DEVELOPING PUBLIC-PRIVATE PARTNERSHIPS IN CHANGING BUSINESS ENVIRONMENT: EVIDENCE FROM THE DANISH AND FINNISH ENERGY SECTORS

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Introduction
Recent studies indicate that decision-making processes regarding public–private partnerships (hereafter PPPs) in service networks need further development from both practical and academic standpoints because of the variable outcomes of completed projects (see e.g. Royer and Simmons 2009; Vilko, 2012). In the public sector, labor-intensive functions have the most likely been externalized, because there has been considerable variation in their utilization (Rothery and Robertson 1995). However, record about PPPs in the public sector suggests that the best practices of the private sector have not been transferred in full-scale (Cordella and Willcocks 2009; Culpan 2009), thus it is not rare that public organizations have not managed to get the expected benefits from their network (Fernández and Kekäle 2007). In fact, less than one of ten organizations have achieved significant benefits from their PPPs (Lonsdale and Cox 1997; McIvor 2000). Moreover, only two large-scale deals of five were successful in the long term at least five years after the introduction, when success assessment has been implemented using objective criteria (cost savings, delivery vs. objectives and stakeholder satisfaction) (Cordella and Willcocks 2009).

PPPs in the developing business environment require rigorous analysis about the expected service offerings and technical features of delivered service. The externalization of services that have public domains is not a decision to use private partner or not, but rather what services and how for ensuring sustainable network development (Aubert et al. 1996; Raiborn, Butler and Massoud 2009). Developing new PPPs are argued to improve budgetary control of public administration, public value of use of services, and the initiative would lead to the emergence of totally new business branches (Bozeman 2009; Correlje and Groenewegen 2009).

Yet, little research about the impacts of PPPs has been published to challenge the practices of partner selection or methods of evaluating successfulness of developing a PPPs in service network (Harland et al. 2005). The partnering approaches typically do not take into account the fact that public sector strategies differ from those in the private sector (Jones 2009; Rahman and Corn 2009). Therefore, the purpose of this study is to analyze events in developing PPPs of two distribution network operators (hereafter –DNOs") in Northern Europe. In doing this, we describe the decision-making processes and that have been employed to develop competitive service network in the maintenance and construction of electricity distribution networks. The process model outlines the steps to be taken in decisions concerned with learning, managing market risks and developing criteria for PPPs.

Theory
Public sector service provision
Public sector organizations are created to deliver service for the well-being of the people. For that purpose, authorities, local or domestic, are supposed to deliver public services to every citizen in precisely the same way, so that the basic principle is equality in front of the law and state (Cordella and Willcocks 2009). Therefore, the value creation logic of public service providers differs from private industrial corporations from which management theories are mainly derived. The private sector directs their interest to shareholder value which is –private value" generated by the owner's interests (Matthews and Shulman 2005). However, public value, to which public sector provision targets, is related to the achievements of objectives set by government programs, the delivery of services to the citizenry, and the value of the use of public goods (Matthews and Shulman 2005; Vargo, Maglio and Akaka 2008). Thus, public value is not directly related to the efficiency of the operations, but rather contribution to the agendas of the public government (Matthews and Shulman 2005).

Despite the fact that public service provision should emphasize value delivered to clients, PPPs have proven to be driven mainly by concerns to lower costs or at least to decrease the deficit (Cordella and

Willcocks 2009). Another rationale for PPPs is the notion that private suppliers are able to achieve economies of scale and scope that are not available for a client (Walker, Knight and Harland 2006; Caldwell et al. 2005; Aschhoff and Sofka 2009). Still, public sourcing should be targeted to create few key suppliers that are competing, because in a fragmented market all suppliers might not be able to provide such benefits in the long term (Walker, Knight and Harland 2006). On the other hand, because of political belief that open competition will increase the efficiency of the public sector (Parker and Hartley 2003) and more or less appropriate use of private management doctrines, the public sector at present tends to pursue better economy, efficiency and effectiveness by a short-term cost-cutting approach (Errindge and Nondi 1994).

In the public sector network development, it is important to consider that the roles of the buyer, client and the supplier need to be clearly differentiated. Local authorities have to identify the characteristics of the provided services and to match those to the citizens‘ needs who are paying for the services directly or through taxation. One of the key points is translating the specific needs into technical specification to be included in contracts (Ancarani 2009). However, the development of service network is a complex interconnected multi-stakeholder system in which service providers, authorities and clients communicate with each other. The system on a general level is reported in Figure 1.

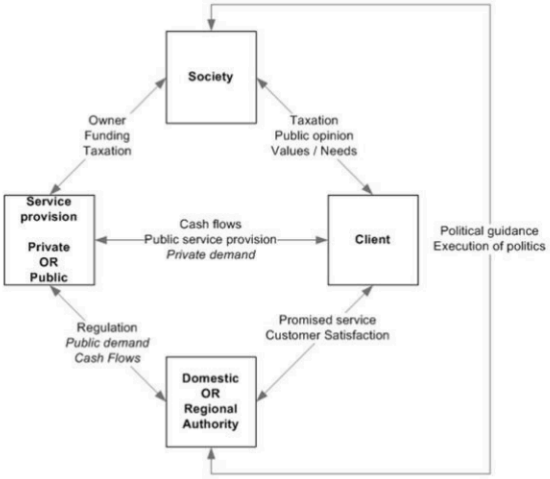

Figure 1 Roles and interactions of actors in public service provision (adapted from Walker, Knight and Harland 2006;Aschhoff and Sofka 2009;Ancarani 2009;Edler and Georghiou 2007)

From the aspect of this study, the two most important elements in the network are the interactions between the client and authority, and authority and service providers. Regulation projects the needs of a client creating signals for monopolies to develop product and service offerings toward society‘s expectations, which may change the premise of operations. In the future, public monopolies are expected to adopt a more service oriented way of operating. Thus, integrating the network offerings from multiple service providers becomes a focal operation principle (Vargo, Maglio and Akaka 2008; Janssen, Joha and Zuurmond 2009). Public organizations need to steer the network of resources in the new operation environment when they act as the core of the service provision (Vargo, Maglio and Akaka 2008). Managing such trends is a topical issue in European countries with many authorities, for instance, energy distribution, health care and data administration. However, mechanisms for the managing and developing such networks are still mostly obscure, and therefore the phenomenon needs further researched.

Public private partnerships

The actual increase of PPPs began at the end of 1990s (Cant and Jeynes, 1998; Morris and Imrie, 1992; Roodhooft and Warlop 1999). Market-like network systems are very effective mechanisms for coordination when the complexity of tasks and specificity of resources is low (Cordella and Willcocks 2009). Thus, externalization of service provision is likely to increase the efficiency of public authorities if activities are unambiguously defined and resources commonly procurable or markets are formed appropriately to support competition which leads to the creation of common systems. However, PPPs can take place despite the complexities regarding object function, if the market framework is simple and transparent enough for coordinating transactions (Jacobides and Hitt 2001; Jacobides and Hitt 2005; Jacobides and Billinger 2006). It is notable that as complex initiatives are, the important

establishing key supplier relationships are using long-term commitments for partnerships in mutual understanding (Caldwell et al. 2005; Goedert 2006).

Even acquiring services from uncompetitive or immature markets depends on abilities to formulate an effective governance framework which increases awareness of transacting methods. On the other hand, initiatives to create novel markets through PPPs have spill-over effects on the competitive dynamics of the supplying industry not depending on the scale of actions (Walker, Knight and Harland 2006; Jacobides 2005). Thus, a locally rational decision may be counter-productive when considered collectively. Decision-making can impact the size, structure and competitiveness of purchasing and supplying sectors (Walker, Knight and Harland 2006). PPPs have typically a rationale to utilize the supplier‘s ability to achieve economies of scale and scope that are not available for a client. However, locally managed outsourcing processes may lead to unsatisfactory results in two cases: (1) outsourcing decision creates a fragmented market of suppliers and is not able to provide such benefits in the long term, or, in the other extreme, (2) outsourcing without centralized control may create powerful players who gain power over the client sector (Walker, Knight and Harland 2006), which tends to restrict competition, increase the threat of opportunism and decrease the innovativeness of suppliers.

Moving all resources needed to perform an activity to partner tends to increase skill erosion, to reduce learning between partners, and to lead strong dependence and a lock-in situation (Uttley 1993; Kerr and Radford 1994; Patterson and Pinch 1995). To avoid undesirable influences of supplier dominance to public value, complete outsourcing is not the preferred form of cooperation in public service provision, although it is commonly applied practice. Therefore, selective sourcing in PPPs (i.e. retaining a minimal organization in-house) is suggested to maintain capability to design operation strategies, to define service provision systems, or to trouble-shoot unexpected problems which may influence public service delivery to citizens (Cordella and Willcocks 2009). From another perspective, orientation to strong customer dominance in emerging markets would also have harmful effects on competition, if the suppliers do not become active players to increase their performance and to take responsibility of their destiny (McHugh, Humphreys and McIvor 2003).

Developing public private partnerships
Evaluation of PPPs should rely on the notion that bureaucratic organizations have to be preserved as long as they provide better coordination than, for instance, market like organizations (Jacobides 2005). Thus, PPPs are possible if simplified coordination of an activity, standardized information and cost savings in every relationships are reached (Jacobides and Hitt 2005; Jacobides 2005). For successful development of public private service network, three main phases should be accomplished: Firstly, the assessment of the position and interrelations of activities within the organisation‘s portfolio (Moses and Åhlström 2008; McIvor 2000). Secondly, defining the right forms to manage supplier relations and building a transaction framework (Janssen, Joha and Zuurmond 2009; Janssen and Joha 2006), and finally, seeking out appropriate partners (Dubois, Hulthén and Pedersen 2004; Dubois and Pedersen 2002)

Research design
The basic insight in the energy industry is built on observations about the Finnish and Danish electricity distribution sector. The electricity system is traditionally divided into four sectors: generation, bulk transmission, distribution and consumption. Distribution has historically operated in a secured natural monopoly position where performance flaws have not been recognized. The paper contributes to management mechanisms of public–private partnerships in changing business environment which are opening through public sectors reform. In-depth interviews have been exploited to explore the influence of the business environment on decision-making in the DNOs. Detailed level of analysis enables exploring interactions between regulation and value network changes in the selected industry (Waltz 2007).

The action-oriented research approach was chosen for this case study (Pihlanto 1994) in which a pattern-matching logic was the mode of the case analysis. The target of the analysis is, thus, to compare empirically based patterns with a theoretically predicted one (Yin 2008). The selected approach allows investigating a phenomenon the boundaries of which cannot be clearly defined in the research context (Yin 2008). The action-oriented approach should not be confused with action research. In the latter case, the researcher is tightly involved in the process under study and aims at altering the behavior and inducing change (Baskerville and Pries-Heje 1999), whereas the action-

oriented approach is more objective and only explains the studied phenomena in a retrospective way (Pihlanto 1994). The researched process is presented in Figure 2.

Figure 2 Research process

The review of the decision-making process was implemented through written reports and a semi-structured interview with the two case firms. A total of ten interviews were conducted in Finland and Denmark (Table 1), which were transcribed for analysis. The interviewees represented owners, managing directors and the operative management of the firms. The written material was a collection of agreements, market analyses, due diligence reports and other documents concerning the case firms. Triangulation of evidence was conducted during the analysis process comparing the interviews with public documentary information (records on organization, financial information, and failure reports) about the case firm.

Position	Case	Organization	Involvement in decision making	Duration
Head of City Council	A	DNO	Yes	60 min
CEO	A	DNO	Yes	130 min
CEO*	A	DNO	No	45 min
CFO	A	DNO	Yes	70 min
Division‘s Director	A	Service provider	Yes	43min
Development Director	A	Service provider	Yes	35 min
Division‘s Director*	B	Service provider	No	79 min
CEO	B	Service provider	Yes	51 min
CEO	B	DNO	Yes	91 min
CEO*	B	Service provider	No	46 min
* Recruited after outsourcing decision				

Table 1 Profile of the interviews Case A and Case B

Analysis and Results

Overview of the industry context and the cases

Practically all failures in the networks immediately affect the electricity supply of numerous customers. Indeed, DNOs have historically operated in secured natural monopolies. Until the present time, monopolies have not faced competition and, thus, have been willing to make only incremental, if any, adaptations to their operations and offerings to improve their correspondence to prevailing customer needs. However, network structures have recently began to change, when management has faced pressures to improve efficiency by regulation.

National sector-specific regulators are often assigned with the task to supervise that neither the distribution charges are unreasonable nor the monopoly positions are misused. Some EU Member States have a long history of formal regulation of the electricity supply sector, whereas others have just quite recently started sector-specific regulation. At present, there are still differences between countries regarding the level of sophistication of the applied methods of economic regulation. In Denmark, the conflict has led to a time-out in regulation, which enabled the regulator to produce a regulatory model on which both sides can agree. In Finland, regulation has been more straightforward

in introducing incentives. However, the development pattern of economic regulation has been similar in most of the EU Member States.

Industry deregulation has not been the only driver for restructuring. Despite the public domain of the provided service, the value potential of ownership was first realized when industrial owners conveyed their interest toward the shares of DNOs. The bids for the shares then steered management to optimize the productivity of the DNOs for a higher procurement value by the insistence of the public owners. Finally, the new industrial owners changed the organization structure and culture by demanding higher profitability and returns for the investments. Thus, rationalization programs were launched during the first regulatory period leading to outsourcing of supportive activities. The trend was reinforced by the performance regulation by the states which, on the one hand, sets limits for acceptable returns and, on the other hand, forces DNOs to improve overall productivity.

The timing of the cases differs when compared to the life cycle of the service industry. Case A was implemented at the early phases of the markets, whereas Case B was timed at the phase of growth. The different time frame of the cases is reflected in the decision-making processes within the studied DNOs. Case A has a rather strong emphasis on determination of appropriate service offering, whereas the efficiency of technical alliance formation was the priority in Case B. Indeed, due to public ownership of the DNOs, local politics had a remarkable role when decisions to use partners in the selected activities were formed in both cases. Overall, business management had realistic insight into latent inefficiencies, but owners reacted in the situation as a result of major changes in domestic policy and regulation.

Case A – A Finnish DNO

In Finland, the period of unregulated monopolies lasted until 1995, when the Energy Market Authority (EMA) was founded to supervise the DNOs. This was the beginning of a series of competitive changes in the electricity distribution sector, which had historically operated in stable market conditions. The first stage of regulation covering the years 1995–2005 focused on reasonable pricing, and it was based on actual costs and case-by-case investigation of network companies. The first decisions on reasonable prices were made in 1999. The next development in the regulatory model was the introduction of efficiency benchmarking in 2001, and in 2003, standard compensations were introduced for interruptions lasting 12 hours or more. The changes in regulation in 1995, 2001, and 2003 have stimulated the Finnish DNOs to purchase supporting operations, which can be seen as an increase in outsourcing take-offs especially in 1995 and at the beginning of the 2000s.

The case in this study is an average-size Finnish network company, primarily owned by local communities. An industrial owner initially had a minority owenership in the company, but became a majority shareholder in 2002. The time frame of the case is set to the years 1999–2002, when changes in the political climate and the business environment took place. In practice, minimizing outages in electricity supply became a critical issue after the amendment of the Finnish Electricity Market Act in 2003. The preparation process to enable outsourcing (Figure 3) was carried out in two parts in Case A: (1) the company was split up and (2) a market interface was determined through a learning process with the service provider, which in this case was the daughter company. The target of the division process was to determine the total costs of maintenance and construction in Case A, and to set limits for market prices. The focus was on determining the feasibility of the market governance framework and on finding possible problems in purchasing. The overall impression from Case A was that actions were well planned and the market creation process was analytical. The results of the learning process with the daughter company provided valuable information for business management, and Case A had quite a good insight into the operational environment of the outsourced function even though the markets were immature.

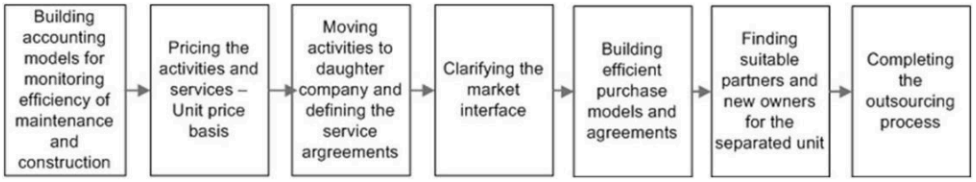

Figure 3 Partnership formation process in Case A

Case B – A Danish DNO

The Danish electricity markets were opened in 2000, which is relatively late, when compared with other Nordic countries. At that time, the regulation of electricity distribution business was also launched and the Danish Energy Regulatory Authority (DERA) was established. The regulatory process encountered difficulties similar to other Nordic countries in the early days of regulation. In the first regulation period of 2000–2003, the revenue cap regime was in force. It was planned to involve a four-year review period and a four-year regulation period, but the regulation period was shortened owing to problems in the regulation. The revenue caps were determined based on historical expenses. Deviations from the revenue cap in terms of over- or undercompensation would be accounted for in the later regulation periods. The efficiency requirement consisted of the general efficiency requirement set by the Ministry and a company-specific requirement determined by a benchmarking model. The efficiency improvements were to be reached in a single year, and that made the Danish approach seem demanding in comparison with its international counterparts. However, the exact company-specific efficiency requirements were determined in negotiations with the industry, and the revenue caps did not impose immediate catch-up.

The process of outsourcing began from monitoring efficiency in Case B (Figure 4) because of obvious performance gaps regarding network maintenance and construction. To improve cost control, the functions were separated to a shared service unit. Despite founding the service center, all issues regarding monitoring financial performance could not be solved, because corporate level overhead costs were partially mixed with those of service units. The maintenance and construction service unit was later moved into a newly founded daughter company that took care of almost all of the construction and maintenance in the Case B firm. The structural arrangements of corporation changed the cost structure significantly more transparent, allowing new options to address existing performance issues. The actions taken to improve the performance of the daughter company were a study about the company structure and the most valuable functions. The analysis determined the problem to which the rationalizing program was targeted. Moreover, the rationalizing program contributed to valuing of the daughter company, which gave an excellent starting point to the negotiations with prospective private owners. At the final phase, the case was accomplished by selling the service company to an industrial owner. The selling basically followed the normal procedure in the municipal sector – it was arranged as an open bidding competition.

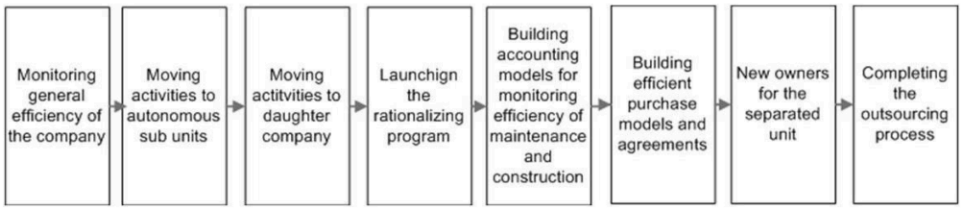

Figure 4 Partnership formation process in Case B

Discussions and conclusions

In this paper, we analysed the network development process in the case of two public private partnerships. The study has several contributions in pointing out the special features that should be considered in the network development process of public service provision. The analysed cases share similarities in terms of process implementation, however, the expected outcomes for the cases were quite different. The actions taken in Case A had targeted to determine the feasible governance framework for supporting activities through market governance, and to foster the emergence of competitive markets, which are able to provide gains for DNOs through competitive rivalry. Case B was more straightforward and the development of the market governance framework did not appear to be a major goal. Most of the actions aimed to solve efficiency problems during the learning process in which acquisition was a solution for performance improvements.

Overall, the process for outsourcing was rather similar in both cases and it supports the theoretically predicted one. The process can be considered to consist of three parts: (1) partitioning the company, (2) determining the market interface through a learning process with the shared service unit, and (3) preparing partnerships with an external service provider. At the first phase, the main objective is changing a function to an independent cost object in the accounting system to increase awareness about performance. The second phase aims to increase understanding about the benefits and issues that are likely when cooperating with external partners. Practically, moving a function to an

independent department and later to the daughter company has been recognized as an effective procedure. Both cases indicate that the performance of the service unit or company is partially dependent on the culture driven by the owner. Thus, outsourcing a function using a joint venture, alliances or complete outsourcing is recommended, because they provide expedients for more fundamental changes in the operations culture.

The two cases differ from each other especially at the level of learning results. The actions taken at the preparation phase had well-defined targets in Case A. The daughter company had efficiently aimed to deliver information about the functionality of the market governance framework and to reveal probable problems in supplier relationships in the long term. The objective was to build a management process for purchasing and learning from an external service provider. The applied process provides rather good insights into the operational environment of an outsourced function which reduces the risks of outsourcing to a sufficient level.

The case analysis confirms some of the results of the earlier studies (see e.g. Jacobides, 2005) indicates that two necessary conditions for market emergence exist to which the outsourcing process should be targeted: (1) efficient coordination and transparency of operations and (2) a governance framework that provides reliable and standardized information for comparing the service providers. The first condition was valid in both cases, but the steps taken toward the required state were better planned in Case A.

The study has obvious limitations due to its case research design. Further research is needed to develop explicit methods for analyzing the impact of industry evolution to the performance of firms.

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