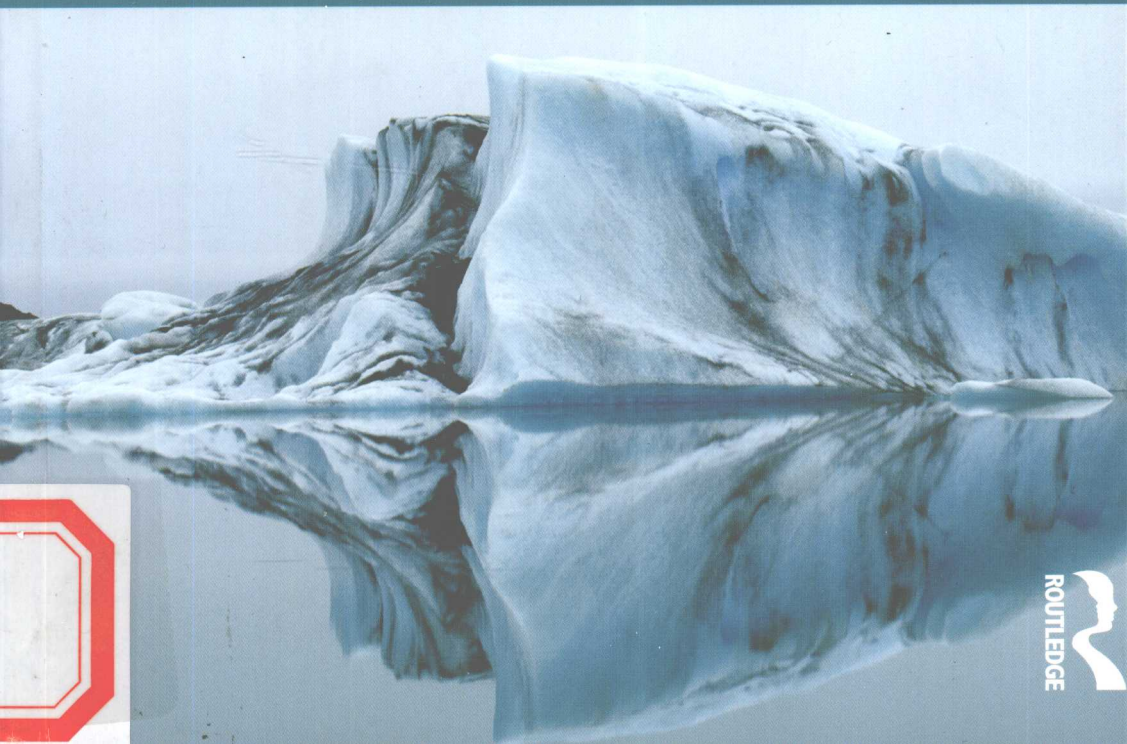




Emanuele Padovani and David W. Young

MANAGING LOCAL GOVERNMENTS

DESIGNING MANAGEMENT CONTROL
SYSTEMS THAT DELIVER VALUE





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Managing Local Governments

Designing management
control systems that
deliver value

**Emanuele Padovani and
David W. Young**



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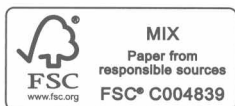
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Preface

This book has been written for both students of public management and managers of local governments. It will also be helpful to managers of county, state, regional, and perhaps even national governments. And it likely will be of interest to managers of semiautonomous public entities, such as water and sewer authorities or public utilities. It should be of special interest to elected officials of cities, towns, municipalities, and other local government entities, as well as to the citizens who elect those officials to office.

The book does not purport to describe, or even support, business as usual. Instead, we argue that local governments (LGs) in general are poorly managed and do not provide anywhere near as much value to their citizens as they could by making some (often relatively minor) changes in how they conduct their affairs.

Most LG managers will resist the sorts of changes we propose – these changes will take them well outside their comfort zones. But, in an era of constrained resources for all public sector entities, including LGs, and with taxpayer resistance to providing increased funding without some evidence of value for their money, it is time for LG managers to make the move.

Middle managers cannot be expected to make these changes on their own – many have been doing the same job for years, if not decades, and the changes we propose will entail new ways of doing their jobs. For very valid reasons, they can be expected to resist these changes. Therefore, senior managers will need to support and encourage the changes, which means that senior managers will be moving outside *their* comfort zones. Thus, if senior managers are to be encouraged to rethink the way their LGs conduct their activities, elected officials will need to insist that the changes be made. Perhaps citizens, as members of citizen boards, or simply as vocal taxpayers, will need to make it clear to these elected officials that remaining in office is contingent upon making some of the changes that we discuss herein.

This book, then, is a call to arms. It proposes new ways of thinking about how LGs can be managed, and it provides enough examples to demonstrate that the changes we propose are not academic “pie in the sky” thinking. They have taken place in some locales, and can take place in others. What is needed is the will to forge ahead.



Acknowledgments

We are grateful to several people for their assistance in preparing this book. David owes a major intellectual debt to the late Robert N. Anthony, with whom he co-authored five editions of *Management Control in Nonprofit Organizations*. Emanuele owes a similar debt to Professor Giuseppe Farneti, who has been his mentor and collaborator for many years.

We both are also grateful to the students and faculty who were with us in three editions of the Summer School on Public Management, which was held at the Forlì Campus of the University of Bologna in Italy. We learned a great deal from these groups. In this regard, we would like to single out two of our teaching colleagues, Leslie Breitner and Janelle Heineke.

Emanuele is especially appreciative to the several local governments where he has conducted his research over the past seven years. They have provided him with examples – some good and some perhaps not so good – that have helped him develop his thinking about the matters we discuss in this book.

Finally, we are both grateful to our families. David's sons (Christian and Tony) spent several months without their father's presence while he was in Italy working on the book (although it is not clear that they suffered much as a result of their greater freedom to cavort!). Emanuele's wife (Valentina) and son (Giovanni) occasionally found him working on the book when they hoped he would be available for some family fun.





Abbreviations

BSC	Balanced scorecard
CF	Cash flow
CVP	Cost-volume-profit (analysis)
I	Investment
IRR	Internal rate of return
LG	Local government
MCS	Management control system
NPM	New Public Management
NPV	Net present value
PVF	Present value factor
R&D	Research and development
ROA	Return on assets
ROE	Return on equity
WCC	Weighted cost of capital
WRA	Weighted return on assets



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Introduction

The book is designed so that the chapters build on each other, but each also can stand on its own reasonably well. The book is not a novel, so it is fine, perhaps even desirable, for a reader who is interested in a particular topic to head directly to the chapter focusing on that topic. To assist readers in that decision, we briefly describe the contents of each chapter.¹

CHAPTER 1: THE CONTEXT FOR MANAGEMENT CONTROL SYSTEMS IN LOCAL GOVERNMENTS (EP)

We begin the book with a discussion of the size and nature of local governments (LGs) across the globe. There are many different types of LGs, and we discuss them briefly, including a description of the kinds of services they provide. We also identify the general characteristics of LGs that affect their ability to develop good management control systems, such as the absence of a profit measure, and, more generally, the difficulty they face in measuring performance.

Readers who are familiar with LGs – or at least with their own LG – may wish to skip Chapter 1, and begin with Chapter 2, where the “meat” of the book begins.

CHAPTER 2: MANAGEMENT CONTROL SYSTEMS: AN OVERVIEW (DY)

In this chapter we put management control into its context as the bridge between strategic planning and task control, and then discuss its various elements. We briefly describe the structure and process of a management control system (akin to describing the anatomy and physiology of a human body). Subsequent chapters expand upon the ideas in this chapter.

CHAPTER 3: BARRIERS TO EFFECTIVE MANAGEMENT CONTROL IN LOCAL GOVERNMENTS (DY)

Here we discuss the many barriers that LGs face in their efforts to implement improved management control systems, and hence to move toward what has been called the New Public Management (NPM) Paradigm. These barriers are multifaceted. They include the fact that a typical LG provides a heterogeneous mix of programs, ranging from street cleaning to social welfare. They include conceptual barriers such as the need for generational and consumer equity. They are related to the difficulty of identifying and measuring positive externalities for some services, and for developing pricing units for others.

The barriers also include a variety of more practical matters that face an LG, such as the lack of a control culture, highly centralized decision making, an absence of market forces for many services and programs, and the existence of restrictive personnel policies. In designing its management control system, an LG's senior managers must take all of these factors into account – a daunting task, indeed.

CHAPTER 4: THE STRUCTURE FOR MANAGEMENT CONTROL (EP)

In this chapter, we argue that an LG comprises a network of “responsibility centers,” i.e., organizational units that have some sort of financial responsibility (as well, often, as some important *non-financial* or programmatic responsibilities). We argue that the concept of profit centers, while perhaps having a distasteful connotation to many LG managers, can be a powerful element in an LG's management control structure. We also introduce the idea of shadow profit centers – profit centers that use an external vendor's prices as a source of surrogate revenue, so that their performance can be compared with the private sector. And we talk about the difficulty that many LGs have in finding the right balance between a program structure and a departmental structure.

CHAPTER 5: PROGRAMMING (DY)

With this chapter, we begin our discussion of the management control process. The first phase of the process – programming – is where an LG makes decisions that have a long-term impact. Such decisions include initiating a new program or purchasing a new fixed asset. New fixed assets can range from a bridge or tunnel to a fire truck, or even to a desktop computer. We discuss a technique called “net present value” that is used in the private sector for such decisions and that could easily be used by an LG. Finally, we discuss two matters that are unique to all public sector organizations, including LGs: assessing benefits when bottom line performance is not

the only consideration, and valuing a human life. The latter is important for projects that are intended to save lives, such as improved traffic safety or cancer screening.

CHAPTER 6: BUDGETING (EP)

Budgeting is the second phase of the management control process. In this chapter, we talk about the general nature of the operating budget, as well as the strategic context in which it sits. We identify some important behavioral aspects of budgeting, and take up the several steps that are involved in the “mechanical” side of the process. Here, we stress the importance of a “revenue-first” policy. We also contrast a line item budget with a program budget, and discuss the importance of including output and other performance measures in the budgeting phase of the process. We conclude the chapter by identifying some of what we call “budgeting misfits” – areas where the budget does not coincide with, or reinforce, certain other aspects of the LG’s strategy or operations.

CHAPTER 7: MEASURING FULL COSTS AND SETTING PRICES (DY)

Here we address the topic of measuring full costs and discuss their role in setting prices. We talk about the two stages of cost accounting, and point out that few LGs have done a serious job of Stage 1 (the easier stage) and almost none has engaged in Stage 2 activities (attaching a mission center’s costs to its outputs). We also discuss the difficulty of setting prices in an LG, pointing out the importance of unbundling prices whenever possible, but also identifying areas where prices based on full costs may not be appropriate. These areas include those where an LG’s senior management team believes that some services (such as public safety or traffic lights) should be funded with general tax dollars, largely because there is no easy way to price them but also because they are, for all intents and purposes, “public goods.”

CHAPTER 8: MEASURING DIFFERENTIAL COSTS AND ASSESSING OUTSOURCING OPPORTUNITIES (EP)

In this chapter, we emphasize the idea that different costs are used for different purposes, and that assessing cost behavior is important for many “alternative choice” decisions that are made in an LG. We discuss cost-volume-profit analysis, and argue that it is as important for an LG as it is for a for-profit company. We spend considerable time on the topic of outsourcing, pointing out that there are different degrees of risk when outsourcing a program or service, and that high-risk outsourcing needs to be managed differently from low-risk outsourcing.

CHAPTER 9: MEASURING PERFORMANCE (EP)

Measuring performance is a tricky matter in any nonprofit, but especially in an LG where much of the revenue is derived from general taxes and government grants, and hence there is no “sales revenue,” as such, for many of an LG’s services. In addition, performance can be measured along four dimensions, which we discuss in this chapter: inputs, processes, outputs, and outcomes. As one moves along this scale, there is an increase in the value of the information but a corresponding increase in the difficulty of obtaining reliable data. Nevertheless, LGs are in a unique position of being able to coordinate the outputs of several different departments toward an outcome that will benefit its citizenry. We use an example of “clean and safe streets” – an outcome whose achievement requires contributions of outputs from several different departments, such as public safety, road maintenance, and trash collection.

CHAPTER 10: REPORTING AND ACTION (DY)

Although reporting is classified as the final phase of the management control process, it is important to keep in mind that the “action” portion of the phase makes the process a closed loop, linking this phase back to all the others. Reports provide information that can help managers take action with regard to ongoing operations, the budget, or the LG’s programs.

The chapter discusses two very powerful accounting techniques that can assist in taking action: flexible budgeting and variance analysis. Both have been used extensively in the private sector but have seen little application in LGs. We provide some examples of how their use could improve an LG’s ability to provide more cost-effective services to its citizens. We also discuss some of the criteria for a good set of management control reports.

CHAPTER 11: THE ORGANIZATIONAL CONTEXT FOR A LOCAL GOVERNMENT’S MANAGEMENT CONTROL SYSTEM (DY)

We use this chapter to pull together a number of concepts that have been discussed in previous chapters, and that can provide the broad context for an LG’s management control system. We begin by summarizing the characteristics of a well-managed local government. LG managers can use this as a sort of “scorecard” to assess where they might best begin to think about areas for improvement. We then position the management control process as one of seven activities that must be integrated and managed in concert if an LG is to be successful in achieving its objectives. We conclude with some thoughts on the change process. It is fine for senior managers to know what