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The owner's supervision over special municipal companies executing the order in house

Key words: owner's supervision, capital companies of the municipal sector, general economic interests, public services, order in house

Summary: The purpose of the research described in the article is execution of the existing system of the owner's supervision over special capital companies of the municipal sector, practicing in house order (SCMS), and to present the idea of the owner's supervision performed by individuals of the local government (LG) over these companies, along with giving the conditions of its implementation.

The article presents discussion around the essence and meaning of the privatization of public aims, methods of their privatization, and detailed analysis of popular so called order in house. The entire problem was presented in the context of the performance of the owner's supervision over a company performing this type of order. Further, the article presents a case study of functioning of this type of companies and presents the model of the supervisory structure on the example of research of empirical municipal companies. The final part of the article presents conclusions from the research.

1. Introduction

Among numerous occurrences and processes which appeared in Poland after 1989 and influenced the transformation of the socio-economic system, one can point to: decentralization of the public power and commercialization, and even privatization of services provided by the public section. A basic institution which makes privatization of public services possible by organ of the public administration is the system of the public-private partnership.

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In Poland this system is still in the first phase of development, continuous evolution, and is the base of many discussions and investigations, mostly for distrust and reluctance between the private business and the public administration. That is why the public administration is seeking new solutions. Some of them make the process of privatization more formal than real, which makes, in practice, inauthentic privatization.

In the article the ways of executing of public objectives by private subjects, focusing especially on the so called in house orders, are analyzed.

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The following research hypothesis was formulated: the structure and the effectiveness of the owner's supervision is dependent on the strategy accepted by the owner in this case (LG).

The research approach is the analysis of predecessors' research and my own research using the techniques of interview, observation and case study. The questions concerned the aim of research, i.e. the construction of the model and the effectiveness of the owner's supervision. Members of boards of directors and management SSK were interviewed.

2. The review of the ways of privatization of public aims

The Polish law allows the execution of public tasks by LG in one of the following forms:

- with own powers, that is to say by a formed entity without legal status, e.g. the budget entity or in some cases the municipal budget institution;
- by giving of the grant in aid to entitled subjects, based on legal regulations resulting from e.g. the law on public use and on voluntary service;
- giving the tasks to chosen subjects in modes provided in law of public orders (LPO), the law on license on building operations or services and the law on public-private partnership (PPP).

The accessible methods for LG, thanks to which the privatization of the realization of public objectives is possible, are:

- the license contract;
- the public-private partnership.

According to the law on municipal economy, LG by the means of the contract can assign the tasks from municipal economy to natural persons, to legal bodies or

to organizational entities which do not have the legal status, chosen in the mode of LPO.

The construction of both the institution of the license as well as PPP eliminate projects which guarantee to the private partner or to the licensee the full cover of outlays of the public subject, or granting a concession. That is why in the economic activity on the same point of public sector (municipal) and private, the described forms of the cooperation are still not popular.

In the last years one can observe occurrence of the position of economic subjects with the participation of local autonomies, by giving companies with 100% LG participation the execution of the tasks on the basis of so called in house order. Nowadays this form has gained great importance in the organization by autonomies of managing waste material according to 'new garbage law'. The form has been however known before, at the organization of the collective transportation, on the basis of the law on public collective transportation, where one introduced the notion of internal subject.

Regulations presented, though in accordance with the legislation of the European Union, cause strong reactions and doubts among liberal circles.¹ These companies are especially subject of dispraise of the unfair competition, or receiving of the public help in the form of compensation.

Advocates of the order in house think that the formula 'the best value money'—that is to say, the best quality for definite money—correlates with this criterion, being the foundation of optimization of effectiveness of municipal sector (3, p. 1).

Nowadays orders in house are very common way of execution of public tasks, because of numerous advantages:

1. The executor of the task is internal subject, separate from autonomy, legal person, qualified in compliance with a Commercial Companies Code (CCC).
2. Despite the fact that sides of in house order have legal status, the order is not given on the basis of regulations of the LPO.
3. A base of such order is the act of the determining organ (Parish Councils) which gives the internal subject the execution of the task.

A company of the commercial law can be recognized as the internal subject, it must fulfill the following conditions:²

1. LG must have a control over internal subject, which is in the form of the company of commercial law. This is the same control as over one's own services.
2. The company—the internal subject should execute the greater part of its own activity on autonomy.

The treaty about functioning of the European Union leaves in the competence of member states to predominate tasks executed in the common interest and set conse-

¹ The decision of the Committee EU of the 20 December 2011 in the matter of the usage, item 106, par. 2

² Orders EU no. 1370/2007 of the European Parliament and the Committee of the 23 October 2007.

quential organizational rules with reference to proper services, though member states must take into account community law (EUL), because all activity concerning delivery of goods and providing of services on the given market is fundamentally economic activity, regardless of the legal status of the given firm and the manner of its financing.

Considering the law on the municipal economy one ought to accept that the internal subject can be capital companies of the commercial law whose stock or shares belong 100% to LG. The acceptance of such criteria became an essential determinant for the leadership of the economic policy of autonomy.

Depriving the market of elements of competitiveness in confrontation with the customer is, according to liberal economic practitioners, an element of return to the order distribute system from the past epoch.

One ought to remember that when the EU legislation allows such form of commissioning services provided in the common economic interest, then it becomes, in present macroeconomic conditionings (with the participation of the public section, including municipal, in the economy, grows), often case.

With objective premises of the usage of the order in house, advised by the EU regulations are (3, p. 1):

- necessity of assuring continuity and certainty of realization of the public task;
- considerable value and degree of complexity of infrastructure necessary for execution of the public task;
- low degree of competitiveness on the market of subjects working on the public tasks.

All concerning interpretations of this type of services emphasize the fact that the order in house should be treated as an exception, and not a rule, as it is a threat for local competitors.

3. The specificity of the owner's supervision over (SCMS)— attempts of evaluation

The municipal company, meeting the conditions of the internal subject and using orders in house, has many advocates in municipal circles. But in the opinion of the greater part of economic practitioners, it is a privileged entity. This situation causes whole range of problems connected with specificity of the performance of the owner's supervision over this type of entities.

Problems of the owner's supervision of capital companies of the municipal business sector differ considerably from those which appear in the private business sector. That is why the problems of efficiency of this supervision raise controversies because of frequent transformations, coming from the research of the suitable model of the functioning of autonomies in Poland.

Nevertheless, in the previous years we could observe a growth in interest of the external supervision, including the mechanisms coming from the environment of the firm, and also with groups of business generally called stakeholders it is the municipal sector that oscillates towards intensifying of internal supervision, based on supervisory function, characteristic of bureaucratic structures. The direction of these changes is forced by internal legislation of member states of the EU, appointing internal entities.

An object of the analysis of the supervision over a municipal company being an internal entity is the execution of the owner's supervision over these subjects created for implementing the new system of municipal garbage economy.

Authors of different ideas of the owner's supervision do not question necessities of leaving some companies with bigger participation of the public section. However, extending of this by the internal legislation of member states of the EU and specifying different kinds of conditions of the privilege (e.g. the manner of the exercising control, or the way determining the compensation), causes the necessity of the change of the manner of exercising the owner's supervision enriching it in new adequate mechanisms for this type of companies.

On the grounds of analyses of literature and one's own research for evaluation of effectiveness of the SCMS, one can adapt the following criteria adequate for municipal sector (1, pp. 196–199):

1. Defining of objectives for the municipal firms.
2. Influence of groups of stakeholders on decisions made by the management.
3. The role of the board of directors and the manner of its work.
4. Competence of members of supervisory board.
5. Manners of paying salary to the management of a company.
6. The degree of influence of external supervisory institutions.
7. Barriers which make it difficult for the company to participate in capital markets.
8. The quality of audits and research of year's balances.
9. Information policy used by the management.

The full analysis of all criteria, in consideration with the limitations coming from the nature of this paper, is impossible. Therefore, the aim of the elaboration is a lot more modest and refers exclusively to the evaluation of the way the board of directors works. This institution, according to the author, as well as in the opinion of many theoreticians and practitioners, is a most important one (6, pp. 45–46).

The research area connected with the realization of aims of the article included an analysis of the way of work of boards of directors of two companies, both dealing with garbage material. With the decision of the Parish Councils, they obtained the status of the internal subject. In the analysis of functioning of boards of directors of these companies, research tools in the form of observation, interview and also analysis of the records (official records of sessions of boards of directors) were used.

On the grounds of extensive analysis of the collected materials one presented following conclusions concerning the way of the work of boards of directors, and one presented the proposals of the improvement of the model of the owner's supervision SCMS of executing in house orders:

1. Functioning of the company of commercial law as internal subject and executing in house orders are connected with the matter of compensation obtained by the company, in connection with realization of public tasks. A fundamental task for supervisory bodies is the range and the manner of settlement of its proper level.³
2. The legislation concerning appointments of internal subject, and also orders in house denote, what premises decide whether the accepted compensation does not determine the prohibited public help. Therefore, boards of directors should pay close attention to the following elements:
 - the precise standard of realization of the public task;
 - the objective and clear algorithm of the manner of the payment of the compensation;
 - the height of compensation which cannot exceed the net costs carried during realization of a given public task, plus the reasonable profit;
 - the level of compensation in the account to costs, which would be carried by typical, well administered firm that has suitable resources for realization of the public task.
3. To establish the compensation for SCMS one should take into consideration the problem of secondary activity. Products of that activity are sold on the market and can result in additional disturbance of the competition. Boards of directors should control the cost accounting of the production of these products/ services, with a special attention whether they are included in partial compensation.
4. Secondary activity should be an exception and should have special justification, subjected to close supervision.
5. SCMS realizing order in house cannot conduct sponsorship activity. This results from the fact that the financial result and amortization should be the surplus serving only to the reproduction of the company's assets, connected with realization of this type of order. Supervisory bodies of companies should show interest also in this aspect.

³ For the compensation one ought to acknowledge every increase obtained by internal subject connected with realization of charging assignment.

4. The model of supervisory structure SCMS realizing the order in house

Presented conclusions show aspects which do not reflect in the present model of the owner's supervision of municipal companies.⁴

In Polish realities of the municipal economy most often supervisory activities are done by boards of directors. Efficiency and intensity of the supervision in large degree depends on the standards of the owner's supervision, activities of council members and the way of monitoring the work of companies and their organs by offices, licensed by the organ determined by decision making body of the community.

One should remember that in compliance with general idea of the owner's supervision, the aims of municipal companies and the construction of the system of the owner's supervision depend on the strategy of the owner that is LG. This proves the theory that the owner strongly affects the strategy of the organization and its owner's supervision (2).

Considering existing manners of the performance of the supervision in municipal companies, as well as presented conclusions from the analysis of functioning of SCMS, the frame model of the system of the supervisory structure for this type of companies has been worked out.

A basic matter in presented model is the change of the manner of board of directors work, aiming at strengthening of its potential. It is possible by obligatory creation in its structure committees or positions responsible for audit of the procedure of calculating the compensation as in the point 2 of the analysis, and also the committee of the financial control according to adequate standards for internal entities. Also, the management of the company should use conclusions coming from the system of internal audit LG (in this the internal audit), which will be according to the present law.

Present standards for members of boards of directors of capital companies require that they were responsible for creating the strategy of functioning. That is why this aspect must be placed in the specific construction of SCMS, realizing the order in house. The range of its qualification should take into account legal aspects of the EU legislation and the opinions of EUL, as well as thorough knowledge of problems from the financial and budget accountancy.

⁴ The model of the owner's supervision of municipal companies is the manner of performance of acts superintending the manageresses in the company, consequential from the existing national system of the owner's supervision and also conditioning consequential of the creature of municipal economy.

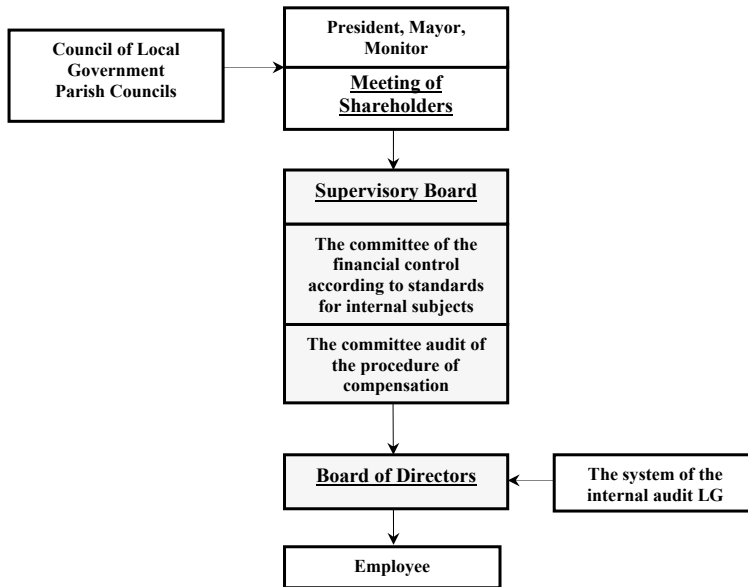


Figure 1. The frame model of the system of supervisory structure for this type of companies being the internal subjects realizing the order in house

S o u r c e: Author's own elaboration according to the outcome of the research.

The presented model of the supervisory structure SSK, in compliance with the accepted research hypothesis, is the derivative of accepted by LG strategy. The complex evaluation of the effectiveness of the owner's supervision for this type of companies demands the system approach. Its full analysis in the paper would be difficult, if not impossible.

LG authorities deciding on conducting the municipal economy in the form of SCMS, realizing the order in house, should remember that giving special rights to economic subjects realizing services for the common economic business is only allowed in the case of impossibility of executing these tasks without sending them to internal subjects. This aspect should be fundamental for regulatory and supervisory authorities of LG.

5. Conclusions

The municipal members of boards of directors should not be restricted by directions of determining organ, but most importantly basing on their own experience and knowledge on specifics of the supervision over this type with entities, as well as with recordings of CCC.

Pragmatics of the improvement of the system of the owner's supervision SCMS should (except for new solutions) take into consideration solutions taken from the private sector, of course after previous verification and modification, e.g. in the matter of manager contracts, or manners of execution of supervisory activities (the monistic model).

The intention of the author is to spark the important discussion about the model of executing the supervision over municipal companies serving public objectives.

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Nadzór właścicielski nad specjalnymi spółkami komunalnymi realizującymi zamówienia *in house*

Streszczenie: W artykule przedstawiono dyskusję wokół istoty i znaczenia prywatyzacji celów publicznych. Dokonano prezentacji metod ich prywatyzacji, a także omówiono szczególnie popularne obecnie tak zwane zlecenie *in house*. Całość zagadnienia została opisana w kontekście sprawowania nadzoru właścicielskiego nad spółką realizującą tego typu zlecenie. W dalszej części artykułu zaprezentowano analizę przypadku funkcjonowania tego typu spółek oraz przedstawiono ramowy model struktury nadzorczej na przykładzie badań empirycznych spółek komunalnych. W końcowej części artykułu umieszczono wnioski wynikające z przeprowadzonych badań.

Słowa kluczowe: nadzór właścicielski, spółki kapitałowe sektora komunalnego, interes publiczny, usługi publiczne, zamówienie *in house*
