



# Different Successful Patterns for Implementing Holding Model in Public Sector

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## Abstract

**Background:** Transitions in the modern business environment cause significant organizational changes not only in private companies, but also in the public sector. Introduction of an adequate organizational model for the public sector could improve the quality level of public services. **Objectives:** This article aims to present general benefits of the application of the holding organizational paradigm in the public sector through a parallel analysis of several cases that were observed individually in our previous research. The goal is to suggest possible restructuring directions to policy makers in cities where the public sector has not been adjusted to the changes in the modern business environment. **Methods:** The case study research based on the documentation analysis, interviews and direct observation using the standard management consulting practice provided an additional and deeper insight into the functioning of public enterprises in one European capital and one small municipality. **Results:** The examples presented in this paper showed that the application of the holding institutional solution in the public sector leads to an improved command, an increased level of control, reduced management costs, better allocation of city resources and decreased overheads in the public sector. **Conclusions:** Switching from a functional towards a network model of the organizational structure improved the performance of public enterprises and increased the quality of public services.

**Keywords:** holding, network organizational model, public sector, state company, municipality, local government, restructuring, change

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## Introduction

The motivation for this paper was the research that the authors performed while being engaged as the business consultants on projects of public sector restructuring in one European capital and one small municipality. During work on these projects, we faced certain issues related to organization, performance and mutual cooperation of public utilities (Todorović et al., 2012b; 2012c). Similar problems were diagnosed in corresponding

companies, in both public sectors that we analysed, since such companies provide the same public service. In order to develop solutions that will outgrow identified issues, we decided to examine several examples of successful public sector restructuring, and to use parts of their concepts as benchmarks for gaining equally effectual outcomes. The main benefit of this paper is the parallel overview of different forms, based on the same approach, used for overcoming same or similar issues that may appear in the public sector, despite the geographical location of the community or number of residents. We tend to present how various communities solved analogous problems by networking their public enterprises.

After describing the theoretical background of our research, we will present most important details related to the methodology that was used during the project. This will be followed by project overview, with special focus on issues that were identified. Through case analysis of four European cities, where the network organization was implemented in the public sector, we will propose different models for overcoming identified issues, all based on the concept of the public sector. Finally, after discussing the recommendations and possible benefits and improvements, we will give certain conclusions why authorities in the community that was included in our project should consider the introduction of network organizational model to their public sector.

## Literature review

Numerous organizational changes caused by business modernization are reflecting on institutional models of public sector organization all over the world. The public sector is improving its efficiency under constant pressure from environment (Verkuil, 1994). Different authors discussed which organizational form of public companies is the most suitable, not only to provide more efficient services to the residents, but also to reduce the expenses and use the city budget optimally. There is wide agreement that the implementation of network model can bring plenty of benefits to public sector. These benefits reflect in better allocation of public resources, more efficient planning on top level, easier dealing with complex problems, identifying the key values, improvements in learning system, and, which is essential for the residents, in increased quality of public products and services (Jaško, et al. 2010). This network concept is necessarily followed by cooperation with other organizations, in order to fulfil the value chain, so the residents are able to receive complete service. Every public enterprise ought to identify its core business and then focus on it. On the other hand, most of non-core activities should be outsourced to other public companies, whose identified core business includes those activities. After completing the outsourcing process, the development of network organizational model can be started (Popović, et al., 2010).

In many municipalities these advantages have been recognized as the opportunity for gaining benefits both for residents and public enterprises (Todorović, et al., 2012b; 2012c). This led to the restructuring of their public sectors through implementation of network organizational model. In most cases, holding institutional concept was introduced. Holding is the term that stands for the corporate form that controls other companies through shares ownership (Dulanović et al., 2009), existing with slight differences in corporate laws of most countries. The result of public sector reform in Italy during 1990s is the introduction of holding solutions to many cities in this country. Certain parts of these new-formed holdings were later sold to private companies, but in most situations cities remained major owners of public companies (Garrone, et al., 2010). One of the main causes for forming a network of public companies is the increase in public sector costs. In the 1990s, complete reform of the public sector in Italy was caused by the increased expenses, which motivated many city authorities to form public holdings. This whole process was followed by the necessary legislation (Bognetti et al., 2007). Next motive for forming a public network is the reduction of transaction costs. They represent the expenses that appear when product move across the borders of organizational system or some of its parts (Dulanović et al., 2007). Decreased overheads cause improvements in business performance of public sector, which leads towards better quality of public services. Local public companies should not be considered as non-efficient monopoly organizations (Hall, 1998). For example, water company 100% owned by the city of Berlin was one of the key partners during water supply privatization in Budapest. Similar examples can be found in other German cities, like Frankfurt and Mannheim (Hall, 1998).

Another reason for introducing network to public sector is the release of some functions that used to be performed in public companies. As it was mentioned before, certain parts of Italian holdings were later sold, which led to the public-private partnerships. In Genoa, for example, city holding Azienda Mediterraneo del Gaz and Acqua was formed in 1995, and already in 1996 49% of its shares were sold to private investors. These public-private partnerships additionally improve the quality of public services.

Holdings first appeared as an institutional model in the public sector in the beginning of the 20th century, when energetic producers in the USA formed holding companies (Hawes, 1984). However, it was very soon forbidden by the Public Utility Holding Company Act of 1935, due to the monopoly (Hawes, 1984). Nevertheless, organizing public municipal companies as a network was not forbidden. Since they belong to different industries, their networking would not lead towards monopoly position. In some municipalities the authorities decided to introduce this model (Todorović et al., 2012a). The main purpose of public sector is to satisfy public needs. Although before mentioned energy companies from USA were providing a public service, they were privately owned and profit-oriented, so their integration was not allowed, since it would harm the residents through increased fees. The examples of successful public holdings can be found all over the world. Issues that we identified during the project can be overcome by implementing specific parts of different patterns that proved to be successful solutions. In this article will be described four cases of good practice from European cities of different sizes. Each pattern provides certain benefits that will be pointed out and analysed.

## Methodology

The authors of this paper have been engaged in two public sector restructuring projects since 2011. First one covered 28 public and public communal enterprises from one large city, while second involved 8 different utilities from one municipality. This means that our conclusions and hypothesis are derived from the sample of 36 public entities that are providing public services in two different public sectors. The total number of 21.666 employees in all these companies was included in our analysis.

For analysing public companies during both projects, we used an approach based on standard management consulting practice (Bosilj Vukšić et al., 2013). We gathered necessary qualitative and quantitative data through documentation analysis, direct observation and interviews with employees.

Documents that describe current organizational structure, systematization and job classifications provided us with enough quantitative data about the number of differently named workplaces in each enterprise, as well as on the public sector level. Since some same positions have various titles in different companies of same public sector, from job descriptions and quality management system we managed to derive most of business processes and get insight into actual number of different workplaces. Through salary reports we calculated the total number of employees on each position.

Since the actual situation differs from one that is described in the documentation, our next step was to visit each company and identify missing processes. For this purpose, observation, as a qualitative research method, was a very useful tool (Todorović et al. 2012c). Separate meetings were organized with top executives of every company, in order to understand the role of each part of the public sector. However, these executives are more involved into strategic issues than in operational ones. For this reason, we also interviewed the employees on lower hierarchical levels. They are directly involved in the operations and are the experts in the processes performed in their departments. This way we were able to become familiar with the business processes within each public company. This was a precondition for successful restructuring (Komazec et al., 2012), as well connected with financial and non-financial performance (Hernaus et al., 2012). Hypotheses about the performance of each public utility were generated from financial reports.

Such comprehensive approach provided us with the opportunity for rather deep analysis and identification of problems at all hierarchical levels, in every public enterprise. Having performed that, we were able to identify the key issues in both public sectors, not only in single companies, but also on a global level. In order to find the most efficient way to deal

with these issues, we decided to analyse organizational models of more developed cities and municipalities. For this purpose, we studied several research that included cases of successful public sector restructuring (Indihar Stemberger et al., 2007; Longo et al., 2008; Szabo, 2008; Weiermair et al., 2008). Certain advantages and benefits brought by the patterns used in these communities to focus on improving parameters that we identified as problematic in our research. Consequently, the mechanisms that were implemented in presented cases can be used to overcome the issues that we faced during our projects, as will be presented in this article.

## Results

### *Project overview and identified issues*

During the projects we identified the functional model of organizational structure in almost all public companies. Its tendency to generalize the efficiency and contribution of different parts of structure to total business success of the company (Hansen et al., 2006) negatively affects the efficiency of the public sector. Although a single company may seem to be operating positively, some of its functions might be rather inefficient (Aharoni, 2000). Same way, on a higher level, if the public sector does not generate losses globally, it is possible that some public enterprises have negative scores. This article tends to question, through analysis of several cases from different cities, whether this side effect can be overcome by introducing network type of organizational structure, with holding as an institutional model.

We also noticed that each public company has its own steering committee, and some of them consist of more than ten people. For this reason, one of the main principles of management, unity of direction (Fayol, 1984), is not applied appropriately. As a consequence, the situations where public company that is supposed to provide another public company with some sort of service has no resources available at that moment are often present. In that case, some private company needs to be hired, usually at a higher price, so the costs are increasing. And if this happens often, total expenses of the public sector are much higher than they would be if network organizational model was implemented. In this paper we will show that the implementation of holding approach is followed by forming a unique board at the head of the city holding, that would deal with strategic decisions on the top level, while operational activities would remain in the companies. This not only significantly reduces management costs in the public sector, but also improves the coordination. This board should consist both of members of all public companies and representatives of the city authorities.

This lack of coordination between different companies is not the only issue. Another side effect of functional organization is the absence of cooperation between public companies and third parties. When organized as a network, public companies can focus only on their core business, which enables their employees to specialize in these activities. This way they are able improve the quality level of their outputs, which enables them to be competitive on free market, as will be presented in case studies analyzed in this paper. Furthermore, introduction of network organization also enables the formation of public-private partnerships, as it was mentioned previously, which are currently not often present in public companies that were involved in our project.

Since every analyzed public enterprise operates separately, under the supervision of its own steering committee, community authorities do not have appropriate control level of activities that are performed in public sector, in both analyzed cases. This reflects negatively on the quality of public services, which harms living standard in these communities. This article will also show that application of network organizational model with holding as institutional model can significantly increase control level in public sector, which is followed by improved quality of outputs generated by public enterprises.

### *Case study: Győr, Hungary*

In order to create a city owned company that will enable professional managing of public assets, local authorities in Győr, town in northwest Hungary, in 2007 decided to completely reorganize the public sector. They implemented holding approach. Since new holding company was supposed to direct and control the business of other independent public

companies, the supervisory board was formed. The idea was to delegate public services to professional managers, instead of leading party members. However, city authorities still had the possibility to place their representatives in the steering committee, which allowed them to keep immediate insight and control. By introducing this kind of unique supervisory board, controlled by government representatives, city authorities in Győr not only enabled management professionalization, but they also significantly reduced management costs, since the restructuring brought a smaller number of board members in the public sector, on a global level.

Another very important goal of Győr holding was to reduce financial pressure on the city budget. Common liquidity control and investments optimization led to certain savings when holding was formed (Szabo, 2008). Its position on financial market was significantly improved due to the size of the new company, so the loans could be taken at more affordable terms than earlier, when each public enterprise negotiated with the creditors individually. Cash flow control was also improved, so all the funding was allocated in accordance with strategy for city development. The networking provided additional forms of financing public companies (Krivokapić et al., 2012). Besides taking loans from commercial banks, holding management implemented one more self-financing concept. It considered forming a sort of internal bank to manage the free resources. This opened the possibility for companies to get credits from other members of the holding, at a more affordable interest rate than any commercial bank could offer.

#### *Case study: Ljubljana, Slovenia*

A public holding in Ljubljana was founded in 1994. Today it consists of four companies: *Energetika Ljubljana*, that provides heating services, *Vodovod i kanalizacija*, which is responsible for water supply, transportation company *Ljubljanski potnički promet (LPP)* and *Snaga* company, which is the provider of green area maintenance, sanitation and garbage management.

The main characteristic of this public holding is the existence of external sources of financing, in addition to its core business. This means that holding members compete with private companies. For example, *LPP* is authorized to provide technical reviews, so besides processing its own vehicles, it also offers this service on the free market. Complete technical review and vehicle registration process can be completed there.

#### *Case study: Milano, Italy*

One of the cities where the holding was formed during already mentioned public sector reform in Italy is Milano. Besides providing the services that are usually under the control of public sector, such as heating, water supply or public transportation, city holding in Milano also manages sports objects, cultural manifestations and food supply of schools and kindergartens. In order to provide better control of the activities performed by public companies, holding members, a very complex set of control instruments needed to be formed. Besides increased level of control, another goal of this system was to secure the city demands in terms of quality and quantity of the services provided.

Figure 1 illustrates the system that enables the city authorities to have an adequate control level of activities performed by public companies. *Finance Department* and *Central Office* are part of the same mechanism. While *Central Office* manages contracting between the city of Milano and public holding, *Finance Department* controls the financial transactions and checks the financial reports of municipal companies that form the city holding (Longo et al., 2008). These two units represent the financial connection between the city and its holding company.

One of the main characteristics of the city holding in Milano, that makes it different from most other similar models, is the existence of separate organizational unit for quality management. Purpose of quality control concept in public sector is to identify the needs of residents and to define the way to satisfy those needs. *Quality Control Service* performs the researches in order to determine the level of satisfaction with the public services among the residents and defines the standards. If some holding entity does not satisfy these standards when providing the service, *Central Office* will stop the payment for that service.



Figure 1

Set of control instruments for activities of municipal companies in Milano



Source: Authors' work, based on the Longo et al. (2008)

Before the holding was formed, city of Milano provided the services directly or via certain agencies, so called *aziende municipalizzate*, that were 100% owned by the city. The goal of the reform was to implement modern management principles into the functioning of public companies. Today, all the activities are managed using the instruments that were previously described. Private companies are also included in the public sector, through partial ownership of some holding entities. City of Milano achieves its ownership rights through a steering committee, which consists of the representatives of current local government. This is the top level of holding management and the lowest hierarchical level where politics play a key role when it comes to membership.

### Case study: Vienna, Austria

The Vienna city holding was found in 1974 and represents one of the first city holdings in this part of Europe. Today it consists of 75 small and large companies and currently is 100% owned by the city of Vienna. In this case, two concepts that are usually considered to be antagonistic are implemented together. First one is focused on the needs of residents, and the second one on gaining profit and providing additional services, besides the public ones. Share that was in the ownership of the city has been changing during the years. In the 1990s, significant stake was owned by the *Bank Austria*. However, since 2001 the city of Vienna has been the only owner of the complete city holding.

One of the main characteristics of Vienna holding is the existence of numerous partnerships between public sector and private companies. The partnerships tend to share risks and profits and the aim is to reach synergy effects, implying the possibility to create competitive advantages (Weiermair et al., 2008). They provide added value for the residents, and require small financial investments. The most common form of partnership is the situation when the city gives land in concession to private company, in order to build some object. After using it for agreed period of time, recovering the investment and gaining certain profit, private company transfers the ownership to the holding. City of Vienna formed the partnership with *Central Danube Region GmbH*. Together they were involved in certain projects of cooperation with other cities on central Danube, and in several infrastructure development projects in this region. Another example is the reconstructing of the house that belonged to famous Austrian composer Wolfgang Amadeus Mozart. In both projects partner was *Raiffeisen Bank* in Austria.

## Discussion

When complete public sector is organized functionally, public companies tend to operate as individual subjects and perform their tasks independently, under the strategic governance of city authorities. Most of them usually form non-core units in their organizational structure, whose task is to provide necessary activities of support. Since these functions are not occupied all the time, significant reserves are generated. For this reason, when performance of public companies is analyzed using the Porter's value chain, certain reserves in the number of people are found in almost every public company that we have encountered. Even if the performance of certain companies is near optimum, they globally generate large expenses, since the complete public sector is financed from the city budget and should not be observed as a group of independent companies, but as a single entity. In cities where holding institutional model is introduced, units such as marketing, finance, accounting, security, objects maintenance, human resources or general and legal affairs can serve more than one public company, leading towards significant reduction of the overheads in the whole public sector, on a global level. However, this also means that the introduction of network organizational model is usually followed by a reduction in the number of employees, which can present a very important issue during the implementation process, especially in public companies (Čudanov et al., 2012).

Most non-core organizational units that are identified when performing functional analysis of different public companies are common to the set of companies that we observed. The implementation of network models of organizational structure could increase the efficiency of the public sector by integrating these non-core functions into unique departments, which will serve the complete holding. However, it means that some of the employees have to change their work location, while certain number may lose the job. Social factors need to be processed carefully when integrating the activities of different organizations (Fabac et al., 2011), in order to ensure sustainability.

Structural analysis of public companies that are not organized as a network in most cases identifies the functional model of organizational structure as present. Its tendency to generalize the contribution of different functions is very present, and can be reduced by introducing a holding solution for the public sector. This can also significantly improve the coordination, which is on low level due to the existence of many steering committees, one in each public company. The practice showed that forming unique board for the whole public holding leads towards better coordination and reduced management costs. The board should include the representatives of all public companies and the delegates of community authorities. Nevertheless, not all public companies are equally important. Some of them might have better business results, provide most essential public services or hire more employees. For all these reasons, selecting adequate members for this board is a very delicate issue that must be approached carefully.

Besides improving coordination, restructuring of this kind also increases the level of control and significantly reduces the overheads in the public sector, due to decreased number of managers. It also upgrades the control range and improves unity of command and unity of direction, two important principles of management (Fayol, 1984). However, this process is very likely to be followed by resistance of certain managers, since their authorizations and power will be reduced, while some of them may even lose their managerial position and be downgraded toward operative tasks.

## Conclusion

Process of restructuring complete public sector is a long-term and comprehensive task, with plenty of issues that have to be overcome. Analysis of current situation in every public company and examination of strategic directions for future development is definitely the first step. Our research presented that implementation of network organizational model proved to be successful solution for public sector organization in several cities and municipalities. Analysed cases showed that the predominant institutional model for the public sector network is holding. The examples presented in this paper showed that the application of holding institutional solution in public sector leads to improved command, increased level of control, reduced management costs, better allocation of city resources and decreased

overheads in the public sector. Positive results were achieved despite the size of the city, its geographical location or cultural characteristics of its residents, due to the high adjustability of the model. The ultimate goals are increased business performance of public enterprises, improved quality of public services and better living standard in the community. For this reason, holding approach gains benefits not only to the city, but also to the residents.

In communities where cooperation between public utilities is not on a high level, introduction of holding model can lead to significant improvements, as described in this article. However, since the activities that are carried out in such organized public companies are only slightly integrated, or not integrated at all, the precondition for institutional changes is the networking of business processes performed in different public entities. The cornerstone of all changes is the successful development of integrated information system, which will increase the efficiency and control level in public companies (Čudanov et al., 2009). Changes in organizational structure are in correlation with technological improvements in the organization (Todorović et al., 2012). This kind of information system also supports the decision making process on a global level. It should be followed by integration of financial and accounting activities, with the standardization of planning and reporting. Integrated system allows the authorities to measure the performance of public companies more reliably, which not only increases the quality of decision making, but also brings more transparency to the activities performed by the public sector.

Local authorities of various communities may find in this paper description of problems similar to those they face on a daily level. Different kinds of network models, all based on holding institutional form, which are presented in this article, show possible ways of dealing with these issues, through restructuring the public sector into the network. Practical implementation of our research reflects in comparison of different public network models, so it can present the guidelines for governments in communities where described problems are identified.

The limitation of this research was the lack of financial indicators related to the period before network solutions were implemented, which prevented us from analysing whether the reorganization was followed with improved business results of public enterprises. When the concept we proposed is implemented and performance indicators can be calculated, we will try to derive certain conclusions about effectiveness of holding model and gained improvements in some of our future research. Our further research will also be focused on developing efficient and effective methodology for introducing holding institutional model to cities and municipalities where public companies are still organized as set of independent entities with functional organizational structure.

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