



# Financial and technical competence of municipal board members: Empirical evidence from the water sector



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## ARTICLE INFO

### Article history:

Received 6 December 2011

Received in revised form 16 June 2012

Accepted 20 August 2012

Available online 21 August 2013

### Mots clés:

Le nouveau management public

Secteur public

Compétences des membres des conseils

Secteur de l'eau

### Palabras clave:

La nueva gestión pública

Sector público

Competencia de junta directiva

Sector agua

### Keywords:

Accountability

New Public Management

Public sector

Board competence

Water sector

## ABSTRACT

The purpose of this article is to investigate municipal board members' financial and technical competence and analyse factors explaining the presence of such competence. Financial expertise estimates were constructed based on the board members' education and professional experience, while financial literacy levels were estimated based on prior board experience and participation in additional training in accounting and finance. Board members' technical competence was assessed in terms of their education. Quantitative data was derived from a survey administered to 354 municipal water utility board members in Finland. The response rate was 52%. The results of the study indicate, first of all, that municipal board members' estimated financial competence levels are not high and that financial competence is associated with organizational form. Secondly, board members' technical competence levels are also fairly low and technical competence is associated with political affiliation. Stewardship theory offers the most plausible explanation for the influence of organizational form on financial and technical competence, while the resource dependency view provides an explanation for the effect of political affiliation on technical competence.

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## 1. Introduction

This paper is concerned with the competence of public sector boards. The use of boards of directors as a governance mechanism has become increasingly common in the “new” or “modernized” public sector characterized by managerialism, marketization and commercialization. As a result of the global wave of New Public Management reforms (Hood, 1995), public services are, to an increasing degree, produced by semi-autonomous public companies and enterprises which are expected to operate more or less according to commercial principles (e.g. Brunsson and Sahlin-Andersson, 2000; Guthrie et al., 2005; Olson et al., 1998; Pollitt and Bouckaert, 2004). Such hybrid organizations (e.g. Shaoul et al., 2012) are often governed by boards of directors; yet the logic of applying this corporate governance mechanism is less straightforward than in the private sector because it involves “a continuous search for the right balance of conflicting purposes and influences, the

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right balance of diverse interests and the right balance between control and autonomy” (Yeung, 2005, p. 568). These conflicting tasks are reflected in the difficulty of defining the role and membership criteria of public sector boards (Cornforth, 2005). On the one hand, the boards may be considered to represent various stakeholder groups, including the general public, which suggests the need to maintain democratic control over the enterprise or company through politically appointed board members. On the other hand, especially in the “new” public sector, the boards may be conceived as the municipal owners’ representatives, whose task is to hold management accountable for the efficient use of funds, provide strategic advice or ensure access to resources. This implies that an equally important selection criterion would be the members’ competence. In the context of business companies, such competence is mainly equated with financial expertise and literacy (e.g. Blue Ribbon Committee, 1999), whereas in the public sector the scope of relevant qualifications is broader and may also comprise competence related an organization’s “specific obligations and policy objectives” (OECD, 2005, p. 50).

Despite their prevalence, public sector boards remain a relatively unexplored topic in corporate governance research (Brennan and Solomon, 2008).<sup>1</sup> Moreover, prior research touching upon the competence of public sector boards is mainly based on case studies (e.g. Collier, 2005; Collin and Tagesson, 2010), and there is thus a need for more empirical research. The purpose of this study is to address these gaps in extant research by exploring municipal board members’ financial and technical competence and factors explaining the presence of such competence. To that end, we analyse quantitative data from a survey administered to board members of municipal water utilities in Finland. The Finnish water sector offers a fruitful research context since; first of all, it is a natural monopoly industry where the utilities’ duty is to offer high-quality technical services while striking a balance between adequate cost recovery and the affordability of services. These characteristics could be expected to require at least some degree of financial and technical competence from the water utilities’ board members. Secondly, the Finnish institutional environment enables the investigation of board competence in a legislative environment which casts municipal board members in the role of monitors and expert advisors but leaves municipalities fairly free to decide who to appoint as the board members of their enterprises or companies, be it political representatives, experts or ordinary citizens. Finally, the Finnish context is particularly appropriate for the study since it allows us to explore differences in financial and technical competence between the boards of two co-existing organizational forms, municipal company and municipal enterprise.

This paper contributes to several fields of literature. Firstly, it adds to the literature on board competence by suggesting how it may be defined and examined in a municipal context. Secondly, it fills a gap in extant research regarding municipal boards by empirically examining variation in competence among water utility board members. Finally, in more general terms, by focusing on the public sector and utilizing a multi-theoretical framework to examine board competence, the study also expands the frontiers of corporate governance research as called for by Brennan and Solomon (2008). Our results indicate that board members’ financial competence is associated with organizational form but not with the members’ political affiliation. In contrast, the members’ technical competence is associated with both organizational form and their political affiliation. These results open up avenues for further research as discussed towards the end of the paper.

The rest of the paper proceeds as follows. The following section concisely outlines the administrative and governance arrangements related to municipal water service organizations in Finland in order to set the study in its empirical and institutional context. Subsequently, the third section elaborates the theoretical perspectives related to this study and develops the hypotheses to be tested. The fourth section presents the operationalization of the concepts of financial and technical competence in this particular study as well as the methods used to collect and analyse the empirical data. The results of the study are laid out in the fifth section and the implications and contributions are discussed in the concluding section.

## 2. Institutional context

Water services<sup>2</sup> form a part of the basic services provided by municipalities. In Finland, as well as in many other countries, the provision of these services is a legislative duty for municipalities. However, water services differ notably from many other municipal basic services such as education and health care (see e.g. Mutiganda, 2013) in that their production may to some extent be considered a business activity because of the New Public Management -inspired legislative requirement for all the water utilities’ costs to be recovered through fees charged to customers as opposed to tax revenue (Water Services Act 119/2001). The production of water services is also a capital-intensive activity with large amounts of money being invested in the construction, maintenance and renovation of water and wastewater networks, treatment plants and equipment. In Finland, as well as in several other Western countries, the majority of such infrastructure is now at an age where constant repair and renovation is needed, and raising customer charges seems unavoidable (ROTI, 2011). These issues make the management and governance of water utilities a particularly challenging task, and the water utilities’ and municipalities’ interest organizations are actively advocating the merging of utilities into larger units in order to attract more qualified personnel and directors (e.g. AFLRA, 2007).

The total number of water utilities in Finland is 1500 and about 400 of these are owned by municipalities while the rest are mainly small user-owned cooperatives and associations (Finnish Environment Institute, 2002). However, approximately

<sup>1</sup> This observation pertains also to other governance mechanisms such as public sector internal auditors (e.g. Roussy, 2013).

<sup>2</sup> Water services may be defined as the abstraction, impoundment, storage, treatment and distribution of surface water or groundwater; and wastewater collection and treatment (EC, 2000).

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