**Full Length Research Paper**

**Integrating public value into public corporate governance-observations from German “Stadtwerke”**

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Accepted 14 May, 2020

A growing number of municipalities worldwide provide public services through separately managed entities. This trend towards “corporatization” raises a range of governance issues that differ from corporate governance at purely private firms. This paper discusses specific issues of “Public Corporate Governance” and their impact on public performance management, by referring to the case of Germany’s municipality-owned, integrated infrastructure firms known as “Stadtwerke”. It argues that while Germany’s “Stadtwerke” can generally take pride in high standards of Public Corporate Governance with a strong focus on economic efficiency and managerial effectiveness, the social outcomes justifying their public mandates are not sufficiently reflected in their governance and performance management schemes. While Public Value is receiving growing interest by public managers of “Stadtwerke”, practical system design and implementation faces a range of obstacles.

**Keywords:** Municipality-owned Companies, Stadtwerke, Public Value

**INTRODUCTION**

The corporatization of public services by municipalities in the area of water, waste management, transportation, energy, or health and welfare aims at the enhancement of efficiency and service quality by injecting managerial practices that are typically employed by private companies (Verhoest et al. 2012; McDonald 2014; Voorn et al. 2017). Corporatization may assume a variety of legal forms ranging from municipality-owned corporations to public-private partnership (PPP) or private finance initiatives (PFI). The outsourcing of the fiduciary duty to provide public services from the direct realm of public administration to a legally separate entity, frequently incorporated according to private company law, constitutes typical problems of agency, as the beholder of the public mandate, the municipality as the principal, delegates the execution and assurance of its mandate to a more or less independently managed agent. Well-known issues of principal-agency-relations such as information asymmetries pose fundamental governance risks to monitor and assure the proper fulfillment of the public mandate by the agent. Furthermore, Public Corporate Governance theory points to specific issues that differ substantially from issues of corporate governance in purely firms (Papenfuß 2013; Papenfuß and Schaefer 2017). One of such differences refers to the nature of performance and its measurement: while private firms are supposed to generate sustainable corporate value, the public mandate also calls for enhancing public welfare, for serving the public interest, for contributing to the public good, and for delivering social outcomes such as equity, justice and participation, while assuring economic efficiency and managerial effectiveness (McDonald 2014). Naturally these are conflicting objectives that require trade-offs and compromises, but also more complex schemes of public performance measurement. New Public Management (NPM) theory has guided the development of public performance management schemes based on the idea of “Value-for-Money” (VFM) that integrates input-oriented metrics (“efficiency”) with measures for output quality (“economy”) and outcomes (“effectiveness”) of public service delivery (Talbot 2010; OECD 2015). Public Value
(PV) theory expands this view and argues that government agencies as “stewards” of public assets should thrive for the generation of public value which requires societal trust, legitimacy and authorization (Moore 1995; Benington and Moore 2011). Yet, in contrast to private value delivered through market-based transactions, the normative objective of public value itself reflects diverse, contested public values and conflicting interests of various stakeholders and results from complex, political processes (Talbot 2010; Bozeman and Johnson 2014). Governance structures and performance management schemes, therefore, need to assure equitable processes to define what constitutes public value, to establish mechanisms for expanding public support and authorization, as well as to develop the required organizational capabilities to generate public value (Moore 1995). A number of evaluation frameworks are proposed that integrate normative definitions of public value with structural and process-oriented mechanisms for assessing organizational capability and democratic legitimacy. Examples are the Public Value Scorecard rooted in the notion of a public value chain and balance sheet (Moore 2015) or the Public Value Map (Welch 2015). This paper addresses the question to what extent the notion of public value is reflected in the design of structures, processes and instruments of Public Corporate Governance at Germany’s municipality-owned, integrated infrastructure service companies known as “Stadtwerke”. It argues that the structures and practices of Public Corporate Governance of “Stadtwerke” demonstrate how to successfully meet economic requirements while maintaining the public mandate. Yet, performance management at “Stadtwerke” places a strong focus on economic and financial requirements, while the contribution to public welfare and the common good is insufficiently measured and monitored. Leaders at “Stadtwerke” are opening up for the concept of public value which they consider to be a powerful approach that provides legitimacy of public enterprise in a market-based economy and serves as the key attribute of differentiation from private enterprise.

METHODS

The analysis of governance structures, processes and instruments of Germany “Stadtwerke” is based on an extensive review of the literature on public corporate governance in Germany and on the management and performance of “Stadtwerke”. A series of structured, in-depth interviews with scholars, experts and leaders of “Stadtwerke” and Public Value theory conducted in February/March 2019 provide further evidence on the governance practices as well as the methodological efforts to incorporate public value into public performance evaluation. The discussion is complemented by empirical studies on the contribution by “Stadtwerke” to the common good.

Governance at „stadtwerke“

In Germany, administrative law requires municipalities to provide services that assure the basic necessities of life for its citizens (so-called “Daseinsfürsorge”), but many municipalities have delegated the fiduciary duties for these services to public enterprises. According to the German Statistics Office, German municipalities held 50% or more of the ownership rights in 15,800 enterprises in 2017, of which more than two-thirds were incorporated as legal entities with limited liability (e.g., GmbH, AG) based on private company law (Statistisches 2018). Of these, 8,300 municipality-owned companies engaged in infrastructure-related services in the area of energy, water, waste, transportation, housing, or culture and sports facility management. Frequently, these service entities are consolidated under the roof of an integrated, infrastructure service conglomerate called “Stadtwerke”, in which the municipality holds 100% of the equity or at least a majority share (Bräunig and Gottschalk 2012; Raupach-Sumiya 2017). Membership in the VKU Verband kommunaler Unternehmen (German Association of Local Utilities of municipally determined infrastructure undertakings and economic enterprises) amounted to 1,474 companies in 2018, employing more than 268,000 employees, and generating 10Bill. Euro in revenues (Verband 2019). 52% of these enterprises were incorporated under private company law, while 49% were governed as entities under public administration law. A key feature of the business model of the “Stadtwerke” is the so-called “Querverbund”, by which profit-generating entities mostly in the fields of energy, water or waste management cross-subsidize businesses with structural losses usually in the area of public transportation or public facility management (e.g., public pools) (Bräunig and Gottschalk 2012; Bundschuh 2014). This business structure allows the “Stadtwerke” to pursue their broad public mandate by exploiting synergies between the various entities or undertakings in respect to administration, procurement, finance, or facility maintenance as well as enjoying tax benefits. Backed by this business structure the German “Stadtwerke” have thrived even under the conditions of market liberalization and deregulation, and command dominant market shares in electric power (61% of retail sales), gas (~67%), heat (70%), and water (86%) (Verband 2019). Deeply rooted in local economies, “Stadtwerke” enjoy a strong

1 Interviews at Stadtwerke München (February 18th, 2019), Eckardt & Partner GmbH (February 19th, 2019), Zeitschrift für Kommunalwirtschaft (February 20th, 2019), Wuppertal Institute and Stadtwerke Wuppertal (February 25th, 2019), Stadtwerke Leipzig (March 6th, 2019), DIW Consult (February 26th, 2019), Handelsshochschule Leipzig (March 6th, 2019), HEAG Darmstadt (March 7th, 2019), Stadtwerke Mainz (March 8th, 2019), Verband kommunaler Unternehmen (March 11th, 2019), Bundeswehrhochschule Hamburg (March 13th, 2019), Stadtwerke Nürtingen (March 18th, 2019)
reputation for high quality services and a high level of customer satisfaction. In general, “Stadtwerke” are considered to be professionally managed and deliver a solid financial performance. According to Pieper (Pieper 2016) who undertook an analysis of financial statements by more than 500 small-, medium- and large-sized Stadtwerke, revenues of “Stadtwerke” grew by 9.9% annually between 2004 and 2012, delivering an average annual net profit of 3.3%, an average return-on-equity (ROE) of 6.2%, and an average return-on-capital-employed (ROCE) of 9.7%.

The governance structure of German “Stadtwerke” and other municipality-owned companies reveal a dual structure that integrates corporate governance institutions from the private sector with those of public governance. As a large number of these companies are incorporated as limited liability companies (GmbH) or joint stock companies (Aktiengesellschaft) the rules and regulations of German private company law in respect to governance, disclosure and financial reporting apply (Papenfuß 2013; Raiser 2010; Hoppe et al. 2012). As an entity with an own legal personality, municipality-owned companies are expected to pursue the objectives of economic efficiency and sustainable creation of corporate value based on the going-concern principle. Specifically, having the fiduciary duty to fulfill a public mandate it would not be justified to take decisions or actions that comprise the capability of corporate value creation. As such, the directors and managers of these municipality-owned companies have a fiduciary duty to the company itself. This is ensured by a two- or three-tiered governance structure stipulated by German company law. In case of a limited liability company (GmbH), these are the member association (Gesellschafter-versammlung) and the executive management (Geschäftsführung); in case of a joint stock company (Aktiengesellschaft) the three-tiered structure includes the shareholders meeting (Aktionärs-versammlung), the supervisory board (Aufsichtsrat) and the executive management board (Vorstand) (Hoppe et al. 2012). While the German Aktiengesetz regulates the statutes, structures, rights and obligations of the individual governance bodies of joint stock companies in great detail and allows for significant autonomy and discretionary power of the executive management, the German GmbH Law provides greater flexibility, but endows the member association with strong directive powers vis-à-vis the executive management. Yet, in both cases the executive management is comprised by professional managers, while the member association or the shareholder meeting and supervisory body of these companies are comprised by representatives of the municipalities, usually including the mayor, who have been delegated into these governance bodies (Papenfuß 2013). Thereby, the public authority maintains powerful channels to influence the strategic direction and major decisions on investment, organization and personnel. Yet, as stated above, these representatives are still obliged by their fiduciary duties to the company.

At the same time, it is duty of the delegates who represent the municipality in the governance bodies to ensure that the public will and policies by the municipality are reflected in the long-term strategy and decision-making of the “Stadtwerke” management. This so-called “duty to influence” (“Ingerenzpflicht”) is derived from the sovereign principle of public authority (Hoppe et al. 2012). As democratically elected members of town halls and local government, the representatives are obliged by administrative law to install structures and processes that assure that their entities pursue the public mandate, meet their fiduciary duties of public service delivery and employ strategies that reflect the public will (Papenfuß 2013; Raiser 2010). Furthermore, the Municipality Code (“Gemeindeordnung”) stipulates three basic principles (“Schrankentrias”) that set certain limits to the business activities of “Stadtwerke”: 1) the activity must have a public purpose, 2) must be backed by sufficient financial capacity of the municipality, and 3) it must abide to the principle of subsidiarity. Finally, the “Stadtwerke” management is bound by competition laws of the European Union, which set rules for matters such as subsidies or procurement, as well as by German public budgetary laws (Papenfuß and Schaefer 2017; Hoppe et al. 2012).

This dual nature of Public Corporate Governance in municipality-owned companies implies conflicting duties for the representatives that need to be matched in practice (Bremer et al. 2006). On the one hand, being subject to private company law, they employ sophisticated controlling and reporting structures like ordinary private firms and publish financial statements in line with general accounting and disclosure rules. At the same time, municipality-owned companies like “Stadtwerke” employ a variety of processes and instruments within public administration to monitor activities along the management process (Papenfuß 2013). Already at the stage of company establishment, critical governance structures, management principles and rules for decision making are laid down in the company statutes and the association contract. These are guided by the Public Corporate Governance Code of public companies that calls on public manager to abide to the “comply-or-explain” principle (Spenlingwimmer 2017). Furthermore, governance is exercised during the regular budget planning and controlling process. Here, an important role is played by the Portfolio Management (so-called “Beteiligungsmanagement”), an administrative function within the municipality that supports the mayor and other administrative functions in the guidance and supervision of the entities (Papenfuß and Schaefer 2017; Cruesen 2014). Next to receiving regular reports by the entities’ executive management and in addition to advice given to the mayor and other representatives that sit on the entities’ governance bodies, the Portfolio Management in many municipalities issues a detailed,
annual investment portfolio report that summarizes the key business activities of the entities, their financial performance as well as planned strategies (Papenfuß et al. 2015).

Public value assessment of “stadtwerke”

While many issues remain unsolved and actual governance practices differ widely, it can be generally concluded that Germany’s municipality-owned companies have developed high level, sophisticated structures, processes and instruments that assure effective, high quality public services, as well as robust supervision of financial health and performance (Papenfuß and Schaefer 2017; Papenfuß et al. 2015; DeutscherStädtetag 2017). However, governance and reporting places a strong focus on financial performance, managerial efficiency and effective service delivery, while non-financial outputs and intended, broader social outcomes related to the public mandate and strategic mission of public municipality companies are more or less neglected (Friedländer 2015; Plazek and Schuster 2018). Due to growing, organizational complexity, a broader variety of business activities and an ever expanding business domain that nowadays encompasses digitization, smart mobility, clean energy or energy management, it becomes increasingly important to integrate the “Stadtwerke” concern under a common “municipality strategy” guided by a comprehensive public mission. For an effective communication of such a strategy and mission, as well as a means for differentiation vis-à-vis private companies, public officials and managers at municipality-owned companies demonstrate a growing interest in the concept of Public Value (Ahrend 2014; Ahrend 2018). Common sense suggests that the high reputation of Germany’s municipality-owned companies, their deep roots in the regional economy, their contribution to the local society and social welfare, or their embracement of clean energy constitute a specific Public Value that sets them apart from private firms. And, in fact, their CSR and sustainability reports emphasize their substantial contribution to society, environmental protection and the common good. Yet, while the notion of public value is quite common, its operationalization as an instrument of governance and performance management is still wanting. One obvious issue is how to evaluate and measure Public Value.

In this respect, the Public Value Scorecard of Meynhardt (Meynhardt 2009; Meynhardt 2015) offers a promising methodology to capture and evaluate a company’s perceived contribution to the common good. Meynhardt’s concept builds on behavioral psychology that defines value as a reflection of basic human needs which have been empirically validated through extensive, experimental testing and which correspond to four dimensions of value: 1) the need for positive self-evaluation (= moral-ethical value), 2) for maximizing pleasure and avoiding pain (= hedonistic-aesthetic value), 3) for gaining control and coherence over once conceptual system (= utilitarian-instrumental value), and 4) the need for positive relationships (= political-social value). The Public Value Scorecard assesses an organization's contribution to the common good based on stakeholder surveys that apply differing inquiry techniques and focus on five sets of items: 1) the utilitarian-instrumental value of the output and outcome of the organization, and the degree of qualitative accomplishment of the organization’s mandate (“Is it useful?”), 2) the utilitarian-instrumental value in respect to economic efficiency and financial validity (“Is it profitable?”), the moral-ethical value and social justification of the organization and its services (“Is it decent?”), the political-social value of organization in respect to its contribution to social cohesion and justice (“Is it politically acceptable?”), and 5) the organization’s hedonistic-aesthetic value and its contribution to people’s well-being (“Is it a positive experience?”).

Though still in its infancy, the Public Value Scorecard is gaining prominence and has been applied by a few public companies (Meynhardt et al. 2017) A recent comparative study of private and public utilities based on the Public Value Scorecard reveals significantly higher scores for the public utilities (Saure 2018).

CONCLUSIONS

The strength of the Public Value Scorecard rests on the fact that it reflects the diverse, relative and subjective perception of public value creation by various stakeholders (Meynhardt 2015; Lindgreen et al. 2019). As such it can be considered as a robust measure for the level of trust, legitimacy and authorization of the assessed organization, which are critical for a public organization.

However, there are obvious drawbacks. The method is rather costly and time consuming. Moreover, the items being assessed reflect the outside perception of the organization’s public value and social impact, but are difficult to transform and link to normative objectives and measures that are required for effective governance and internal performance management. What is required is to establish an empirically robust connection between results of the Public Value Scorecard that represent the outside-in linkage of the various stakeholders with the organization, and normative performance metrics that reflect the inside-out linkage between material items of organizational performance and the varied expectations of its stakeholders. The approach promoted by the Integrated Reporting movement that is gaining momentum in the business world may well serve as such a robust link to the Public Value Scorecard. The integration of financial and non-financial, CSR- and
sustainability-oriented reporting into a coherent narrative of financial, social and environmental value creation suits well to the governance requirements of public companies to capture their creation of public value (Eccles and Kruzus 2015; Katsikas et al. 2017).

REFERENCES


