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Ownership strategy: A holistic and praxis oriented view on corporate governance*

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ABSTRACT

Swedish municipalities are sometimes using wholly owned corporations in order to conduct certain municipal operations. They have, however, been criticised for being passive owners. This paper presents a development of the concept of ownership strategy, with the aim of reconciling the fragmented field of corporate governance. The concept is empirically developed in order to explore the ownership strategies of municipal owners. From data collected through a survey from Swedish municipalities, it is showed that the municipalities to a certain extent act in accordance to rational ownership strategies.

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1. An orthodox notion of ownership strategy constituting a reconciliation of separated corporate governance research

Ever since Adam Smith, it has been argued that the joint stock company's efficiency will suffer because of absent and disinterested owners. Beginning in the start of 1900, a whole scientific industry has grown based on this notion, and today it has established itself as the field of Corporate Governance. This field has some strong common features, but has, as all industries, been differentiated into smaller areas, thus creating the productivity effects of division of labour, but at the same time obscured the basic notion of ownership. The aim of the paper is to unite the fragmented field into a typology of corporate governance mechanism, and to bring back ownership to the centre of the field.

The need of this reconciliation becomes evident when some characteristics of the corporate governance filed is displayed:

1.) It was initiated in UK (Smith, 1776), emigrated to US (e.g. Seager, 1904; Clark, 1907; Veblen, 1923; Berle & Means, 1932), where it developed into a science industry (e.g., Schleifer & Vishny, 1997), and then it was exported to Continental Europe (e.g., Baums, Buxbaum, and Hopt, 1994).) and Asia (e.g., Aoki and Dore, 1993). Thus, it carries the marks of Anglo-American scientific and business tradition, mainly neo-classic economics and absent ownership, as compared to the continental European marxism and dominant capitalistic or state owners.
2.) It is dominated by two approaches, the management approach, which emphasise strategic choice (e.g., Hill, and Hoskisson, 1987; Hill and Snell, 1988; Hoskisson and Turk, 1990; Hoskisson, 1987; Hoskisson, Johnson and Moesel, 1994.and the equilibrium determinism approach, which emphasise the market capacity to create equilibrium (e.g. Demsetz & Lehn; 1985; Williamson, 1975; Jensen & Meckling, 1976). The two schools do, however, acknowledge the basic notions of rational choice. Approaches opposing rational choice, such as certain parts of Marxism (Lash and Urry, 1987) the stakeholder view (Donaldson, and Preston, 1995) and the stewardship approach (Davis, Schoorman and Donaldson, 1997), have been of lesser importance.
3.) The theoretical development has been focused on the importance of single governance mechanisms on corporate efficiency, such as ownership structure, board of directors, organisational structure. Only a few studies, within the context of the equilibrium determinism approach, have developed a multi-mechanism approach (Demsetz and Lehn, 1985).

4.) Strangely enough, sometimes even the very basis of corporate governance, the ownership as an influential factor, has been disregarded in studies.

5.) Empirically the focus has been on listed corporations. Governance of small corporations or state corporations has been of lesser interest, not to mention the rather insignificant interest in other associational forms, such as partnerships and federations. A growing literature has emerged, however, that investigate the establishment of corporations in transitional economies, and corporations in transitional phase from state ownership to private or public ownership.

The aim of the paper is to take one small step towards A.) reconciliation of what the differentiation has separated through establishing an integrated view on corporate governance, thus observing all the governance mechanisms available; B.) bringing back orthodoxy, i.e., recover the notion of ownership through developing a concept of ownership strategy, thus emphasising the capacity of ownership and owners. This will be accomplished through presenting an integrated view on corporate governance in section 1 of the paper, developing the notion of ownership strategy in section 2, converting the notion of ownership strategy into testable hypotheses concerning municipal corporations in section 3, testing these hypotheses on data from wholly owned Swedish municipal corporations in section 4, and finally, in section 5, summarising the findings and presenting the major conclusions of this mission into reconciliation and orthodoxy.

2. AN INTEGRATED VIEW OF CORPORATE GOVERNANCE

The influential Cadbury report (1992), defined corporate governance as: *"The system by which companies are directed and controlled…"* Although the definition does not mention particular interest groups, it would be denying the obvious if not two groups of economic actors were recognised as the prime principals of corporate governance. Managers are defined as the group of actors that have the right to influence the production function of the company, i.e., the mix of the production factors. Owners are defined as the group of actors that have the right to terminate the company and to change the top management composition. These two categories of economic actors exist in every economic system, and in every different company association form. These main actors of a company are embedded in an institutional milieu, consisting of 1.) behavioural rules such as habits, regulations and laws, 2.) markets, and 3.) organisations. The two groups of actors have interest that is a function of a.) their individual preferences such as need of prestige and wealth, and b.) their position in the economic system, which tie them to different networks. With the difference in preferences and position, the actors cannot be assumed to have goal congruence. A company is, however, an organisation that is ultimately in the hands of those that have the right to terminate the company, i.e., the owners. Thus, the owners have both the right and the incentives to reduce the goal congruence between them and the managers, in order to make the managers execute the will of the owners. Corporate governance as a research subject is focused on how this conflict is mediated through different corporate governance mechanisms and what results it produce, ultimately the efficiency of the company.

The easiest solution is to internalise the conflict into one single person, making the owner the manager. This solution is, however, only possible in situations of very small companies. With growing size and with the possibility to enhance productivity gains through division of labour, with specialised information flow and competence, thus creating information and competence asymmetry, a separation emerges between an owner and a manager. In order to exploit the fruits of the division of labour, the owner does not only have to control the manager, as the traditional focus of corporate governance has been, but to facilitate managerial action. Facilitating is not the opposite of control, but a dimension of its own, where owners contribute to the capacity of the managers to shape the production function of the company in a productive fashion. One common facilitating mechanism in companies is risk capital, which can give the manager a capacity to engage in riskier investments.

Corporate governance is thus defined as the system where the will of the owners are implemented in a company through controlling and facilitating managerial action. This system consists of a set of different mechanisms. Presently we do not have one specific theory with the capacity to deal with all available mechanisms in a systematic fashion. Thus, the field is left with the second best alternative, a typology of governance mechanisms. I offer a typology of governance mechanisms (cf. Collin, 2000) that organise the mechanisms of governance according to its occurrence in the company's transformation process, and to its main behavioural focus (Table 1.)

TABLE 1. A TYPOLOGY OF CORPORATE GOVERNANCE MECHANISMS

	THE COMPANY AND ITS ENVIRONMENT			
BEHAVIOURAL FOCUS OF MECHANISM	***Company input factors***	***Company trans-formation process***	***Company output***	***Company environment***
Premise	• Market for managerial labour	• Internal managerial labour supply • Organisation structure		• Culture • Mass media
Action	• Debt capital	• Board of directors		• State legislation • Regulations
Output	• Owner capital	• Auditing	• Product market	

The mechanisms are directed towards influencing the managers behaviour through influencing the premises of the managerial action, directly influencing the action, or influencing the action indirectly through reactions on the output of the company (cf Perrow, 1972). This dimension of the typology is important for owners since it indicates the knowledge needed by the owner in order to influence the company through the managers. Inspired by Ouchi (1980) we can assert that output control is possible to utilise in order to influence managers when output is measurable in a meaningful way, such as the risk-adjusted profit, number of products sold and so on; action control is adequate when there is knowledge about the transformation process, and premise control is relevant when it is hard to measure the output and there is a high degree of information symmetry and competence asymmetry.

The mechanisms of governance are located at the factor markets of the company, in the company, at the output markets of the company, and within the institutional environment of the company. This dimension is important for owners since it indicates the accessibility of the mechanism, those inside the company being easier to influence than factor markets and environmental factors.

The supply of capital creates opportunities for investments. Credit capital offer the opportunities through its being the basic mean for investments, but puts a strain on actions due to its continuos demand on cash flow, and when risking bankruptcy, its right to discontinue the company (Berglöf, 1990). Residual capital, often termed ownership capital, supply the investment with risk capital, but at the price of profit and the right to discontinue the company no matter risk of bankruptcy. The supply of managers creates opportunities to get managers outside the company with specific skills. These factor markets of capital and managerial labour are supported by different intermediaries that can function as efficiency enhancing organisations, such as investment funds at the stock market, and headhunters operating at the managerial labour market.

In the transformation process of the company, the board of directors, supported by a market for directors, aligns the strategy of the corporation with the organisational structure, with the ultimate capacity to give direct orders to the top management, i.e., to directly affect the action. The composition of managers through recruitment is performed through the use of the external managerial market, but first and foremost by the internal supply of managers. The auditors make the scrutinising of the actions performed by the managers, in the interest of the owners and the state.

The output of the company is subject to the competition level of the product or service markets. With increasing levels of competition, the restraints on management increase, ending at the perfect competition where not even price is possible to influence.

The governance mechanisms of a single company are embedded in the company environment, constituted by culture, that bounded rationality through traditions and norms, mass media, that offer information and analyses of the company to the public, and state legislation and regulations by associations, that influence actions through rules and sanctions.

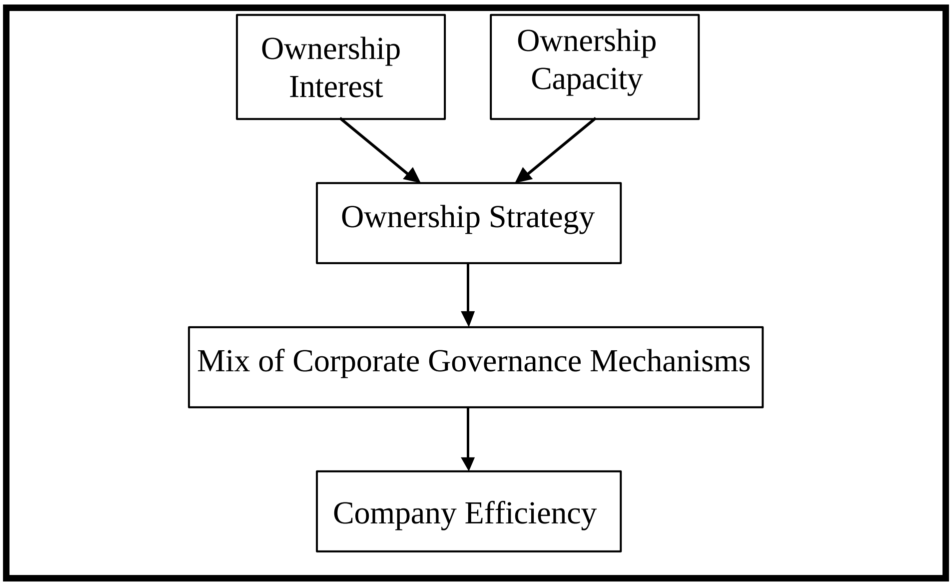
The mechanisms of governance just listed are available in every company. They differ, however, in substance because of differences in the company’s legal constitution, e.g., partnerships and joint stock companies have different forms of ownership capital. They differ, both in substance and collection of mechanisms, because of the company’s specific situation, e.g., being located in a capitalistic economy or in a transitional economy. But most important, they differ in substance and collection of mechanisms because they are being utilised by the owners of the company. That is the concept of ownership strategy, and it constitutes this papers orthodox effort to bring back ownership to the focus of corporate governance.

3. OWNERSHIP STRATEGY AS A CONCEPT

Even before Berle & Means (1932) it was fashionable to state that the owners had retired and left the company in the hands of the top managers. Few attempts have been made to conquer that statement. Agency theory (Jensen & Meckling, 1976) has dealt with it as costs of absenteeism, i.e., agency costs. Within the context of Property Right, Demsetz & Lehn (1985) have argued that the ownership structure is but a consequence of rational actors. The owners increase the concentration of the ownership structure when stronger capacity is needed, and decrease the concentration when it is not needed, for example when the company is exposed to strong state legislation. Thus, ownership structure, i.e., the organisation of residual capital, is a factor that owners influence in order to govern the corporation.

In this section I will continue the tradition of regarding owners as rational actors and argue, as visualised in figure 1, that the interest and capacity of the owners constitute the ownership strategy, defined as the actual composition of the available governance mechanisms. The collection of governance mechanism influences the efficiency of the company. Thus, a relationship between the owner and the efficiency of the company termed ownership strategy.

FIGURE 1. OWNERSHIP STRATEGY



All the listed governance mechanisms are within the reach of owners, their utilisation being a function of the interest of the owners and their capacity. The interest of the owner determines ultimately the legitimate efficiency of the company. A company owned by the state, with the owners interest being that of producing good health care is inexpressible inefficient if it produces high profit and low quality health care. A company owned by funds with short-term profitability as major interest, would be utterly inefficient if it made investment with long-term profitability. Thus, legitimate efficiency is a function of the owner's interest.

The interest of the owner influence the way the owner utilise the governance mechanisms that are available. The utilisation is, however, affected by the owner's capacity to utilise the mechanisms. Information, competence and costs are factors that constitute the owners capacity. For example, to compose the board of directors with the owner depends on the owners access to information networks, to the owners competence of evaluating company plans, and what investments in competence the owner are willing to do in order to gain the necessary competence. Lacking incentives to make the necessary investments, lacking competence or information access, the rational owner would chose to use the market for directors in order to find someone to represent the owner. Thus, ownership capacity is the freedom of action the owner has in utilising the corporate governance mechanisms.

The interest of the owner and the capacity of the owner to use the collection of available governance mechanisms constitute what is here termed ownership strategy. Thus, the definition of ownership strategy is the actual composition of the mix of corporate governance mechanisms the owner have made in order to make it possible for the company, ultimately the top managers, to fulfil the aims of the company. The composition, as noted above, have to ensure that it both controls the managers and facilitates their actions. Consequently, the ownership strategy, through its composition of governance mechanisms, influences the efficiency of the company.

There is, however, no possibility to theoretically deduce an ownership strategy without specifying the interest and the capacity of the owner. Ownership strategy is therefore empirically bound to specific companies. A partnership company will pay more attention to the use of the external managerial labour market, since they will recruit a potential partner owner, than they will observe the rationing of residual capital. A listed steel-producing corporation, on the other hand, will pay more attention to the usage of residual capital and the profit they can produce for the stock market.

Next section will be an example of deducing ownership strategy in one empirical context, that of corporations, wholly owned by municipalities in Sweden.

4. Hypotheses of ownership strategies in Swedish municipal corporations

Sweden's 350 municipalities own 1010 wholly owned corporations. These corporations constitute a significant part of the capital controlled by the municipality (not less than 45% of capital and 25% of turnover). By law the corporations are not allowed to exercise state authority, such as tax collection and social security. They are in many cases restricted to price their product according to full costs, and to only sell them within the bounds of the municipal territory. They have to adhere to the government principle of open information, implying that every Swedish citizen has the right to take part of every document of the corporation, including every incoming letter or e-mail.

Facing these huge restrictions, Swedish municipalities have nevertheless found reasons to utilise the corporate form in municipal operations. It has been found that the corporate form fulfils three different municipal interests (Collin & Hansson, 1991):

- Rationalisation, when the capitalistic corporate form is considered to help management to focus on costs, but the organisation is still considered as a municipal operation.
- Competitiveness, when the corporate form makes it possible to avoid certain features of municipal organisations that are considered to hamper an organisations capacity to become competitive on a capitalistic market
- Privatisation, when the corporate form prepare the company for private, capitalistic owners, makes it easier to value the company, and makes it easier to transfer the company

These interests influence how the municipality as an owner is using the available governance mechanisms – as will be obvious when we deduce the usage of the different mechanisms.

The capacity of the owner can be assumed to be very strong since 1.) the costs of influencing the corporation are low, mainly because the municipality does not have to form a coalition with other owners, and 2.) the owner has considerable knowledge about the operations of the company, because the operations are closely related to other operations of the municipality. The capacity being strong reduces the complexity of deduction, mainly because we do not have to consider the costs of organising the ownership. Had it been listed corporations, with a very diversified ownership structure, the costs of organising the ownership would be considerable, as expressed in the notion of collective action (Olson, 1965). The costs of organising would have created different hypotheses, but it would not change the logic of deducing hypotheses from the interest of the owners into a collection of predictions stating the specific ownership strategy. Thus, the use of municipal wholly owned corporations as the empirical example of ownership strategy is a methodological trick in order to reduce complexity, thereby making the point of the argument clearer.

Municipalities have wholly owned corporations because of three different reasons, and these reasons form the ground for three different ownership strategies. We will now deduce hypotheses concerning every single governance mechanisms, to find out how the three strategies differ in their composition of governance mechanisms.

Owner capital

Profit, risk, the size of equity and transferability are important factors when considering owner capital. The owners supply part of the credit capital, termed equity capital. It is the main risk capital of the company, and it is compensated through gaining the profit of the company. The size of equity limits the top manager's possibility to engage in uncertain or risky projects. The transferability of the shares makes it possible to very smoothly transfer control of the corporation, i.e., to let the corporation be subject to the action of the market for corporate control (Jensen, 1989).

A municipality has not interest in profit since it is a democratic institution, producing for the citizen and not for profit. Their operations could therefor be expected to disregard profit. In the strategy of rationalisation, where the corporate form is chosen only because of its capacity to reduce costs, the operations are still more important, making profit of lesser concern. In the strategy of competition, there is a need of being considered as legitimate competitor, which includes avoiding the appearance of being paid by the taxpayer. Thus, they need a certain level of profit in order to appear legitimate market actors. The strategy of privatisation has the need of being regarded as an ordinary company, thus putting strong emphasis on profit. Since privatisation imply selling the corporation, profit becomes a necessary requisite in order to get a value on the company.

Thus, we hypothesise: *The strategy of rationalisation does not put an emphasis on profit. The strategy of competition put a moderate emphasis on profit. The strategy of privatisation put a strong emphasis on profit.*

Risk can be considered as variance according to finance theory, or probability for losses, according to behavioural finance. The strategy of privatisation could be expected to include the notion of risk as variance since the aim is to offer the corporations share on the market for corporate control, were presumably the finance theory notion is influencing the pricing of the shares. The strategy of competition does not have to consider the valuation effects of risk, but the impression of being a legitimate competitor, including the capacity to make profit, thus we can expect a focus on risk as probability of losses. The strategy of rationalisation is focused on costs, disregarding profit, and thereby disregarding the two notions of risk presented here.

Thus, we hypothesise: *The strategy of rationalisation does not put an emphasis on risk. The strategy of competition put an emphasis on probability of losses. The strategy of privatisation put an emphasis on variance of profit.*

The size of equity constitutes the basic risk capital, and thereby put a limit on manager's capacity to engage in risky operations. It is a strong instrument for both control and facilitation of managerial action. It is a general resource that gives managers large freedoms of action, and it does not demand any operational knowledge from the supplier. It is indeed, a credible signal to the managers, informing them about the size of adventurous action the owners can tolerate. It further constitutes a de facto assurance to other credit holders, such as debt capital, influencing their efforts of monitoring and the price of their credits, i.e., the interest. The size of equity will be of importance when an owner does not have intimate knowledge about the operations and when the owner needs to give large freedoms of action to the managers. In the case of municipal corporations, this will be the case for corporations facing the strategy of competition, and with the additional reasons of easiness of valuation, it will also be the case for the privatisation strategy. Equity is but a method of covering excess costs for corporations facing rationalisation strategy, thus making the size of no importance.

Thus, we hypothesise: *The strategy of rationalisation does not put an emphasis on the size of equity. The strategy of competition and privatisation put a strong emphasis on the size of equity.*

Transferability of shares is the ultimately control instrument of the owner, since a threat of transfer makes the position of the top management highly uncertain. In the case of wholly owned municipal corporations, this threat can only be credible for corporations subdued to the strategy of privatisation. And even in this case, the threat is dependent on the availability of a potential buyer.

Thus, we hypothesise: *The strategy of rationalisation and competition does not put an emphasis on take-overs. The strategy of privatisation put but a moderate emphasis on take-overs.*

Debt capital

Debt capital put a pressure on the corporation through its relentless demand on the cash flow, making it a preferred control mechanism by agency theorists. The financial pressure imply costs for the company, financial stress costs and premiums paid on interests, both costs which constituting the price paid for the control effect imposed through debt exposure. These costs can be reduced, however, through the use of collateral or surety, but at the expense of the controlling capacity. Collateral can be used when the company has assets with a market price, for example in the case of house apartments, but not in the case of water pipes. It retains some controlling capacity because triggering the collateral implies dissolving the corporation. Surety can be used in every situation, but reduces sharply any financial discipline on the management.

Owners with privatisation strategies would prefer to avoid surety since it makes the corporation harder to value for potential buyers, and it reduces sharply the financial pressure on the managers, thus reducing the impact of owner capital on the managers. This imply that the owner have to adjust the level of collateral, creating a balance where the price of risk is not too high, but where the debt capital pressure still is perceptible. This will be the case too for corporations with competition strategy, since they probably have assets with market value. Another reason for owners with competition strategy to avoid surety is the need of imitating the competitors, not only because of a need of creating financial pressure, but also for the sake of gaining societal legitimacy. The strategy of rationalisation is focused on costs, thus having incentives to reduce costs through the use of surety. Thus, we hypothesise: *The strategy of rationalisation will use municipal surety. The strategy of competition and privatisation will use collateral and avoid municipal surety.*

Supply of managerial labour

The supply of managerial labour comes from the external managerial labour market and from internal supply, sometimes labelled 'internal market for managerial labour'. It is the supply of the most vital resource of the company and the resource that is the focus of corporate governance, the manager.

The resource is hard to evaluate, which is the very reason that there is a field of corporate governance. Would it been easy to monitor the effort, and to know the right effort, then there would be no problem connected to delegation of managerial rights to managers. But with increasing height in the hierarchy, the number of factors influencing the performance of the manager increases, making it costly, if possible, to know the correlation between the efforts made by the manager and the effort needed in order to satisfy the interest of the owner. The recruitment of managers is even more uncertain. It has to calculate the performance effect of selecting a person to a new management position, with membership in a new management team, or at least, in the case of internal recruitment, with new organisational rights, thus changing the old relationships, and, in the case of external recruitment, in a new organisation.

There are two main alternatives of supplying managers, the internal supply through 'the internal labour market', and the external managerial labour market. The creation and maintenance of an internal labour market (Collin, 1997) has its advantage of being capable of creating information of the capacity of the individual and of the individual's way of functioning within the organisation. Additionally, it has the capacity to infuse organisational values into the person, thus directing the person towards the goals of the organisation. To bind rationality has, however, not only positive effects, but it also limits the manager's capacity to explore new possibilities. Except of offering a larger supply, the external managerial labour market has the advantage to offer persons that differ in attitudes and orientation compared to the internal recruits. Thus, one could expect to find internal recruitment when aiming at stability and external recruitment when facing strategic change. Rationalisation strategy is a steady state strategy, thus implying preference for internal recruitment, and privatisation is a radical change, thus external recruitment being preferred. The strategy of competition could prefer external recruitment, because of its change in orientation compared to the other municipal operations. The aim is, however, to retain the corporation within the municipal organisation. One mean of retaining would be to select managers from within the municipality, to ensure the penetration of municipal norms. Thus, for this strategy there is no single direction.

Thus, we hypothesise: *The strategy of rationalisation will use the internal labour market, i.e., internal recruitment. The strategy of competition will be indifferent, and the strategy of privatisation will use the external managerial labour market.*

What goes without saying is that the size of the organisation is crucial when it concerns the possibility of creating an internal labour market, and by that have the opportunity of internal recruitment.

The former experience of the recruited manager is of concern. Among the different ways of characterising the experience, the division of experience in private and governmental experience is of importance for municipalities. Since the municipality is a political organisation, an owner would prefer to recruit managers with an experience from this institutional field. This is especially true when dealing with the rationalisation strategy. The privatisation strategy is, however, oriented towards acting as a full private corporation, thus making the owners prefer persons from private corporations. The competition strategy offers the same indifference as with the external/internal dichotomy. On one side, they prefer private experience since they need the competence of competition. On the other hand, they need to retain the corporation within the municipal organisation, thus preferring persons with governmental experience, capable of understanding the norms of the municipality, and to make these norms effectual in the corporation. Thus, there will be indifference in this strategy.

Thus, we hypothesise: *The strategy of rationalisation, when using the external labour market, will tend to recruit managers with long governmental experience. The strategy of competition will be indifferent, and the strategy of privatisation will recruit managers with long private economy experience.*

Organisation structure

Municipal organisations are often too small for being organised in other forms than the functional form. The control system, however, could be expected to differ according to ownership strategy. The organisation subdued to rationalisation is an organisation that is close to the core operations of the municipality, thus with demands of equal treatment, which is ultimately secured through the blind application of written rules. The regulation of actions would be bureaucracy. In the strategy of competition and privatisation, there is assumable no norm of equal treatment since the corporation is acting on a market. Additionally, the acting on a market demands capacity to act fast and with new actions when facing new situations. The basic regulation of action on the organisation would therefor be by vision and strong culture.

Thus, we hypothesise: *The strategy of rationalisation will tend to emphasise bureaucracy. The strategy of competition and privatisation will tend to emphasise vision and a strong culture.*

The reward system is crucial for the performance of individuals. The rewards for top management are within the reach of the owners. Option programmes are considered a perfect instrument for aligning the top management interest with the ownership interest. Since wholly owned corporations are not listed, this is a possibility that is without reach for the municipal owners. Commission on the profit is then the alternative to align profit and the manager's interest. In the case of rationalisation, it is, however, not probable that the manager get a wage that is correlated to the profit of the corporation. In the case of competition, one could expect to find more of commission on profit, and in the case of privatisation, an alignment to profit could be expected to be of outmost importance.

Thus, we hypothesise: *The strategy of rationalisation will use a fix wage, the strategy of competition will have part of the wage in the form of commission on profit (i.e., bonus), and the strategy of privatisation will use commission on profit to a large extent.*

Board of Directors

The board of directors is the formal interface between the corporation and the company. It has at least four functions: to monitor the company and its management, to make strategic decisions, to provide service to the firm, and to be a conflict resolution body. The owners appoint most members of the board, depending on the specific legislation in the country. Thus, the owners can influence the firm through selecting board members, and through direct action at the board meetings.

Owners with a rationalisation strategy are probably not paying any attention to the differences between the corporate form and the municipal democratic form since it is only a device for cost reductions. Thus, they tend to populate the board with people recruited because of their political competence, and the board members tend to be very operational in their board behaviour, with a tendency to monitor details, creating a high frequency of interaction between the owner, the chairman of the board and the C.E.O. The function being emphasised at the board would be control, due to the aim of reducing costs, and decision-making, due to the interest of high operative involvement. Emphasising control, the chairman will tend to be a politician. Service is not possible since the members have random professions and competence, except for them being politicians.

Owners aiming at competitive efficiency have to create a creative milieu for the C.E.O. At the same time, however, the company cannot expand over the limits of the municipality and the laws regulating municipal operations, this being especially important for a corporation that is not intended to change ownership. Thus, a delicate balance has to be made when the aim is competition without privatisation. Politicians representing the owner and focusing on the boundaries of the corporation are indeed needed. At the same time, competence about competitive markets would be expected, in order to give proper service to the C.E.O. Thus, there will be a mix of competencies at the board. Being in between two extreme strategies, all functions of the board would be active in the board. Control, mainly from the politicians, to ensure competitiveness. Service, mainly from the professional businesspersons, to enable competitiveness. Strategic decision making, from both parties, to align the managers. Finally, conflict resolution, to balance the two wills of politicians and functional professionals. This will probably imply a tendency to have a politician as a chairman, in order to secure the municipal influence on the corporation. The interaction between the owner, the chairman and the C.E.O. will presumably be low since the C.E.O. needs the freedom of action to create competitive advantage.

Owners aiming at competitive efficiency in order to privatise the corporation will support innovation and the expanding faculty of management. The composition of the board would be governed by the principle of heterogeneity fostering innovation (Pelled, 1996). Thus, the board will consist of directors representing a variety of competencies. The board will have an emphasis on the service function, enabling the top management to be innovative. This imply that the chairman tend to be elected from the industry persons, and the level of interaction will be low, in order to create favourable conditions for innovation.

Thus, we hypothesise: *The strategy of rationalisation will have a majority of politicians at the board of directors, will appoint a politician as chairman of the board, will have rather frequent board meetings, and there will be a frequent interaction between the owner representative, the chairman of the board and the C.E.O. The board will focus on control and decision-making.*

The strategy of competition will have a mix of politicians and persons with industry competence at the board of directors, will appoint a politician as chairman of the board, with *low frequency of board meetings, and with low frequency of interaction between the owner representative, the chairman of the board and the CEO. The board will deal with all the functions.*

The strategy of privatisation will have a majority of industry professionals from the private economy at the board of directors, will appoint a industry person as a chairman of the board, will have rather infrequent board meetings, and there will be rather infrequent interactions between the owner representative, the chairman of the board and the CEO. The board will focus on service.

Auditing

Auditing is the instrument of the owners and the state in order to ensure the legality of the corporation. Since auditing can contribute to the control function of the board, it can be used more in the situations where the control function is reduced. Absent owners will tend to have more intense relationship with the auditors than present owners. We would therefore expect owners with the strategy of privatisation to have intense relationship with the auditors, owners with competition strategy to have less intense relationship, and owners with the strategy of rationalisation to have but scant relationship.

Thus, we hypothesise: *An owner with rationalisation strategy will have a minimum of contact with the auditor, an owner with competition strategy will have medium contact with the auditor, and the owner with privatisation strategy will have intense contact with the auditor.*

Product market

Product markets could in the case of a municipality vary from complete monopoly to highly competitive markets. Competition has been found to be a highly influential factor concerning the economic efficiency of a corporation (Springdal, 2001). Thus, an owner could position the product of the corporation on a highly competitive market, thereby reducing the freedom of action of the managers. On the other hand, it put a stronger demand on the enabling function since the top managers have to have the opportunity and the support of innovation. Thus, one would expect to find a low emphasis on control when the corporation is facing a strong competition.

Thus, we hypothesise: *The level of competition will vary negatively with the use of governance mechanisms aimed at control.*

Culture

Traditions and institutions on a regional or national level are termed culture. It has to be considered in cross-country studies since it influences the attitudes of actors (Hofstede, 1980), and ultimately the behaviour of the actors (Lubatkin, Lane, Collin & Very, 1999). Since the empirical objects of this paper are Swedish municipalities, there is no variance in the cultural factor.

Mass Media

Mass media influence the reputation of the firm, of the owners and of the top managers, and can be supportive or disruptive on the moral of the organisation members, thus making it a governance mechanism. Municipalities are always scrutinised by mass media, as all government organisations are. Sweden has a tradition of publicity, which grants every Swedish citizen the right to read the documents of the state, with few exceptions. Corporations, on the other hand, have the tradition, and the legal protection, of being closed societies. This has been used as an advantage for municipal corporations that are facing competition. Them being organised as a public agency would imply that their competitors could take part of their documents, thus creating an information asymmetry that would damage the municipal companies capacity to compete.

When trying to predict the ownership strategy one can notice that mass media is a cheap, but hard to control instrument, with the negative aspect that mass media is not only scrutinising the corporation and its management, but also the owners of the corporation. Therefor it is a sword with many edges, and directed both ways. Thus, the major advantage of mass media is presumably for owners that are highly absent from the corporation, such as owners in highly dispersed ownership structures. In municipal corporations, with one sole owner, the information gathering of the journalists would not offer any strong advantages for the owners. A rather negligent attitude towards mass media would therefor be expected. Thus, we hypothesise: *A municipal owner tends to disregard mass media as an instrument of governance.*

State Legislation and Regulations

State legislation is constraining the freedom of action for everyone involved. It constitutes a low cost instrument of control (Demsetz & Lehn, 1985), imposed on the organisation, and constraining every actor's action. Thus, we hypothesise: *A municipal owner tends to be less intense in governance of the corporation when there are many and/or strong laws regulating the corporation.*

Regulations made by associations to which the corporation belongs have the same effect as state legislation, they restrains the freedom of action for the corporate actors. A corporation can be member of associations because it renders them good will or because the association have another, more tangible utility to offer, for example information. Some of these associations, such as trade associations, have the function of monitoring and regulating their members, and thereby giving them reputation. These regulations are not the same as the state laws, but the sanctions can be as strong due to the consequences for the company and the corporation. Thus, we hypothesise: *A municipal owner tends to be less intense in governance of the corporation when there are many regulations facing the corporation.*

Ownership strategies summarised

Ownership strategy is the composition of the mix of governance mechanisms an owner is creating in order to ensure the fulfilment of the aims of the owned organisation. We have developed three different strategies used by municipalities when controlling and developing their wholly owned corporations, which are summarised in table 2. The ownership strategy of rationalisation is focused on the operation of the company and its costs, emphasising the interactive mechanisms, such as the board and the owner – C.E.O. relationship. It put hardly any effort on owner capital mechanisms such as size of equity; indeed it puts it offside through extensive use of surety. The contrast to rationalisation is the strategy of privatisation. It have an arm-length distance to the company and its operations, emphasising the freedom of action of the CEO and focusing on owner capital, such as rationing equity, and take-over. In between is the strategy of competition, being in-between in the utilisation of many governance mechanisms. Probably it is a rather unstable organisational form since it appears to be easier to govern a corporation according to municipal principles, as in the case of rationalisation, or according to private corporation principles, as in the case of privatisation.

TABLE 2 OWNERSHIP STRATEGIES FOR WHOLLY-OWNED MUNICIPAL CORPORATIONS

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

These strategies have been pragmatically deduced, using practical reason and agency theory. There are, however, two deficiencies that will not be considered here, that of equilibrium of mechanisms and the specificity of the situation. Ownership strategies consist of a mix of governance mechanisms. The deduction in this part of the paper has been discrete, i.e., disregarding the influence the usage of one mechanism could have on another mechanism. For example, in the strategy of privatisation, a lack of candidates as a new C.E.O. with private experience could strengthen the boards control orientation and the frequency of meetings, in order to assure and transmit the values of market orientation towards the presumably less market oriented recruited C.E.O. with a dominance of governmental experience. Thus, the specific equilibrating action of the owners in order to fine-tune the mechanism mix cannot be considered at this level of conceptual development. The example highlights the second deficiency of the ownership strategy hypotheses, the influence of unpredictable, and specific situations on the ownership strategy, such as a sudden lack of candidates with private experience on the managerial labour market. These circumstances, low conceptual development and specific situations, could imply that the predictions cannot be tested on a sample with generalisation purposes, but only examined in case studies.

5. EMPIRICAL TEST OF THE OWNERSHIP STRATEGY HYPOTHESES

The Swedish municipalities owned 1010 wholly owned corporations 1998. Due to financial restraints on the project, only a sample of these was selected. The sample selection was biased. Included were corporation from all industries, in order to cover a wide variety of businesses; included were corporations with sales>5.000.000Skr (approx 580.000 Euro) and with at least one employee, in order to cover only those corporations that were organisations and not only legal shells created of tax reasons; and finally, an effort were made in order to include corporations from every single municipality in Sweden, in order to ensure geographical variety. The final sample contained 334 corporations, i.e., 33% of the population.

A survey was constructed, with the aim of covering many details of the corporation, including governance. Since no instrument has been developed, according to the author's knowledge, covering all aspects of governance, it was a true innovative mission. It was sometimes hard and very often even impossible to find questions making it possible to observe the factors objectively. Thus, some questions had objective data nature, such as amount of surety, some had an uncertain objective nature, such as number of contacts between the chairman and the C.E.O., and some were of purely subjective nature, such as questions observing attitude data.

The survey was made in three different forms. The reason was that there were an ambition to cover all three main actors of corporate governance, an owner-representative, the chairman of the board and the C.E.O. A test of the survey on three corporations made it very clear that politicians, mostly owner-representative and chairman, were not interested in too many pure data questions, if they answered. In order to reduce the risk of low response rate on behalf of the politicians, a much simpler and shorter survey were constructed. The C.E.O. got the most advanced and longest survey.

After two reminders, the response rate were 22,2% for owner-representative, 24,0% for chairman, and 47,0% for C.E.O. Comparing to other studies that have been surveying the same population of owner-representatives, i.e., often full-time engaged politicians, the extremely low response rate were not a surprise. Comparing to the response rate when sending surveys to private owners, the response rate were very low. So, there are some common features with politicians that make them fail in responding.

Since we are observing ownership strategy, the responses of the owner-representative would have been the best. The response rate were, however, considered to be to low, and biased towards small corporations, reducing our capacity to generalise. A choice was made to use the C.E.O. responses when possible, and only the other responses when needed, as for example, when we test differences in interaction frequency between the chairman and the auditor. Thus, we have a new instrument, sometimes measuring objective data, and sometimes subjective data, and collecting this data from mainly the C.E.O., which theoretically is the object of the ownership strategy, not the subject. The error sources are numerous, and large in magnitude.

To test the hypotheses, the independent variable, ownership strategies, had to be constructed. Since ownership strategy is an un-known concept, the observation of the specific ownership strategy could not be left for the respondents to do. Thus, the strategy was judged, using indications from the survey. The categorisation was a four-step process: 1. All corporations that had been subject to privatisation ambitions were categorised into privatisation strategy; 2. those that scored >4 (on a 7 scale) on the statement that the corporation most important function was to create competitive advantage were categorised as competition strategy; 3. those that scored >4 on the statement that the corporations most important function was to reduce costs were categorised as rationalisation strategy; 4. those remaining that had a difference between the statement of competition and cost reduction >0 were considering being subject to competition strategy and those with a difference <0 to be within the realm of rationalisation. Unclassified were 4 corporations, which were given 'no value'. Two strategies had 17 corporations, and a new class of strategy, the mix strategy, were created. The weakness of this classification is that the selection of the criteria is subjective. The strength of it is that it can be repeated if using the same instrument.

The outcome of the classification was 71 corporations (53%) classified as belonging to the privatisation strategy, 33 corporations (24%) belonging to the competition strategy, 14 corporations (10%) belonging to the rationalisation strategy, and 17 corporations (13%) belonging to the mix strategy. Thus, a domination of the privatisation strategy. One of the advantages of a corporation is that it is easily transferred to a new owner, thus sell-off could be expected to very often be an option. In the municipality case, this option could be triggered because it free the municipality from the responsibility of conducing the operation of the corporation, and it give the municipality cash, which could be much appreciated in a municipality facing close to financial stress.

The low number of corporations in the rationalisation strategy makes any statistical test very vulnerable. Considering the other data difficulties, the analysis has to be considered as but an examination of hypotheses about ownership strategies.

Table 2 shows the hypotheses and the ANOVA or chi-2 tests performed on the survey data.

TABLE 2. HYPOTHESES AND ANALYSES OF MUNICIPAL OWNERSHIP STRATEGIES

Corporate Governance Mechanism	Strategy of Privatisation	Strategy of Competition	Strategy of Rationalisation	Mixed Strategy	n	F-Ratio	F prob
Owner Capital							
Profit	Strong emphasis	Moderate emphasis	No emphasis				
"Customer more important than profit"	4,19	4,47	5,62	5,18	128	4,27	0,0066
Share of corporations with explicit profit claims	46	42	29	47	135	1,62	0,65
ROE	5,6	8,04	6,12	6,26	99	1,56	0,2
Risk	Variance	Probability of losses	No emphasis				
"Large differencies in profit is not good"	4,4	5,38	4,92	4,36	130	3,03	0,032
"It is important to avoid losses"	6,67	6,79	6,85	6,81	132	0,47	0,7021
"It is important to have a continious level of profit"	4,24	4,61	3,54	3,94	129	1,91	0,13
Size of Equity and debt capital	Strong emphasis	Strong emphasis	No emphasis				
Debt/Total Capital	0,18	0,2	0,13	0,22	124	0,81	0,49
Share of corporations with Surety	59	66	58	41	124	2,68	0,44
Debt/Total Capital for corporations with surety	0,16	0,16	0,08	0,14	72	0,63	0,6
Debt/Total Capital for corporations without surety	0,19	0,23	0,2	0,29	49	0,68	0,57
Take-over	Moderate emphasis	No emphasis	No emphasis				
"The municipality should be able to sell the corporation"	5,63	4,76	3,75	4,76	130	4,76	0,004
Managerial Labour market							
Recruitment source	External	Indifferent	Internal				
Proportion of TMT externaly recruited	0,6	0,73	0,76	0,31	77	3,72	0,015
Institutional Experience	Private	Indifferent	Governmental				
Share of C.E.O:s experience from private firms	0,41	0,24	0,35	0,41	134	2,24	0,09
Organisation structur							
Formalisation	Vision and strong culture	Vision and strong culture	Bureaucracy				
"It is important that the employees follow the rules"	6,2	6,33	6,46	6,41	132	0,4737	0,7
"It is important that the employees are occupied by the corporate aims""	6,28	6,36	6,61	6,65	131	1,23	0,3
Reward system	Bonus	Partly bonus	Fix wage				
Share of salary being fixed	99,8	100	100	100	125	0,3	0,82
Board of Directors							
Board composition: Competence	Industry dominated	Tie	Politician dominated				
Share of directors with political competence	0,89	0,97	0,94	0,91	59	0,44	0,72
Board composition: Chairman	Industry	Politician	Politician				
Proportion of charimen being poilitichian	88%	100%	100%	75%	32	9,24	0,41
Frequency of board meetings	Low	Low	High				
Frequency of board meetings	7,43	7,12	6,77	7,62	130	0,47	0,7
Interaction frequency	Low	Low	High				
Interaction frequency between C.E.O. And Chairman	45	39	31	32	126	0,59	0,62
Board functional emphasis	Service	All functions	Control & Decision making				
Control: "Important that the board monitor the CEO"	6,14	6,53	6,53	6,65	133	2,74	0,0459
Service: "The board should be composed of a variety of competencies"	6,12	6,45	5,61	6,29	134	1,79	0,15
Decisionmaking: "Important that the board decide about the strategy"	6,43	6,63	6,38	6,76	134	1,04	0,38
Conflict resolution: "Important to avoid conflicts in the board"	3,88	3,88	3,77	5,23	132	3,15	0,0273
Auditor							
Interaction frequency	Intense	Medium	Low				
Interaction frequency between Chairman and Auditor	2,68	4,14	2	1,8	40	4,75	0,007
Product market	No	specific	hypothesis				
Share of total sales that are facing competitors	82	75	51	58	108	3,85	0,012
Culture	No	specific	hypothesis				
Mass Media	Negligence	Negligence	Negligence				
"Mass Media offers important monitoring function of the corporation"	3,83	3,81	4,85	4,06	134	1,37	0,256
State Legislation and Regulations	No	specific	hypothesis				

The analysis considering owner capital shows that profit is regarded as more important in the privatisation and competition strategies, compared to the rationalisation strategy, although the average ROE is lower for the privatisation strategy and higher for the competition strategy. One should note, however, that the number of observations is much lower for ROE since some corporations reported no ROE with the argument that the profit was negative.

The risk attitude had mixed results. Privatisation strategy considered variance as less troublesome than the other strategies, although variance did not get consistent answers from the rationalisation strategy corporations. The attitude towards avoiding losses was almost equally strong for every strategy.

Capital rationing, in form of size of equity and surety did not show strong differences between the strategies. One can observe, however, the differences between corporation gaining surety and those not having surety. Thus, there is a capital rationing, but it is the use of surety in order to reduce the needed equity.

The take-over mechanism is considered important in the case of privatisation, and of much lesser importance in the case of rationalisation.

The owner capital appears to behave close to the predictions, with more emphasis in capital aspects and profit in the privatisation strategy than the rationalisation strategy. The rationing of capital is, however, an exception.

The municipalities tend to use the external managerial labour market to a large extent, since 60% of the TMT were externally recruited in the least externally recruited strategy. The order is, however, contrary to expected, strategy of rationalisation having more external recruitment than privatisation. Experience from private companies were, however as expected, higher in the privatisation case, but much lower in the competition strategy. Thus, the external recruitment for rationalisation and the emphasis on governmental experience in the competition strategy needs some speculations in the concluding section.

The organisation structure was measured in a very crude way, and it turned out to show no significant difference. Interesting to note, however, is the reward system, being almost exclusively based on fixed pay. The only case of bonus appeared at the privatisation strategy, according to expectations.

The board of directors did not show any differences according to ownership strategy. Politicians dominate the board and the position as chairman. Only a slight lesser domination, though according to expectations, was found in the privatisation strategy. The dominant presence of politicians, them being direct owner representatives, could be interpreted as an emphasis on direct control, to be capable of giving direct order to the CEO and to ensure full access to all information. The function of control were also the only function were we could find significant differences between the strategies, the rationalisation strategy putting more emphasis on control of the C.E.O. than the privatisation strategy. Thus, the board appear to be the arena for politicians and only a slight difference in attitudes were recognisable concerning the control function.

The interaction between the auditor and the chairman were intense in the competition strategy, but only medium in the privatisation strategy. It is not according to expectations. One rational explanation could be that corporations facing competition strategy are acting in the legal twilight zone, thus experience a large need of legal advice. The corporations facing privatisation has for long been established as legitime corporations, and therefore they do not need the knowledge of them being legally legitimate.

The product market could influence the corporations in the privatisation strategy since they have, on average, 82% of their sales on a competitive market, while the rationalisation corporations only have 51%. A deficiency of the data on competition is that we do not know the nature of the competition, being oligopolistic or approaching perfect competition. Thus, the constraining effects of competition cannot be understood.

Mass Media showed no significant difference, which could indicate that mass media is of no concern when governing wholly owned corporations.

6. SUMMARY AND CONCLUSIONS ABOUT OWNERSHIP STRATEGY AS A CONCEPT RECONCILING THE DIFFERENTIATION AND BRINGING BACK ORTHODOXY

Summarising the results, one has to notice that we have been trying to measure a new concept, using a newly developed instrument, submitted to obstinate responders, forcing us to use the second best source of information, the C.E.O. of the corporation. The analysis has been conducted on a dependent variable that has been subjectively constructed, based on meagre survey data. Thus, the conditions for testing the theory of municipal ownership strategy have not been good.

The results indicate, however, that we cannot disregard the concept of ownership strategy. The results are not strong, but it appears that the predicted strategies exist, to a certain extent. The owner capital behaved as expected, but with the exception that rationing of capital did not appear to be an ownership instrument.

The managerial market got mixed results, the institutional experience according to predictions, but external recruitment quite the opposite. One reason to the contrasting result of external recruitment could be that rationalisation in a municipal operation using a corporate shell is a much more dynamic change of the organisation than to use the corporation in order to create competitive advantage or possibility to privatise. In the last two cases, the organisation has been prepared, the competitive status been present before in incorporation. In the case of rationalisation, it could be a factual strategic change of the organisation, instead of the potential change in the case of privatisation. Thus, an agent of change is much more needed in the case of rationalisation. As studies have showed, for example, in the field of organisational demographics (Pelled, 1996), diversity creates an innovative climate, and people that have no investments in the old strategy enforce strategic change. Thus, external recruitment could be a mean of arranging the innovative climate in an organisation facing rationalisation.

The reward system did not vary with strategy. It could be due to a culture of equality, everyone in an organisation being treated the same way. Since the municipality wholly owns the corporation, the reward principles of the municipality have been implemented. Another, less culturally biased explanation, is that the owners do not care about equality, but they wants to give a very clear signal to the C.E.O. that the corporation is a part of the municipality, subdued under the same reward system. No matter cause, equality or signal of belongingness, the outcome is the same, similar reward system in the corporation as in the municipality.

The board was dominated by politicians, interpreted as them having a strong control interest. Only a very tiny indication were present that there were a differentiation according to strategy in board composition and functional orientation concerning control.

The auditor played a more important role in the competition strategy, which were interpreted as a need of legality. This interpretation imply that the auditor is less of an owner instrument in relation to the corporation, but an instrument in creating legitimacy.

One can conclude that an owner has several instruments as its disposal. In this exploration of municipal ownership strategies, we have showed that they use some mechanisms in a predicted way, other mechanisms they use according to another logic, and some mechanisms according to no understandable logic. The basic difficulty testing the concept of ownership strategy on municipal corporations is that they do not have one single and clear-cut efficiency yardstick present, such as shareholder wealth. On the other hand, it has the advantage to pick wholly owned corporations, which have a high probability of having present owners. The mainstream research has been focused on the listed corporations, those that created the very debate about absent owners and the separation between ownership and control.

Dispersed ownership does not, however, add a distinct new problem to the concept of ownership strategy. It only makes it more complex through adding the possibility of coalitions within the ownership. One has to acknowledge that absent owners is not a characteristic of dispersed ownership structures. Absent owners is a cause of an ownership strategy, where the owner chose to be absent, according to a rational calculus. It can be rational, as in the privatisation strategy predicted here, to be absent, and it can be rational to be absent if you have 200 shares in LM Ericson, i.e., 0,00000028% of the shares. The rationality differs, but the consequence is the same, an absent owner.

The most important contribution made by ownership strategy is perhaps not its capacity to predict, but to prescribe, or at least to be an efficient basis for analysing an owner, or for an owner to analyse its own actions. It shows, through the typology of mechanism, what instruments that are available on a general level. The concrete availability differs, however, between countries, industries and in time. They are oriented towards different aspects of the control of the corporation, which makes it possible to use one equally oriented mechanism if another mechanism is not available. For example, when the external managerial labour market does not function properly, an internal managerial supply could be arranged through the establishment of an internal managerial labour market. Additionally, the ownership strategy concept put forward here does emphasise the two ownership aspects, that of control and that of facilitating, thus exploiting division of labour.

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