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Governance Strategies in local government: A study of the governance of municipal corporations in a Swedish municipality

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ABSTRACT

Municipal corporations can be seen as a method of disintegrating municipal operations but retaining control through those corporations. We assume that the municipal influence of the corporation can be described through the concept of governance strategy. Through a case study of seven corporations in one Swedish municipality, we found that emphasis was put on corporate strategy as a governance mechanism and that the board only retained a latent capacity. Furthermore, financial control and executive compensation were hardly ever used as a governance mechanism, which led us to formulate the ‘chamber concert’ hypothesis: The use of governance mechanisms is influenced by traditions, norms, knowledge, and governance needs.

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Introduction

Local government can choose from a range of methods to perform its duties to citizens. It can, for example, perform a service itself or outsource it to other actors. One alternative to full integration or full outsourcing of a service is to perform the service through an entity owned by the municipality; and the use of a corporation that is wholly owned or is involved with government in a public-private partnership is a particular way to do this. The governance of such entities, however, differs from governance through an organisational hierarchy such as the municipality or through contract administration as in the case of outsourcing. Instead, the governance of municipal corporations can be conducted through a *corporate governance strategy*.

Governance strategy has been proposed as a conceptual instrument of understanding the use of different governance mechanisms in organisations (Collin, 2007). It has been applied to large multinational organisations as well as to local sport associations. The concept assumes that the setup of governance mechanisms can to a certain extent be explained by the interest of the principal and the principal's capacity to make use of those mechanisms. Thus, it stands in contrast to much corporate governance research that is focused on environmental determinism and instead offers a strategic choice perspective (Eisenhardt, 1989). The idea emphasises that a principal can have the capacity and interest to (a) design specific corporate governance mechanisms and (b) compose a mix of them which will ensure fulfilment of the will of the principal.

A municipal corporation is owned and governed by the municipality, presumably in the interest of the politicians. As such, it offers a goal for the corporation to satisfy which differs from the presumed financial goal of the capitalistic corporation (e.g., Downs, 1957). It is, nevertheless, still a corporation, with all the corporate governance mechanisms available, such as capital structure, managerial labour markets, executive compensation, board of directors, an organisational strategy and structure, and audit (cf. Schleifer and Vishny, 1997). A municipal corporation can therefore be expected to be subject to a governance strategy, and local government, being the owner of that corporation, can be expected to exercise a governance strategy.

The aim of this paper is to explore the governance of corporations in local government, i.e., municipal corporations. The method of exploration will be to use the concept of governance strategy, which makes it possible to understand the use of corporate governance mechanisms as a means of implementing the will of the principal.

The use of a case study technique will enable us to seize on the many facets of governance. The contributions of this exploration will be to evaluate the concept of governance strategy in a new empirical area and, furthermore, to indicate particular governance strategies used by municipalities. While our aim is to create a fresh understanding, the converse situation could apply, i.e., providing practitioners, politicians, and managers with a tool for action or evaluation.

The paper continues now with a summary of the concept of governance strategy as it constitutes the major method of understanding the governance of corporations. We briefly describe the case of a Swedish municipality and its seven corporations; they constitute the empirical base of the paper. This is followed by the analysis of the corporations, a summary of the findings, and conclusions from the study, including suggestions for praxis.

Corporate Governance Strategy and its application to Municipal Corporations

The theme of corporate governance evolved from the observations of big business corporations in the United States at the end of the 1800s and the beginning of the 1900s. Ever since then, with the classic studies such as those of Berle and Means (1932), Galbraith (1967), Williamson (1975), Jensen and Meckling (1976) and Fama (1980), the problem in the scientific field of corporate governance has been the separation of ownership and control. Situated in Europe, the debate has not been sensed as urgent because the large corporations of Europe have tended to be controlled by large owners, such as families, corporations or national governments. The idea of the separation of ownership and control could, however, be used even in Europe, where more corporations experience absentee ownership and where the basic idea of a corporation is autonomy, including autonomy from its ‘owners’, i.e., the shareholders. The concept of governance strategy developed from an effort to change the perspective from one of absentee ownership to one of active ownership and to apply the principles of corporate governance (Collin, 2007).

The aim of the concept of governance strategy is to create an understanding of the actions of the dominant shareholders of a corporation. It is based on the assumed existence of a number of governance mechanisms: capital structure, including ownership structure, board of directors, market for managerial labour, executive compensation, strategy and structure of the corporation, auditors, product market, and the environment, especially the mass media (cf. Schleifer and Vishny, 1997). The concept assumes that given certain conditions, the owners will engage in designing single mechanisms and compose a mix of those mechanisms with the aim of making the corporation capable of satisfying the objectives of the owners. Thus, it is a rational model of acting entities, but compared to the traditional model of agency theory, the focus is not on the agent, but on the principal.

Insert Figure 1 about here

The model (illustrated in Figure 1) claims that the performance of corporation is produced through the governance mechanisms that are influenced by exogenous forces but also through the governance strategy of the owner. The owners will create a governance strategy based on their capacity as a principal and on their interest.

We now turn to a description of the various elements of the model in relation to the municipality, starting with the basic concept of property rights, continuing with the numerous corporate governance mechanisms, and ending with the principal's capacity and interest.

The model uses a property rights approach, implying that the rights to influence and to gain advantage for an organisation are distributed among parties in the organisation. It disintegrates the notion of ownership and considers the actual distributions of rights, influenced by institutional factors and historical reasons. This feature is especially important when considering municipal corporations. Municipal corporations are situated in an institutional milieu quite different from the one that created the debate on separation of ownership and control. They are often wholly owned by the municipality, but when private owners are invited as owners, the municipalities maintain a majority control of the voting rights. The objective of the corporation is seldom to create profit. Indeed, in Sweden as an example, municipalities are forbidden by the Municipal Act to engage in activities with the object of making profit. Thus, most corporations have the objective (articulated or unstated) to create service rather than profit.

With a less pronounced objective of profit, the corporate governance mechanism of capital, especially of equity, can be expected to be weak. Making a reasonable or satisfying profit is good enough. Indeed, to make a huge profit could create unnecessary attention from the mass media and thus add to the political risk the corporation is already exposed to, being located in the political sphere of society (Meyer, Karim and Gara, 2000; Zmijewski and Hagerman, 1981; Watts and Zimmerman, 1986). In the municipal context, profit can even be interpreted as a signal of political irresponsibility, as when excess fees are asked for in the delivery of service (e.g., Anthony, 1985; Cosling, 1992)

The debt side of capital can also be expected to attract little attention in governance if there are credible traditions that municipal corporations do not go bankrupt, but always get support from the municipality, which has almost endless resources due to its taxation capacity (Chan, 2003; Jones and Pendlebury, 2004).

If the principal of the corporation is more subject to promote the products or the service produced by the corporation, more direct governance can be expected. This would probably make the board of directors an important governance mechanism since it is the mechanism by which owners can directly impose their will on the corporation through their decisions within the corporation or through their influence on the CEO.

The managerial labour market consists of the supply of potential or actual managers. It can vary due to factors such as location of the corporation, but probably due more to the industry in which it is located. Historically, executive compensation in the municipal corporation has been low compared to private industry, but there is a lower risk of unemployment. In industries where the private and the public have intense relationships and exchanges, compensation can be expected to approach that of private industry and thus increase the size of the external managerial labour market.

Turning to the internal aspects of the corporation, the strategy and structure of the corporation can be important governance mechanisms. The strategy, restricted in definition to the orientation of resources in order to satisfy markets, may even be just as important as the board of directors as a governance mechanism, since it is through this strategy that a municipal corporation can provide satisfaction to its major principals. It should be stressed that in traditional strategy theory, the definition of strategy includes gaining profitable competitive advantage in order to satisfy the principal, which presumably has profit as an objective. In certain cases, competitive advantage is not needed for municipal corporations since many of them operate as monopolists. And, as stressed earlier, the not-for-profit orientation, strategy, and resource configuration are designed to produce not surpluses but services. This would also include an expectation of the organisational structure as a governance mechanism, since the structure also has to be designed according to demands of service, not of the profit calculus.

Finally, strategic opportunism is added to the model, which implies the organisation's capacity to redirect and reshape its strategy in order to utilise opportunities. Corporate governance is focused on discipline, but has to acknowledge that entrepreneurial action is needed for long-run efficiency. We are not using the more complex concept of corporate entrepreneurship (Zahra, 1996), mainly because the markets of municipal corporations are rather simple and do not call for complexity. Instead, we claim that the governance mechanisms create opportunities to implement strategy and reshape it, thereby creating the performance of the corporation.

To summarise, a municipal corporation is located in a political institutional context, where production of service, not profit, is stressed; accordingly, the principal in its governing strategy stresses governance mechanisms. This in turn enables the principal to influence the production of the service of the corporation. The municipal corporation and its principals are subject to institutional influence which limits their capacity to engage governance mechanisms, for example, executive compensation as a governance mechanism is restricted in use by the tradition of low executive compensation and low employment risk.

The model depicted in Figure 1 contains characteristics of the owner, i.e., the principal, that influence the governance strategy. In order to be able to create a governance strategy, an owner has to have both a capacity to create a strategy and an interest in it. The interest is a function of the direction – to what purpose the corporation is governed, such as profit or service – and the strength of interest – that is, if it is considered to be of importance by the owner. The capacity to create a governance strategy comprises the owner's information about the corporation and its conditions, the competence of the owner to process the information and make rational decisions, and finally governance costs – the effort needed by the owner to implement a governance strategy. It can be expected that municipal corporations are subject to owners with an interest in creating a governance strategy since the municipality does not own a corporation in order to create risk reduction through diversification, but has a specific interest in the service or product of the corporation. The capacity of the owner can vary, depending on whether the municipality creates a specific unit with the aim of governing the corporation, or at least monitor it, or if governance is left in the hands of the politicians, who seldom have both information and competence to govern a particular corporation, for their particular attributes are presumably in making political, not business decisions.

These, then, are the categories of the governance strategy that will be used to describe and explain the governance of the municipal corporations, to which we now turn.

The empirical method of the case study

To explore the governance strategy of a municipality, we chose a case study methodology, including one municipality as the object. Since the concept of governance strategy is not yet well developed, the possibilities of making distinctive operationalisations were weak. Thus, the concept calls for an empirical method to make it possible to explore different ways of observing the phenomenon in its context (e.g., Ryan, Scapens and Theobald, 1992). This is the main argument for case study methodology. One single municipality and its corporations were chosen as the object because we wanted to inspect not only a single governance strategy as it is executed in one corporation, but to see the patterns of governance emanating from one single owner.

The municipality of Kristianstad in Sweden proved to be a good choice since it represents a medium-sized municipality, with about 75.000 inhabitants 2007 and with one major city as the centre, containing about 29.000 residents. We selected a medium-sized municipality as the selection criteria implied avoiding the peculiarities of small and large municipalities, especially those that arrived with scale economies, such as level of formality, i.e., formal management control systems. The economic characteristics of the municipal area are that of the main industries – food industry and government services. The range of municipal activities is quite wide since the municipal level is the most extensive administrative governmental level in Sweden (Mattisson, Paulsson and Tagesson, 2003). Kristianstad municipality has about 6800 employees and a budget (2005) of slightly less than 400 million euros (3.7 billion Swedish krona).

Kristianstad municipality has seven corporations. Data from the corporations were collected through one personal interview with the CEO and one with the Chair of the Board, as well as from annual reports and complementary data through open resources such as newspaper and internal documents. We also interviewed the highest ranked administrative officer of the municipality and the chair of the council, which is the highest ranked politician. Altogether 16 interviews were conducted, 13 by both authors of this paper, 3 by only one author. The interviews lasted between one and two hours and followed an interview guide containing questions focusing on the various governance mechanisms. They were taped, and an interview document was produced for each interview.

The data were coded in order to simplify the analysis. A coding scheme was developed in which 27 categories from the model of governance strategy were described and examples of how to code different observations were given. The categories consisted of the exogenous influence on the different governance mechanisms (sum of 10 categories, omitting the internal managerial labour market, plus the category of strategic opportunism), the capacity of the principal (sum of 3 categories), the strength of the interest of the principal (one category) and then the use of the governance mechanisms (sum of 11 categories plus the category of strategic opportunism). The mechanisms were coded by strength influenced exogenously and by the municipality in five values from ‘very weak’, via ‘moderate’ to ‘very strong’. A five-value scale was also used to observe the strength of the capacity and the interest of the principal.

Both authors independently coded the interview data, using the coding scheme to interpret the data from their memory of the interviews, the interview documents and the set of documents that had been collected. For each of the 7 cases, 27 categories were coded, using a scale from 1 to 5; the maximum coding deviance was 4 for each category and case. The maximum of deviance was therefore 756 (7 cases × 27 categories × 4 maximum deviance). The deviance produced by the coders was 194, representing an inter-rater reliability of 74%. After discussing the coding scheme [available from the first author], some errors and bad descriptions were corrected, and after debating the interpretation of the data the two coders arrived at a consensus coding. The category of highest inter-rater reliability was capacity of the principal, both in terms of access to information and competence of the owner. The lowest inter-rater reliability was the use of structure in the governance strategy, which had its cause in a bad instruction in the original coding scheme. This deviance is therefore more an error than a difference in observation. Accordingly, we believe that the final coding of the seven corporations fairly well represents the case investigated.

The Corporations of Kristianstad municipality

Kristianstad municipality owns seven corporations, four wholly-owned and three in joint ownership with other partners. Formally, they are controlled by the municipal council (consisting of elected politicians) who each year inspects the accounts and select directors to sit on the board (see Figure 2). The practical side of this formality is performed by the executive committee (consisting of selected politicians) and implemented by the municipal executive manager, who is a professional employee.

Insert Figure 2 about here

The corporations of Kristianstad municipality are as follows:

- ***Housing Ltd***[*], which is the dominant housing corporation in the area, offering mostly apartments, but also business shopping areas. It had sales of 57,694,000 euros in 2005, total assets of 298,661,000 euros, and 141 employees. It earned a ROA of 4.2% and had a solidity (equity/total assets) of 14.2%.
- ***Chimney Ltd***, which inspects and sweeps chimneys and ventilation pipes. It has a monopoly in inspection activities. It had sales of 1,157,000 euros in 2005, total assets of 848,000 euros and 16 employees. It earned a ROA of 14.8% and had a solidity of 66%.
- ***Waste Ltd***, which collects and partially processes waste from households in the municipal area. It enjoys a monopoly in its business. It had sales of 12,288,000 euros in 2005, total assets of 14,689,000 euros and 77 employees. It earned a ROA of 2.7% and had a solidity of 7.4%.
- ***Energy Ltd***, which owns a power network, distributes electricity, and produces and distributes district heating. It enjoys a monopoly in power network and district heating. It had sales of 30,147,000 euros in 2005, total assets of 66,105,000 euros and 86 employees. It earned a ROA of 7.7% and had a solidity of 44%.
- ***Harbour Ltd***, which owns premises and operates the harbour of Åhus. The corporation is owned jointly with the customers that use the harbour, for example, the Absolut corporation. It had sales of 7,172,000 euros in 2005, total assets of 14,521,000 euros and 40 employees. It earned a ROA of 3.3% and had a solidity of 14.9%.
- ***Airport Ltd***, which owns and operates the premises of the local airport. It is owned 54% by the municipality and the remaining share by the County Council (Region of Skåne) and three other municipalities in the surrounding area. It had sales of 3,127,000 euros in 2005, total assets of 10,930,000 euros and 32 employees. It earned a ROA of 0.7% and had a solidity of 95.8%.
- ***Science Park Ltd***, which comprises housing corporations that emanate from the university located in Kristianstad. It is jointly owned with other state agencies aiming at business development. It had sales of 514,000 euros in 2005, total assets of 309,000 euros and 4 employees. It earned a ROA of 12.4% and had a solidity of 63.6%.

[*] The names of the corporations have been changed to English names that convey their activities. The Swedish currency krona has been transformed to the euro, using an average exchange rate of 9.28 krona = 1 euro.

The Governance Strategy of Kristianstad Municipality

The governance strategy of Kristianstad municipality is represented by the codified data in Table 1.

Insert Table 1 about here

The capacity of the principal has been interpreted as being rather low in all corporations. The main reason for this is that the principal very often is represented by politicians, of whom almost none have experience in owning or governing or managing a corporation. Informational capacity has been interpreted as being slightly higher than competence, depending on national and regional cooperation among municipalities and among politicians. Thus, the principal has access to networks where governance information can be gained.

The governance costs, which are inverted since it is assumed that low costs of governance increase the capacity of the principal, are moderate but with a high variance. The variance is caused by Airport Ltd and Harbour Ltd having rather high governance costs since they are jointly owned with other public and private owners (PPP); thus, the municipality has to deal with other owners as well. Additionally, the airport industry is heavily regulated, making it very difficult to influence the corporation.

The strength of interest is interpreted as less than moderate, but with some significant exceptions. One significant exception is Housing Ltd, which is probably of significant interest since it represents a very well-performing corporation, having a dominant position in the market of housing which involves many voters and constitutes these voters' main monthly expense and basic living conditions. Most of the other corporations do not influence the voters as significantly as Housing Ltd. They deal with operations that have political interest as strategy, for example waste collection, but not in implementation, for example using big or small cars or frequency of collection. Another example is Airport Ltd, as it is considered to be very important for the area to have access to an airport, but the management of the airport is of no political concern. Thus, most of the corporations deal with businesses where politicians are not engaged in the operations. Disintegrating the operations from the municipal operations, but retaining the strategic control of the operations, could be one reason for the existence of the corporations.

Strategy appears to be the strongest governance mechanism, followed by the use of managerial labour market mechanisms. Very weak mechanisms are the product market, the capital structure, and executive compensation. The highest variety is to be found in the mechanisms of the board and the internal managerial labour market.

Strategy, as the most strongly emphasised governance mechanism, supports the idea that the municipality disintegrate the operations since it is rather non-political in nature, as long as it produces the service needed, and within the financial frames given. This reflects the goal of the municipality to create service, not financial return. Consequently, the financial control appears to be very weak. As will be apparent in the small story we tell later, financial control is not a means for achieving a goal, but is only a rather rough and imprecise signal of performance.

The managerial labour market, and especially the external market, is moderately used, which is also true for the internal market, but with higher variance. This indicates that the corporations do not use internal labour markets to an expected extent, stressing control through socialisation and the use of firm-specific knowledge. The use of external market can, however, be speculatively explained by the notion that there exists a rather limited external managerial labour market, in some cases restricted to the industry. Thus, while they do not have firm-specific knowledge, they have industry-specific knowledge. Since some of them operate in industries where the production and the products are very similar, like waste collection and energy, there is no important firm-specific knowledge to carry. Thus, the only advantage of internal over external recruitment is that you may gain slightly more information about the individual in the former. In a very restricted labour market, where the corporations in the industry demonstrate rather intense cooperation, the information advantage of an external candidate is less than in huge managerial labour markets.

It being a restricted managerial labour market is also indicated by the low emphasis on executive compensation. Top managers are typically compensated according to the compensation package of top managers within the democratic municipal organisation. This could be interpreted as a strategy of compensation stressing the equality of managers within municipal organisations, reducing their envy and their competitive attitude, and stressing their identity with the municipality. Only in one case could indications of higher variety of compensation be observed. This variety could be explained by the indication that the corporation was exposed to an external managerial labour market of bigger size due to more private firms employing people; thus, the corporation experienced more competition and had to offer slightly better conditions in order to be able to recruit a CEO.

The product market had a low impact, which can be interpreted as a rational reflection of the monopoly power of the corporations. Some of the corporations enjoyed contractual monopoly and some of them, for example Housing Ltd, almost had a practical monopoly.

The board was not a strong mechanism in most of the corporations. The composition of the board was rather one-sided; a total dominance of politicians in wholly-owned corporations, and either a dominance of politicians or equal distribution between politicians and industry experts in partly-owned corporations. The composition of the politicians as directors reflected the political balance of the municipal council. Thus, one could interpret one of the major functions of the board as being that of principal identification, where an ambiguous principal presents its will and ambitions for the agent (Collin, 2007). Indeed, one could develop this idea into a fifth function of the board, namely, that of conflict resolution (Collin and Smith, 2006), adding to the list of functions service, decision making, monitoring (Johnson, Daily and Ellstrand, 1996), and principal identification.

The board had low importance as a governance mechanism, but mirrored the balance in the municipal council. This indicates that the board is an arena for the politicians in which they create and solve conflicts among themselves. In this function, the board stresses not the conflict between the principal and the agent, but the conflict within the principals. This appears to be the normal procedure for municipal boards. The board can, however, convert itself into a very active governance instrument, almost becoming part of management, as the little story now to be told indicates.

The story is about Waste Ltd, its less successful expansion and the very strong turn-around of the corporation. Waste Ltd was performing a traditional business in waste collection, governed by the old traditions of waste collection with a strong production orientation. An expansionist CEO arrived, and in combination with new ideas from the municipal council about waste collection, the corporation expanded into new product areas. The expansion was very costly and failed to pay return within a few years. The losses were very large and required new equity from the municipality. The recurrent losses and the magnitude of the losses finally provided the municipality with the signal that the development of Waste Ltd was not good. The directors of the board were not re-elected, and the size of the board was downsized to only three directors, selected from the top level of the political elite of the municipality, with one of the three local government commissioners as chairman of the board. The CEO was fired and a new CEO was recruited. A new downsizing strategy was formulated and implemented, and training of the employees was initiated.

This anecdote indicates the governance potential of the board. The board initially mirrored the balance of the municipality council, and the board implemented the product expansion strategy. It could be debated whether or not this action was even illegal. According to Swedish company law, the board has the responsibility to look after the business of the corporation, not to support the business of the owner. In this case, it could be argued that the expansive strategy was in the interest of the owner, but not the corporation. Additionally, the corporation's waste collection operation has to be performed under the legal restriction of prime cost principle, i.e., it is against the law of local government to make profit on waste collection from the citizens. The huge losses from the other operations could run the risk of being financed by the waste collection operations, thus being illegal. The auditors did not, however, report on these two risks of mismanagement and of illegal action in any public statement. As can be seen from Table 1, we also interpret the auditors to be a rather weak governance mechanism.

The board did look after the balance of political power, but neglected the corporation's economic health, thus performing the function of conflict resolution within the group of principals. The financial performance of the corporation had to be very bad in a consecutive run of years before the signal was created that drove the municipality to action. Then the 'balancing' board was replaced by a board with strong legitimate political power, thereby supporting the new CEO in the downsizing strategy. The story indicates that strategy is an important governance mechanism; that the board is a governance mechanism with very strong but latent power, and that capital structure, with financial performance as a signalling device, is a weak governance mechanism.

The overall strength of the sum of the governance mechanisms varies among the corporations, the strongest governance (average 2.8) being Waste Ltd, for reasons just explicated, while the weakest governance (average 1.8) was Science Park Ltd. The variance of governance has been explained by the influence of exogenous forces by the 'beast' hypothesis, expressed as: "…tougher environments create tougher beasts" (Collin 2007:232), signifying that the strength of governance increases with the influence from exogenous forces. This hypothesis cannot be rejected in the data at hand since there appears to be a linear relationship between the strength of exogenous influence and the strength of governance. Using 63 observations of exogenous influence and governance strength, we found a Spearman correlation of 0.57 with very strong significance.

The variance within a corporation between the use of the different governance mechanisms have by the same author (Collin, 2007) been suggested to be dependent on what is termed the ‘orchestra’ hypothesis, claiming that a principal with a limited set of available mechanisms will use these mechanisms even more intensively, i.e., with only a few instruments at hand, you play them more loudly. That hypothesis would be supported if a lower strength of governance would be correlated with high variance, indicating that with weaker governance some mechanisms are more strongly used. This hypothesis appears to be rejected by the data, as shown in Figure 3. Science Park Ltd has a low variance and a low governance strength, and Waste Ltd has a high strength and high variance. It appears to be a slightly positive relationship between strength and variance.

One explanation for this rejection is that the municipality will probably not use executive compensation or capital control with more emphasis, thus increasing the variance when increasing the strength. This action could at first sight indicate a very advanced governance strategy, being capable of distinguishing between governance mechanisms when there is a need to increase governance of the corporation, selecting the most appropriate mechanism. For example, the low emphasis on executive compensation could be a rational choice of a governance strategy emphasising the similarity of CEOs and municipal managers. On the other hand, the increasing variance could also be a sign of conservative traditions restraining the principal from use of some mechanisms because they have never been in use or a normative pressure stating that they should not be used. An interpretation along the restrained path is that the principal is restrained, not by tradition but by knowledge, i.e., that the principal uses the mechanisms it is acquainted with and avoids those where the principal has less knowledge.

With these interpretations, the orchestra hypothesis of governance strategy can be reformulated into a ‘chamber concert’ hypothesis claiming that the principal will use the instruments of the orchestra that tradition, norms, knowledge, and governance capacity simultaneously make available.

Insert Figure 3 about here

The chamber concert hypothesis is further supported by the correlation found between the capacity of the principal and the strength of governance. Both the rating of the principal’s access to information and the competence to use the information, building the principal’s capacity, were found to be less weak when governance strength increased. Since the variance of competence and information was so low and the number of observations so limited, the relationship, according to the Kruskas-Wallis test was of weak significance (0.09) for information and only indicative (0.14) for competence. There is a causal link that is unclear – that is, whether it is the governance strength that builds the competence and creates the information flow (as for example in the case of Waste Ltd, where the principal had to accumulate more information and competence), or whether it is the competence and information that create the necessary conditions for governance. No matter the problem of causality, the link between capacity and strength gives us the justification to maintain the chamber concert hypothesis; that the orchestra is playing with the instruments that the tradition and norms indicate, that the members of the chamber orchestra know how to play the instruments, and that the instruments are suited to the piece of music the chamber orchestra plays. Thus, both institutional and rational choice have to be considered when explaining governance strategy.

Finally, we have found that the governance of the municipal corporation is partly exercised to satisfy the principal's need for freedom of action. Two indications in our case support this conclusion. The financial control is very weak and mainly performed in order to create signals of financial distress. The management of the capital structure is not used to improve the performance of the corporation. Since the corporation is almost risk-free, it is not in need of equity. Since equity represents capital raised by taxation of the citizen, the citizen would bear less taxation burden if the municipality had stronger capital management. It can be assumed that to have a corporation without any equity, a year of deficit would demand owner contribution, which would bring mass media attention to the corporation and to the governance of the corporation. With equity, no owner contribution is needed and thereby attention to the governance is avoided.

Another indication of freedom of action on the part of the owner is the case of a holding company that could control all the shareholdings of the municipality, creating a more powerful and professional governance, but at the expense of the politicians on the board. This would reduce the number of possible positions and the possibility of exerting operational influence on the corporation. The holding company idea has been put forward, but only as a means of state tax evasion since a loss sustained in one corporation could be deductible from a profit made in another corporation, but not as a means of improving governance. Thus, the present governance strategy is implemented for the principals to have freedom of action.

Conclusions regarding corporate governance of municipal corporations

Our analysis of the governance strategy performed by Kristianstad municipality supports some earlier notions of governance strategies and provides material for developing the concept of governance strategy that includes principals from an institutional context where service is more important than profit.

The most important observations can be summarised as follows:

- A municipal corporation can be seen as a method of disintegration governance while not outsourcing service, thereby retaining not only control of the product itself but also control of the production of the service.
- Strategy secures the delivery of the demanded service, thus representing the most important governance mechanism that can assure the efficiency, i.e., goal achievement, of the corporation.
- Financial control is stripped of governance functions and reduced to a signal of diseconomy.
- The use of governance mechanisms cannot solely be interpreted as a means of disciplining the agent; it is also a means of creating freedom of action for the principal.
- The board has a latent capacity, but performs mainly a conflict resolution function.
- The 'beast hypothesis' is supported: The tougher the environment, the stronger the governance strategy.
- The 'chamber concert hypothesis' is developed: The use of mechanisms is influenced by traditions, norms, knowledge, and governance needs.

Our conclusion is that the collection and mix of governance mechanisms in use can fairly well be understood by the concept of governance strategy, though to this must be added the notion of rational and irrational restriction on the use of the mechanisms, as expressed in the chamber concert hypothesis.

A more important question than that of conceptual contribution is whether the governance strategy of the municipality is efficient from the ultimate principal's point of view. That is, whether politicians in a democracy can be regarded as only the agents of the citizens, thereby being subject to governance themselves. This is the problem of the principals of the principals, which is an overriding contemporary problem, not only in government but also in the economy, where the main shareholders are not individuals, but funds collecting investment capital from individuals. We did consider *en passant* the principal of the principal, i.e., the citizen and the mass media, when explaining that the interest in Housing Ltd was that of finding support from the citizens, and when explaining the weak use of capital control as a means of avoiding mass media attracting attention to the management of the corporation. We also found indications that politicians use governance mechanisms in order to retain freedom of action on their behalf, and at the expense of the citizen. This is an agency problem of government that the concept of governance strategy probably cannot deal with. But as we found in our analysis, it can reveal some of these problems.

The practice implications of the concept of governance strategy and the analyses are both of interest for the management of municipal corporations and for local government. The study found several mechanisms to be of use, but also identified some restrictions on their use. An owner of a municipal corporation could make an inspection and learn whether there were traditional restrictions on the use of governance mechanisms that prevented them from using the governance mechanisms. They would be able to inspect the board and its composition and find out whether they had to stress the conflict resolution function through the board, or whether they could find other areas for conflict resolution, opening the possibility for the board to perform other important functions, such as providing support to the corporation. They would also be able to consider whether it was possible to make more use of capital control, especially making it possible to create signals of financial discomfort faster and earlier.

Managers of municipal corporations could make use of the concept of governance strategy when trying to understand the interest and the actions of the owners. For example, in this case, the simple compensation scheme would probably not be a fruitful object of action since it appears to be both a traditional and strongly maintained governance mechanism. If in need of more reward, a manager could be more successful in widening the freedom of action through engaging in strategic opportunism, as long as it was made within the overall frame of the strategy, as shown in the development of Waste Ltd, at least in the beginning. In such ways, the concept of governance strategy could be used in agency conflict by both the principal and the agent.

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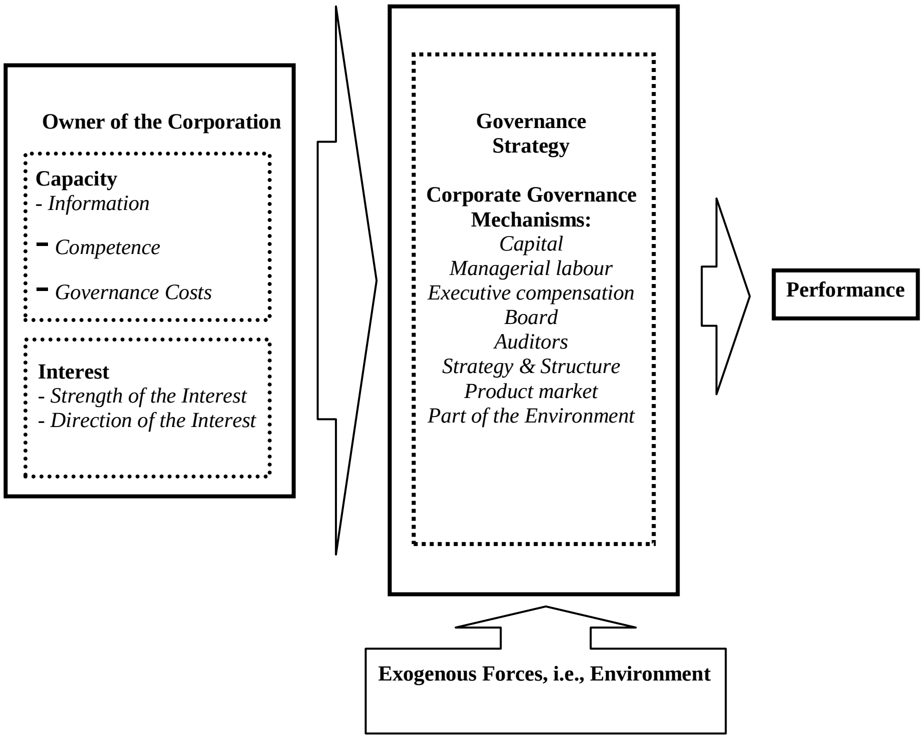
Figure 1. The Model of Governance Strategy



Source: Collin (2006:150)

Figure 2. The Organizational Structure of Kristianstad Corporate Ownership

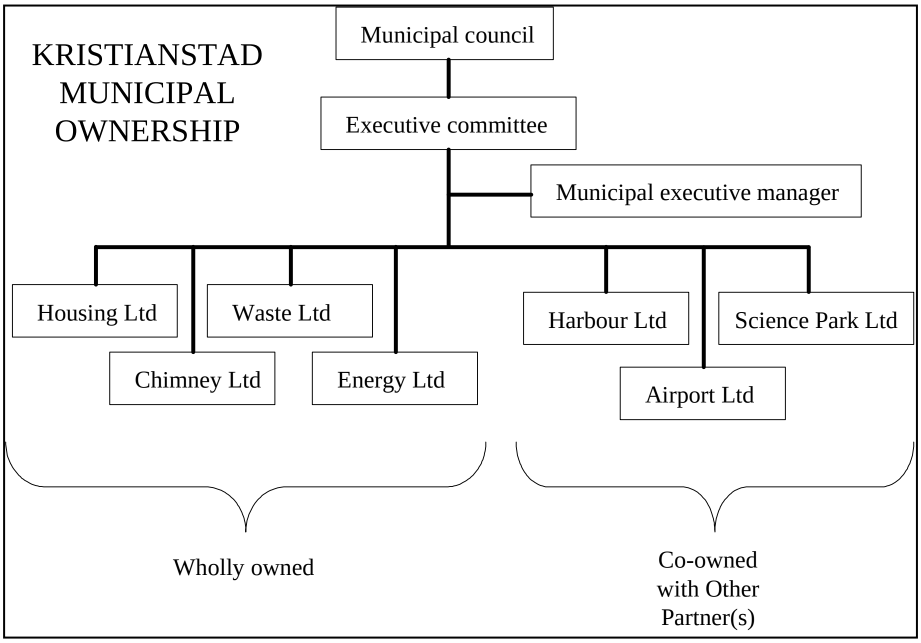


Table 1. Representation of the governance strategy of Kristianstad municipality

	Strategic action Mean	Strategic action St.dev.
Capacity of the principal		
Information	2.00	0.82
Competence	1.43	0.53
Governance costs (inverted)	3.29	1.60
Overall assessment of capacity	6.71	*2.14*
Interest of the principal		
Strength of the interest	2.14	1.21
Governance mechanisms		
Market for capital		
Equity	1.29	0.49
Debt	1.14	0.38
Market for managerial labour		
External	3.14	0.90
Internal	3.14	1.35
Executive compensation	1.14	0.38
Board of directors	2.00	1.15
Auditors	2.00	0.82
Strategy	3.86	1.07
Structure	2.57	0.98
Product market	1.71	0.49
Overall Strategic opportunism	2.43	0.53

Figure 3. Governance strength and variance in seven corporations