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CORPORATE GOVERNANCE AND INTERNAL CONTROL: EVIDENCE FROM LOCAL PUBLIC UTILITIES

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Abstract

Privatisation and market liberalisation have produced new kinds of relationships for local public utilities. First of all, the relationship with citizens-users has been modified on the basis of their various expectations about the quality of services in a potentially competitive system. In the same environment, cooperation and integration could be realised too, among companies interested in enlarging their range of public services, as well as their geographical market.

Some public utilities have also been listed, in order to raise financial resources and to support their growth. This has emphasised specific financial expectations concerning company's durability and share value on the stock exchange; moreover, it has underlined the importance of correctness, transparency, equitability and ethics in corporate governance.

In this context, implementation of governance structures and processes finalised to satisfy all interests converging into the firm becomes crucial and should be sustained by adequate internal control systems. One of these is management control system, which assists governance activities favouring their effectiveness and efficiency: these conditions represent the internal control's operational objectives, as stated by the international best practice.

Management control identifies the virtuous steps to fulfil pre-established purposes. In fact, management control gives emphasis to the links among stakeholders' expectations, operational behaviour and results; it draws attention to the risk factors that could be an obstacle to the achievement of expected results and it induces to check consistency among expectations, purposes and results, and to take corrective action, if necessary.

Therefore, there is strong integration between corporate governance and management control; particularly, this latter helps reach the balance of effectiveness and efficiency in operational activities. Considering local public utilities, the management control facilitates the equitable achievement of public interest and citizens-users protection, on the one hand, and the adoption of managerial approaches to lead the company, on the other hand.

Adopting a prevailingly empirical approach, this paper aims at analysing the relationships between corporate governance and management control by means of the comparison of three local public utilities, marked by different proprietary structure, complexity and evolution.

Keywords: local public utilities, privatisation, liberalisation, corporate governance, internal control, management control.

1. Introduction

This paper aims at investigating the relationships between corporate governance and management control systems in local public utilities. This topic has been little studied in the literature, which is mainly focalised on forms of privatisation and on structure and appointment of public utilities' corporate governance boards, also considering the role of the local government.

Indissoluble relationships exist between corporate governance and control activities. Indeed, corporate governance has been defined as the system by which companies are directed and controlled (Cadbury Report, 1992); moreover, corporate governance provides for the coexistence and coordinated functioning of different internal control systems:

- the corporate governance control system, which establishes the tasks of corporate governance boards in order to guarantee proper direction of the firm;
- the internal control systems in strict sense, which assure the reliability of information and support the actualisation of top management's decisions, according to principles of effectiveness, fairness and lawfulness.

Privatisation of municipalised firms and market liberalisation in the sector of public utilities have stressed the need to adopt business economics principles instead of the previous bureaucratic approach, typical of the public sector. In the past, constant covers of losses and financial requirements by the local governments, together with a protected supply system and clear orientation to the respect of procedures, have often interfered with the spread of culture of control, especially as concerns the effective fulfilment of durable profitability, competitive and social success at the same time.

Expectations converging into public utilities have recently enlarged as a consequence of the sector reform, and have produced the necessity to satisfy financial, social, environmental and competitive interests, adopting logics of global responsibility of the company towards all its stakeholders.

With reference to selected companies, this paper focuses on privatised local public utilities considering the implications of privatisation for the establishment of purposes and the translation of these ones into organisational behaviour. The paper has the following structure: the second paragraph describes the evolution of local public utilities' governance; the third paragraph deepens the relationships between corporate governance and internal control in local public utilities, paying specific attention to management control; the fourth paragraph presents the research questions and the methodology, introducing the firms analysed too; the fifth paragraph shows and discusses the empirical findings; finally, the sixth paragraph offers some concluding remarks and identifies topics for future studies.

2. Governance evolution in local public utilities

Since the Nineties, significant legislative reforms concerning privatisation and market liberalisation have involved the Italian sector of public utilities (Grossi, 2005), with effects on their ownership, governance and expectations converging into the firms, stimulating the research of new strategies and management solutions (Garlatti, 2005; Mulazzani, ed., 2006). This has raised the interest in public governance and corporate governance as a matter for debate, on the basis of the new role of the local government as a guarantor of the community's expectations and as a shareholder (not always the sole) of the local public utility.

Privatisation process (Dossena, 1990; Costamagna, 1993; Faraci, 2002; Bruni, 2004; Marinò, 2005; Kikeri-Kolo, 2005; Piras, 2005; D'Souza-Megginson-Nash, 2006; Barucci-Pierobon, 2007; Fumagalli-Garrone-Grilli, 2007; Boubakri-Cosset-Guedhami, 2008) begins with the conversion of a municipalised company into a stock company (*formal privatisation*), in which the local government is the sole shareholder. Afterwards, shares can be sold to private investors (*substantial privatisation*), sometimes by means of a listing process.

Substantial privatisation affects the public utility's ownership asset concretely, although the process is usually just partial, since the local government continues to be the major shareholder with significant influence on the appointment of corporate governance boards. However, the substantial privatisation permits the local government to open the ownership to private shareholders, raising financial resources as well as finding stable partners to start or to share industrial and commercial long-term projects.

In both formal and overall substantial privatisation, the proper governance of the local public utility implies logics of interest composition, suitable to gain stakeholders' confidence and approval. Indeed, these are the basic conditions to develop durable relationships, to obtain resources for company's activities and therefore to produce results in accordance with internal and external expectations (Freeman, 1984; Coda, 1988; Freeman, 1994; Salvioni, 1997; Salvioni, ed., 2007).

Market liberalisation (Bulckaen-Cambini, 2000) has also affected the relations between the public utility and its stakeholders. The relationship with the users of services has changed, according to their expectations about quality and rates in a market that is currently open to the competition, while in the past it used to assure strong protection to public utilities. In this modified situation, there are also important opportunities to develop forms of cooperation and integration with other local public utilities, in order to enlarge the range of services provided to the community, as well as the geographical extension of the market, with advantages connected to economies of scale.

In the shortly described context, the governance of a local public utility should be inspired by principles of social equitability, effectiveness, efficiency, risk control and environmental protection, paying attention to the expectations of:

- the local community – represented by the local government (Catturi, 2004; Padovani, 2004; Grossi, 2005) – as concerns service peculiarities and protection of the environment, which is threatened by pollution provoked by the public utility with its activities;
- public and private shareholders, who have clear economic interests in terms of dividends and investment valorisation.

3. Governance and internal control

An adequate reaction to the modifications in public utilities' sector requires that systems of direction, control and disclosure are rethought. Corporate dimensions and complexity, as well as the actual share of capital held by private investors – due to the listing process too – imply significant differences among single public utilities. Nonetheless, there is a general increase in the adoption of business economics principles and instruments, which are gradually replacing the administrative and bureaucratic approach that is typical of the public sector.

This change is substantially imposed by the raising interests involved in the public utility's activity, which multiply the factors to be monitored and the connected need for information as a support to decision making and to the evaluation of behaviour and results. Similarly, stakeholders also manifest expectations of information with reference to different dimensions of public utility's performance (financial, social and environmental): therefore, the ability to disclose complete and impartial communications becomes more and more crucial in order to manage approvals and to optimise the virtuous circle that binds resources, activities and results[1].

[1] Increasing importance recognised to external disclosure is confirmed by the more and more frequent publication of voluntary documents addressed to all the company's stakeholders, which offers complete information about the public utility's governance. Today the most significant examples in Italy – among both listed and unlisted firms – are the social report, the environmental report and the sustainability report that describe the firm's governance structures and analyse the results produced in the interest of the stakeholders.

Consequently, the public utilities that have been privatised and that are in potential competition with other firms, have adopted internal control systems (CoSO Framework, 1992; Sides-Grosso, 2001; Comoli, 2002; Gandini, 2004; Marchi, 2004; CoSO-ERM, 2004; PWC, 2004; Italian code of corporate governance, 2006; Beretta-Pecchiari, 2007; Rittenberg-Martens-Landes, 2007). Internal control systems are oriented to help the fulfilment of specific purposes as: compliance with laws and regulations; transparency and reliability of financial disclosure; efficiency and effectiveness of operations; safeguard of company's assets.

In listed public utilities, specific company's bodies are usually in charge of different forms of internal control; on the contrary, in smaller firms, especially in the unlisted ones, the same unit can be entrusted with more control functions. In particular, the most important internal control systems supporting corporate governance are the following: surveillance on administrative correctness, based on the Italian legislative decree no. 231 of 2001; risk management; internal audit; management control.

New expectations converging into public utilities after the reforms emphasise overall the necessity to implement internal control systems suitable to help value creation for shareholders and all other stakeholders, facilitating the durable profitability. From this point of view, public utilities should monitor their ability to reach pre-established targets with the least use of resources, also guaranteeing adequate quality of services, timely intervention and continuity of supply at the same time. In other words, public utilities should realise controls to promote efficiency and effectiveness in the operational activities by which top management's strategies are actualised, in accordance with internal and external expectations.

Many aspects make it difficult to integrate strategies and operations, emphasising the importance of effective coordination of behaviour. Some examples are: the variety of performance key factors existing in the new context of local public utilities; a number of people involved in operational activities; the efforts to change, also required inside the organisation. As a consequence, the role of management control system has increased.

Management control facilitates the effective transfer of top management's policies and purposes into organisational behaviour, conferring unity to operations and helping the performance optimisation, especially when it is accompanied by an ethical code of conduct.

3.1. Governance and management control

In the already quoted CoSO definition (1992), internal control is «a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations;
- reliability of financial reporting;
- compliance with applicable laws and regulations».

This definition combines two different meanings of control (Anthony, 1965; Brunetti, 1974; Airoldi, 1979; Giovannoni, 2004; Beretta-Pecchiari, 2007).

On the one hand, the reference to compliance and financial reporting reliability objectives emphasises the nature of inspection and surveillance that is typical of some control activities. On the other hand, the contribution to operational effectiveness and efficiency underlines the function of company's guide and governance that characterises other forms of internal control, whose adequacy also depends on clear, complete and transparent information.

The second meaning refers to management control (Anthony, 1965; Brunetti, 1974; Amigoni, 1988; Bergamin Barbato, 1991; Flamholtz, 1996; Salvioni, 1997; Berry, 2005; Anthony-Govindarajan, 2007; Merchant-Van der Stede, 2007), which is orientation of behaviour towards established targets, adopting principles of effectiveness and efficiency.

Management control is a complex activity, which originates from the top management and involves the whole internal organisation. Indeed, by means of management control, corporate governance policies are transferred to operational levels, in relation to the contribution the company expects from each employee for the achievement of global targets.

If it is properly realised, management control:

- gives emphasis to the links among stakeholders' expectations, management policies, operational behaviour and results;
- facilitates company success, because it permits monitoring all competitive, financial and social key factors for the development of the company's activity;
- guarantees consistency between appropriately hierarchised targets and actually achieved results;
- draws attention to risk factors that could threaten the achievement of expected results, provoking financial losses, reduction of company's assets, as well as stakeholders' confidence crises;
- permits timely identification of critical or non-prearranged elements and deviant behaviour, on which to activate corrective action;

- favours internal transparency and cohesion within the company, among corporate governance boards, top and middle managers and employees.

Therefore, management control facilitates the effectiveness of governance in different ways: it helps to monitor the evolution of risk factors and success factors; it confers unitary finalisation to action; it supports the optimisation of financial performances, respecting the basic conditions of sustainable development. Management control supports value generation, which represents a requirement for the equitable satisfaction of all stakeholders' expectations, even the social and environmental ones. To sum up, management control helps the proper realisation of the virtuous circle of approval, resources, activities and results.

Effectiveness of management control depends on the adequacy of its two static components (the organisational structure and the information system) and its dynamic one (the control process), which compose a system. Indeed, evident interrelations exist among the three components, since:

a) the control process takes place inside the organisational structure and it makes use of detailed data produced by the information system;
b) data are structured with reference to organisational complexity (and variously elaborated on the basis of result areas) and they consider the same period of time covered by control processes.

As regards public utilities, privatisation and market liberalisation have stressed the need to deepen how purposes established by corporate governance bodies and top management are translated into operational behaviour. This is the key to understand how public utilities, oriented by their public shareholders, can operate in the interest of the community without neglecting other stakeholders.

Reforms involving public utilities have increased the factors to be monitored, stressing the importance to pursue together:

- effectiveness, in accordance with the public function of satisfying the users' primary needs (Catturi, 2004);
- efficiency, by means of the reduction of production, maintenance and distribution costs, in order to maximise the gross margin respect to bond rates, as well as to compete in the liberalised market.

In public utilities' current context, management control should therefore facilitate the joint achievement of social, financial and competitive success, according to logics of global responsibility and sustainable development (Elkington, 1994; Clarke, 2001; Salvioni, 2003; Norman-McDonald, 2004; Ho-Taylor, 2007; Wang-Lin, 2007).

4. Purposes and methodology of research

4.1. Research questions

Moving from the previously illustrated theoretical framework, this paper aims at analysing the operational choices of three local public utilities as concerns how to fix governance purposes and to transfer them into the organisational behaviour. Therefore, the case studies are focalised on the relationships among public governance and management control, trying to answer the following research questions:

1. Do the privatisation typology and degree affect the role of the local government in defining the firm's purposes and forms of control and reporting?
2. Does the actually implemented management control system guarantee a satisfactory monitoring on key factors for economic, competitive and social success?
3. What kind of interactions are there among corporate governance bodies, operational managers and the body responsible for management control?
4. Does the organisation perceive the importance of management control for behaviour orientation?
5. Is the effectiveness of management control system methodically reviewed and evaluated?

4.2. Methodology

In order to realise the empirical research, a set of questions about governance and internal control systems (management control, internal audit and risk management) in public utilities was prepared.

The questionnaire was composed of 106 open questions and multiple choices we asked to corporate agents responsible for internal control. Our interlocutors were previously selected by the chairman of the firm, we had contacted by mail in order to introduce our research. The interviews were conducted by two researchers together.

During each interview we checked a small number of answers we had already collected from the public documents published by the firm on its website (by-laws, corporate governance report, social report, environmental report, sustainability report). Answers to all other questions were directly given by the company's people charged with internal control responsibilities; we noted the answers immediately and we also recorded the interviews, for following checks.

The interviews were realised at the firm's headquarters in May 2007 and they lasted variably from one hour and a half to four hours. This variability depends on the different development of internal control systems in the three companies, to the point that we obtained no answer to some parts of the questionnaire.

With reference to the topics discussed in this paper, the questionnaire contained 38 answers about:

1. the involvement of the local government (Commune) in fixing company's purposes; the relationships among financial, competitive, social and environmental dimensions of performance; the influence of privatisation and listing process on the establishment of purposes;
2. performance indicators used by the company and their disclosure to the Commune and other stakeholders;
3. characteristics of the management control unit and the involvement of other internal (or external) bodies in planning, programming and controlling;
4. the organisational structure of management control;
5. the information system of management control;
6. the management control process and budgeting;
7. the check of users' satisfaction about services, and improvement activities;
8. how management control is felt inside the company;
9. the assessment of management control system.

Existing the management control system in each of the three selected companies, all the questions obtained answers from the companies' agents (or pre-inserted information was verified). This specific part of the interviews lasted from one hour to one hour and a half.

4.3. Company selection

All three public utilities analysed[2] in the paper are stock companies that operate in Northern Italy and offer numerous kinds of services: electricity, water, gas, heating, urban sanitation.

In phase of company selection we looked for public utilities characterised by different levels of privatisation and adoption of business administration principles and tools. In fact, the three companies can be considered as a suitable representation of the major steps in public utilities' evolution, as observed in recent years.

[2] Due to privacy reasons, companies' names are not written in the paper.

The first company ("PU-1") has undergone a formal privatisation: the Commune holds the whole capital of the firm. The company is strongly deep-rooted in its local territory and it is a typical small enterprise[3]. Indeed, from a business economics point of view, the PU-1 has implemented a management control system, but it realises neither internal audit activities nor systematic risk management. Due to its features, the PU-1 represents certainly most of Italian local public utilities.

The second firm ("PU-2") has also undergone a formal privatisation, but it looks very different from the PU-1. First of all, the PU-2 has many local governments (65 Communes and 2 Mountain Communities) as shareholders[4]. Moreover, the PU-2 has entered a phase of critical development: together with other small public utilities operating in neighbouring territories, it has promoted a federative model based on the establishment of a new firm that facilitates organisational rationalisation and fund raising for all adherent companies. Nevertheless, each of them maintains clear operational independence in its own territory and it valorises its brand, improving the relation with the local community.

The PU-2 introduced its management control system long ago; today, it has also the internal audit system and it is implementing specific risk management procedures. On this matter, our interlocutors expressed their conviction that effective internal control is a key factor for economic and social success, particularly when a firm is growing: without any doubt, such an approach is virtuous, even if it is unfortunately not very diffused among local public utilities.

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[3] As concerns corporate governance, at the time of the interview, the PU-1 had a board of directors composed of seven non-executive members, a chairman with executive powers because of the temporally lack of a CEO, and a deputy chairman who could be entrusted with particular management tasks. Neither independent directors nor standing committees existed in the board.

The board of statutory auditors had entirely been appointed by the Commune, in quality of unique shareholder.

The company had also a surveillance board in compliance with the Italian legislative decree no. 231 of 2001. This surveillance board included managers (from Accounting, Sales, etc.) who weren't directors of the company.

[4] When we realised the interview, the PU-2 was directed by a board composed of an executive chairman and four non-executive directors; none of them was independent. No standing committee was established inside the board of directors.

The board of statutory auditors had been appointed by the local public governments.

Finally, there was the surveillance board required by the Italian legislative decree no. 231 of 2001: the body was composed of the company's internal auditor, the chairman of the board of statutory auditors and a non-executive director.

The third company ("PU-3") is at the highest level of development for a public utility, since it is a large listed firm[5]. Its privatisation was substantial, although the Commune has maintained strong control on the company thanks to a share of about 70 per cent of the capital (at the time of the interview) and the power to appoint most of the directors.

Some years ago the PU-3 undertook a strategy of external growth, at first by means of the acquisition of smaller local public utilities (guaranteeing special powers of corporate governance to the other Communes) and afterwards considering the possibility of merger with other listed public utilities.

In the PU-3, all internal control systems finalised to support the governance are widely developed and adequately integrated each other and with operational structures.

The peculiarities of PU-3 make probably the firm hardly comparable to other Italian local public utilities.

5. Findings and discussion

The presentation of findings is organised according to the nine topics identified in the paragraph on research methodology.

[5] Belonging to a regulated capital market (the Italian stock exchange), the PU-3 is subjected to rules about appointment and composition of corporate governance boards.

When the interview took place, the board of directors was formed by a chairman and CEO and seven independent directors (two of whom had been elected by minority shareholders). The independent directors were also members of three standing committees: the nomination committee (really uncommon in Italy), the remuneration committee and the audit committee.

The board of statutory auditors had been appointed in compliance with the Italian legislation (Law no. 262 of 2005, the so-called "Savings Law") that requires a transparent procedure based on lists of candidates presented also by minority shareholders. The chairman of the body had been chosen among the auditors appointed from a minority list.

In the PU-3 there were also an executive committee – entrusted with debating and carrying out the strategies – and a risk management committee. These committees were mixed, including the chairman and CEO together with many other officers.

In accordance with specific laws for listed companies, market regulations and the Italian code of corporate governance, the PU-3 had also the following bodies: the officer in charge of internal control (coinciding with the internal auditor); the executive responsible for the preparation of the company's accounting documents; the person responsible for internal dealing; the officer responsible for keeping the book of relevant persons as concerns the market abuse discipline; the investor relation manager. Moreover, the PU-3 had a risk management unit and the surveillance board in compliance with the Italian legislative decree no. 231 of 2001.

5.1. How are governance purposes established?

In none of the three companies analysed, the privatisation has substantially affected the local government's supremacy in setting out governance purposes: since the local government is the sole or the major shareholder, it continues to influence the general meeting's resolutions through its representatives.

The nature of the activity exercised by public utilities and their strong relation with the local territory stress the existence of integrations or constraints between public service purposes and economic purposes. In other words, the three companies strive to reconcile the orientation to quality (which is implicit for the satisfaction of the community's needs and sometimes imposed by legal standards for some categories of service) with the necessity to obtain a profit in order to remunerate the owner and to reinvest money in the activity.

Contribution to local development is fundamental in current and future strategies of the three public utilities, with a strong identification of each firm with its territory and users' fidelity (as affirmed by the PU-1 during the interview). The privatisation has nevertheless produced wider attention to the economic implications of the activity, which determine the concrete company's ability to compete, particularly on regulated markets. Indeed, the privatisation has promoted the joint adoption of effectiveness and efficiency in reply to various internal and overall external changes as:

- the abolition of the system by which in past years the local government covered losses and financial requirements of the public utility;
- the new system of rates finalised to protect the users, implicating evident restrictions on the possibility to use the rates as a lever for value creation;
- the competition in the sector.

Moreover, the PU-3 underlines that, as a consequence of the listing process, it has committed itself to reach a profit in the interest of all the shareholders; nevertheless, the firm is aware that it must continue to valorise its relation with the local users, because this relation has been the reason for the establishment of the public utility and for its unbroken growth.

The approach adopted by the three companies reflects the concept of triple bottom line (Clarke, 2001): good corporate governance requires the joint pursuit of financial aims, social equity and environmental protection, affirming the global responsibility of the firm towards all its stakeholders and developing a positive company's image in order to rise confidence and approval and to improve the corporate reputation.

Global responsibility summarises financial, social and environmental responsibility. For example, the PU-1 defines these three dimensions of responsibility as in the following:

a) *financial* responsibility expresses the ability to pay remunerations that meet the expectations of the stakeholders who have given resources to the company, as well as the aptitude to create employment;
b) *social* responsibility means to offer welfare and well-balanced growth to all the stakeholders, respecting human and labour rights and shouldering the social consequences produced by the impact of activities on the environment;
c) *environmental* responsibility consists in operating in harmony with the environment, preserving it in the interest of future generations.

These three dimensions interact for the definition of sustainability, which refers to the ability to realise the economic development of a firm, in present and future harmony with the social and environmental context where the activities are exercised (WCED, 1987).

5.2. Key performance indicators and their disclosure to the local government and the other stakeholders

Consistently with the adoption of a wide notion of responsibility, the three public utilities arranged a set of key performance indicators that is useful to represent the different kinds of results obtained in the period; therefore, the indicators can also support top managers in assessment and decision making.

The key performance indicators (or just a part of them, selected in accordance to the stakeholders' ability to understand them) are also disclosed outside the firm. This helps the public utility to improve its relationship with the stakeholders, explaining transparently the factors it considers crucial in order:

- to operate in condition of durable balance between costs and revenues;
- to compete properly in the market;
- to contribute to the local economic development;
- to protect the environment.

Empirical evidence shows that the three companies emphasise the monitoring of economic, competitive, social and environmental performances, analysing the evolution of the key performance indicators represented in Table 1.

Table 1: **Major indicators of global responsibility and sustainability**

	PU-1
Economic performance indicators	Value of production, Ebitda, Ebitda/value of production, investments.
Competitive performance indicators	• Rate of new client acquisition and ability to maintain. • Number of supply points for each service.
Social performance indicators	Creation and distribution of added value among employees, financial backers, the public administration, the local government (as unique shareholder), the company itself (profit reinvestment), grant receivers. • Users: number of users, number of contacts and connected requests, number and length of supply interruptions.
Environmental performance indicators	• Indicators related to environmental certificates and other awards conferred by specialised institutions. • Consumption of primary resources (fuel) and secondary resources (electricity and thermal energy). • Quantity of energy produced and distributed by means of district heating. • Gas emissions. • Quantity of water distributed, treated, lost and employed to produce electricity. • Quantity and typologies of waste produced. • Emissions of NOX, SOX, CO2, etc.
	PU-2
Economic performance indicators	Value of production, ROS, ROI, ROE, leverage, liquid assets.
Competitive performance indicators	Evaluation of suppliers' performances and compliance with the company's requests (half-year analyses made by the Purchase Department).
Social performance indicators	Creation and distribution of added value among employees, financial backers, the public administration, local governments (as shareholders), the company itself (profit reinvestment), the community. • Users: number and typologies of users (domestic or business), number of complaints and reasons, number of calls to the phone centre, waiting time at the counter. • Personnel: number of employees and educational qualification, hours of training, number of employees joined to unions and subject to collective agreements, number of accidents at work and causes. • Suppliers: number and typologies (profit firms or not-for-profit organisations); half-year performance evaluation.

Environmental performance indicators	• Consumption of electricity, water, paper. • Consumed power/sales; consumed water/sales; produced waste/sales. • Quantity of waste disposed, transported, reconverted and subjected to thermal valorisation. • Consumption of electricity, water and fuel for dump functioning. • Emissions of NOX, SOX, CO2, etc.
	PU-3
Economic performance indicators	Sales, Ebitda, Ebit, net profit, stockholders' equity, net debt, net investments, cash flow, ROI, ROE, Ebitda/sales, ROS, Ebitda/financial expenses, net debt/equity, net debt/Ebitda.
Competitive performance indicators	• Market shares of specific businesses. • Benchmark indicators, determined monthly by the Marketing Department.
Social performance indicators	• Personnel: number of employees, gender, educational qualification, job category, type of employment (full time or part time), geographical distribution, number of accidents, hours and type of training. • Local community: activities realised to advantage of inhabitants. • Users: number of users at the counter and medium wait time, number of requests of information, number of complaints, analysis of the quality of services (actual quality compared to the standard). • Suppliers: number and geographical distribution.
Environmental performance indicators	• Energy produced, transported and sold. • Drink water picked up and distributed. • Waste disposed and reconverted. • Direct and indirect consumption of energy by primary source. • Total water withdrawal by source; water recycled and reused. • Direct and indirect greenhouse gas emissions. • Emissions of NOX, SOX, CO2, etc.

Source: direct interviews and companies' annual reports (financial reports, social reports, environmental reports and sustainability reports).

The financial performance indicators are adequately disclosed in the mandatory financial reports of the three companies (annual report, half-year report and quarter-year reports in relation to the nature of the firm and the connected rules). The other types of indicators are methodically published in voluntary social and environmental reports prepared on the basis of specific national and international guidelines (GRI, GBS, Social Statement), which define principles and schemes of disclosure[6].

It is interesting to underline that the PU-1 is involved in a project of financial, social and environmental integrated communication, promoted by the Commune and directed to all the companies in which it holds a share. This confirms that the Commune is paying increasing attention to external expectations of information on activities in which it has invested funds, and that it is committed to awaken the public firms too.

None of the three companies analysed is obliged to prepare privileged reports for its own public shareholder, which is addressee of the same mandatory and voluntary documents divulged to all the stakeholders. Particularly, the transmission of financial information to the local government follows the same rules of disclosure to a generic shareholder that looks over the annual and interim reports.

In an informal and unstructured way, the Commune that is the sole shareholder of the PU-1 can require an estimate of the revenue at the beginning of the year, as well as the pre-final data at the end of the year. In the PU-2, during the year the chairman has full autonomy regarding disclosure of financial results to the local governments, within his tasks of shareholder relation manager. For both PU-1 and PU-2, the concrete choices depend on logics of service valorisation in the territory, which needs open dialogue between the local government and the firm.

Finally, due to its nature of listed firm, the PU-3 must respect the Consob regulations[7] and comply with the Italian stock exchange code of corporate governance, which includes specific rules about company information handling[8] and investor relation[9], in order to guarantee symmetric information for all the investors.

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[6] More exactly:

- the PU-1 publishes its social and environmental report following the guidelines of the GBS (an Italian initiative);
- the PU-2 prepares its sustainability report referring to the GBS, the GRI ("Global Reporting Initiative", probably the most used standard all around the world) and the Social Statement (promoted by the Italian Minister of Labour on the basis of the EU Green Book on corporate social responsibility);
- the PU-3 prepares its sustainability report with reference to the GRI.

[7] The Consob is the public authority responsible for regulating the Italian securities market. Its activity is aimed at the protection of the investing public. In this connection, the Consob is competent for ensuring transparent, complete and accurate information by listed companies.

[8] The code of corporate governance recommends the adoption of procedures aimed at preventing that the firm's disclosure «occurs selectively (i.e. anticipated early only to cer-

5.3. Bodies in charge with establishing targets and responsible for management control

Management control makes use of the interaction among various company's institutional and organisational bodies.

In particular, the corporate governance boards define long-term strategies that are translated firstly into plans and secondly into programs.

The operational managers at different organisational levels must coordinate the resources in order to reach intermediate and partial aims.

The controller must assure the proper functioning of management control system; he assists the operational managers focalising their attention on the key factors they can control inside their own units; moreover, the controller processes information produced by the responsibility centres.

The empirical analysis aimed at verifying at first the existence of a body responsible for management control and, afterwards, the tasks assigned to other persons at different corporate and organisational levels.

First of all, all three companies have implemented the management control system and identified who is responsible for it: in all three cases, this task is assigned to a specific unit belonging to firm. This choice is imputable:

a) in the PU-1, to the facility with which the controller acquires and processes information, considering the small dimension of the company too;
b) in the PU-2, to the closeness to management problems and to the organisation;
c) in the PU-3, to the systematic and well-timed approach the controller can guarantee in supporting operational activities, and also to reasons of privacy – better assured by an internal person – as concerns analyses on corporate businesses.

Evidently, internal units in charge of management control are very reliable regarding: continuity of support to operational units; identification with the firm and suitability for its peculiarities; protection of company information. Companies seem to seek more after these advantages when corporate dimensions and complexity increase.

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tain persons, such as shareholders, journalists or analysts) or in an untimely, incomplete or inadequate manner» (Italian code of corporate governance, Article 4).

[9] «The board of directors shall ensure that a person is identified as responsible for handling the relationships with the shareholders […]» (Italian code of corporate governance, Article 11).

From an organisational perspective, in the two unlisted companies the unit entrusted with management control responds to the CEO (or to the equivalent executive chairman). The listed firm, due to its high complexity, has appointed three deputy managing directors, one of whom is responsible for strategic development; the management control unit refers to him.

As regards professional skills, the unit in charge for management control has a mixed profile: even though financial and business economics education prevails, there are also management engineers (one is the chief of the unit in the PU-2), employed probably in order to make the most of their knowledge of ICT as a support to management control.

It is interesting to underline that, in the two unlisted companies, management control is a centralised activity. The management control unit operates directly in the subsidiaries too: the group is considered as a unity, where the holding company establishes general strategies and manages the information system. Nonetheless, operational complexity has determined the introduction of subordinate controllers in some of the PU-2's subsidiaries.

In the PU-3, the management control system is based on a centralised unit in the listed holding firm and peripheral units in some subsidiaries, one for each business (production of electricity; sales of gas and electricity; the environment). There aren't any hierarchical relationships between the centralised unit and the peripheral units, since the controllers of these latter operate as subordinates of the person responsible for the specific business. However, the units cooperate and share information in order to prepare aggregated budgets and reports, usually monthly[10].

The process of fixing targets and analysing results is differently arranged, depending on the number of responsibility levels that exist in the organisational structure under the chairman or the board of directors. The situation in the three public utilities interviewed is shown in Table 2.

[10] By the fifth working day of each month, peripheral controllers prepare data to be transmitted to the holding company's controller, who realises a sort of consolidation. Consolidated data are afterwards submitted to the executive committee.

Table 2: **Responsibility levels in the three public utilities**

	PU-1	PU-2	PU-3
1st responsibility level	Chairman (temporarily executive)	Chairman (executive)	Board of directors
2nd responsibility level	People responsible for activities	CEO	CEO
3rd responsibility level	People responsible for services	• Staff and control units • Accounting department • Technical department • Environmental department	• Businesses (production of electricity; sales of gas and electricity; the environment) • Corporate functions (i.e.: Personnel)
4th responsibility level	Foremen	Sub-units of the ones at the 3rd level	Responsibility centres

The board of directors (or the chairman) takes part to the process of establishing targets and assessing results, but in different ways in the three firms.

Substantially, in the PU-1 the chairman approves the budget and the investments; afterwards these are submitted to the board of directors for formal ratification, especially in case of relevant impact on the liquidity. Reports containing the comparison between targets and results are transmitted to the board of directors every three months.

In the PU-2, plans and programs pass from the chairman to the board of directors, whose meetings can be open to the CEO on his demand. The variance analysis between targets and results is normally presented once a month to the board of directors, but the interval is sometimes shorter, thanks to the computerised system in which the responsibility centres managers insert their data directly.

In the PU-3, plan and budget approval is one of the board of directors' tasks. Thanks to its composition, the executive committee can indirectly influence the board's decisions, because the chairman and the deputy chairman of the board are also members of the committee. However, the executive committee has no formal role in budget approval; the same happens with reference to the two monthly reports on the results (a concise one and an analytical one). Results are quarterly presented to the board of directors.

The three public utilities analysed in the research strive to involve all the organisational levels when operational targets must be established, adopting a participative approach of budgeting.

In the two unlisted firms, the responsibility centre managers propose operational targets and provide initial data for budgeting.

In the listed company, on the contrary, the responsibility centre managers transmit the proposal of targets for their own unit to the person responsible for the business, who must consolidate the targets. Everyone of the three business officers reflects upon data received and can intervene in the case that targets are not very coherent with the company's general purposes. Each business officer also receives a quarterly report to check partial results; the report focuses on the officer's specific business and it can be concise or analytical, depending on the activity's peculiarities. The business officers can be invited to discuss quarterly results with the general managers, in order to identify opportunities of improvement. On the opposite, responsibility centre managers are just informed on target-result variances; if necessary, following meetings can be realised to study the problems in depth.

In the budgetary process of each public utility interviewed, with differences due to the firm complexity, central and/or peripheral controllers give their support devising and consolidating information and assisting people at the head of centres, services, activities, businesses and staff units, who manage information directly.

5.4. The organisational structure of management control

The correct design of management control system requires to divide the company into responsibility centres, or elementary units that compose the organisational structure. These units give a specific contribution to the general performance of the firm, and they are led by a manager who must coordinate pre-assigned resources in order to realise operational activities in compliance with the general strategies set out by the top managers and transferred into the organisation.

The activity of each responsibility centre is guided and evaluated through measurable indicators or parameters, prevailingly economical. The typical activity of every single centre makes it possible to distinguish among cost centres, revenue centres, profit centres and investment centres.

The public utilities interviewed tend to use cost parameters. Revenues are not very adapt, because they are often determined by fixed public rates (i.e.: rubbish fees) or they are bound by external authorities (as the gas authority and the territorial water authority). Moreover, revenues depend on the number of citizens the company provides with services, that is the number of inhabitants of the zone, which cannot be influenced by the firm. These reasons explain why revenues are not very used by public utilities as control and evaluational parameters in the responsibility centres (or in the whole firm).

The previous considerations also permit affirming that public utilities must strive to reduce their operational, auxiliary and structural costs in order to obtain profits. Indeed, the three firms analysed have adopted parameters based on costs and they use margin measures that are determined by specific typologies of costs. In particular:

a) the PU-1 monitors the service net and gross margin, as well as the costs sustained in structural centres;
b) the PU-2 evaluates its operational units considering their costs and margins, but also quantitative non-monetary parameters (for example, the quantity of waste disposed);
c) in the PU-3, the complexity requires to control both operational costs and operational gross margins in each business, together with the ability of responsibility centre managers to respect the budget.

5.5. The information system of management control

The information system of management control collects, processes and delivers information to selected corporate users in order to support decision making, the translation of general policies in operational behaviour and the performance evaluation.

The information system works in the interest of internal bodies as directors, top managers and responsibility centre managers, as well as for the company's external stakeholders, who are addressees of mandatory, voluntary and recommended disclosure.

Internal need for information differs from external one. Generally, information for internal users is more detailed and finalised to identify the contribution of partial components (products or services, clients, geographical areas, responsibility centres, processes, etc.) to the global economic performance. External stakeholders tend instead to evaluate this latter, leaving out of consideration how it has been obtained.

While financial accounting satisfies the external informative expectations primarily – by means of annual, half-year and, when required, quarterly mandatory reports –management accounting (more exactly, cost accounting) puts emphasis on partial measures directed to facilitate internal decision making and evaluations. Management accounting timeliness is fundamental to take prompt corrective action and to guide activities towards the established targets.

In all three public utilities interviewed, internal reports are produced every month. They are usually directed to the top management and they are deepened in quarterly reports, eventually examined with the managers of business or responsibility centre. Internal reports aren't transmitted to the local government, which receives the mandatory financial reports, in quality of shareholder.

As concerns the objects of management accounting in the three companies analysed, information is structured with reference to services and typologies of customers (distinguishing between domestic users and corporate clients). The PU-2 also makes geographical analyses, due to the different location of the companies belonging to the Group.

However, an information system is really effective if it also sustains the evaluation of competitive, social and environmental performances. From this point of view, the three public utilities should certainly improve their information system. Multidimensional reports haven't been developed yet, but it is interesting to mention two initiatives:

- the PU-1 has implemented an integrated information system in order to control financial data, market data and information on the personnel;
- the PU-3 realises temporal and spatial analyses comparing its services to the ones provided by other public utilities of similar territories.

5.6. The control process and the budgeting process

The control process is the dynamic component of management control system; in strict sense it consists of the following steps integrated with planning and programming:

1. to establish general long-term purposes and to specify them in particular short-term targets;
2. to assign the particular targets to the organisational units;
3. to measure actual results;
4. to compare results with targets;
5. to take corrective action, if necessary (or to modify the targets).

The role exercised by the local government and the firm's directors and officers in setting out purposes and assessing performance has already been considered in this paper. Attention is paid now to the link between the long-term plan and the short-term budget.

The budget usually represents the first year of the plan and it can be divided in significant sub-periods.

In all three public utilities, the annual budget is divided in months and it is fixed: it is prepared before the year begins and it covers the following twelve months, with the possibility to adjust it during the year (usually after the first six months). The budget covers the first year of the plan, which is rolling and has middle length (normally three or four years).

Finally, it is important to stress that the approval of plans and budgets by the board of directors, appointed by the local government, is a form of public control on the company's activity.

5.7. Checks on user satisfaction

The relevance of public services provided to the community underlines the importance of procedures to check the quality perceived by the users, in relation to the service's peculiarities and the firm's whole operating.

This is clearly confirmed by the three public utilities interviewed, which started some years ago to involve the users in processes of quality control.

Specific structures and officers have been established to facilitate the dialogue with the users: counters on the territory, call centres, a complaints department for domestic clients, and new corporate officers in charge to deal with business clients. In particular, the latter is an initiative of the PU-1.

Moreover, the two unlisted public utilities have carried out marketing researches on perceived quality. Moving from the feed-back collected, the companies have taken corrective action as the reorganisation of the Client office, the adjustment of the bill system and new techniques to reduce the queue at the counters.

Different company's bodies take part to the feed-back analysis, as represented in Table 3.

Table 3: **The analysis of feed-back on perceived quality**

	PU-1	**PU-2**	**PU-3**
Bodies responsible for feed-back collecting and analysing	External consultant	Quality department	External consultants
Bodies in charge to audit the analysis	Chairman and CEO	CEO	Chairman and CEO. Executive committee (which decides about service improvement)
Other addressees of the results	Board of directors and part of the personnel (managers and clerks)	Client office, responsible for monitoring the effectiveness of corrective action	All units interested

The strong link with the territory seems to stimulate a clear orientation to quality, overall in the unlisted local public utilities whose success depends considerably on the relations among user satisfaction, economic profitability and public governance.

5.8. How is management control felt inside the company?

Control processes can be effective if the top management and the controller are able to create cohesion around the company's purposes and to explain the usefulness of systematic data collection, variance analysis and open dialogue between the top management and the responsibility centres. In this sense, the relationships between the top management and the organisation should be formal and prearranged as concerns contents and time, as well as informal and personal to promote a transparent dialogue inside the company.

Indeed, in the firms interviewed, these kinds of formal and interpersonal (or informal) relations coexist and should help overcome the doubts about management control.

In public utilities, management control is felt in two conflicting ways:

a) on the one hand, it is considered as an internal consultancy that supports performance improvement;
b) on the other hand, it is felt as an imposition from the top levels and as a burden on the tasks of responsibility centre managers, who are required to notice data.

In particular, in former municipalised firms there is often suspicion towards management control – as declared by the PU-1 – since it questions the results obtained and sometimes the targets pursued too. This is in evident contrast with the previous administrative and bureaucratic approach that permitted substantially accepting every result without raising objections.

In order to increase the awareness of the role of management control and cost accounting, the PU-3 has launched an educational program directed to its employees. This project, realised in cooperation between the management control unit and the personnel department, aims at collecting suggestion and criticism by the responsibility centre managers (for example, about difficulties met in phase of data insertion into the information system); moreover, the program is finalised to clarify the importance of a correct use of accounting instruments.

5.9. The evaluation of the management control system

Similarly to every other corporate function or activity, management control should be reviewed in order to assess its adequacy and effectiveness. The unit entrusted with this task should be the internal audit, more exactly within the ambit of management audit.

Nevertheless the audit of the management control system, to arrive at a global evaluation of its structure and functioning, can be hampered by the actual development of internal audit and by the nature that top managers ascribe to it (as a simple review of compliance or as an activity of assurance and consultancy).

About this aspect, the research has identified the existence of wide margins of improvement, overall in the two unlisted companies.

In fact, internal audit doesn't exist in the PU-1: the evaluation of the management control system is indirectly given by the chairman, when he assesses its validity in forecasting the evolution of internal and external conditions, as well as the financial risks.

In the PU-2, which has an internal audit unit, the evaluation on the management control adequacy considers only cost accounting. The audit report containing the evaluation is submitted to the chairman, who transmits it to the board of directors too.

6. Conclusions

Findings of this research are the starting point for some considerations, even if the analysis has been conducted on a small set of firms. A limit of the research is that it is difficult to generalise the results, due to the little number of companies interviewed; nonetheless, the three selected cases well represent the current changes in local public utilities towards more effective integration between the public function of services and the managerial direction of the firm.

This evolution characterises both formal and substantial privatisation and takes place in small companies of low complexity and very localised custom, as well as in large firms with spatially complex relationships.

The research findings signal the scope for further improvement as regards the establishment of purposes and the management control in local public utilities. To sum up, the results show that all three companies have adequate management control systems to steer and monitor their financial performance, apart from the typology of privatisation. On the contrary, management control on competitive dimension seems to be not very developed yet. Moreover, the organisational culture seems still close and reticent about management control, although the top managers strive to promote it.

Following the research questions, it is possible to propose some concluding remarks.

Research question 1. The privatisation has been realised in different ways in the three public utilities; just in the PU-3 it has determined the entry of private shareholders, more exactly by means of a listing process. Nonetheless, also in this case the local government has maintained a dominant position in establishing governance purposes and steering activities, thanks to its right to appoint the most part of corporate governance boards' members. Therefore, in all three companies the public shareholder represents the community's interests adequately.

The conversion into a stock company has instead produced the equalization of the local government to all other shareholders as regards the diffusion of final reports. Indeed, the local governments have usually access to the same mandatory and voluntary documents at disposal of every other stakeholder (as financial, social, environmental and sustainability reports).

Research question 2. With reference to the adequacy of the management control system in relation to the different dimensions of performance, the monitoring of competitive key factors seems to be neglected: in particular, benchmarks are considered just by the listed public utility in its product analyses.

On the contrary, all three companies continually control the evolution of social and environmental performances, publishing specific reports for all the stakeholders too.

Research question 3. Considering the role of corporate bodies in the establishment and transfer of purposes and in the connected assessment, the research has verified satisfactory interaction between the chairman, the board of directors, the CEO and the other top managers. Moreover, the budgetary process also involves managers from lower levels, bringing forth a participative budget.

Research question 4. The control culture is not very deep-rooted in the personnel yet. The organisation shows traces of the previous bureaucratic approach, so the employees meet difficulties in understanding the role of management control as a service to the proper function of the firm. Consequently, educational programs realised by the PU-3 in order to help the personnel recognise the importance of management control for continuous improvement of the firm are very appreciable.

Research question 5. The review of management control is scarcely structured and systematic and the assessment is usually focalised on the accounting system. Certainly, this is provoked by the lack of internal audit inside the company (or by its focus on compliance, if an internal audit unit exists), and by too little attention to the connections among different internal control systems. Instead, internal control systems should be correctly projected and regularly reviewed, so that they contribute well to fulfil management targets and to satisfy the primary expectations of the local government, the other shareholders and the community.

To conclude, the separation of ownership and management after the privatisation of local public utilities stresses the need to compose equitably:

a) on the one hand, the protection of public interest connected to the nature of services provided and to the role of the public owner;
b) on the other hand, the entrepreneurial autonomy and the ability to create value for all the company's stakeholders, against management rigidity factors too.

All of this underlines the significance of introducing effective internal control systems, and particularly of projecting (or reprojecting) a management control system suitable to monitor the key factors emphasised by privatisation and liberalisation processes.

The three public utilities analysed seem to have begun the adaptation of their internal control systems to the new internal and external situation. However, these internal control systems are still far from assuring an appropriate support to the optimisation of the virtuous circle that binds approval, resources, activities and results.

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