publicized scandals in many OECD countries. Besides, there is an increasing concern about the impact of NPM reforms on public officials' ethics (Maesschalck, 2004). Authors from the U.S. context, also forcefully expresses their concerns about the ethical consequences of NPM innovations such as privatizing and they argue for a re-regulation (Frederickson, 1999). Some other authors argued what has been labelled the New Public Service (Denhardt and Denhardt, 2000). NPS is seen as an alternative to the dichotomy between the old Public Administration and the NPM. They propose new mechanisms in which the primary role of the public official is to help citizens, meeting their interests rather than attempt to control or steer society. Contrasting the NPM, the NPS recognizes also that the relationship between government and its citizens is not the same as that in a business activity between the firm and its customers. Therefore, the privatization process is seen as a market-based mechanism and because of its failure in some contexts becomes inappropriate, also for the ethical problems that arise from its application. Following the NPS, therefore, the privatization process seems to be inappropriate but the emphasis is more on ethical issues relating to public officials' behaviour rather than directly to that process.

A reasonable alternative (Pestoff, 1992; 2008) to the privatization process is given by the New Public Governance perspective (Osborne, 2006). This perspective includes many modes of governance (e. g. joined-up governance, network governance, co-production and cooperation). These are looked as alternatives to the privatization process in public service provisions; it seems also that they might be able to solve many of the above-described issues (corruption, conflicts of interest, and unethical behaviour). These problems are partially solved through participatory citizenship in the government of complex issues like the public service delivery (Klijn, 2008).

This discussion has pointed out how the privatization process assumes different meanings and aspects in relation to different perspectives (NPM, NPS, NPG). What seems to emerge is that in times of partial privatizations, deregulation in public service delivery and reorganization processes, the shape and the power of the governing bodies

are constantly changing. Some questions arise: does the accountability system keep up with these developments? Moving from NPM, NPS to NPG approaches would better address the over-mentioned issues and grant the public interest for citizens? Could be the implementation of an accountability system the solution to the lack generated by these partial privatization processes?

### **3.3 Privatization, public service providers, corruption and conflicts of interest**

Many countries have implemented large privatization programs, but in many others (e.g. in Italy and Norway), the State retains a large presence, often across many sectors of the economy (La Porta et al., 2002). The effects of privatization have been widely investigated, but results are contrasting. In fact, while many empirical studies found that privatization leads to an improvement of firm performance (La Porta et al., 2002; Zahra et al., 2000) others show that privatization does not necessarily lead to increased competition and efficiency (Manzetti, 1999; Puntillo, 1996; Black et al., 2000). Furthermore, some of the main criticisms against the privatization process are based on the belief that the gains in firm profitability are achieved at the expense of society. These gains are claimed to be extracted from consumers through the use of market power (Bayliss, 2002). Moreover, the most serious concern with privatization, as it has so often been practiced, is corruption (Stiglitz, 2002).

Stiglitz (2002) suggests that: “In country after country, government officials have realized that privatization meant that they no longer needed to be limited to annual profit skimming. By selling a government enterprise below market price, they could get a significant chunk of the asset value for themselves rather than leaving it for subsequent officeholders. In effect, they could steal today much of what would have been skimmed off by future politicians”.

This is partially due to the difficulty to place a value to the public assets. Other related contributions include Shleifer and Vishny (1998) and Laffont and Meleu (1999), who discuss the link between corruption and the decision to privatize, and Kaufmann and Siegelbaum (1997) who discuss corruption and the optimal design of privatization.

The privatization process is thus susceptible to corruption. Corruption in turn affects the outcome of the privatization process in terms of post-privatization market structure and

therefore economic efficiency (Bearse et al., 2000). Post-privatization market structures are in many cases dominated by the large stake of the State in public service providers (e.g. Italy and Norway). Therefore, there is an urgent need for accountability (Paul, 1992).

The problem of corruption associated with the privatization process seems thus crucial. We do not argue that an increase in corruption in the public sectors is actually caused by the privatization process. Privatization may, in fact, be no more than a convenient vehicle for corruption (Kaufmann and Siegelbaum, 1997). Sources of corruption depend largely upon the ability of politicians and bureaucrats to create new control rights or to define old control rights, the exercise of which can be sold to extract rents. Indeed, maintaining a partial ownership link the government sustains the government official's direct control rights, with the special opportunities for rent-seeking that this implies. Where the government retains exceptional governance powers, such as through the use of so-called "golden shares", this risk - and the potential for corruption - increases (Kaufmann and Siegelbaum, 1997). In cases of partial privatization processes, managers of still State-owned firms are often political appointees and their employees were given a status of equivalent to that of the civil servants. Therefore, the impact of their actions seems to be directly related to the citizens (clients or customers).

Their actions are relevant issues for ethical considerations. Moreover, the recent scandals in the public sectors let us think about the importance of ethical systems which avoid conflicts of interest that might lead to corruption and unethical behaviours in public services. The importance of renewal of the ethical system and its introduction in the governance structure of public service providers is thus crucial. In doing so, it is important to take into account that public sector employees can face conflicts, especially when personal goals are not consistent with maximising the benefits of citizens. Public officials can face a conflict when they are able to advantage their own position at the cost of other shareholders. However, the lawful resolution of these conflicts rests on the principle that public officials have an obligation to look after the interests of all shareholders. That theoretical simplicity of goals and principles does not seem to hold sway in the public sector. Showing many partial privatization processes, the current situation let us think about the importance of understanding what a conflict

of interest is, and how it may be avoided in public service providers. This aspect becomes more critical in these firms because of the involvement of the public interest.

The Organization for Economic Cooperation and Development (OECD) has undertaken extensive work on conflicts of interest in public sector and has developed the following simple and practical definition: A *“conflict of interest”* involves a conflict between the public duty and private interests of a public official, in which the public official has private interests which could improperly influence the performance of their official duties and responsibilities (OECD, 2006). While conflicts of interest should be avoided wherever possible, conflicts often happen without anyone’s fault. Conflicts of interest can – if not identified, disclosed and managed effectively – cause public officials to put private interests above the public interest; thereby compromising their work and creating a catalyst for serious misconduct and corruption. Public service providers and also the other public sector organisations must ensure that conflicts of interest are seen to be managed in a transparent and accountable manner.

The perception that conflicts of interest are not being managed properly can undermine confidence in the integrity of public officials and public sector organisations (OECD, 2005). In many cases having a code of ethics with prescriptions on conflicts of interest and sanctions, may be helpful, even if implementation action are needed. This is also needed because of the growing sense among the public in western democracies that corruption by public officials is increasing (Chapman and O’Toole, 1995; Frederickson, 1999). There is a significant shift in public service ethical standards and, subsequently, in unethical behaviour (Bovens et al., 2008; Hondeghem, 1998; OECD, 2000; Van Wart and Berman, 1999). Those considerations lead us to the consciousness that something must change in public sector organizations. The importance of citizens’ interest and the need to focus on public value lead us to consider strategically the accountability system that each public organization could adopt. This becomes more important in public service providers which are still State-owned. In those cases the adoption of businesslike method must be accomplished with the consideration of the public interest and value, and with the right tools for improving effective accountability to the citizens.

### **3.4 Methods**

The methodology adopted in the chapter is a cross-country case study which is conducted by the comparison of the Italian and the Norwegian privatization processes. The cross-country case study was chosen for several reasons. First, it has been widely used in prior public sector studies (e.g. Christensen and Lægheid, 2001; Grossi and Reichard, 2008; Argento et al., 2010) because it is a useful tool to define common trends and differences in the national contexts. Second, this methodology is particularly suitable for answering “how” and “why” questions, and is ideal for generating and building theory in an area where little data or theory exists (Yin, 2003). Finally a case approach was deemed appropriate for capturing the complexity of the privatization process (Yin, 2003).

The analysis has been conducted following three main directions:

1. Identification of the main drivers and motivations of the privatization process in both countries;
2. Investigation of the current situation of the Italian and the Norwegian context in relation to the privatization process;
3. Analysis of the the accountibility and the ethical systems of the Italian and Norwegian public service providers.

In the first two steps a historical background of the privatization processes in Italy and Norway is presented, in order to understand the historical and cultural traditions of their political-administrative systems (Olsen, 1992) of both countries. The importance of historical trajectories and traditions is evident in public sector research (Christensen and Peters, 1999). Moreover, to explain the privatization process it is necessary to combine the historical context or cultural traditions, norms and values which can have major impact on the features of a public istitution (Christensen and Peters, 1999) and on the privatization processes.

In the third step, service providers’ codes of ethics are collected (from the website) and their content analysis (Krippendorff, 1980; Ingram and Frazier, 1990; Holst, 1981) is carried out.

The content analysis methodology has been widely used in literature, particularly in corporate social disclosure studies (Parker and Saal, 2003). Content analysis objectively and quantitatively examines written or oral communications in order to make inferences about values, meanings or understandings being conveyed (Riffe et al., 1998; Holst, 1981). This method was chosen as it is able to analyze explicit (manifest content) as well as implicit (latent content) statements in texts (Krippendorff, 1980). This methodology is particularly suitable in our study because it a useful tool for the objective, systematic, quantitative and reliable study of published information (Krippendorff, 1980) but also for measuring comparative positions and trends in reporting (Guthrie and Parker, 1990). In sum, while analysing the privatization processes and the ethical and accountability issues that could be derived from the study, we used an inductive research approach (Stenbacka, 2001). This was done to find relevant information and the possibility of conducting such a case study between Italy and Norway. On the other hand, a deductive research approach (Rice and Ezzy, 1999) was used while searching for the necessary literature, and finding a research gap that the other researchers have failed to develop.

The study focus on public service providers in Norway and Italy. Two groups of public service providers – one from Italy and one from Norway – were selected. We included in our analysis 26 services providers from Italy, and 22 from Norway. All are owned by a Ministry. The 26 Italian public service providers (Table 1) are owned (totally or partially) by the Italian Ministry of Economy and Finance (MEF).

Table 1 – Companies owned by the MEF in Italy (2008)

Company	Ministry	%
Alitalia	MEF	49.9%
Enel	MEF	21.1% <sup>1</sup>
Eni	MEF	20.3% <sup>2</sup>
Finmeccanica	MEF	33.7%
Anas	MEF	100.0%
Arcus	MEF	100.0%
CDP	MEF	70.0%
Cinecittà Holding	MEF	100.0%
Coni Servizi	MEF	100.0%
Consap	MEF	100.0%
Consip	MEF	100.0%
Enav	MEF	100.0%
Eur	MEF	90.0%
Ferrovie dello Stato	MEF	100.0%
Fintecna	MEF	100.0%
GSE	MEF	100.0%
IPZS	MEF	100.0%
Italia Lavoro	MEF	100.0%
Poste Italiane	MEF	65.0% <sup>3</sup>
RAI	MEF	99.6%
Sace	MEF	100.0%
Sicot	MEF	100.0%
Sogesid	MEF	100.0%
Sogin	MEF	100.0%
Sviluppo Italia	MEF	100.0%

Source – Our elaboration

In the Norwegian case, 22 companies mainly operating in the service sector are selected (Table 2). They are owned by several Ministries (Ministry of Transport and Communications, Ministry of Trade and Industry, Ministry of Petroleum and Energy, Ministry of Justice and the Police, Ministry of Labour and Social Inclusion, Ministry of Health and Care Services, Ministry of Foreign Affairs, Ministry of Culture and Church Affairs, Ministry of Education and Research, Ministry of Agriculture and Food). The Norwegian situation seems very singular. Indeed, at present, the various Ministries

<sup>1</sup> CDP also holds 17.36% in Enel.

<sup>2</sup> CDP also holds 9.99% in Eni.

<sup>3</sup> CDP also holds 35.0% in Poste Italiane.

administer State-ownership interests in 80, fully or partially owned, companies. These companies can be divided into four categories, based on the objective of the State's ownership (Norwegian Ministry of Trade and Industry, 2008):

1. Companies with commercial objectives;
2. Companies with commercial objectives and ensuring head office functions in Norway;
3. Companies with commercial and other specific, defined objectives;
4. Companies with sectoral policy objectives.

One of the main purposes of the ownership management of the companies in Categories 1-3 is to maximise the value of the State's shares and contribute to a positive industrial development of the companies. Most of the companies where the main objective of the State ownership is commercial are managed by the Ministry of Trade and Industry's<sup>4</sup> Ownership Department.

The State ownership in the other companies where one of the main objectives is commercial are managed by the Ministry of Local Government and Regional Development, the Ministry of Agriculture and Food, the Ministry of Petroleum and Energy and the Ministry of Transport and Communications. Companies with sectoral policy objectives (category 4) comprise companies where the main objectives of the State ownership are not commercial in nature. The sector-policy companies are companies with State ownership stakes which have sector-policy and social objectives and where the main objectives of the State ownership are not commercial in nature (table 2).

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<sup>4</sup> Over the past few years several SOCs have been transferred to the Ministry of Trade and Industry. This ministry is now in the process of becoming a more specialized ownership ministry.

## Partial Privatization Processes, Public Service Providers and Accountability Issues

Table 2 – Companies with sectoral policy objectives in Norway

Company	Ministry	%
Avinor AS	Ministry of Transport and Communications	100%
Bjørnøen AS	Ministry of Trade and Industry	100%
Enova SF	Ministry of Petroleum and Energy	100%
Gassco AS	Ministry of Petroleum and Energy	100%
Gassnova SF	Ministry of Petroleum and Energy	100%
Innovasjon Norge	Ministry of Trade and Industry	100%
Itas amb AS	Ministry of Justice and Ministry of Labour and Social Inclusion	53.4%
Kings Bay AS	Ministry of Trade and Industry	100%
KITH	Ministry of Health and Care Services/ Ministry of Labour and Social Inclusion	80.5%
Norfund	Ministry of Foreign Affairs	100%
Norsk Eiendomsinformasjon AS	Ministry of Justice and the Police	100%
Norsk Rikskringkasting AS	Ministry of Culture and Church Affairs	100%
Norsk samfunnsvitenskapelig datatjeneste AS	Ministry of Education and Research	100%
Norsk Tipping AS	Ministry of Culture and Church Affairs	100%
Petoro AS	Ministry of Petroleum and Energy	100%
Simula Research Laboratory AS	Ministry of Education and Research	80%
SIVA SF	Ministry of Trade and Industry	100%
Statnett SF	Ministry of Petroleum and Energy	100%
Statskog SF	Ministry of Agriculture and Food	100%
UNINETT AS	Ministry of Education and Research	100%
Universitetssenteret på Svalbard AS	Ministry of Education and Research	100%
AS Vinmonopolet	Ministry of Health and Care Services	100%

Source – Our Elaboration

These companies are managed by the individual Ministries responsible for sector policy in the various areas. For example, the State ownership in Statnett SF, and Statskog SF is managed by the Ministry of Petroleum and Energy and the Ministry of Agriculture and Food, respectively. Examples of objectives which form the basis for the State ownership in the sector-policy companies are providing the population with safe, environmentally friendly and good air traffic services everywhere in Norway (Avinor AS), control over

the sale of beverages containing alcohol (AS Vinmonopolet) and to provide good and equal specialist health services for everyone who needs them (the regional health authorities). Even if the sector-policy companies do not have any commercial main objectives, commercial results and efficient use of resources are key issues for these companies (Norwegian Ministry of Trade and Industry, 2008).

Therefore, in this study we focus on the companies included in the category “Companies with sectoral policy objectives in Norway” (Table 2).

### **3.5 Privatization in Italy and in Norway: a historical overview**

#### **3.5.1 The Italian case**

Italy provides an interesting case study on privatization. When the privatization process was launched in the midst of a dramatic political, economic and financial crisis, the Italian public enterprise sector was larger than in other major OECD countries (OECD, 2003). Nevertheless, in the 1990s Italy performed the third largest privatization in the world (after the UK and Japan). Privatizations realized between 1992 ad 1999 as 185,000 billion lire (more than €95 billion), which accounts for 12.3% of the GNP in 1992. This gave relief to the State finances, and it can be considered a success (De Nardis, 2000). However, privatizations did not necessarily translate into a real shift of control over privatized businesses. Privatizations in the industrial sector involved many cases of actual transfer of control, but in other significant cases, the State maintained more than 50.0% of the shares. The privatization process in Italy was characterized by a *stop and go* dynamic (Marelli and Stroffolini, 1998) that is summarized below.

Until the beginning of the 1990s, the State sector in Italy was large and pervasive. SOEs were conceived as industrial and social policy instruments rather than profit maximizing entities. They typically operated under strong political interference. As a consequence, their operating and financial performance was very weak as compared to private firms. Indeed, although SOEs may have made a significant contribution to growth in the 1950s and early 1960s over time they increasingly became the source of production inefficiencies and misallocation of resources (Barca and Trento, 1997). Under the pressure of debt and deficits, Italy’s fiscal conditions rapidly deteriorated at the beginning of the 1990s.

As consequence, the first step in the Italian privatization programme was to put in place Law 359/1992 which converted IRI into limited companies, with the State as the sole shareholder, and the centralization of decision-making in the hands of the Ministry of Treasury. This was done in order to create, wherever possible, the conditions “to go public” and to make them subject to the provisions of civil law (OECD, 2003) and to reach a fiscal stabilization as a requisite to join the European Monetary Union (Goldstein and Nicoletti, 2003).

The results of this process have been outstanding. Over a decade, Italy implemented 70 major sales of privatization proceeds mainly through public offers of shares, placing Italy in the third and fourth position in the global ranking by revenues and transactions, respectively (Goldstein and Nicoletti, 2003). The control structure of the SOE sector was extremely complex and characterized by the involvement of different State holding companies, public entities, ministries or local government bodies

Until 1992, the majority of State assets were owned by three large holding companies: IRI<sup>5</sup>, ENI<sup>6</sup> and EFIM<sup>7</sup>, under the direct control of the *Ministry of State holdings*. The most important public entities were ENEL, the electricity State monopoly, IMI, a special credit financial institution, and BNL (one of the most important banks). The largest entities owned by ministries were FS (Ferrovie dello Stato), operating in the railway system, and PP.TT (Poste e Telecomunicazioni), managing the postal and telecommunication services (Goldstein and Nicoletti, 2003). Public sector companies were more conceived as instruments for industrial and social policies and not surprisingly, their financial and operating performance was generally poor. The privatization policy was needed. The objectives of the privatization program are officially stated by the MEF and presented to the Parliament on November 1992. The MEF had the duty of formulating proposals on privatization to a committee of three ministries – MEF, Budget and Planning, and Industry – and final decisions had to be approved by the Council of the Ministries, chaired by the Prime Ministry. However, the MEF has been playing the key role of agenda setter in privatization issues, liaising with State holding companies and with the management of SOEs.

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<sup>5</sup> IRI was a conglomerate with a highly diversified portfolio of assets in the industrial and financial sector.

<sup>6</sup> ENI was mainly involved in oil and gas.

<sup>7</sup> EFIM was involved in defence, transports and aluminium.

During 1996-2000, the Italian privatization process, not differently from the rest of the world, reaches its peak. The last stage of the privatization process has two main features consisting in much smaller in scale with respect to previous years and characterized by private equity placements and block transactions to institutional investors. These new aspects of the privatization process are obviously related and determined by the changed market conditions which slowed the privatization process worldwide. Indeed, governments do not want to sell shares in a depressed market. Furthermore, selling new shares of a partially privatized company at a price lower than the initial public offering price would force initial investors to realize a capital loss (Megginson and Jeffrey, 2001). This changing environment has forced the Italian government to shift the privatization method from public offers to private sales, and when this was not possible, to tap institutional instead of retail investors.

Looking at the current situation the focus is on the MEF and on the public service companies owned by it (the year of analysis is the 2008). As in the majority of developed countries, the MEF is still an influential shareholder in several privatized companies, such as ENI, ENEL, *Finmeccanica*, and *Alitalia*. Furthermore, it still fully owns FS, the railway system operator, and RAI (Italian Radio Television) the television broadcasting company. The MEF is the holding of this public group of companies operating in the public service delivery and therefore it determines their governance system. Planning and control functions are performed by the MEF that influences also the governance structure of public service companies.

As shown in Table 1, it seems that the Italian privatization process is now stopped. Moreover, the effects of this process are not immediately visible. Accountability practices are not well implemented. Therefore, the effects of the privatization process are disputed and contested and ethical concerns emerge.

### **3.5.2 The case of Norway**

The reform movement started later in Norway compared to many other countries. Norway has been characterized by a strong statist tradition (Olsen, 1992) a political-democratic context of public services, based on equality, and a big universal welfare

State. It has been a reluctant NPM reformer (Olsen, 1992) for different reasons. Norway's political administrative culture has been collectively oriented with a great importance to *Rechtsstaat* values and equality and not oriented to the individualism and efficiency that are important features of modern reforms (Christensen and Lægheid, 2003). However, despite the pressures for public reforms, Norway has not been characterized to any strong public management reform path, reflecting also a healthy economic situation and a well-functioning public apparatus (Christensen and Lægheid, 2009). Contrary to the Italian case, the absence of an economic crisis together with strong confidence in an active and large public sector makes for relatively low external pressure. State ownership in Norway is extensive, not only in traditional public service related sectors, but also in industry, particularly the energy, transport and telecom sectors (OECD, 2003).

The rationale for maintaining State ownership in companies varies, but can be grouped under four main categories (OECD, 2003):

- *Sector policy concerns.* Ownership is in some instances seen as an important means of attaining specific sectoral goals, for example, the monopoly on wines and spirits is used to restrict and control availability of alcohol;
- *Norwegian ownership.* Maintaining Norwegian ownership in strategic sectors such as in the petroleum sector, the hydropower sector and the financial sector are deemed important for the whole of business activity in the country;
- *Natural resources.* There is broad consensus on the need to maintain political control with the utilization and extraction of natural resources;
- *Head office location.* State ownership ensures that companies establish their head office in Norway, ensuring employment of key-personnel and taxable earnings in the country.

However, in the 1990s some gradual reforms in the central government apparatus were introduced (Christensen and Lægheid, 2001). This happened partly because the OECD put pressure to Norway to adopt more radical reforms (Christensen and Lægheid, 2009).

The assumption for the reform programs until the end of 1990s was that the pursuit of efficiency should not affect negatively other values like democratic representation, a

state based on the rule of law and professional quality (Lægreid and Roness, 2003). The aim of the reform was maintenance and modernization rather than radical change aimed at marketization or minimizing the role of the State (Christensen and Lægreid, 2008, Pollitt and Bouckaert, 2004). Norway does not as such have a broad privatization goal, but has privatized (partially or fully) approximately 19 companies, mainly manufacturing industries, in the period 1999-2002, and Parliament has endorsed the (further) selling of shares in a handful of other companies. Parliament has directed the Government to focus its efforts on how to improve management of State owned companies and how to stimulate profitable and sustainable industrial growth and development in Norway.

The most oriented reform period was 2001-2005, when the government proceeded with a comprehensive program for converting civil service organizations into SOCs. The result was the change of Norwegian public administration agencies into SOCs, the introduction of a so-called “quality” reform for universities and higher education, and in merging the unemployment agency, the national insurance agency, and the social affairs agencies. All of these new forms of organization contained elements of NPM in the sense of structural rationalization and an increased emphasis on efficiency (Christensen and Lægreid, 2005).

In 2005 a new government won the election and it run on an “anti-NPM ticket” arguing that NPM reforms should be stopped or modified because of their negative consequences, such as reduced political control and increased fragmentation (Christensen and Laegreid, 2001). The government modified or stopped some of the NPM-style reforms, but the process is still incomplete.

It seems that the Norwegian privatization process is now stopped and the current government is tending to stress collective features and societal solutions, is voicing support for a large public sector and is skeptical toward competitive tendering, outsourcing and privatization.

Looking at the actual situation in Norway, about three quarters of the Norwegian economy are controlled by the State, and State ownership in commercial entities is extensive both at the central and Municipal level. As an illustration, the State’s holdings amount to about 40.0 per cent of the total value of the companies listed on the Oslo

Stock Exchange. The value of the State's shares on the Oslo Stock Exchange has a total value of NOK 333 billion (Christensen, 2003). The high level of State ownership of commercial entities in Norway is not the result of one concerted strategy, and the motivations for specific ownership involvement have varied over time and have to some extent been random. The great majority of companies where the State owns shares are organized according to the Norwegian Law on Joint Stock Companies; the Law which also regulates privately owned commercial corporations. They pay tax along the same lines as private companies, have to answer to the same competition regulations, etc. Similar general principles are followed whether the State holds 100 per cent, is a majority shareowner or holds a minority post.

### **3.5.3 Privatization in Italy and in Norway: different drivers but same final status**

Moving from the historical overview on the Italian and the Norwegian privatization processes some main differences and similarities between the two countries have emerged.

The first important difference refers to the main drivers of the privatization process. Indeed, in Italy it has been motivated by the need for efficiency, improvement of the the quality, accessibility and universality of services, to overcome the ineffectiveness of public ownership (Saraceno, 1981; Cafferata, 1995; Bognetti and Robotti, 2007). On the contrary, in Norway, given the strong financial position of the State, fiscal improvement considerations have not been seen as a main driver of the privatization (OECD, 2003; Christensen and Lægreid, 2009). Particularly, the Norwegian government did not have need to establish an overall policy for reducing State ownership. Instead, the focus has been on how to improve the State ownership, not to downsize it.

Moreover, what emerges from the comparison between the two countries is the role of the Ministries as owners of many SOCs operating in the service sector. Indeed, while in Italy the Ministry of Economy and Finance is the sole Ministry that holds stake, Norway has been traditionally characterized by a Ministerial governance (Christensen and Lægreid, 2001), and there are several Ministries that hold stakes in SOCs.

However, despite the different patterns of privatization in the two countries what emerges is that the privatization process is now stopped and that this process ended-up

with public service providers still owned by the State (partial privatization). One of the most relevant concerns with the partial privatization process is the existence of corruption and ethical problems that might arise from conflicts of interests among various actors (Groot and Budding, 2008). Indeed, in recent years, the negative impact of privatization on the ethics of public officials has been stressed by numerous scandals in many OECD countries. Besides, there is an increasing concern about the impact of NPM reforms on public officials' ethics (Maesschalck, 2004).

Being this the situation, it is crucial to understand the level of accountability in both countries in SOCs providing public services in order to underline possible ethical problems.

The next section provides a description of the current status of codes of ethics adopted in the selected Italian and Norwegian SOCs in order to verify whether and to what extent transparency, ethical prescriptions and accountability are included in their governance system.

### **3.5.4 The ethical structure**

Recently the relevance of ethical concerns has encouraged the implementation of initiatives to restore confidence and maintain integrity in businesses (Bozeman, 2009). Especially in public service providers well-defined ethical structures help to prevent corruption, conflicts of interest and unethical behaviours. Therefore, the adoption of a code of ethics is a step towards improving the ethical culture in today's public sector.

The term "code of ethics" is defined as written standards that are reasonably designed to deter wrongdoing and, to promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; full, fair, accurate, timely and understandable disclosure in reports and documents; compliance with applicable governmental laws, rules and regulations; the prompt internal report on violations of the code to an appropriate person or person identified in the code; and accountability for adherence to the code (SEC, 2003).

Mandatory codes of ethics have been introduced only recently in Italy for public service providers (Law 231/2001). This is the result of changes in systems of public

administration and it reflects the effort to newly defined generally valid ethical values. The new codes outline values and ethical principles that should guide public officials in their professional activities.

On the contrary the *Norwegian Code of Practice for Corporate Governance* stipulates that the board of directors in State-owned companies should adopt ethical guidelines for the company. Therefore, in Norway there is not a law that makes compulsory the adoption of codes of ethics. Generally, it can be said that there is a broad trust and confidence in the public service by the Norwegian citizens. This confidence has always been considerable and it is rooted in the basic values of the welfare State (OECD, 2005).

In order to investigate ethical and accountability issues we analyzed in their content the codes of ethics of the public service companies been selected.

The first step in the content analysis methodology is to determine the documents to be analyzed and the units of analysis (Krippendorff, 1980). The choice of documents that provide the source data for a content analysis depends on their availability, accessibility and relevance (Cullinane and Toy, 2000). In our cases, codes of ethics were generally found in the Corporate Governance section of a companies's website. Codes of ethics were collected in English or in local language. This process yielded 33 codes of ethics (22 from Italy and 11 from Norway) that were content analyzed. The analysis was on the current version of the codes. The content analysis will help to identify existing and potential ethical concerns faced by those companies in the current Italian and Norwegian contexts. In order to carry out the content analysis, we took as a basis several studies of the content analysis in different countries (Bondy et al., 2004; O'Dwyer and Madden, 2006). We looked for indications of how corruption and conflicts of interest were avoided through ethical principles, values, norms, rules of conduct.

Despite the new Italian regulation, some of the analysed public service providers have not disclosed the code of ethics on their website. In the 26 companies owned by the MEF, 22 disclosed the code of ethics (84.7%).

Among the 22 Norwegian companies, 11 disclosed their codes of ethics on the website (50.0%), the lower percentage of disclosure in Norway is due to the absence of a law that requires the disclosure, contrary to what happens in Italy.

The results of our content analysis are reported, underlining the main topics the codes deal with. Before studying more deeply the topics analysed in the codes, it would be of interest to analyse several formal aspects: title, extension, date and scope of application. Concerning the title of the document, in the Italian case most companies simply use the denomination "Code of Conduct of X" (38.46 %). Other titles reported are "Ethical Standards" (15.38%), "Standards of Ethics and Conduct" (23.07%), "Code of Ethics" (7.6%). In only few cases there are incomplete indications of codes implementation realized by communication and disclosure actions.

In the Norwegian case most companies use the denomination "Ethical Guidelines for X" (80.0%). Other report the denomination "Code of Conduct of X" (20.0%). With regard to their length, the length on average is approximately fourteen pages for the Italian cases. Nevertheless, there are larger codes, such as 23 or 30 pages. Quite different is the length of the Norwegian codes of ethics that is on average approximately five pages. Also in this case there are larger or shorter codes of 12 pages and also with just 1 page.

Regarding the date, in the Italian case most codes were drawn up and took effect four or five years ago (36.6 % from 2001 to 2003, 45.5% from 2004 to 2006, and 17.9% from 2007 to 2008). In the case of Norway most companies do not show the date of implementation of the codes. Only the 25.0% indicate the date of implementation that is from 2005 to 2009.

The scope of the analysed codes takes in mainly employees and the customers, emphasizing the ethical role played by managers, directors and partially public officials.

Focusing on the content, in the Italian case codes are mainly imperative, stating a guide for standards of conduct that firms would like their actors to follow. The structure of

the codes usually shows two blocks: a first block, which states the values and basic principles encouraged by the company, whereas the second block translates the principles into certain standards of conduct for the actors in their internal and external relationships. In the case of Norway the codes do not follow a clear structure but they list several guidelines that give to the company, the employees and the partners, guidance and support in the daily duties and decision-making process.

Going more in dept in the analysis, in the Italian case, the 45.4% of the analysed codes miss a clear statement of their values and principles. The 36.4% lacks indications on detailed norms of conduct. Tools of promotion and sensitization to the importance of the public interest and value are present in only the 18.2% of cases. In the Norwegian case the situation is very different. The 85.0% lacks clear statements of their values and principles. Indications about norms of conduct and about the importance of public interest and value are totally omitted.

The analysed Italian codes are usually made up of provisions covering the following areas: use of public resources for personal benefit (31.0%); definition of the target group to which the code is addressed to (23.6%); duties to the public in confrontation with private interests (22.8%); definition of behaviour or conduct constituting violation of the code (13.6%); statement of preventing conflict of interests (9.0%); sanctions in case of violations (0%).

As mentioned above, in the case of Norway the guidelines contained in the codes consist in several principles that can be classified as follows: general provisions (30.0%) indicating that employees will be managed by both the general ethics, business ethics and management ethical values and norms; loyalty (55.0%) referring to the use of public resources for personal benefit; professional independence (75.0%) that can be seen in context with loyalty and neutrality; openness (85.0%) referring to the degree of transparency of the firm in relation to the various stakeholders.

From the analysis of all the codes (Italy and Norway), it seems that many codes are characterized by general contents containing fewer principles expressed often in terms of "ought", should or may (and not "must"). Many are also ambiguous or unclear. The

main ethical concerns in the analysed companies have to do with the absence of information on conflicts of interest disclosure. Moreover, none of the analysed codes have been characterized by a formulation process that includes consultation with citizens or their representations. Probably these are the major lacks emerging from the analysis.

Ethical aspects seem critical in the governance system of public service providers in both Italy and Norway. Accountability, transparency, openness, public officials' duties, sanctions, complex relationships among actors, public interests, and values are all key aspects to take into account. It seems that the analysed codes of ethic fulfil the role of compulsory documents. They simply suggest guidelines that are quite similar to a code of practice. The analysis shows clearly that the introduction of ethical issues is at a beginning stage in both countries and that more emphasis on ethical and accountability issues are urgently needed.

### **3.6 Discussion and findings**

In several OECD countries, SOCs still represent a substantial part of GDP, employment and market capitalisation. They are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunication, whose performance is of great importance to broad segments of the population and to other parts of the business sector.

In order to verify the *status quo* of the privatization process in Italy and Norway, a historical overview has been provided.

The Italian privatization process has been characterized by a *stop and go* dynamic. In fact, despite in the 1990s Italy performed one of the largest privatization programmes in the world, many public service companies are still State-owned, and the current market competition is not effective. To the contrary, in the case of Norway the privatization took place later, showing a reluctance of the Norwegian Government to this reform until the 1990s when some reforms were also implemented in Norway (Christensen, 2003).

Despite the different motivations and contexts what emerges from the historical analysis of the Italian and the Norwegian privatization processes is that the current situation in both countries results in a partial privatization process that led to public service companies that are State owned and operating in the provision of public services and goods.

Looking at the historical background of the two countries has been useful to understand the different drivers of privatization. What emerges from the historical overview is that different are the motivations and the pressures toward the privatization in the two countries. Indeed, in Italy the privatization process has been motivated by the need for efficiency to overcome the ineffectiveness of public ownership (Saraceno, 1981; Cafferata, 1995; Bognetti and Robotti, 2007), while in Norway, given the strong financial position of the State, fiscal improvement considerations have not been seen as a main driver of the privatization reflecting also a healthy economic situation and a well-functioning public apparatus (Christensen and Lægreid, 2009).

Today, both countries are characterized by situations in which the Ministries are still the major owners of service providers, even if in the case of Italy there is only that MEF as the main owner, thus suggesting a concentrated and principal strategic directions. Moreover, although the role of Ministerial governance has different development in the analysed countries (in Norway there are several Ministries involved in the governance directions of SOCs, as a pattern derived from the historical agencification of the Norwegian public sector) a common pattern exists in relation to the ethical and accountability problems. The findings from the content analysis of the code of ethics of both the Italian and the Norwegian service providers highlight that although the contextual and historical differences in which the privatization process has developed a clear lack of accountability, of implementation actions on the codes of ethics, and of transparency resulted from both the analyzed countries.

The study argues the possibility to discuss the privatization process from different theoretical perspectives (NPM, NPS, NPG) thus giving interesting insights. In particular moving from NPM to NPS and NPG approaches, the need for accountability

and transparency in SOCs providing public services and goods become critical for citizens, in order to avoid corruption and unethical behaviors. Ethical issues arising from conflicts of interest and corruption of public officials may be a reason for the failure of privatizations. Furthermore, the relation between corruption and the provision of public services has been widely debated in the last two decades and many studies demonstrated that corruption reduces economic efficiency and the provision of public services (Boycko et al., 1996; Cuervo and Villalonga, 2000). The growing attention on corruption is demonstrated by the increasing attention that recently has been paid to ethical issues in the public sector. The most important tool to improve and promote ethical structure is the code of ethics.

In order to verify whether the code of ethics really attempt to pursuit these objectives, a content analysis of codes of ethics of 33 Italian and Norwegian SOCs operating mainly in the service sector has been carried out. The results suggest that a major emphasis on accountability system is needed. Considerations on citizens' public value and interest are due (Bozeman, 2009).

Moreover, the results highlight that actions in line with ethical and accountable procedures are sporadic, unstructured, and introduced recently in both countries. The lack of accountability is the main weakness of the governance systems involving the Ministry(ies) and the public service providers. Probably, the lack of evidence of any real efficiency associated to the privatization process gains and the decline in accountability produced by restructuring and downsizing public services is thus evident (Bozeman, 2007). Although a window dressing may be likely, the disclosure of the codes of ethics on the Internet reveals a public commitment with stakeholders, not just an internal procedure. This seems a good starting point. Stringent requirements relating to transparency and public disclosure are needed to combating corruption. Public service firms should therefore be open about dilemmas relating to corruption, conflicts of interest and accountability. In addition, many problems still refer to how the fundamental values of public service organizations have been undermined by this partial privatization process (Lawton, 1998). Besides, political and policy considerations are significant and pervade leadership, strategy and the management of public service organizations.

Governmental reforms are needed in order to use market principles and to outsource public goods and services. But nowadays, the public sector with its modern representative democracy can be described as a concatenation of principal-agent relationships (Strom, 2003). Hence, public accountability is an essential precondition for the democratic process to work, since it provides citizens and their representatives with the information needed for judging the propriety and effectiveness of government.

The findings from this study suggest that it is needed to define and evaluate public services and public services organizations. Relations and communications between the government and the citizens become fundamental. New modes of governance, more citizens-oriented go in that direction (Klijn, 2008; Pestoff, 2008). The attention is on NPG (Osborne, 2006) with its emphasis on partnership, networking (Klijn, 2008) and lateral modes of organizing than the vertical command and control forms typical of the NPM (Newman, 2001). It also takes a more pragmatic view on public services that can be delivered publicly and privately. The more general concept of public governance (Osborne, 2006) often includes administration, stakeholder pluralism, management within networks, and legitimacy (Frederickson, 1999). These new modes of governance may address the accountability deficit in the Italian and Norwegian governance public services structures. The analysis shows that accountability tools are often introduced through pilots, or incrementally to build support for more inclusive and transparent governance (Bovens et al., 2008).

The lack of accountability has been the bigger concern, particularly with regard to the privatization process (Braithwaite, 2006). Mandatory codes of ethics are not enough, but a good starting point. Surely, other means are needed to promote a high level of public services. More citizens' participation through a bottom-up process may fill the complex process of building codes with shared vision, values, and interests.

Public service providers have many stakeholders and they are particularly visible to citizens. Issues of legitimacy become important and the use of codes of ethics may legitimize public officials' actions ensuring that their effects fall within the norms of society.

### 3.7 Conclusions and future research directions

Ethics and accountability issues are gaining prominence in the governance debate in the last decades. There is a perception that standards in public life are in decline and those ethical structures are not well implemented. This raises questions about the costs of misconduct by who have been entrusted with guarding the public interest. The chapter shows that the perception of a fall in public standards is linked to the shifting role of the State, which is undergoing tremendous reform.

Moving from a historical overview on the main patterns of the privatization process in Italy and Norway, the chapter shows that the privatization has been a starting point in the improvement of public services, but now this process is ended up with public services providers still owned (totally or partially) by the State. The most relevant issue arising in cases of partial privatization process relates to ethics and accountability to the citizens. The implementation of an effective ethical structure is needed. To this aim the code of ethics represents an important tool and in order to verify the effectiveness of ethical structure in the Italian and Norwegian SOCs providing public services and goods their codes of ethics are content analysed. The results of the content analysis lead us to some interesting conclusions. Although the contestual and historical differences in which the privatization process has developed in the two countries a need for better implementations of ethical structures is urgently needed. Indeed, what emerged was that public service providers and their owners are under pressure to transform.

The results and findings from this study suggest that despite the Italian and the Norwegian contexts have been characterized by different drivers and motivation towards privatization, and the SOCs still owned by the government (through its Ministry in the case of Italy, and its Ministries in the case of Norway) have introduced codes of ethics, actions to implement ethical and accountable procedures are sporadic, unstructured, and introduced recently in both countries. The lack of accountability is the main weakness of their governance structure. Therefore, the study contributes to the ongoing debate on privatization and in particular on the ethical concerns related to partial privatization processes.

The cross country comparison allowed us to define common trends in the privatization process of two European countries. In order to catch the environmental, social and political differences between the two countries, a historical approach has been adopted. The comparison between the Norwegian and the Italian privatization processes has highlighted how despite the main political, institutional and cultural differences between the two countries, the privatization process ended up in both cases with a partial privatizations. Moreover, privatization is often seen as a tool or mechanism of New Public Management. However, there are important distinctions between NPM and privatization. The chapter argued that privatization is a broad tool kit, while NPM provides an approach to public management reform. Moreover, privatization and NPM have both come under growing attack from academics, politicians and the media. There is an increasing concern about the impact of NPM reforms on public officials' ethics and some now argue for greater, rather than less regulation, particularly after the financial crisis in late 2008. New models have recently been proposed that challenge NPM (see Osborne, 2006) and new paradigms for government activity, policy making and service delivery are emerging that bring with them important implications for public service managers, like NPG (Osborne, 2009) and New Public Service (NPS) as alternatives to both the traditional public administration and NPM (Denhardt and Denhardt, 2000). They are based on the idea that the relationship between the government and its citizens is not the same as business activity between a firm and its customers.

The NPG perspective includes many modes of governance, like joined-up governance, network governance, co-production and cooperation that are seen as alternatives to privatization of public service provision, particularly for social services. NPG offers a valid alternative to privatization, since it relies on active citizen participation in the governance process of the services they depend on in their daily lives. Given the limits of the current Italian and Norwegian privatization processes, conflicts of interest and corruption require greater public sector accountability. Public accountability is an essential precondition for the democratic process to work, since it provides citizens and their representatives with the information needed for judging the propriety and effectiveness of government.

By identifying and investigating these aspects the chapter explicitly fills the gap in the literature suggesting the need for more studies that focus on ethical and accountability concerns (Bozeman, 2007) in relation to privatization.

New modes of governing are evolving with a high degree of autonomy from the State, governing without government (Rhodes, 1997; 2007). However, there are those who argue that it is more appropriate to speak of a shifting than a shrinking role of the State (Kooiman, 1999). Even if in many countries the role of the State is transforming from being based on constitutional power towards functioning as a facilitator and cooperative partner (Pierre, 2009; Hysing, 2009; Lundqvist, 2001; Sorensen, 2006), the Italian and the Norwegian contexts seems to be characterized by a high intervention of the State in both the private and the public sectors. However, contrary to the Italian experience that might be considered a late comer in the development and involvement of Third sector and community organizations (TSVOs) in the production/provision of public services, Norway is characterized as many of the Scandinavian countries by high degree of TSVOs involvement in the society.

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## – Chapter 4 –

### DOES THE BOARD OF DIRECTORS CONTRIBUTE TO THE INNOVATION OF STATE-OWNED COMPANIES?

#### **Abstract**

In the wake of the global financial crisis of 2008-2009 many industrialized States worldwide have increased their stakes in corporations, characterizing even more the organization type of State-owned companies (hereafter indicated as SOCs). Therefore, the idea of governments as value-creating institution is increasing and the focus on its main drivers is emerging. Moreover, there has been a great deal of both scholarly and professional interest in “innovation” believing that it is essential to the improvement and effectiveness of the public sector. This chapter seeks to add knowledge on the governance mechanisms in SOCs (and in a more extended view also in other government owned companies) influencing their innovation capacity. Drawing on the innovation literature, the agency and the resource-based theories, we analyse a sample of 88 Norwegian SOCs mainly operating in the service sector. The results show that some aspects of board composition, board working-style and board members’ knowledge and competences influence significantly the type of innovations. Implications for the theory and the practice and future research directions are discussed.

**Keywords:** SOCs; governance mechanisms; board of directors; innovation

#### **4.1 Introduction**

Despite the massive waves of privatization in recent decades, many companies around the globe today, particularly in vital industries such as telecommunications, energy, public utilities, and banking, still remain at least partially state-owned (Bauer, 2005; La Porta et al., 2002). Notwithstanding their importance, questions regarding the efficiency, effectiveness, value creation and innovation in SOCs are needed. Notably innovation plays different roles in SOCs and in other government owned companies. While the government uses innovation policies to enhance the innovative capacity of various industries as well as the overall economic development, SOCs develop new products/services through innovation to gain competitive edge in the market place (Shyu et al., 2001). However, the governments that control SOCs in various ways affect their corporate governance directly. It is interesting that, despite both governance and innovation have been central to strategic

## **Does the Board of Directors Contribute to the Innovation of State-Owned Companies?**

management (Hitt et al., 1996; Moore and Hartley, 2008), what has been lacking are theoretical and empirical links between these two factors. For example, the role of the board of directors as a value creating body (Huse, 2009) in the innovation processes of SOCs is under researched. Nonetheless, its analysis and investigation gives interesting contribution especially to answer the following research questions:

- Is innovation a valuable feature of governance and a useful concept in SOCs?
- Does the board of directors contribute to the innovation of SOCs?

In this chapter we consider SOCs as arms length corporate entities established to pursue public policy and commercial objectives (Boardman and Vining, 1989). They are wholly or partially owned either by the central or the local government and are very similar to private firms in the way they function. They operate in many sectors of the economy and account for a significant portion of government activities (Bozec and Dia, 2007).

Drawing on the literature on innovation, agency (Jensen and Meckling, 1976) and resource-based (Barney, 1991; 2001) theories, the purpose of the chapter is to test whether and to what extent board composition, board's working-style, board members' knowledge and competences influence innovation (product/service, process and organizational) in SOCs. We test these relationships through a multiple linear regressions analysis on Norwegian empirical data. The results show that some aspects related to board composition (board size, women directors ratio), board working-style (length of board meetings) and board members' knowledge and competences influence significantly the type of innovations.

The study contributes to the theory and the practice in several ways.

First, we suggest that innovation is a core task of SOCs improving their responsiveness and efficiency (Mulgan and Albury, 2003), and thus it has to be promoted by governments around the world as a key tool to improve public sector effectiveness (Walker, 2006).

Second, by analysing the Norwegian context we contribute to the studies investigating internal governance mechanisms in SOCs mainly operating in strategic sectors (OECD, 2010). Indeed, the findings from the Norwegian context shed new light on the role of the State. This is also in line with recent developments suggesting that its role has been critical and of value during the last (2008-2009) global financial crash (Musacchio and Flores-Macias, 2009). Third, by analysing the role of board of directors in relation to innovation, we fill the gap in the literature for more knowledge on how innovation is managed and

generated in public sector organizations (hereafter indicated as PSOs), and in SOCs in particular (Walker, 2003). Our findings clearly suggest that innovation is within the grasp of governing bodies in SOCs (Borins 1998; Light 1998; Moore 1995; Walker et al. 2002) and that knowledge and competences are fundamental.

Fourth, as suggested by previous studies, our results seem in line with the idea of the Norwegian State as historically a rather unified and integrated central system (Christensen, 2003). In practice, the system has been very robust, creating a stable environment, a cultural consensus, the peaceful coexistence of many actors in an atmosphere of mutual trust that influence positively innovative behaviours in SOCs (Christensen and Laegreid, 2005).

Fifth, by using multiple linear regressions analysis (MLRs), we add new findings on the research stream of innovation in SOCs coping with the lack of quantitative empirical analyses on PSOs (Houston and Delevan, 1990; Walker, 2008).

The rest of the chapter is organized as follows. In the next section, the debate on innovation in SOCs is presented showing the existence of many types of innovation (both in the private and in the public sector), finally identifying the main types of innovation used in our analysis. In the third section, an outlook of Norwegian SOCs is given. In section four, the role of the board composition and working style, and of the board members' knowledge and competences is discussed in relation to innovation; the main hypotheses are thus formulated. The methods and results are described in section five and six. In section seven the discussion and the main findings are presented. Finally, conclusions and future research directions are discussed.

#### **4.2 Why is innovation important for SOCs?**

The paucity of research on innovation in the public sector is often attributed to its relative lack of innovation and that it is inherently less innovative than the private sector (Albury, 2005). Contrary to this prevailing myth, the history of the public sector is rich in innovation and recently there has been a great deal of both professional and scholarly interest in innovation in the public sector (Altschuler and Behn 1997; Borins 1998; Hartley 2005; Moore 2005, Mulgan and Albury 2003; Albury 2005).

While some analysts focus primarily on innovation as a contribution to improving public sector efficiency and quality in service delivery, others also recognise its potential for reclaiming some legitimacy of government as a *value-creating institution*, by being more

responsive to the needs and aspirations of citizens and users of services (Moore and Hartley, 2008). The focus on SOCs and other government-owned companies helps to understand whether and how they contribute to this value creating process. In fact, innovation is increasingly embedded in the language of governments across the globe. However, it is sometimes used as a label without explanation of what is meant by the term, or analysis of what is distinctive (Hartley et al., 2008). In this sense, innovation may be fashionable rhetoric rather than an analytical term (Albury, 2005). This is not surprising given that it is a term redolent with generally positive resonances – modern, new, change, improvement (Albury, 2005). But to avoid the pro-innovation bias which is present in much of the literature (Burns, 2007) there is a need to examine rigorously the claims for improvement through innovation<sup>1</sup>.

Many European and non-European countries have developed actions in favour of innovation [e.g., PUBLIN Program (Koch and Hauknes, 2005; Koch et al. 2006)]. Nevertheless, there is too little evidence on its main drivers. With specific reference to SOCs, there is a need for knowledge on why and how they adopt innovations, the diffusion mechanisms, and the relationship between governance and innovation. This is a fundamental gap to cope with in the domain of Public Administration and Management (hereafter indicated as PAM) research. Particularly, public management scholars discuss what constitutes public sector innovation, what sorts of changes in government count as important innovations, how much innovation occurs, whether it is sufficient for a rapidly changing society, and which governance structures and mechanisms promote or retard innovations (Hartley 2005; Osborne and Brown 2005; Walker et al. 2002, Koch and Hauknes 2005; Moore 2005).

#### **4.2.1 The types of innovation in SOCs**

Over the past four decades, research and practice has constructed an increasingly sophisticated and robust knowledge base on innovation in the private sector (Hamel and Getz, 2004). This has focused primarily on manufacturing industries with the service sector receiving scant attention until recently, and an almost complete dearth of research on innovation in the public sector (Albury, 2005). The evidence base, although growing, remains limited and it is therefore necessary for scholars to develop more knowledge about

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<sup>1</sup> For example, as shown by some authors the British State suffers from hyper-innovation (Moran, 2003).

the nature of innovation in PSOs (Walker, 2008). We address this gap with specific reference to SOCs.

There are some similarities in innovation processes and outcomes (from which it is important to learn), but also distinctive and important differences between innovation in the *private sector* and in the *public sector* (Osborne and Brown, 2005). The private sector literature still focuses mainly on technological innovation, especially new product/service development (Hartley, 2005). On the other hand the literature on innovation in the public sector is more focused on service and organizational innovation (Hartley et al., 2008).

In the private sector, a successful innovation is often seen to be a virtue in itself, as a means to ensure competitiveness in new markets or to revive flagging markets. In the public sector, however, innovation is justifiable only where it increases public value (Moore, 1995; Bozeman, 2009). Moreover, while there is a lot to learn from product and service development in the private sector, policy-makers, managers and researchers in the public sector need to recognize their own contexts more explicitly (Hartley, 2005). Indeed, recently there has been a growing expectation around the globe that public organisations should and will innovate to enhance performance and this refers particularly to SOCs in which the responsibility of the national governments is obvious and direct (Musacchio and Flores-Macias, 2009). Therefore, SOCs may respond to internal and external changes and independently develop and implement innovations (Walker et al., 2002; Downe and Martin, 2007) by using the tools and concepts from the innovation literature. Since SOCs differs in important aspects from private industry, there is a need to adapt tools and concepts thus reaching different conclusions on the dynamics of innovation.

In the literature it is possible to find different types of innovation. Here below we propose a conceptual framework identifying the main types in the public and in the private sector rather arguing why we use certain types of innovations in relation to SOCs.

It is highly complex and it is impossible to offer a simple definition of innovation. Rather, a range of dimensions that characterizes innovation can be drawn out. Innovation is: a process through which new ideas, objects and practices are created, developed or reinvented (Rogers, 1995; Kimberly and Evanisko 1981); related to the introduction and application of ideas within a role, group or organization (King, 1992); most commonly associated with processes, products or procedures, or outcomes (Abernathy et al., 1983); something new

## Does the Board of Directors Contribute to the Innovation of State-Owned Companies?

and novel to the relevant unit of adoption, rather than newness per se (Rogers, 1995); designed to benefit the individual, the group, organization or wider society (Hosking and Morley, 1991; Anderson and King, 1991; Hosking and Anderson, 1992), although an innovation can have a negative and unanticipated impact (Osborne, 1998); associated with discontinuous change, frame-breaking rather than frame-bending (Osborne, 1998), and a process of creative destruction.

Innovation is strategic to public sector life (Yapp, 2005). Given the focus on meeting needs in the public sector, the nature of product/service innovation in public organizations is best understood through their relationship to users (Hartley, 2005). Particularly, in the public sector literature on innovation, three types of product/service innovation have been identified and tested (Osborne, 1998; Walker et al., 2002). *Total innovations* involve providing new services to new users. *Expansionary innovations* involve a public organization taking an existing service and providing it to a new group of users. The third type is *evolutionary innovations* providing a new service to existing users.

Edquist et al. (2001) focused on organizational process innovations affecting management and organization. They focus on two types of organizational process innovations: marketization and organization. Marketization innovations modify the operating processes and systems to increase the efficiency reflecting the core New Public Management (hereafter denoted as NPM) themes of contracting and externalization of public services (Schilling, 2005). Organization innovations are innovations in structure, strategy, and administrative processes (Damanpour et al., 2009); they include improvements in an organization's practices and the introduction of new organizational structures (Borins 1998; Light 1998; Walker, 2008).

In the public sector we also need to consider innovations in governance (Moore & Hartley, 2008). In recent years, such innovations have included new political arrangements in local government as well as changes in the organizational form for the planning and delivery of public services (Moore and Hartley, 2008).

Finally, some studies focus on the consequences of the adoption of innovation (service, technological, and administrative) in PSOs (Damanpour et al., 2009).

In the literature on innovation in the private sector there are also many types of innovation that have been identified during the years (Jansen et al., 2006; Kimberly and Evanisko, 1981). The traditional and most used distinction is among: product, process and organizational innovation (Boer and During, 2001; Daft, 1978).

Product innovations occur in the operating component and affect the technical system of an organization including the adoption of products (which are material) or services (which are intangibles) (Kimberly and Evanisko 1981; Damanpour and Evan 1984)

Process innovations affect management and organization. They change relationships amongst organizational members and affect rules, roles, procedures and structures among organizational members (Damanpour et al., 2009).

Organizational innovations<sup>2</sup> are differentiated from process and product/service innovation because of their reliance on relationships with other organizations and actors (Damanpour and Evan, 1984).

Being many SOCs and the other governmental owned companies involved also in private sector activities and subject to market competition, we choose to use in our analysis the most used distinction of innovation in the private sector: product/service, process and organizational innovation.

#### **4.2.2 The Norwegian context and the role of SOCs**

Inspired by the NPM, many countries have been interested by structural devolution and the establishment of new or reorganized SOCs (Christensen and Laegreid, 2003). Indeed, in many countries [e.g, Italy, Norway, France, Canada, Greece, etc. (OECD, 2005)] the State is deeply involved in strategic sectors. Many SOCs are also directly involved in the production/provision of public services (OECD, 2005), hence questions regarding their efficiency, effectiveness, innovation and governance structures and mechanisms become critical for the public interest.

Despite several examples of privatization and partial privatization during recent years, State ownership remains common in Norway<sup>3</sup>. Norway is a small country with only a few

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<sup>2</sup> They are initially indicated as ancillary innovations (Damanpour, 1987), organization-environment boundary innovations.

<sup>3</sup> According to Roland et al. (2001) the value added share of SOCs in the business sectors in Norway is the highest of all EU and European Economic Area countries. In 1998, the share was 29.0%, up from 27.0% in

## Does the Board of Directors Contribute to the Innovation of State-Owned Companies?

large corporations, there are not many people with a long history of being rich, and the State and public authorities are important actors (Rasmussen and Huse, 2010).

A distinct feature of the Oslo Stock Exchange is the strong concentration of the market value. The energy and electric utility related sectors, represented by companies as *Statoil*, *REC*, *Fred Olsen Energy*, *Hafslund*, *Revus*, *PGS*, *Arendal Fossekompani* and *DNO*, are by far the largest at Oslo Stock Exchange. These sectors represent about 50.0% of the value in terms of market capitalisation<sup>4</sup> (Rasmussen and Huse, 2010).

The Norwegian State is the main shareholder of *Statoil* (oil), *Telenor* (telecommunication), *Yara International* (plant nutrients), *Norsk Hydro*<sup>5</sup> (aluminium), *DnBNOR* (bank and financial services) and the *Kongsberg Group* (high-tech in defence and marine sectors), but it has also large shareholdings in *Aker Solution* (constructions). *Hafslund* (utility) and *Arendal Fossekompani* (utility) have a strong municipal ownership. *Statoil*, *Telenor* and *Hafslund* used to be State or municipal enterprises, but were introduced on the Oslo Stock Exchange as a part of a privatization process of public enterprises. The Norwegian State and Oslo Municipality have still the majority of the shares. The Norwegian government is by far the largest shareholder at the Oslo Stock Exchange, having 39.5% of the shares of the listed companies in terms of market value. The shares are owned directly through the Norwegian government's holdings of shares (35.1% based on market capitalisation). The rest, 4.4%, is owned indirectly through *Folketrygdfondet*, the Government Pension Fund - Norway.

The Norwegian Ministry of Industry and Trade has in its ownership report for 2008 presented 52 companies in which the ministries administer the State's direct ownership interest (*Nærings* and *Handelsdepartementet*, 2009). There are certain companies that are run directly by the State, e.g. in the health and education sector. Other companies are run

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1991, which is approximately double of what we find in Sweden and Greece, the nations ranked below Norway. In the EU, the average SOC share of value added was only 9.0%. The Norwegian pattern is partly related to the dominance of SOCs in the oil industry, but State ownership is definitely present in many other sectors as well (OECD, 2003).

<sup>4</sup> The 25 largest companies (11.0% of the total number of companies) represent almost 86.0% of the total market value of the listed companies. *Statoil*, the national oil and gas companies, alone represents more than 40.0% of the total market value. The five largest companies represent 64.0% of the market value, and the ten largest companies represent more than 75.0% of the market value (Rasmussen and Huse, 2010).

<sup>5</sup> *Norsk Hydro*, a major Norwegian corporation with a considerable state ownership, was recently split, and the oil and gas parts were merged into *Statoil (StatoilHydro)*, the fertiliser part into *Yara International* and the aluminium part remained in *Norsk Hydro*.

as separate companies incorporated as AS (private limited firms) [like the *Avinor* (the air transport control company, including ownership of airports), *NSB* (the Norwegian State Railways), *Statkraft* (Europe's largest renewable energy company, state enterprise – not AS), *Vinmonopolet* (exclusive rights for wine and spirits retail in Norway), etc.] or ASA (public limited corporation) [like *Statoil* (national oil company of Norway), *Telenor* (telecommunication), *Yara International* (supplier of plant nutrients), *DnBNOR* (bank), *Norsk Hydro* (aluminium and renewable energy) and the *Kongsberg Group* (high-tech production group in maritime and defence sectors)].

Municipalities are similar actors as the State. There are many arguments behind the governmental or municipal direct ownership in Norwegian companies. Most of them are based on political reasoning, such as elements related to important public and national interest (Rasmussen and Huse, 2010). State ownership may ensure command over common natural resources. One important argument behind the direct ownership of listed companies is to ensure head office functions in Norway. As a large owner, the Norwegian government does have the opportunity to influence corporate governance practices of SOCs. To ensure that the companies being wholly or partly State-owned and the State itself enjoy the confidence of the financial markets, the Norwegian government issued in 2002 the State's principles for good ownership to clarify the Norwegian government's role as a large owner (Rasmussen and Huse, 2010).

#### **4.3 Governance mechanisms and innovation in SOCs: the role of the board of directors**

Several studies on boards of directors in the private sector and also in the public sector (Considine, 2003; Clatworthy et al., 2004) have focused mainly on the relationship between board structural characteristics and company performance, providing mixed support for the expected positive association between these two variables (Dalton et al., 1999). Therefore, the influence of board composition on company performance is not simple and direct but complex and indirect. It seems thus important to look for predictors of performance.

Innovation is one of the most important predictors of company performance, leading the firm to the development of capabilities that in turn enhances its performance (Caves and Ghemawat 1992; Teece et al. 1997; Zahra and Garvis 2000). Indeed, firm innovation has been considered a mediating variable between board of directors and company

performance (Huse, 2007; Miller and Triana, 2009). However, few studies have analyzed in more details the relationship between boards of directors and innovation (Zona et al., 2009).

Being innovation one of the key challenges (Hitt et al. 1996) for many companies from the private but also from the public sector it has also to be considered for the survival and the continuously value creation process in PSOs (e.g., SOCs), even if with different degree of analysis. Innovation in SOCs is not an optional luxury but needs to be institutionalized as a deep value (Albury, 2005).

Innovation is thus vital to companies and researchers have increasingly examined the relationship between governance and innovation strategies both in the private (Baysinger et al., 1991; Graves, 1988; Hansen and Hill, 1991; Hill and Snell, 1988; Hitt et al., 1996; Zahra, 1996) and in the public sector (Hitt, Keats, and De Marie, 1995; Moore and Hartley, 2008). Especially, the factors that drive the evolution of innovation in PSOs (e.g., SOCs) need to be explored. Indeed, the role of the board of directors is critical and may influence the innovation patterns of SOCs. To this aim we focus on *internal governance mechanisms* in SOCs by analysing the contribution of the board of directors to SOCs' innovation. In the development of our hypotheses we refer mainly to the agency and the resource-based theories.

#### **4.3.1 Board composition and board working style**

Conceptualizing the board of directors from the principal-agent framework (Jensen and Meckling, 1976) has been very useful to explain the way boards are structured and how they function (Hermalin and Weisbach, 2003; Zahra and Pearce, 1989). This chapter addresses whether and to what extent the board of directors influences innovation in SOCs (Yermack, 1996).

The size of corporate boards has received much attention particularly given prominent business failures of large companies (Jackling and Johl, 2009). Board size becomes a potentially important determinant of innovation. Indeed, the total number of directors may influence the way they perform their tasks (Fama and Jensen, 1983) and determine their abilities to promote innovation. Despite the inconsistent findings relating the impact of board size on innovation, there is a growing consensus on the inverse relation between board size and firm performance (Jackling and Johl, 2009). Yermack (1996) presents evidence that small board of directors are more effective than large boards as benefits of

increased size can be out-weighted by the cost in term of poorer communication and decision making associated with larger group. Accordingly to Jensen (1993) large boards of directors are more likely to incur agency costs than smaller ones (Jensen, 1993). Indeed, as groups increase in size they become less effective because the co-ordination and process problems overwhelm the advantages from having more people to draw on (Jensen, 1993). Thus, there are costs associated with a large board size which may impede the effectiveness of the management (Conyon and Peck, 1998) and consequently the level of innovation. Therefore, the board size and this form of firm value creation are negatively correlated (Yermack, 1996; Huse, 2007; Jackling and Johl, 2009) also because larger boards tend to be associated with higher levels of cognitive conflicts (Forbes and Milliken, 1999). Following this reasoning, we formulate the following:

Hypothesis 1 – *The higher the board size the lower the level of innovation in SOCs.*

Gender diversity represents an important issue in board of directors' composition. Norway has the highest ratio of women directors in Europe that is partially due to the fact that the Norwegian government issued a legislative proposal aimed at achieving an overall target of 40% female representation on the boards of listed firms. The law became effective in 2005 and offered two years for transition time. Our analysis does not catch the effect of the law because it refers to 2003 and 2005 data and because we analyse both listed and not listed SOCs. However traditionally there is a strong effort, above all in SOCs, to reach the gender equality in the boardroom (Huse, 2007).

For this reason it seems important to focus on the contribution of gender diversity on innovation. Women directors may differ from men in several attributes. They have different values (Selby, 2000) and different knowledge and expertise (Hillman et al., 2002; Singh et al., 2008) compared to their male counterpart. Moreover, they bring in the boards different attitudes, opinions and problem solving (Eagly, 2005). Therefore, women serving to the board of directors, enhance the level of diversity in the boardroom.

Diversity delivers a broad range of perspectives, increases the search for information, enhances the quality of brainstormed ideas, facilitates creativity, generates more strategic alternatives (Erhardt et al., 2003; Watson et al., 1993) and impact positively the level of firm innovation. In support to these arguments, some authors point out that homogeneous boards of directors are more likely to inhibit the critical evaluation of alternatives with negative effects on innovation (Janis, 1972).

## **Does the Board of Directors Contribute to the Innovation of State-Owned Companies?**

We measure gender diversity as the ratio of women directors in the boardroom. Moreover, drawing upon the previous arguments we expect that:

*Hypothesis 2 – The higher the ratio of women directors the higher the level of innovation in SOCs.*

For what concerns the board working style a specific focus is on the time board members spend together during the board meeting. In order to perform better, the board must have working structures that allow its members to use their knowledge and skills (Forbes and Milliken, 1999). The time directors work together, can determine substantially the degree to which board fulfil their tasks (Forbes and Milliken, 1999;). An effective board requires time for preparation and influence the board task involvement (Huse, 2007) that in turn may influence the level of innovation. Spending time together in board meetings is important to have virtuous boardroom dynamics and create innovative board behaviour (Nordqvist and Minichilli, 2009). Therefore, we formulate:

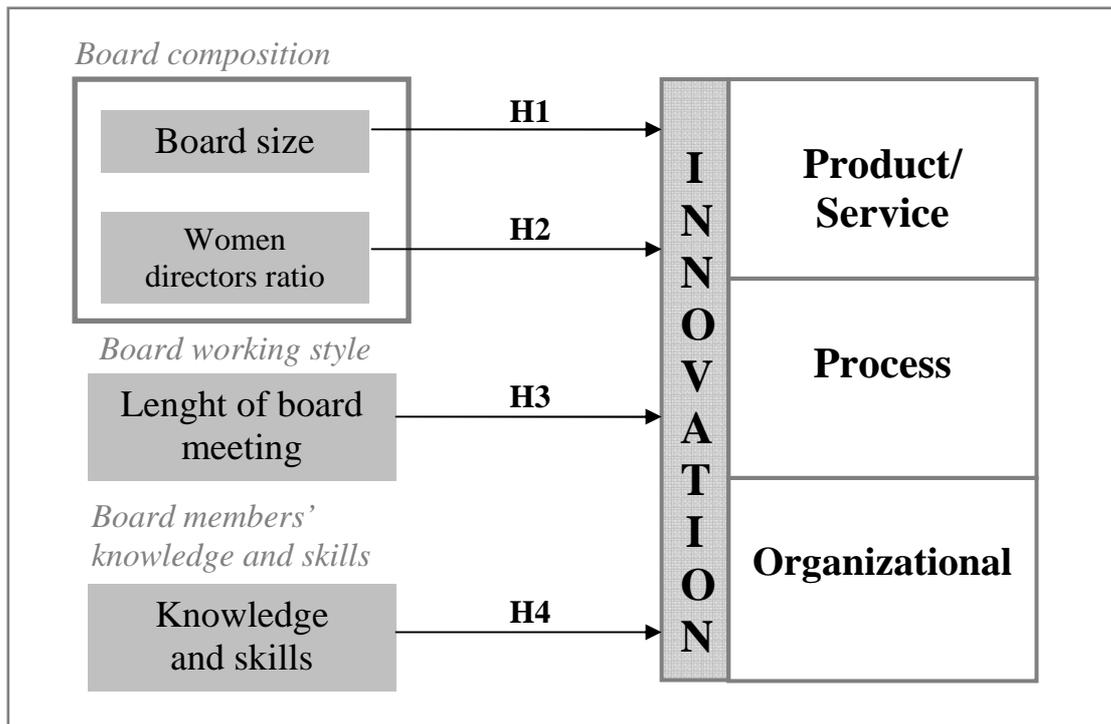
*Hypothesis 3 – There is a positive relationship between the length of board meetings and the level of innovation in SOCs.*

The last hypothesis refers to the level of knowledge and competences of board members. Basing on the resource-based view (RBV) of the firm (Barney, 1991; 2001; Sirmon et al., 2007) we analyse whether and to what extent the board of directors is a strategic resource that contributes to the level of innovation in SOCs. Boards require a high degree of specialized knowledge and competences to function effectively (Forbes and Milliken, 1999). Boards as elite and strategic-issue-processing groups must have members who possess knowledge and competences useful for problem solving (Ancona and Caldwell, 1988). Boards of directors of SOCs need to have knowledge and competencies in order to deal effectively with strategic issues (Forbes and Milliken, 1999) and then influence the level of innovation. Thus:

*Hypothesis 4 – There is a positive relationship between the level of board members' knowledge and competences and the level of innovation in SOCs.*

In figure 1, we show our research model indicating the above formulated hypotheses.

Figure 1 – The research model and the main hypotheses



Source – Our elaboration

## 4.4 Methods

### 4.4.1 The Sample

From a survey database about actual board behaviour (Huse, 2009) we selected a sample of Norwegian SOCs. Data from CEOs were collected in 2003 (*Innovation survey*) and in 2005 (*Follow-up survey*). The innovation survey and the follow-up survey were funded by the PULS program of the Norwegian Research Council together with various actors in Norwegian industry (Huse, 2009).

The 2003 survey was sent in October 2003 to 1,530 Norwegian firms. The survey sample includes all firms listed on the Oslo Stock Exchange in 2002. It includes, in addition, 1,000 largest Norwegian firms public limited corporation (ASA) and private limited firms by share (AS), which are outside the Oslo Stock Exchange in 2002. There are 488 CEOs who answered the questionnaire, which give a response rate of 32.0%.

The 2005 survey was sent out in October 2005 to 3,300 firms. This survey sample includes all firms surveyed in 2003 that still existed in 2004. It also contains all firms listed in the Oslo Stock Exchange in 2004, and the 100 largest ASA and AS firms in 2004. Last, it contains 1,500 smaller sized AS firms with less than 50 employees. The overall response

## **Does the Board of Directors Contribute to the Innovation of State-Owned Companies?**

rate was 33%. The survey uses 6-8 pages questionnaires. In particular 265 questions were asked to the CEOs, 235 to the chairpersons and 215 to the other board members.

For this chapter we selected the companies that have CEO answers for both the year 2003 and 2005. 373 firms met this selection criterion. From the 373 firms we selected 88 companies in which government or governmental institution hold stakes.

For the purposes of our research the dynamic perspective is obviously preferable to the static perspective implicit in cross-sectional analysis, therefore we decided to do a causal analysis. Hence, the independent variables were measured in 2003 and the dependent variable (the measures of innovation) in 2005. Indeed, it seems logical to think that the effect of the independent variables on innovation requires time; it will not appear immediately, but after a delay. We use two years in view of our wish to overcome the problems of causality inherent in cross-sectional data referred in the literature (Salomon and Shaver, 2005).

In the finale sample we had 88 Norwegian SOCs (Table 1). The percentage of ownership by the government or governmental institution is on average 61.0%. In many cases (23.0%) the Municipalities hold shares in the companies rather than the central government. Particularly, in 34.0% of the cases government or governmental institution hold the 100.0% of the stakes. In the 47.0%, more than 50.0% of the stakes, and in the 19.0% of the cases, less than 50% of the stakes. However in all the cases the government or institutional government hold at least the 15.0% of the stakes.

Different typologies of company are identified in the sample: companies listed on the Oslo Stock Exchange (B; 10.2%), other publicly tradable companies (ASA; 17.0%); private joint stock companies with more than 100 employees (AS-L; 30.7%); private joint stock companies with 50-100 employees (AS-M; 19.3%); private joint stock companies with less than 50 employees (AS-S; 16.3%); companies having other corporate forms as foundations (C; 9.1%). For what concerns the main industry, the 51.09% of the companies operate in the service industry, the 26.28% in the production industry, the 8.03% in the finance and real estate industry, the rest (14.60%) in other industries.

Table 1 – Companies in the sample

<b>Firms Type</b>	<b>Frequency</b>	<b>Percent</b>
Large private limited companies (AS-L)	27	30.7%
Medium private limited companies (AS-M)	17	19.3%
Other publicly traded companies (ASA)	15	17.0%
Small private limited companies (AS-S)	12	16.3%
Listed companies (B)	9	10.2%
Firms with an alternative organization form (C)	8	9.1%
<b>Total</b>	<b>88</b>	<b>100.0%</b>

Source – Our elaboration

#### 4.4.2 Measures

##### The dependent variable

In line with our theoretical framework we conceptualized innovation as consisting of product/service, process and organizational innovation. To develop measures for innovation, 11 items were taken from Huse (2007). Respondents rated their firm's actual emphasis on each item using a seven point scale. The 11 items were subjected to principal component analysis with varimax rotation. The 11 items loaded in three factors (product/service, process and organizational innovation). A detailed report of the principal component analysis can be found in Table 2.

## Does the Board of Directors Contribute to the Innovation of State-Owned Companies?

Table 2 – Factor analysis of innovation measures

Items	Prod./Serv. Innovation <sup>a</sup>	Process Innovation <sup>a</sup>	Organizational innovation <sup>a</sup>
Being the first company to introduce new product/service for new market	<b>0.74</b>	0.42	0.08
Being the first company to introduce new product/service for existing market	<b>0.83</b>	0.17	0.43
Being characterised by commercialising new products/services	<b>0.82</b>	0.34	0.20
Being characterised by investing heavily in risky/innovative process technological R&D	0.24	<b>0.78</b>	0.32
Being the first company in the industry to develop and introduce totally new technologies	0.14	<b>0.82</b>	0.33
Being characterised by pioneering the creation of new process technologies	0.25	<b>0.76</b>	0.44
Being characterised by copying other company's process technologies	0.27	<b>0.68</b>	0.42
Being the first company in the industry to develop innovative management systems	0.11	0.14	<b>0.68</b>
Being the first company in the industry to introduce new business concepts and -practices	0.19	0.23	<b>0.76</b>
Being characterised by considerably changing the organisation structure to facilitate innovation	0.23	0.34	<b>0.72</b>
Being characterised by implementing development programs to facilitate creativity and innovation	0.26	0.16	<b>0.75</b>
Eigenvalue	<b>1.22</b>	<b>5.36</b>	<b>1.36</b>
% of Variance explained	<b>12.28%</b>	<b>46.39%</b>	<b>10.32%</b>
Cronbach	<b>.79</b>	<b>.89</b>	<b>.76</b>

<sup>a</sup>Absolute loading of .50 or higher are significant

### The independent variables

The *board size* indicates the number of board members with voting rights in 2003.

*Women director ratio* indicates the percentage of women directors in boards. It was calculated as the number of women directors divided by the total number of board members.

*Length of board meetings* reflects the general duration of information exchange in board meetings in 2003. It was measured as the duration in hours of an ordinary board meeting.

Directors' *knowledge and competence* was measured by six items on a seven points Likert-type scale (5 = fully agree, 1 = fully disagree). The CEOs were asked to value the board members: a) knowledge of the firm's main operations; b) knowledge of the firm's critical technology and key competence; c) knowledge of the firm's weak sides and its products

and services; d) knowledge of the development regarding the firm's customers, markets, products and services; e) knowledge of the firm's suppliers and customer negotiation power. The variable output knowledge and competences was built as a mean of the items. The Cronbach's alpha coefficient was .86.

### **The control variables**

*Company size* was measured as a linear transformation (ln) of the absolute number of employees in 2003. We used the number of employees provided by the CEOs in the survey.

The variables related to the *ownership structure* are dummy variables. The first dummy variable (*100% State or local government ownership*) is coded 1 when the government or governmental institutions hold the 100.0% of the stakes, 0 otherwise; the second dummy variables (*More than 50% State or local government ownership*) is coded 1 when the government or governmental institutions hold at least the 50.0% of the stakes, 0 otherwise. Finally, the last variable (*Less than 50% State or local government ownership*) is coded 1 when the government or governmental institutions hold less than 50.0% of the stakes, 0 otherwise.

The variables related to the *industry type* are dummy variables. The first is *manufacturing and production*, coded 1 when the firm is in the manufacturing and production industry, 0 otherwise; the second is *service* coded 1 when the firm is in the service industry, 0 otherwise; the variable *finance and real estate* coded 1 when firm is in the finance and real estate industry, 0 otherwise; the last variable is *others* and it represents a residual category and it is coded 1 when firms are in this residual category, 0 otherwise.

*CEO tenure* is equal to the number of years the CEO has served on the board in 2003.

### **4.4.3 Analyses**

Table 3 presents a summary of the statistics for the variables included in the analysis. Firm size is on average 1,927 employees (the median is 95) with a minimum value of 11 and a maximum value of 32,000. CEO tenure is on average 6.66 years, ranging from 0 to 30 years. The board size is on average 6.52 with a minimum value of 3 members and a maximum value 11. On average the 27% of board members are women ranging from cases in which there are no women to cases in which women represent the 60% of the board members. The length of board meetings is on average 3.39 hours ranging from 0.50 to 8 hours. Directors' knowledge and competences is on average 4.44 with a minimum value of

## Does the Board of Directors Contribute to the Innovation of State-Owned Companies?

1 to a maximum value of 6.83. Product/service innovation is on average 4.24 ranging from 1 to 7. Process innovation is on average 4.14 ranging from 1 to 6. Finally, organizational innovation is on average 4.38 ranging from 1 to 6.75.

Table 3 – Summary Statistics

	Mean	Median	Standard Deviation	Minimum	Maximum
Company size (number of employees)	1,927.63	95.0	5,605.67	11.0	32,000.0
CEO tenure	6.66	5.00	5.48	0.00	30.00
Board size	6.52	7.00	1.94	3.00	11.00
Women directors ratio	0.27	0.29	0.17	0.00	0.60
Length board meetings (in hours)	3.39	3.00	1.33	0.50	8.00
Knowledge and competences	4.44	4.50	1.12	1.00	6.83
Product/service innovation	4.24	4.50	1.64	1.00	7.00
Process innovation	4.14	4.00	1.09	1.00	6.00
Organizational innovation	4.38	4.50	1.14	1.00	6.75
100% State or local government ownership	0.34	0.00	0.47	0.00	1.00*
50% State or local government ownership	0.47	0.00	0.50	0.00	1.00*
Manufacturing and Production	0.26	0.00	0.44	0.00	1.00*
Service	0.36	0.00	0.48	0.00	1.00*
Finance and real estate	0.08	0.00	0.27	0.00	1.00*

Source – Our elaboration

\* These descriptive statistics refer to dummy variables

In order to test the main hypotheses, we used multiple linear regression analysis. First, the control variables at the company and the board level were entered. Second, the explanatory variables (board size, women directors ratio, length of board meetings, and directors' knowledge and competences) were added and the significance of the change in  $R^2$  was assessed. We run the regression on the three dimensions of firm innovation (dependent variable): product/service innovation (**Model I**), process innovation (**Model II**), and organizational innovation (**Model III**).

### 4.5 Results

Table 4 presents correlations for the dependent, independent and control variables. Intercorrelations among independent variables were generally low thereby minimizing the problem of unstable coefficients (because of collinearity) in the linear regression models.

Also the **VIF test** suggests that multicollinearity does not defect results. The results of the regression analysis are presented in Table 5. We used SPSS to run the regression analysis.

Three models are presented. In **Model I** (product/service innovation was the dependent variable), we run the regression including first the control variables (the adjusted  $R^2$  was .04) and than the independent variables (the adjusted  $R^2$  was .06). In **Model II** (process innovation was the dependent variable), we run the regression including first the control variables (the adjusted  $R^2$  was .23) and than the independent variables (the adjusted  $R^2$  was .47). Finally, in **Model III** (organizational innovation was the dependent variable), we run the regression including first the control variables (the adjusted  $R^2$  was .25) and than board size, women directors ratio, and directors' knowledge and skills (the adjusted  $R^2$  was .40). When we added the explanatory variables in the three models, we assessed for each step the change in the adjusted  $R^2$ .

The results show that although the board size has no significant relationships with product/service innovation (Model I), it is negatively related to process [ $P < .001$ , (Model II)] and organizational innovation [ $P < .05$ , (Model III)], partially supporting Hypothesis 1.

Women director ratio has no relation with product (Model I) and process innovation (Model II). Instead it has a positive and significant relation with organizational innovation [ $P < .05$ , (Model III)].

Although the length of board meetings (in hours) has no significant relationships with product/service innovation (Model I), it has a positive and significant relationship with process [ $P < .001$ , (Model II)] and organizational innovation [ $P < .05$ , (Model III)]. These results give partially support to Hypothesis 2.

Finally, also in the case of directors' knowledge and competences while we found no significant relationships with product/service innovation (Model I), we found a positive and significant relationship with process [ $P < .001$ , Model II] and organizational innovation [ $P < .001$ , Model III]. Thus also Hypothesis 3 is partially supported.

**Does the Board of Directors Contribute to the Innovation of State-Owned Companies?**

Table 4 – The correlation matrix (88 observations)

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. Product/service innovation	-													
2. Process innovation	.11	-												
3. Organizational innovation	.20*	.49**	-											
4. Company size (number of employees)	-.09	.19*	.16	-										
5. 100% State/LG ownership	-.03	.30**	.25**	.13	-									
6. More than 50% State/LG ownership	.09	-.04	.07	-.04	-.68**	-								
7. Manufacturing and Production	.07	.05	.15	.20*	.10	-.10	-							
8. Service	-.06	-.01	-.06	-.12	-.02	.10	-.45**	-						
9. Finance and real estate	-.09	-.09	-.09	-.08	-.21*	.09	-.17*	-.22**	-					
10. CEO tenure	-.14	.12	.07	-.12	.14	-.17*	-.05	.09	.08	-				
11. Board size	-.03	.47**	.45**	.15	.38**	-.25**	.20*	-.02	-.13	.19*	-			
12. Women directors ratio	.02	.04	.12	.01	.03	-.03	.15	-.06	-.06	-.01	-.01	-		
13. Length board meetings (in hours)	.13	.44**	.41**	.27**	.17*	.02	.17	-.11	-.14	-.06	.37**	.12	-	
14. Knowledge and competences	.12	.46**	.48**	.12	.26**	.04	.18*	.11	-.29**	-.03	.23**	.12	.36**	-

\*\* Correlation is significant at the 0.01 level (2-tailed);\* Correlation is significant at the 0.05 level (2-tailed)

Table 5 – Multiple linear regressions (88 observations)

	Model I		Model II		Model III	
	Prod./Serv. Innovation		Process Innovation		Organizational Innovation	
Company size (ln number of employees)	-.08 (-.09)	-.12 (.09)	.18** (.05)	.05 (.05)	.21*** (.05)	.10** (.05)
100% State/LG ownership	.16 (.42)	-.03 (.46)	.95*** (.25)	.32 (.23)	1.07*** (.25)	.52** (.25)
More than 50% State/LG ownership	.39 (.39)	.21 (.41)	.55** (.23)	.28 (.21)	.91*** (.24)	.66** (.22)
Manufacturing and Production	.19* (.39)	.15* (.40)	-.10 (.23)	-.36* (.20)	.09 (.23)	-.15 (.22)
Service	-.29 (.36)	-.32 (.37)	.06 (.22)	-.14 (.19)	-.01 (.22)	-.19 (.20)
Finance and real estate	-.66 (.60)	-.58 (.60)	.21 (.36)	.28 (.30)	.26 (.36)	.34 (.32)
CEO tenure	-.03 (.03)	-.03 (.03)	.02 (.02)	.01 (.01)	.02 (.02)	.01 (.01)
Board size		-.04 (.09)		-.21*** (.04)		-.16** (.04)
Women directors ratio		.12 (.77)		.16 (.39)		.21** (.41)
Length board meetings (in hours)		.15 (.13)		.13** (.06)		.17** (.07)
Knowledge and competences		.14 (.15)		.30*** (.08)		.29*** (.08)
<b>Adj R<sup>2</sup></b>	.04	.06	.23	.47	.25	.40
<b>F Change</b>	<b>.85</b>	<b>.79</b>	<b>5.29***</b>	<b>9.76***</b>	<b>7.42***</b>	<b>9.25***</b>

B – Unstandardized Coefficients are used and standard errors are in parentheses.  
The levels of significance are: \* < 0.1; \*\* < 0.05; \*\*\* < 0.01

#### 4.6 Discussion and findings

In the chapter we have attempted to analyse how board structural characteristics, functioning, knowledge and competences influence innovation in SOCs. Drawing on agency and resource-based theories we developed hypotheses aimed at showing how such boards' characteristics, and attributes may influence innovation in SOCs. Moreover, we tested our hypotheses on a sample of 88 Norwegian SOCs operating mainly in the service sector.

## Does the Board of Directors Contribute to the Innovation of State-Owned Companies?

Our results showed that board size is negatively related to process and organizational innovation (*Hypothesis 1*). According to the theoretical arguments, a high number of directors is likely to increase the cognitive conflicts and factionalization in the board, and reduce the board effectiveness (Zona et al., 2009) thus influencing negatively the impact on innovation. Therefore, keeping boards small can help improve SOCs innovation and than their performance (Jensen, 1993). This result seems to suggest that also in SOCs, smaller boards of directors may be more effective in controlling the CEO and monitoring top management in respect of decisions which entail high risk and uncertainty, as the strategic decisions on innovation. This finding is in line with Lipton and Lorsch (1992) also focusing on the adoption of small boards arguing that companies with larger boards of directors could experience lower performance and consequentially lower innovation. This leans on the idea that communication, coordination of tasks, and decision-making effectiveness among a large group of people is harder and costlier than it is in smaller groups. The costs overwhelm the advantages gained from having more people to draw on (Jackling and Johl, 2009).

We found support for the relation between women directors ratio and organizational innovation (*Hypothesis 2*). However we found no relation with product and process innovation. This result is not surprising. Indeed, while product and process innovations require specific knowledge and competences in order to use in a proper way technology (Ettlie et al., 1984), organizational innovation is also influenced by individual characteristics of people (Kimberly and Evanisko, 1981). It is related more on cognitive process rather than product and process innovation. It is influenced by process of learning and organizational knowledge (Nonaka and Takeuchi, 1995) and it could be seen as the output of various intervening mental processes (Hodgkinson, 2003). Moreover, women directors, through the diversity they bring on boards, give a broader range of ideas and information because they are expected to have a different body of knowledge (Milliken and Vollrath, 1991). Indeed, unique ideas and perspectives influence the identification, development and selection of decisions (Mintzberg et al., 1976). Our results are consistent with previous studies suggesting that diversity in terms of gender, or other attributes, is related positively to innovation (Bilimoria, 2000; Hillman et al., 2002; Milliken and Vollrath, 1991). Thus, women directors bring in the board a certain level of diversity that in turn influences positively the level of organizational innovation.

A third finding was the impact of the length of board meetings on process and organizational innovation (*Hypothesis 3*). This partially follows conclusions in studies indicating that boards contribution to strategy (one of the boards' task more oriented with innovation) to a large degree depend on creative and interactive board meetings where the board involvement goes beyond ratification and output control (Hitt et al., 1996; McNulty and Pettigrew, 1999). Indeed, time pressured board members may, as predicted by agency theory, spend sufficient time on quantitatively related control tasks, but other tasks may suffer due to time constraints (Brunninge et al., 2007; Hitt et al., 1996). This result suggested that in SOCs for a board to perform well it is not enough to have the very best and competent board members. The board must also have working structures that allow the directors to use their knowledge and skills (Forbes and Milliken, 1999; Gabrielsson and Winlund, 2000). The amount of time devoted to actual board work can significantly determine the degree to which boards fulfil their tasks (Forbes and Milliken, 1999). Therefore, also in SOCs spending time together in the boardroom seems to be an essential ingredient for virtuous boardroom dynamics and creative and innovative behaviour (Nordqvist and Minichilli, 2009) that in turn influences the level of process and organizational innovation. Longer meetings also support process orientation and board climate where many actors can voice their opinions (Huse, 2005).

We found strong support for the hypothesized relationships between the level of board members' knowledge and competences and process and organizational innovation (*Hypothesis 4*). This finding is in line with previous research indicating that innovation is generally seen as the result of novel and creative combinations of knowledge and resources (Prahalad and Hamel, 1990). Having competent and skilled board members positively influences the level of process and organizational innovation in SOCs. Indeed, these board members are expected to add value to the SOCs by influencing the decision-making process in relation to process and organizational innovations. Their relevant knowledge helps in providing external control to the management and by assisting the CEO in determining strategic actions.

Based on the RBV of the firm (Barney, 1991; Sirmon et al., 2007) the chapter suggests that the board of directors is a strategic resource that contributes to the innovation of SOCs. Moreover, drawing on resource based theory may give the chance for further development and advancement in the studies of board as a strategic resource for the innovation patterns

## **Does the Board of Directors Contribute to the Innovation of State-Owned Companies?**

of SOCs. RBV considers the board as a firm-internal resource of competitive advantage (Barney, 1991). Therefore, RBV is a realistic approach to study boards in SOCs. Especially recent developments of RBV in relation to a competence based view, absorptive capacity, and dynamic capabilities (Sirmon et al., 2007), offer a more dynamic perspective than most other theories used to understand boards of directors. These considerations may obviously influence the analysis of the role of board of directors in the innovation of SOCs.

In all the three Models we found no significant relationships between the independent variables and product/service innovation. There could be several explanations for the absence of this relationship. One could be that the development of new products/services requires strong leadership, technical support from independent specialists and close collaboration with costumers to get things going (MacPherson, 1997). Hence product/service innovation in SOCs seems to be contingent on other issues rather than the structural characteristics and knowledge of the board of directors.

Moreover, the SOCs in our sample are characterized by a high presence of outside board members [there is also a formal requirement in Norway that indicates that directors of SOCs might be preferably outside directors (OECD, 2010)]. This partially justify why in our results we found no relationships with product/service innovation. Indeed, when uncertainty and risk are involved – as they are in decisions on new product innovations – inside directors are likely to have better information (Zahra, 1996). They have knowledge of the businesses of the firms whose boards they are on and as a result they are more willing to adopt new product/service development strategies because they have greater knowledge about them – and hence, less perceived uncertainty (Hoskisson et al., 2002). That is why in our sample probably we found significant relationships mainly with process and organizational innovation.

Finally, many SOCs in our sample are mainly involved in the service sector and therefore the measures that we have used for identifying the level of product/service innovation are not appropriate. Perhaps, using items derived from studies on public organizations may (Osborne, 1998; Osborne and Brown, 2005; Moore and Hartley, 2008) give more challenges in measuring service innovation. These are services which are responsive to the needs and aspirations of individuals and communities, which treat users with respect and dignity, and which enable greater individual and collective engagement (and greater self-organization) in the achievement of desirable social outcomes (Albury, 2005). SOCs operating in the public service production/provision may also be underpinned by a deeper

challenge to develop universal “personalized” public services thus influencing the way in which SOCs realize their product/service innovation.

The findings of this study are in line with extant research on the board of directors that has emphasized its potential contribution to firm’s value creation (Huse, 2007; Zahra and Pearce, 1989). Especially our contribution is on innovation as a form of internal value creation (Huse, 2007).

Several theoretical perspectives have underlined the specific roles the board may play. In this chapter the focus has been on agency and resource based theory. We suggest that boards of directors contribute to the innovation of SOCs; they may assume a mediating role between change’s requests coming from outside and the resistance arising within SOCs. The board tasks in SOCs are enriched by new control issues, overcoming board constraints on management (to reduce divergence on interests with stakeholders) in order to shape innovation directions, breaking organizational habits and forcing the organizational change (Stiles and Taylor, 2001).

With specific reference to the Norwegian context, there is a law requirement (OECD, 2003) providing 10 principles for good corporate governance of companies in which the State is shareholder. Among these guidelines the role of the board of directors seems to be central. Indeed, the board of directors is responsible for the objectives being attained in Norwegian SOCs; the composition of boards of directors shall be characterized by competence, capacity and diversity based on the distinctive nature of each company; on behalf of the owners, the board of directors shall have an independent control function vis-à-vis the company’s management; the board should have a plan for its work and should work actively on building its own competence; the board’s work shall be evaluated. All these aspects indicate the critical and fundamental role that the board of directors has in Norwegian SOCs and how it is important to analyze its contribution to innovation.

The Norwegian context seems characterized by the fact that financial crisis or no, the State remains the largest owner in Norwegian trade and industry and in many other sectors in which SOCs operate. A large State owner can provide increased predictability and stability, and serves as a guarantee that allows the companies to continue to focus on long-term value creation even in times where prices and values fluctuate wildly, making it even

harder for business decision-makers to plan for the future. Therefore, State ownership seems to be an advantage. The State, in all its ownership decisions and management, places great importance on complying with the division of roles and responsibilities which follows from corporate legislation and generally accepted principles for corporate management and owner control.

#### **4.7 Conclusions and future research directions**

The study of innovation in SOCs hardly needs justification as scholars, policy makers, business executives, and public administrators maintain that innovation is a primary source of economic growth, industrial change, competitive advantage, and public service (Borins, 1998; Boyne et al., 2005; Christensen and Lægreid, 2009).

Drawing from the innovation literature, agency and RBV theories, the chapter explores the role of the board of directors in the innovation of SOCs, testing hypotheses on a sample of 88 Norwegian SOCs.

The study makes several contributions to the research of innovation in public sector and in particular in SOCs.

First, by analysing the context of Norwegian SOCs, it adds knowledge on the studies that focus on the role of the State in specific and strategic sectors through private law companies (OECD, 2010). Norway has not been characterized to any strong public management reform path, reflecting also a healthy economic situation and a well-functioning public apparatus (Christensen and Lægreid, 2009). Moreover, the ownership composition in Norway is in itself particularly well suited for exploring the issue of innovation in SOCs. Despite several examples of privatization and partial privatization during recent years, State ownership remains common in Norway. Indeed, the Norwegian pattern is partly related to the dominance of SOCs in the oil industry, but State ownership is definitely present in many other sectors as well (Christensen and Lægreid, 2003). This makes it especially appropriate to study the innovation in SOCs.

Second, by analysing innovation in SOCs we suggest to consider innovation as a core task of public sector. Moreover, our findings are in line with previous studies suggesting that innovation has to be promoted by governments around the world as a key tool to improve public sector efficiency and effectiveness (Walker, 2006). Indeed, while innovation is an

issue of considerable significance for both public and private sector, in the private sector literature still focuses mainly on technological innovation, especially new product development, showing some limitations in applying concepts about *product* innovation to *service* and *organizational* innovation. In this article we used a comprehensive measures of innovation (product/service, process and organizational innovation) filling this gap in the literature.

Third, by analysing the role of board of directors in relation to innovation, we fill the gap in the literature for more knowledge on how innovation is managed and generated in PSOs, and in SOCs in particular (Walker, 2003). Although presenting many similarities with private and non-profit boards (Cornforth, 2003) in terms of their role in strategic decision-making processes (Huse, 2007), the role of the board of directors is still not well examined in the public management literature. Our findings clearly suggest that innovation is within the grasp of governing bodies in SOCs (Borins 1998; Light 1998; Moore 1995; Osborne 1998; Walker et al. 2002) and that the role of knowledge and competences is fundamental.

Fourth, by using multiple linear regressions analysis, we add new findings on the research stream of innovation in SOCs coping with the lack of quantitative empirical analyses on PSOs (Houston and Delevan, 1990). Moreover, the survey methods enabled us to catch more in-depth details on the investigated phenomenon.

Although the growing interest on the issue of innovation in public sector there is a need for future research in this field in order to understand the determinants of innovation in SOCs. Further developments of the RBV theory in relation to boards of directors may give new insights also in the studies of innovation in SOCs. Especially, competence based view, absorptive capacity, and dynamic capabilities (Sirmon et al., 2007), may offer a more dynamic perspective to understand the role of boards of directors in the innovation of SOCs.

Interesting research directions in the analysis of the relationships between internal governance mechanisms and innovation in SOCs may arise from considering a more behavioural approach when studying issues related to boards, governance and value creation (Huse, 2007). This approach may give new insights to the study of innovation in this kind of PSOs by looking more deeply to processes and actors and by understanding and investigating the human side of governance.

#### 4.8 References

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## Does the Board of Directors Contribute to the Innovation of State-Owned Companies?

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## Conclusions

This thesis has focused on four main research questions: which are the governance structures and mechanisms that are used for managing PSOs? Which is the governance system adopted by the Italian LPUs? What are the consequences of partial privatization for the accountability of PSOs in Italy and Norway? Does the board of directors (as an internal governance mechanism) contribute to the innovation of State-owned companies? Along each direction, various issues and concepts have been discussed, basing on different perspectives in order to catch the plurality of views and values. This study provides an extensive overview and a thorough evaluation of the state of the art in terms of governance structures and mechanisms of PSOs, as well as their interactions and overlaps. In this section, some reflections are done focusing on the key findings emerging from the study and stemming from that some comprehensive future research directions are outlined.

The chapters included in this thesis have shown how the debate on governance structures and mechanisms is fertile and promising in the domain of PSOs. However, complexity, ambiguities, paradox exists within it. Moreover, the study clearly has shown how differences in culture, traditions, legislative systems among national contexts worldwide affect the final “outcome” of the studies on Public Management (PM) and public services. This variety of course has led to the proliferation of various models, experiences, case evidences, common trends, and different patterns. However, it has led the studies on Public Administration and Management (PAM) in different and often conflicting and overlapping directions. Therefore, the need for a clearly distinctions between temporal phases and theoretical frameworks evolving along them are needed. Conscious of these aspects and stemming from the argument advanced in Osborne’s article (2006) that PAM has actually passed through three dominant modes [Public Administration (PA), New Public Management (NPM), and New Public Governance (NPG)], the study has taken this argument as its “light motif”. Particularly, being the context of PAM studies wide and complex, the thesis tests qualitatively the argument advanced by Osborne (2006) on a sample of 184 scholarly publications. The complexity has thus been addressed by the use of systematic methods (Newbert, 2007)

## Conclusions

for reviewing the relevant literature and thus verifying the above mentioned main theoretical arguments and determining the state of the art in relation to governance structures and mechanisms in PSOs.

Many underlying, yet interrelated themes were discussed in this thesis and need to be emphasized here, as they help to provide a useful conclusion. The first is the significance of the presence of multiple actors operating in the domain of PSOs which gives more complexity to the overall debate and theories that could be used to address various issues and future studies. What type of “governance regime” (Pestoff, 2009) is envisioned or implied by different scholars? Is it traditional PA, NPM or perhaps NPG? The study emphasizes that NPG as a “governance regime” is therefore suitable to be further developed and offers many logical tools and opportunity to improve the existing knowledge on the management of public services. However, and this is the second theme, the need to be accountable is becoming even more a pressure for PSOs. It is interesting than to answer questions investigating if the are public sectors’ actors, private for-profit firms, Third Sector Organizations (TSOs) and community organizations involved in the management of public services? Therefore, defining clearly lines of accountability in these networked forms of governance is a challenge for future studies. The role of accountability [accountability, social accountability, social audit and accounting (Pestoff, 2009)] becomes even more critical and studies relating the above mentioned different dimensions of accountability with organizational types (public services, private non-profits, and for-profit organizations) and governance regime [traditional PA, NPM, and NPG (Osborne, 2006, Osborne, 2009)] are well appreciated (Osborne and Ball, 2010).

Finally, the focus on internal governance mechanisms shed light on the role that the board of directors has in particular types of PSO. Actually, the role of boards in public organizations is still not so developed as in private or non profit ones (Farrell, 2005). It is often possible that by borrowing corporate governance’s models from private to public organizations a number of outstanding issues remain (Hodges et al., 1996). In fact, there is a need to adapt corporate governance principles to meet the considerable diversity of objectives and management structures within the public services. However, the literature on boards in public organizations has revealed that governing bodies have

many similarities with private and non profit boards (Cornforth, 2003; Farrel, 2005), in terms of their accountability requirements and strategic role in the decision-making processes. Therefore, by focusing on listed LPUs [governed by the private law form of the joint stock company (JSC)], and, more in general, on State owned companies (SOCs) mainly operating in the service sector, the study contributes to the debate on the comparability and interactions between internal governance mechanisms (the board of directors) from both the private and the public sector studies. Indeed, being those companies organized through the JSC form and involved in the production and provision of public services (at the local, national, and international level) questions regarding their value creation become fundamental. Particularly, they have many elements directly derived from the private sector (Hodge et al., 1996) therefore a clear reasoning on how it will be possible to go from concepts as “corporate governance” and “public governance” to the one of “public corporate governance” is strategic for the future debate.

The role of the board of directors as viewed in the private sectors should be reconsidered when it comes to PSOs. This is partially due to the complexity and mix of various interests involved in their governance systems. In listed LPUs and SOCs the board of directors has the same problems and critical aspects of boards in private firms (how independent are independent director; dominating influence by the controlling shareholder; the existence of multiple agency relationships that in turn affects the level of conflicts on interest). Besides, the board should also be considered as a negotiation or political arena in which diverging interests find balance. Therefore, understanding the roles that boards play is important and ways to improve their effectiveness and “credibility” need to be implemented. Theoretical discussions and debates on which is the role of the board of directors and corporate governance in the discourse of Public governance (PG) and public services requires the improvement of citizens and community organization involvement in such governing body. In line with this reasoning the study identifies the role of the board of directors, in LPUs and SOCs, understandable and referring to the debate on “public corporate governance”. In this framework it is possible to include all the studies focusing on “corporatization” as a particular phenomenon in the management of public services (Grossi and Reichard; 2008; Grossi, and Mussari, 2009; Ruter et al., 2005). We are conscious that concepts

## Conclusions

and theories on boards are not completely translatable in the public sectors domain, and that the word “board” captures a variety of governing body typologies (e.g. councils, cabinets, etc.), the main focus is on PSOs using the board as an internal governance mechanism, thus assuming a meaning quite similar to that used in the private sector.

The debate is also on the relationships between management, PM, and public services. Actually, although many scholars analyze the relationships between management, PM, and public services (Pettigrew, 2005), and others clearly indicate that the PM needs help, there are many cases in which corporate governance can learn something from PG (Benz and Frey, 2007). Hence, this thesis contributes to shed new light on the role of boards in listed LPUs and SOCs, along both the directions.

Indeed, corporate governance (CG) can learn from the PG by considering concepts such as “public value” and “public interest”, thus the nature of participation and democracy in the governance of corporations. To the contrary PG can learn from CG by analysing the board of directors (where this is possible) from a dynamic and behavioural perspective (Huse, 2007). In fact, there are some studies in the PM field that focus on the “human side” of boards considering the board as a fundamental governing body involved in the public sector value creation process (Boyne, 2003; Kirkbride, 2003; Benz and Frey, 2007). However, those studies did not focus on the dimensions that influence the board effectiveness and did not take into account the role of knowledge and competences.

The literature on boards in the public sector, as shown in some parts of this thesis, may thus benefit from taking into account the role of actors, arena, processes and behaviours (Huse, 2007) when analysing boards. Indeed, it is also necessary to focus on processes and open the “black box” of board behaviour in PSOs, especially for the delicate nature of the involved interests. So, going from the analysis of the so called “usual suspects” to a clear focus on processes, competences and knowledge, decision-making culture, boards’ tasks, and value creation gives interesting future research insights and directions. Moreover, by focusing on some of those aspects, the study has shown which is the role of the board of directors in the innovation processes of SOCs, thus analysing the relationships between boards and companies’ value creation (Huse, 2007) instead of performance indicators.

The exploration and analysis of the topics included in the study has aimed at testing and building knowledge. This has been done through the use of various research methods (both qualitative and quantitatively) and by the analysis of two different national contexts (the Italian and Norwegian one). The comparison of these so different contexts has given to the study an overall international research dimension and has contributed in interpreting the findings widely and following a more systematic approach.

Here below, a brief discussion on the main findings and critical aspects that have been emerged from the four chapters is presented providing unique insights into the overall debate.

In the first chapter it has been highlighted that PSOs at all levels have come under increasing pressure from deregulation and the continuous comparison with the private sector. They have made considerable efforts to improve their efficiency, to reduce costs by downsizing and rationalization, by introducing new managerial concepts and tools and by being more responsive to the citizens or customers (Pollitt, 2009). It has been highlighted that the main issues are related to the evolution of different ways of public services provision during the years (Cafferata, 1993). It has also been shown that PSOs have experienced and are experiencing many changes in how to govern complex public services production and/or provision. Therefore, the citizens become more and more informed and the ICT development changes completely the way of understanding public services (Torres et al., 2005). The primary aim of this chapter has been to investigate governance structures and mechanisms in PSOs in order to improve the understanding of the current national and international patterns. This has been done by assessing the relevant literature on the topic and by finally analysing systematically 184 published articles. Hence, it has been possible to develop knowledge building and understand drivers, causes and effects of PSOs' strategic choices. This chapter has contributed to the on-going debate in several ways. First, by assessing the relevant literature on the evolution of governance structures and mechanisms in PSOs, it has helped overcoming the implicit limit of much PAM research that has been small scale, undertheorized and has been focused on application rather than theory building (Ferlie et al., 2003). Second, it quantitatively shows that the analyzed articles are classifiable following Osborne's

## Conclusions

(2006) arguments. Actually, the findings are in line with the discussion on the emergence of the NPG and on the shift to Public Management. Third, by discussing the way research questions, theories, settings, and sources of data interact, the chapter clearly has highlighted the relationships between those elements and the evolution of the governance regimes in PSOs. Particularly, the national context seems to have a determinant role as shown by the recent tendency of most empirical studies to be drawn on multiple contexts non-including UK and/or US. What has especially emerged is that worldwide there are different and co-existing experiences of governance structures and mechanisms of PSOs. Nevertheless, there are also hybrid model of governance characterized by the co-existence and interaction of hierarchical, market-based and network (collaborative) frameworks (Osborne, 2009). Moreover, different governance structures and mechanisms introduce distinct problems, for the theory and practice, of public accountability (Skelcher, 2007). Indeed, the creation of “hybrid organizations (and other novel institutional arrangements) in the public sector needs to be accompanied by a reconsideration of our notions of accountability” (Skelcher, 2007). From this systematic literature review it has emerged that for many public services there are good reasons for trying to achieve local access for the population and building in opportunities for citizen and/or consumer involvement and accountability. Indeed, this is an essential component of the public service *ethos* and mission. In line with this last consideration, co-production or citizen and TSOs involvement in the provision of public services could prove highly relevant proposals for democratic and welfare State reforms. In fact, co-production provides a missing piece of the puzzle for reforming democracy and the welfare State. It contributes a view and understanding of conditions at the micro level or the site of production of welfare services (Pestoff, 2006). However, there could be problems due to the lack of accountability and the increasing interest on the role of coordination and collaboration and a “glass ceiling” for the participation of citizen. Therefore, the concepts of co-production and co-governance (Brandsen and Pestoff, 2006) may be useful to crash this glass ceiling. As emerged in this study, ***co-production*** could be useful and refers to the delivery of a public service by citizens and non for profit and voluntary organizations, acting at arm’s length from the State. Moreover, ***co-governance*** is needed because it grants the active co-involvement in the internal public sector policy development and implementation processes jointly between

the non for profit and voluntary organizations, citizens, and the State (Brandsen and Pestoff, 2006; Osborne and McLaughlin, 2004). Admittedly, there is overlap between the two types of interactions and the distinction can become quite blurred. However, what this theoretical distinction allows us to do is to consider discrete moments in the nature of and rationale behind these inter-organizational network interactions and suggesting a way to improve accountability in the governance of PSOs (Brandsen and Pestoff, 2006) and contribute to the development of new paradigms of participative democracy (Pestoff, 2008) and empowered citizenship (Fung, 2004).

The second chapter has examined how in listed LPUs questions regarding the ownership structure, the board composition and independence, and the role of service charters may be challenging. The agency theory (Fama and Jensen 1983; Jensen and Meckling 1976) has been used in order to investigate the complex co-existence of agency relationships in the governance system of LPUs. Along this theoretical debate four propositions have been formulated and discussed through a multiple case study analysis on 10 Italian listed LPUs. This chapter has contributed to the debate on “public corporate governance” in LPUs by showing how the agency theory prescriptions (the board of directors as a conflict resolution arena) often are not useful tools to fill their lack of accountability. Service charters represent a good starting point to cope with. However, the best solution would be the direct involvement of citizens in the provision of public service and in the decision-making process, as ways of co-productions (Pestoff, 2009).

Moreover, the chapter has provided new and insightful findings for the practice and the local administrators by understanding the paradox of “public corporate governance” in LPUs. Indeed, it has emerged that local public services are under the formal control of politicians (directly in the case of Local governments), and the associated policy context. Politicians themselves are elected representatives of wider constituencies and stakeholders, with a democratic mandate to represent the whole, which includes future generations as well as the current population. This means that public management, operating to take account of the political and policy context, is inextricably linked to governance issues. Therefore, the role of the ownership structure, board composition and independence becomes important and the focus on theoretical perspectives more

## Conclusions

oriented to the public value and interests needed. This allows us to overcome to the intrinsic limit of the agency theory that gives us only a one-dimensional view of behaviour, ignoring the co-operative aspects of social life (Dilulio, 1994) as better indicated in the co-production concept. Finally, it has been emerged that there is a need for future research on LPUs to focus more on internal governance mechanisms given the limited presence of competition in the national and international arena that stops in a certain way the possibility of the market to correct public sector inefficiency. Therefore, trying to solve the paradox of corporate governance in LPUs could give interesting perspectives for the improvement of public services even in context of low competition.

The third chapter has focused on conflicts of interests, ethics and accountability issues in the governance debate on privatizing public sector activities. The chapter looks at whether privatizing public sector activities might improve or detract from New Public Management (NPM) reforms. The analysis has been on the Italian Ministry of Economy and Finance and on various Norwegian Ministries. It starts by noting that privatization is an important part of market reform programs, which are expected to improve economic efficiency by reducing the role of the State in the economy. Yet, some countries in Europe have only recently begun to privatize, so they may be considered as examples of partial privatization. The primary aim of this chapter has been to show the impact of privatization on the accountability system for providers of public services. The chapter makes several contributions to the debate on privatization, accountability and governance systems of public service providers. First, it is clearly showed how in the debate on public service providers accountability, themes such as conflicts of interests, and unethical behaviours are considered critical to the successful definition and implementation of their governance systems.

Second, it is shown that valid alternatives to privatization exists (Pestoff, 2008). Indeed, NPS and NPG may able to solve, in part, some of the ethical issues related to conflicts of interest and corruption, due to greater citizen participation in public service delivery. However, it is important to remember that given different perspectives on privatization, like NPM, NPS and NPG, the power of governing bodies are also changing. This gives rise to questions about the capacity of accountability systems to keep up with these developments.

Third, the findings suggest the *stop and go* characteristic of the Italian process and the *reluctance* of the Norwegian government to privatize and the existence, in both countries, of situations in which the Ministries are still the major owners of service providers. Moreover, although the role of Ministerial governance has different development in the analysed countries a common pattern exists in relation to ethical and accountability problems.

Fourth, from the analysis of the historical background of the two countries the chapter emphasises that while in Italy the privatization process has been a way of reducing inefficiencies in the public sector (Bognetti and Robotti, 2007) and adapting to te competitive pressures emerging in the international market (Saraceno, 1981; Cafferata, 1995), Norway has not been characterized to any strong Public management reform path, reflecting also a healthy economic situation and a well-functioning public apparatus (Christensen and Læg Reid 2009).

Finally, the findings from the the content analysis of the code of ethics of both the Italian and the Norwegian service providers highlight that although the contestual and historical differences in which the privatization process has developed a clear lack of accountability, of implementation actions on the codes of ethics, and of transparency resulted from both the analyzed countries.

Chapter four studies innovation in SOCs being counscious that hardly it needs justification as scholars, policy makers, business executives, and public administrators maintain that innovation is a primary source of economic growth, industrial change, competitive advantage, and public service. Drawing from the innovation literature, agency and RBV theories, the chapter explores the role of the board of directors in the innovation of SOCs, testing hypotheses on a sample of 88 Norwegian SOCs. Through the analysis of the Norwegian SOCs, the chapter has contributed to the studies that focus on the role of the State in specific and strategic sectors through private law companies. Indeed, the findings from the Norwegian context shed new light on the role of the State enforced by the recent developments suggesting that its role has been critical and of value during the last (2008-2009) global financial crash (Musacchio and Flores-Macias, 2009) recognising its potential for reclaiming some legitimacy of government as a *value-creating institution*, by being more responsive to the needs and

## Conclusions

aspirations of citizens and users of services and intervening in cases of large scale effect crisis.

What emerged is also that Norway has not been characterized to any strong public management reform path, reflecting also a healthy economic situation and a well-functioning public apparatus (Christensen and Læg Reid, 2009). The results seem in line with the idea of the Norwegian State as historically a rather unified and integrated central system (Christensen, 2003). In practice, the system has been very robust, creating a stable environment, a cultural consensus, the peaceful coexistence of many actors in an atmosphere of mutual trust that influence positively innovative behaviours in SOCs (Christensen and Laegreid, 2005). Indeed, the ownership composition in Norway is in itself particularly well suited for exploring the issue of innovation in SOCs. Despite several examples of privatization and partial privatization during recent years, State ownership remains common in Norway. Indeed, the Norwegian pattern is partly related to the dominance of SOCs in the oil industry, but State ownership is definitely present in many other sectors as well. This has made it especially appropriate to study the innovation in SOCs. The investigation of innovation in SOCs derives from the consideration of innovation as a core task of public sector. Moreover, the findings are in line with previous studies suggesting that innovation has to be promoted by governments around the world as a key tool to improve public sector efficiency and effectiveness. Indeed, while innovation is an issue of considerable significance for both public and private sector, in the private sector literature still focuses mainly on technological innovation, especially new product development, showing some limitations in applying concepts about *product* innovation to *service* and *organizational* innovation. In this chapter we have used a comprehensive measures of innovation (product/service, process and organziational innovation) filling this gap in the literature. Moreover, the role of the board of directors in relation to innovation has been investigated filling the gap in the literature for more knowledge on how innovation is managed and generated in SOCs. The findings clearly suggest that innovation is within the grasp of such governing body in SOCs and that the role of knowledge and competences, team dynamics and diversity is fundamental. The multiple linear regressions analysis has contributed to add new findings on the research stream of

innovation in SOCs coping with the lack of quantitative empirical analyses on PSOs in general. Finally, although the growing interest on the issue of innovation in public sector has been highlighted, there is still the need for future research to understand the determinants of innovation in SOCs. In particular, further developments of the RBV theory in relation to boards of directors may give new insights also in the studies of innovation in SOCs. Especially, competence based view, absorptive capacity, and dynamic capabilities (Sirmon et al., 2007), may offer a more dynamic perspective to understand the role of boards of directors in the innovation of SOCs. Interesting research directions in the analysis of the relationships between internal governance mechanisms and innovation in SOCs may arise from considering a more behavioural approach when studying issues related to boards, governance and value creation (Huse, 2007). This approach may give new insights to the study of innovation in SOCs by looking more deeply to processes and actors and by understanding and investigating the human side of governance.

Research on governance regimes (structures and mechanisms) in public service organizations is still relatively under assessed and new directions stemming from what is already done are needed. The overall thesis has not only revealed how governance regimes are affected by and reacted to new forms of global organizations, but also how in particular the New Public Governance regime has undertaken active role in the shaping of the cosmopolitan universe of networked forms of governance. The overall intention has been that this thesis has added to the field of Public management and public services with both conceptual and empirical contributions, but there is still a large research agenda to be pursued if the understanding and practices of governance are to yield clear improvements in society and its public services. This study has addressed the importance that accountability in its various forms assumes in PSOs and the role that governance mechanisms play. It has been highlighted that especially when new actors are involved or are assigned to the production/provision of public services, there remain deficits of transparency, accountability, and control on the outcome which a governance system might be expected to entail. This is a critical issue for the Public management field and more research on the actors, the arena, the processes, and the contexts would be of great importance and relevance.

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