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# Financial and structural impacts of quasi-marketization of the Helsinki Metropolitan Area's bus services



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### ABSTRACT

This study describes the phases of quasi-marketization of the Helsinki Metropolitan Area's bus services and analyzes the financial and structural consequences for purchasers and providers. Qualitative data was collected through interviews, a focus group, and extensive document reviews, while the quantitative data was received from a sub-regional authority and from the Finnish Patent and Registration Office's database. According to our findings, even if the clear purchaser-provider split was a difficult and long process, the threat of competition and particularly the introduction of tendering resulted in reductions in contract prices. Bus operators started to compete for market shares and over the years of the quasi-market they lost their profitability and consumed their own assets. The quasi-market format could not provide equal terms of competition between municipal and private operators, resulting in all municipal and many small operators disappearing from the market. The market structure became more concentrated as the number of purchasers and providers fell. The quasi-market framework was initiated by the central government and it has been instrumental for local political decision-makers to increase the responsiveness of operators through competitive contracting.

## 1. Introduction

A quasi-market is a planned and regulated market of public services through which public authorities, as collective consumption units, act as purchasers by organizing competitive tendering between public and private service producers who compete to win a contract from the authorities. Quasi-marketization refers not only to the process of a public service industry's de- or reregulation, but also to core operational processes, including separating purchasers and providers, specifying collectively needed services, and introducing competition (Le Grand, 1991; Kähkönen, 2010). However, according to some studies (Curtice and Fraser, 2000; O'Flynn and Alford, 2008), the purchaser-provider split might be more difficult to achieve in practice than is commonly assumed.

This empirical study demonstrates that achieving a purchaser-provider split and competitive neutrality in the Helsinki Metropolitan Area proved to be very challenging.

The study reviews the events and summarizes the phases of quasi-marketization of local and sub-regional bus services of Helsinki Metropolitan Area. The quasi-market developments are analyzed using the perspectives of local public policies and competitive conditions in a quasi-market. As several previous studies (Hilke, 1992; Kennedy, 1995; Bekken et al., 2006; Veeneman and van de Velde, 2014) have indicated

that the introduction of competition has delivered immediate savings in bus services, in this study, instead of authorities' budgetary savings the main focus is on the analyses of bus operators' financial standing.

The empirical research questions are the following: How has quasi-marketization changed organizational and market structures and what have been the short-term financial impacts on the purchasers and the long-term financial impacts on the providers? Furthermore, the theoretical purpose of the study is to reflect on our empirical observations in order to contribute to conceptual discussions about the nature of quasi-market formation and the challenges in urban bus services.

The study summarizes regulatory changes made in the early 1990s, reviews the structural changes in the quasi-market from 1993 to 2015, and analyzes the financial implications for bus operators from 1998 to 2014. The empirical contribution of the study is that it is capable of demonstrating somewhat surprising long-term changes. The organizational arrangements of the quasi-market were unstable and, in the end, the city governments were required to give up both their purchasing and provision roles. Municipal operators were privatized and most of the smaller bus operators have been driven out of the market by the competition. In addition, the remaining operators have faced severe financial difficulties and their owners have been forced to allocate more capital to bus operators by issuing new equity as well as granting them subordinated loans.

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Regarding this article’s structure, we first discuss our methodology, followed by our analytical framework by clarifying the basic propositions of the quasi-market concept. After this, we begin to cover our findings by outlining the regulatory reforms and quasi-marketization events. We then review the structural impacts of quasi-marketization, early-stage changes of contract prices, and financial effects on bus operators. At the end of the empirical section, we analyze the relationship between operators’ market share weighted financial ratios and average bidders per competitive rounds. In the first part of the discussion section, we summarize our empirical findings and assess them by considering how they fit in with previous bus studies. In the second part of our discussion, we sum up our remarks about quasi-market formation in the Helsinki Metropolitan Area. The study closes with our conclusions and public policy recommendations.

## 2. Materials and methods

This paper presents analysis and findings from a long-term and multi-method empirical study. Qualitative data was collected through a focus group, semi-structured interviews, the reviews of audit reports, law drafting materials, legal cases, newspaper articles, and government documents. The focus group was convened in 2001–2002, when the final negotiated contracts were ending and being replaced by competition-based contracts. The focus group represented a mix of interests, including representatives from the City of Helsinki, the sub-regional authority, the Employers’ Federation of Road Transport, the Trade Union for the Public and Welfare Sectors, the Transport Workers’ Union, and the Federation of Public and Private Sector Employees. The interviewees were selected on the basis of the focus group’s recommendations and they were top or expert officials from service purchasing, service producing, or lobbying organizations. The face-to-face interviews lasted from one to one-and-a-half hours, and they were tape-recorded and transcribed for analysis. The analyzed newspaper articles were published in 1994–2015, and the audit reports in 2005–2009.

The quantitative data covers the bus operators’ annual financial statements and Helsinki Region Transport (HSL) Statistics. We focus on the period 1998–2014 because a new Finnish Accounting Standard—based on the fourth and seventh EU company law directives—was being enacted in December 1997. Bus operators’ financial statements were collected from the Finnish Patent and Registration Office’s database and data on market shares and numbers of bids were received from the sub-regional authority.

Our quantitative analyses detect long-term developments in bus operators’ financial performance. It is worth noting that previous studies have not reported long-term findings indicating—or offered a detailed picture of—how bus operators manage their finances in the new competitive environment. We conducted this analysis by reviewing the bus operators’ annual reports, following the analysis guidelines provided by the Finnish Committee for Corporate Analysis.

## 3. Analytical framework

Quasi-marketization aims to introduce and integrate certain types of market mechanisms into the system of public services; these include less restricted market entry, open public procurements, and dynamic pricing via periodically recurring competitive bidding (Hansen and Lindholm, 2016). The theory of quasi-markets suggests that a quasi-market helps to enhance the responsiveness of public and private service providers and to share risks associated with operations (Le Grand, 1991; Raftery et al., 1996; Le Grand et al., 1993).

		Bus service agents	
		Public	Private
Nature of relationships between principal and agents	Hierarchical	I	II
	Contractual	III	IV

Fig. 1. Generic options for organizing public services (adapted from Lane, 1997).

The key ideas of quasi-market theory can be clarified by the terms of agency theory, as the latter is similarly based on the necessities and advantages of specialization that the principal brings along defined aims and financial resources, while the agent focuses on operational performance (Luchman and Cunliffe, 2013). A principal needs to find an agent as a specialist in professional services to carry out given assignments. We illustrate this by using a four-fold typology of organizing public services, as presented in Fig. 1.

In the classic case of public administration (Type I), illustrated in Fig. 1, the government sets up a public agency to carry out public duties with a hierarchy of settings. Type II is a rarer case in which some public duties are given to private sector agents via top-down arrangements (i.e. typically via legal or license obligations) (Lane, 1997).

Instead of a pure top-down relationship, the government may create a contractual relationship with the public or private service agent (Types III and IV). If the government makes a contract with a public agent, it is an example of contracting in (Type III), whereas a contractual relationship with a private agent is contracting out (Type IV) (Valkama et al., 2013). The contractual relationships can be based on (i) mutual negotiations or (ii) competition. Quasi-market competition typically refers to competition in a market via competitive tendering of non-profit and pro-profit service providers through making the lowest bids or the most economically advantageous tenders, whereas competition for a market refers to the struggle to create a new market (Geroski, 2003).

Splitting purchasers and providers delegates some decision-making duties to operative units, increasing their autonomy, and allowing purchasers—including policymakers—to concentrate on more strategic issues, while service providers can focus on technical issues of service delivery (Harden, 1992; O’Flynn and Alford, 2008). Purchasers and providers are able to improve their skills and efficiencies as they can specialize in their core function. However, the separated quasi-market parties can also face problems, such as a lack of confidence, conflicts of interest, and disagreements over contractual interpretations (Gottschalk and Solli-Sæther, 2005).

The quasi-market format’s abstract dimensions can be analyzed from the perspectives of institutional, organizational, spatial, and temporal factors (Mügge, 2011; Breslau, 2013). The institutional factors refer to financial systems and legal norms, even though the quasi-market format’s fundamental institutional conditions depend primarily on legitimacy issues. The organizational aspect refers to the stability of purchaser-provider separation, as well as the market players’ characters and emergence. Spatial issues of a local quasi-market focus on the territorial platform’s sustainability and effectiveness, how scalable the territorial based demand functions and supply capacities are, how the quasi-market is capable of generating indirect effects beyond the locality, and how the quasi-market can be replicated in other locations. Temporal factors refer to the rapidity and recurrence of a quasi-market’s core processes.

## 4. Research findings

### 4.1. Overview of Helsinki metropolitan bus services' quasi-marketization

In the 1980s, the metropolitan area bus services' regulatory framework could be characterized as an era of strictly regulated and non-competitive markets. In 1991, a new public transport law made it legally possible to introduce competition into public bus service provision in Finland (Ministry of Transport and Communications, 2003). Second, the restrictions on foreign ownership of enterprises were removed from company law and related legislation in 1993 (Kiander and Romppanen, 2005). Third, the first public procurement law came into effect in 1994, including the introduction of open, transparent, and fair competitive bidding in public procurements (HE, 1992). Around the same time, the public transport law was changed by giving up the means-tested (i.e. including an investigation of a service need) regular bus service licenses given by state authorities in such cases, where municipalities decided to fund local bus services on a contractual basis (HE, 1994). These regulatory developments were framed by the Europeanization of Finland's national economy, particularly through Finland's membership of the European Economic Area in 1994 and the European Union (EU) in 1995.

The public procurement law forced the sub-regional authority of the Helsinki Metropolitan Area to start competitive tendering of sub-regional bus services (i.e., services between different municipal jurisdictions of the sub-region) because the negotiated contracts were not lawful anymore and the authority did not have internal operators. The sub-regional authority saw it also as an opportunity to cut service costs as it believed that the negotiated contracts were too expensive. The authority initiated plans to use three- and possibly five-year contracts and published its first call for bids in 1994 (Seutuliikenteen kilpailuttaminen, 1991; Ministry of Transport and Communications, 2003; Liikennevirasto, 2012).

The legal position of the City of Helsinki was different in the way that it organized local bus services through internal and external operators. The internal operators included both an internal unit (i.e., municipal transport enterprise) and legally an external (i.e., limited company) bus operators. Both of these were considered as in-house units in terms of public procurement regulation. The requirement to introduce competitive tendering applied only to such contracts that the City of Helsinki had made with externally owned operators. However, the City of Helsinki also wanted to make budgetary savings and made a local choice to quasi-marketize local bus services through the introduction of a purchaser-provider split and competitive tendering in 1997. Fig. 2 illustrates the main events that took place in the creation of the bus services market in the Helsinki Metropolitan Area.

Fig. 2 demonstrates the range of changes in the public and private governance of the metropolitan area's bus services, including changes in organizational forms, amalgamations of procurement activities, and corporate acquisitions. Furthermore, key industrial and competition disputes are highlighted in the timeline.

### 4.2. Structural impacts of quasi-marketization

Separating purchasers and providers through an organizational split turned out to be a tangled, multi-phased, and painful process in Helsinki. Before 1995, the internal unit of the City of Helsinki delivered not only bus services but also tram and underground services. However, this kind of organizational solution did not fit the context of the industry's quasi-market since the municipal enterprise dispensed autonomy and transparency. For example, the bus services did not have

their own financial accounts. City councillors had to separate the production of municipal bus services from other municipal transport services and grant an internal semi-autonomous position by creating a differentiated internal bus unit in 1995 (Valkama and Flinkkilä, 2003).

However, the new organizational form (i.e., the differentiated internal bus enterprise) provided some managerial autonomy to the municipal bus unit, but it proved to be a short-lived organizational model. The private bus operators were critical and argued, for example, that the municipal bus enterprise was not able to go bankrupt causing a lack of confidence characterized the relationship between the City of Helsinki and the bus industry interest group. The Finnish Bus and Coach Association clearly pointed out that the internal bus enterprise was too closely connected with the purchasing functions of the city and insisted that the unit had to be corporatized to equalize governance terms for all companies who operate in the metropolitan area (Helsingin Sanomat, 2004). Gradually, the city councillors agreed with external pressures and the internal enterprise was externalized when it was corporatized and merged at the beginning of 2005. However, even this separation between the municipal purchaser and provider proved to be vulnerable to conflicts, as a private operator complained about illegal municipal aid being awarded to the merged limited company (Helsingin kaupunki, 2015). Finally, approximately ten years later, the city government decided to sell the municipal bus operator to a private bus company. Fig. 3 summarizes the organizational changes, illustrating both the slow implementation of the purchaser-provider split and privatization measures.

In 1993, before competitive tendering was introduced, the largest bus operator had a 25 per cent market share with a total of 13 operators (Liikennevirasto, 2012). In the competitive quasi-market, small companies began to lose their market share, and the four largest operators were able to grow (see Table 1), with these changes being partly caused by acquisitions. The interviewed experts believed the tendered targets (i.e., the packages of bus routes) may have favored incumbent and larger operators. The external and especially poorly capitalized or small rural operators had not taken the trouble to submit serious, risk-taking bids (Valkama and Flinkkilä, 2003). During the two decades that followed the introduction of competitive tendering, only one new bus operator has been able to enter and become established in the market without a preceding privatization move. This newcomer was a subsidiary company of the state-owned railway corporation, which bought one of the existing private operators in 2005. The focus group discussions outlined the fact that incumbent market players have enjoyed some limited economies of scale. The restricted availability of urban rental depots has been a particular factor explaining why existing operators have been able to defend and expand their market shares (Kilpailuvirasto, 2007; Järviluoma, 2017).

Systematic competitive bidding created a more challenging environment to operate in and run a profitable bus business than when operators' contract rewards were based on negotiations. Table 2 demonstrates how private operators tried to cope with the competitive quasi-market by changing their internal cost structures by replacing their own buses with leased buses.

Prior to the beginning of quasi-marketization, there were four procuring public authorities in the area. Three city governments (i.e., Helsinki, Espoo, and Vantaa) procured local bus services, while the sub-regional authority procured bus services between different jurisdictions of the metropolitan area, first through negotiated contracts and later through competitive tendering (Valkama and Flinkkilä, 2003).

At the beginning of the quasi-market, the joint municipal authority was a multi-service organization managing sub-regional public bus transport, municipal waste management, and air pollution control.

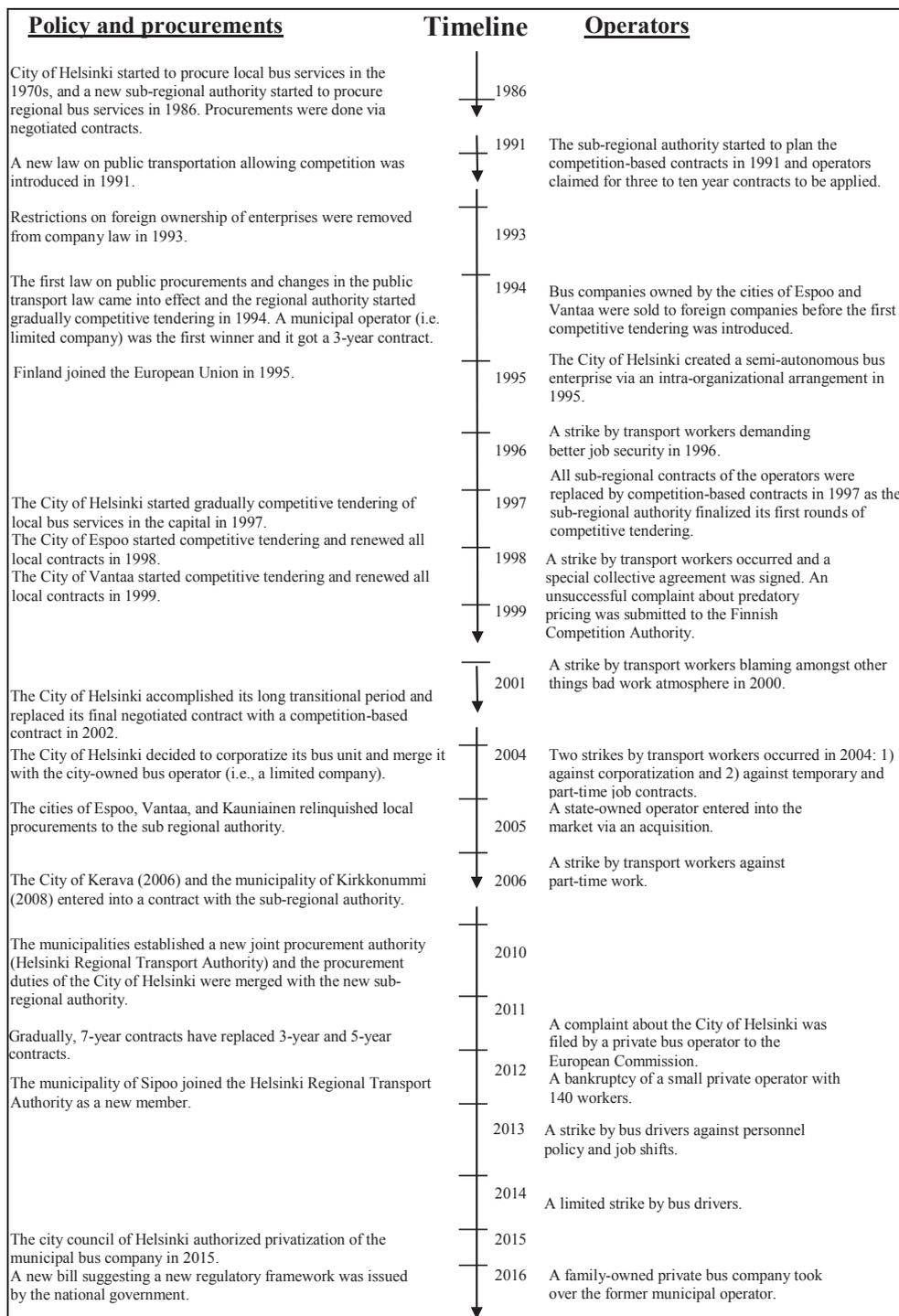


Fig. 2. The main events of the development of sub-regional and local bus service quasi-markets in the Helsinki Metropolitan Area.

However, the authority was transformed in 2010 by excluding non-public transport services from its operations and focusing on all kinds of urban public transport services; namely, urban buses, as well as trams, underground and commuter train services, and ferries (HE, 2009).

During the years of quasi-marketization, the sub-regional authority was able to standardize the contract management of local and sub-

regional bus services, as well as to increase their integration with the other means of public transportation. This was possible because local governments gave up their operative duties of public procurement of local bus operations, transferring the management of competitive tendering to the transformed (i.e., new) sub-regional authority, making it the single principal authority organizing competitive tendering

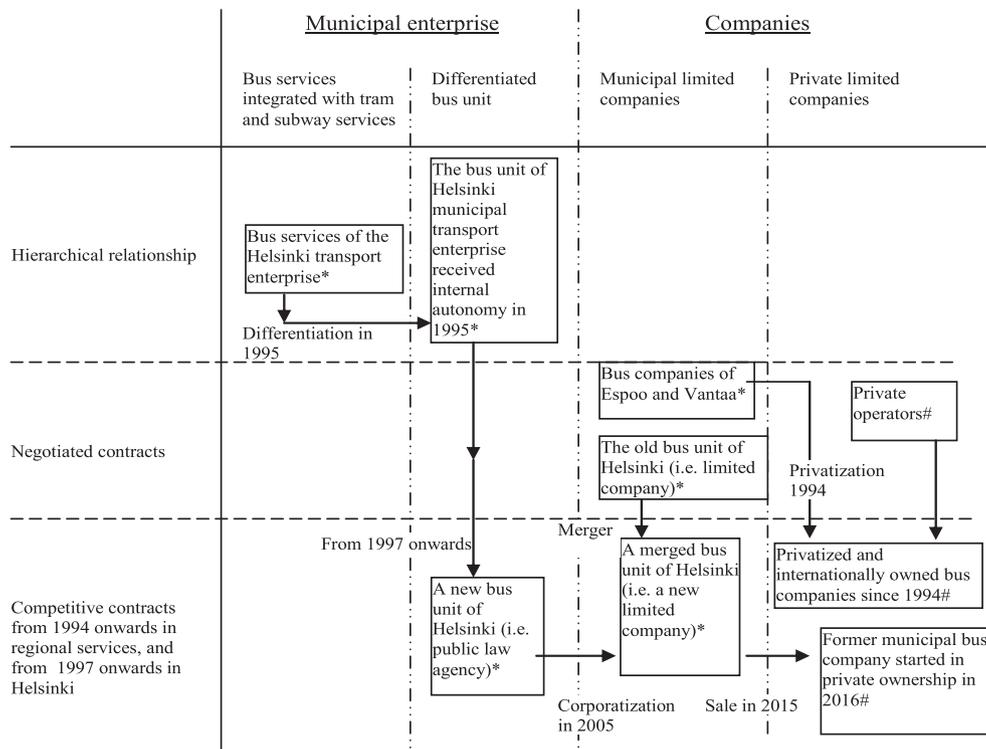


Fig. 3. Developments in the organizational and contractual systems between bus operators and the public authorities in the Helsinki Metropolitan Area. Municipally owned operators are marked by \* and private companies operating under contracts to municipalities are marked by #.

Table 1

Market share development and the number of procurement authorities (CT = competitive tendering) (Valkama and Flinkkilä 2003; Liikennevirasto, 2012; Rantanen 2017).

	Year					
	Before CT	After the introduction of CT				
		1994	2003	2005	2011	2013
Market share of the largest bus operator	25%	32%	42%	31%	31%	37%
Market share of the four largest bus operators	82%	93%	96%	91%	95%	94%
Total number of operators	13	8	8	8	9	7
Market concentration measured by Herfindahl–Hirschman Index	0.195	0.244	0.308	0.242	0.253	0.250
Total number of procurement units	4 authorities	4 authorities	2 authorities	1 authority	1 authority	1 authority

Table 2

Largest operators leasing liabilities scaled by total asset.

Year	Municipal	Private
1998	0.00%	0.71%
1999	0.00%	4.17%
2000	0.00%	8.65%
2001	0.00%	17.09%
2002	0.00%	31.16%
2003	0.00%	41.27%
2004	0.00%	47.96%
2005	4.44%	41.62%
2006	3.73%	55.75%
2007	2.55%	45.74%
2008	1.20%	30.79%
2009	0.06%	51.19%
2010	0.05%	67.17%
2011	0.03%	57.79%
2012	0.05%	85.19%
2013	0.03%	70.02%
2014	0.01%	71.21%

(Liikennevirasto, 2012; HE, 2009). The City of Helsinki wanted to corporatize the sub-regional authority, which is a public law entity with municipalities as its only legally acknowledged members, but other local authorities rejected this suggestion. The sub-regional authority has expanded over the last 20 years to include three new member municipalities, doubling its geographical area, as illustrated in Table 3.

The current regulatory framework of the quasi-market is based on the national legislation harmonizing with the European Parliament’s and the European Council’s regulations on public passenger transport services by rail and by road, which were issued in 2007. The EU Regulations (Regulation [EC] 1370/2007) define how public authorities are allowed to define the nature and extent of public service obligations in public bus services and so allow the authorities to organize more numerous, higher quality, and lower cost bus services than free markets could deliver. However, fairly recently, the Finnish central government (i.e., a coalition government of center, conservative, and populist parties) introduced a new bill proposing a new regulatory framework designed to improve operational preconditions for the free-market-based bus transport industry promoting economic liberalization

**Table 3**  
Changes of the sub-regional authority.

	In 1994, when competitive tendering was started	In 2015, after 20 years of experience with the competitive quasi-market
Name of the authority	The Helsinki Metropolitan Area Council	Helsinki Regional Transport Authority
Organizational form	A multipurpose, sub-regional public authority	A single-purpose public authority for an extended sub-region
Services (i.e., fields of operation)	Municipal waste management, sub-regional public bus transport, air pollution protection	Sub-regional and local public transport
The member municipalities of the authority	Espoo, Helsinki, Kauniainen, and Vantaa	Espoo, Helsinki, Kauniainen, Kerava, Kirkkonummi, Sipoo, and Vantaa
Number of residents in the jurisdiction of the joint municipal authority	874,953 on December 31, 1994	1,201,831 on January 31, 2015
Land surface area	743.1 square kilometers	1506.75 square kilometers

of the metropolitan bus services (HE, 2016). The sub-regional authority believes that if the bill is accepted by the legislature, any operator could enter the market and challenge publicly funded services in the future (Helsingin seudun liikenne, 2016).

#### 4.3. Early-stage reductions of contract prices

The threat of competition was obvious after the new public transport law made it legally possible to introduce competition in 1991. Local authorities utilized this situation by negotiating some contract discounts before they started actual competitive tendering. Table 4 presents the reported percentual contract savings both through the negotiated contracts under the threat of competition and the first competitive tendering. The introduction of the first calls for bids caused some extra transaction costs for the local authorities, but once the processes became routine, these costs shrank considerably. According to an interview with a top civil servant with the sub-regional authority, the transaction costs for the competition-based procurements did not play a significant role (Valkama and Flinkkilä, 2003).

The stakeholder groups' representatives considered the reported percentual savings reliable, and none of the interviewees or focus group members challenged them. However, the interviewees believed the substantial decline in the first tendered prices by the sub-regional authority in 1994 may have been due to cross-subsidization from negotiated contracts because only a small share (i.e., 15 per cent) of the regional services was put under the first competitive tendering, enabling the providers to use profits from the negotiated contracts as cross-subsidies to support very low tenders (Valkama and Flinkkilä, 2003).

In our study, we found that comprehensive and coherent data on long-term budgetary savings in money and detailed data on quality changes was not available. For example, management accounting of local authorities was not regulated, letting them carry out cost accounting independently without unified standards (Helin and Valkama, 1995).

#### 4.4. Financial development of bus operators

To understand the financial development of bus operators following the implementation of competitive tendering, we conducted a ratio analysis for the largest bus operators in the Helsinki Metropolitan Area over the 17-year period between 1998 and 2014. Our dataset from 1998 to 2004 comprises four operators: Concordia Bus Finland, Veolia Transport Finland, HKL Bussiliikenne, and Suomen Turistiauto. However, at the end of 2004, the City of Helsinki decided to merge the two bus operators that it held a majority of shares in, i.e., HKL Bussiliikenne and Suomen Turistiauto. The new operator, Helsingin Bussiliikenne, commenced operations on January 1, 2005. Therefore, between 2005 and 2014, our dataset consists of three bus operators.

The bus operators' financial ratios are reported in Table 5 panel A. The ratios are arrived at as follows. First, we calculated individual key

figures of profitability (EBITDA, ROE) and leverage (E/A, D/E) for each bus operator over the period 1998–2014. We then calculated operators' market share weighted mean values for each annual ratio. These ratios provided information about profitability (EBITDA, ROE) and leverage (E/A, D/E).

The development of bus operators' profitability has been very poor. The weak development of shareholders' equity ratio (ROE) signifies that bus operators have consumed their own equity, and the proportional share of debt (D/E) has risen on their balance sheets. Moreover the largest bus operators' average equity ratio (E/A) weakened dramatically from 41.4% in 1998 to below zero in 2014.<sup>1</sup> At the same time, Table 5 panel B shows that the average number of kilometers in tendering bus traffic (KM) has increased from 53,360 to 94,529 million kilometers between 1998 and 2014. During the same period, however, the average number of bidders per competitive round (BIDDERS) has dropped from 4.29 to 3.35. This development is consistent with Tinnilä and Kallio (2017) who report a reduction in bidders as well as the number of bus operators in the Finnish metropolitan area.

The figures in Table 5 are consistent with a report by the Finnish Government (HE, 2009) which states that bus operators' profitability in the Helsinki Metropolitan Area is significantly below the average for bus operators in Finland. Both private and public sector owners had to allocate new working capital (i.e., share capital and/or subordinated loans) to their bus companies in order to enable the operators to afloat. It is important to note that, especially for large bus operators, an exit from the markets generates large losses mainly due to heavy specific investment. Specific large assets like equipment and depots prevent bus operators' capability to adapt to any market changes. It means that if a bus operator loses a public procurement tender, it cannot offer the same service for local business or directly to consumers.

#### 4.5. Relationship with bus operators' financial ratios and competitive statistics

The Pearson and Spearman bivariate correlations between operators' financial ratios and competitive tendering statistics are reported in Table 6. Most of these correlations are high in absolute value, and Pearson's and Spearman's correlations are very similar.

We observed that bidders per round tend to be associated positively and in a statistically significant manner with operators' profitability measured by EBITDA (Spearman 0.835, Pearson 0.687), and ROE (Spearman 0.583, Pearson 0.561). Moreover, the relationship between operators' equity ratio (E/A) and the number of bidders per round seems to be positive (Spearman 0.674, Pearson 0.613) and statistically significant. Finally, the level of bidders per round tends to have a negative and statistically significant relationship with the proportion of

<sup>1</sup> The only exception in this decreasing trend is 2006 when shareholders allocate a total of over 35 million euros capital to bus operators. That operation temporarily increased operators' E/A-ratio and decreased D/E ratio.

**Table 4**  
Reported percentage reductions in contract prices (per bus kilometers) based on the threat of competition and the introduction of competitive contracts by local authorities (Helsingin Sanomat, 1998; Haatainen, 2003; Valkama and Flinkkilä, 2003; Liikennevirasto, 2012).

Purchasing authority	Percentage price reductions via the negotiations	Introduction of the first competitive tendering	Percentage share of the firstly tendered services	Percentage price reductions via the first tendering	Reported use of the competition-based savings	Year when the share of competition based contracts reached 100%
Sub-regional authority: sub-regional services	5% in 1992 & 0.5% in 1994	Gradually starting from 1994	15%	33.2%	Ticket discounts, improvements of inter-municipal bus services, and discounts of municipal subscriptions	1997
City of Helsinki: local services in Helsinki	3.5% in 1995, 3.5% in 1996 & 3.5% in 1997	Gradually starting from 1997	15%	17.4%	Cut-backs of municipal subscriptions	2002
City of Espoo: local services in Espoo and Kauniainen	No reported price reductions	Comprehensive execution in 1998	100%	32.6%	Improvement of local bus services	1998
City of Vantaa: local services in Vantaa	No reported price reductions	Comprehensive execution in 1999	100%	28.9%	Improvement of local bus services and cut-backs of municipal subscriptions	1999

debt (D/E) in operators' capital structure (Spearman  $-0.728$ , Pearson  $-0.744$ ).

We observed that the share of tendering tends to be associated in a negatively and statistically significant manner with operators' profitability measured by EBITDA (Spearman  $-0.598$ , Pearson  $-0.900$ ) and ROE (Spearman  $-0.544$ , Pearson  $-0.546$ ). Moreover, the relationship between operators' equity ratio (E/A) and share of tendering seems to be negative (Spearman  $-0.613$ , Pearson  $-0.874$ ) and statistically significant. Finally, the share of tendering seems to have a positive and statistically significant relationship with the proportion of debt (D/E) in operators' capital structure (Spearman  $0.794$ , Pearson  $0.677$ ).

## 5. Discussion

### 5.1. Financial and structural impacts

Fig. 4 summarizes the main phases of the quasi-marketization of the Helsinki Metropolitan Area from the perspectives of the local public policies. To begin with, deregulation opened up an avenue to extend local considerations and choices in public bus operations, but the life-cycle of the quasi-market may move on through the suggested further deregulation in the near future. The national government plans to eliminate the priority position of publicly procured bus services, which would limit the scope of the local service policies.

The introduction of the legal framework of a quasi-market helped the City of Helsinki and the sub-regional authority to negotiate the small reductions (i.e., from 0.5% to 5.0%) of contract prices by utilizing the threat of competition, but remarkable reductions (i.e. from 17.5% to 33.2%) of contract prices were achieved via the first calls for bids (Valkama and Flinkkilä, 2003; Ministry of Transport and Communications, 2003). These observations are consistent with the current literature's findings that the introduction of competitive tendering has delivered savings in many cities (cf. Hensher and Wallis, 2005; Walters and Jansson, 2008; Wallis and Bray, 2014).

On the other hand, a highly competitive quasi-market has dramatically and long-lastingly weakened bus operators' financial position. Bus operators have consumed their equity and the proportional share of debts has risen on their balance sheets. These results are in line with findings from the Swedish markets (Ernst and Young, 2013). According to the Finnish transport agency (Liikennevirasto, 2012), the remaining operators are trying to cut costs all the time in order to survive because they cannot find alternative and profitable markets in the country. We can also point out that an exit from the quasi-market and entry into a new market would cause extra switching costs.

After more than 20 years of competition, the quasi-market's competitive structure is reasonable, but the largest operator has a market share of 34 per cent. To begin with, the quasi-market structure was an oligopsony, since there were a few purchasing authorities and many providers. Nowadays, it is reminiscent of a partial monopsony, as there is only one procurement body left and the four largest bus operators have increased their combined market share to 95 per cent. The dominant operators have been able to grow their market shares, especially through mergers. However, price competition between bus operators has been intense, given the radical and long-term deterioration of their financial performance and earning power. As only one purchasing unit remains in the quasi-market, it is capable of setting the pricing mechanism to ensure that their objectives for public transport are reflected in tenders (e.g. the extent of transfer of patronage risk and the securing of certain qualities of service) in the whole sub-region.

Municipal operators have survived the competition in many central European cities (Zatti, 2012). However, in this case, municipal operators were dropped from the quasi-market, as happened in many other large Nordic cities (Hansson, 2011). In the end, the municipal operators' disappearance resulted from the local political choices to apply privatization policies. Our financial statement and audit report analyses suggest that municipal operators had inflexible cost structures and were

**Table 5**  
Some key ratios for bus operators in the Helsinki Metropolitan Area from 1998 to 2014.

	(A) Financial ratios				(B) Tendering ratios	
	EBITDA (%)	ROE (%)	E/A (%)	D/E	KM	BIDDERS
1998	12.8	5.2	41.4	1.4	53.360	4.29
1999	8.6	-21.2	32.8	4.1	70.149	4.29
2000	5.4	-49.2	22.2	7.0	79.520	4.29
2001	7.4	-38.1	22.3	248.9	84.430	4.29
2002	6.3	-42.4	15.3	259.9	83.225	4.00
2003	5.2	-44.5	5.5	254.4	85.000	4.00
2004	4.5	-42.7	-4.3	266.4	83.000	4.00
2005	4.1	-34.9	-19.6	282.5	82.800	3.90
2006	4.6	-30.8	15.4	5.7	83.900	3.80
2007	4.1	-21.5	13.3	6.6	83.600	3.80
2008	1.5	-137.5	9.1	12.7	87.700	3.45
2009	1.9	-77.0	2.1	463.7	88.800	3.10
2010	2.4	-69.8	-0.2	594.7	89.700	3.10
2011	1.7	-71.7	-4.9	645.2	90.799	3.23
2012	4.4	-56.7	-4.5	644.7	92.059	3.35
2013	4.7	-24.0	-2.5	646.9	92.708	3.35
2014	3.2	-48.4	-7.1	640.4	94.529	3.35

*Note:* EBITDA is earnings from operations before interest, taxes, depreciations, and amortizations divided by net sales; ROE is return on shareholders' equity [= net profit margin divided by average equity during the financial year]; E/A ratio is balance sheet equity divided by total assets; D/E ratio is balance sheet debt divided by book value of equity; KM: Number of kilometers (in millions) in tendering bus traffic; BIDDERS is the average number of bidders in competitive tendering rounds between 1998 and 2014.

**Table 6**  
Correlation matrix. The Spearman (Pearson) correlations are above (below) the diagonal.

	EBITDA	ROE	E/A	D/E	KM	BIDDERS
<b>EBITDA</b>		<b>0.718**</b>	<b>0.699**</b>	<b>-0.537*</b>	<b>-0.598*</b>	<b>0.835**</b>
Sig.		0.001	0.002	0.026	.011	0.000
<b>ROE</b>	<b>0.700**</b>		0.444	<b>-0.502*</b>	<b>-0.544*</b>	<b>0.583*</b>
Sig.	0.002		0.074	0.040	0.024	0.014
<b>E/A</b>	<b>0.867**</b>	0.443		<b>-0.843**</b>	<b>-0.613**</b>	<b>0.674**</b>
Sig.	0.000	0.082		0.000	0.009	0.003
<b>D/E</b>	-0.446	-0.199	<b>-0.634**</b>		<b>0.794**</b>	<b>-0.728**</b>
Sig.	0.073	0.444	0.007		0.000	0.002
<b>KM</b>	<b>-0.900**</b>	<b>-0.546*</b>	<b>-0.874**</b>	<b>0.677**</b>		<b>-0.815**</b>
Sig.	0.000	0.023	0.000	0.003		0.000
<b>BIDDERS</b>	<b>0.687**</b>	<b>0.561*</b>	<b>0.613**</b>	<b>-0.744**</b>	<b>-0.718**</b>	
Sig.	0.002	0.019	0.009	0.001	0.001	

\*Correlation is significant at the 0.05 level (2-tailed) and \*\*Correlation is significant at the 0.01 level (2-tailed).

thus unable to reduce their costs as effectively as the private operators. First, the private operators change some of their fixed costs to variable costs by replacing their own buses with leased buses. Second, the collective agreement of the municipal sector included a more rigid shift system than the collective agreement of the private sector (Salomaa, 2015).

Bailey (1999) has argued that bus services are very suitable public goods for competitive markets since the overall lack of economies of scale typically leads to pluralism in service provision, but Cambini and Filippini (2003) have claimed that the industry has some economies of scale. Our findings modestly support the idea of economies of scale in urban bus services. We found that market entry has been difficult, and the interviewees pointed out that the urban depot holdings, along with the discounts for bulk purchases of buses, seem to provide noteworthy scale benefits.

## 5.2. Quasi-market formation

The organizational dimension of the quasi-market format has been problematic in the studied case. The City of Helsinki had a demanding dual role in the quasi-market as it was purchasing local bus services and, at the same time, selling both local and sub-regional bus services. It took many years for the city councillors to organize a clear purchaser-

provider split through the changes of organizational forms of municipal bus service operations. First, the city differentiated (i.e., separated) its internal bus operator from the unit of municipal tram and subway services in 1995. Second, the internal bus operator was reorganized by corporatizing it and establishing a new municipal limited company in 2005. Our findings provide a plausible reason to cast doubt on the organizational axiom of quasi-market theorization, according to which both public law (i.e., not-for profit) and private law (i.e., for-profit) operators are suitable organizational forms in competition for the same service contracts. Our findings demonstrate that they do not operate on equal terms. For example, internal operators of municipalities cannot go bankrupt like private law operators, they cannot collect capital financing on equal terms, and they have to follow different collective agreements.

Considering a quasi-market's spatial aspect, the studied quasi-market with negotiated contracts was initially a local concept in Helsinki. Its geographical territory became larger, first, when competitive contracts were introduced by the old sub-regional authority and, second, when the sub-regional authority started to collaborate with new municipalities outside of the metropolitan area. However, the quasi-market is still only a sub-regional market. The Helsinki Metropolitan Area is one part of the Uusimaa Region and the majority of its 26 municipalities resist the quasi-market model because they consider

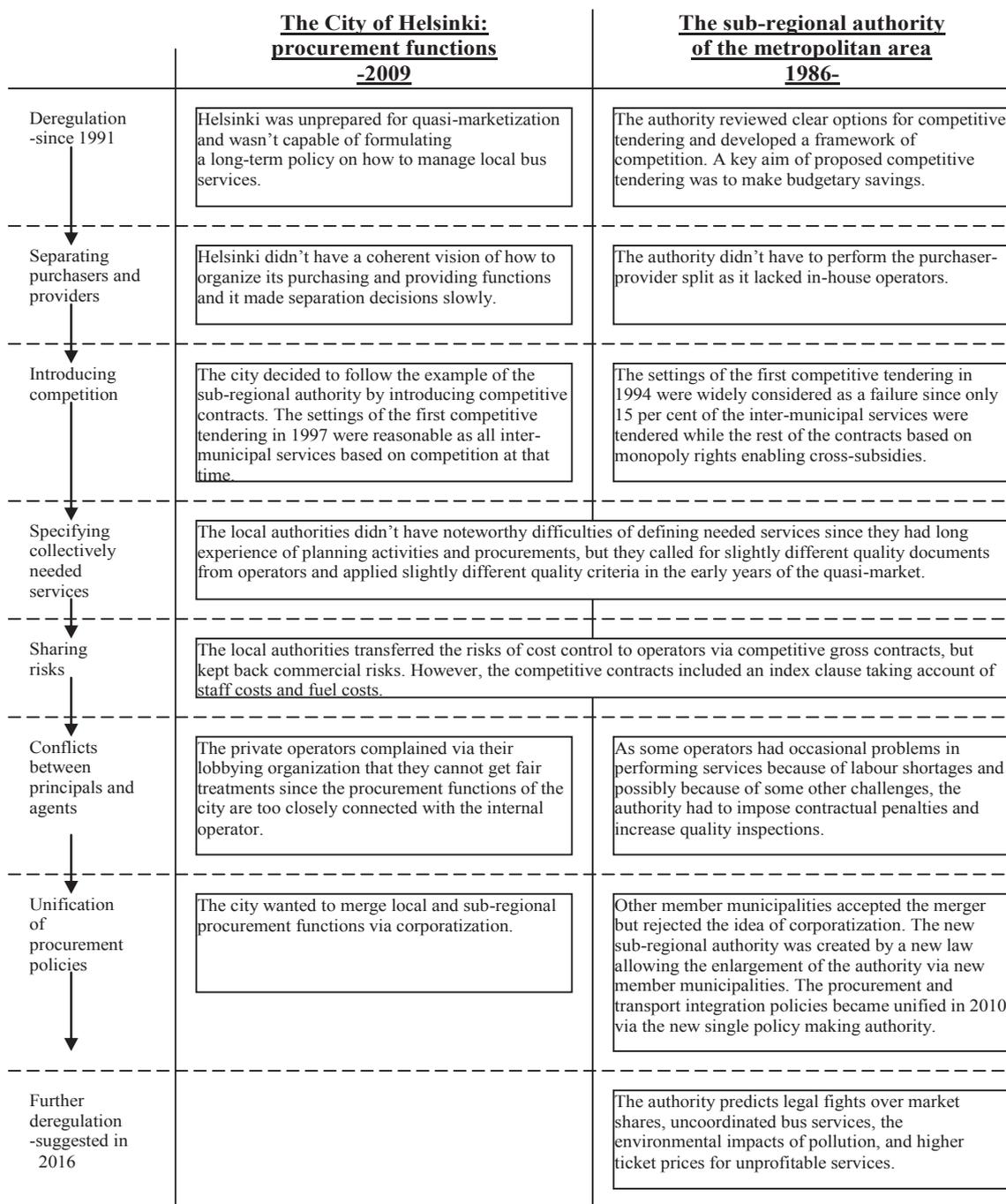


Fig. 4. The summarized main phases of the quasi-marketization of the Helsinki area bus services.

municipally funded services as expensive. The Finnish Bus and Coach Association has also strongly opposed the quasi-market becoming region-wide (Liikennevirasto, 2012). This may have something to do with the fact that small rural operators have not been able to become established in the quasi-market over the years.

We have demonstrated that the introduction of competitive tendering was a temporally critical moment. The closed market's narrow opening as only 15 per cent of the inter-municipal services of the metropolitan area was opened through the first competitive tendering in 1994 included a governance risk. It caused competition distortion as the interviewees considered that the gradually phased implementation of competitive tendering provided an opportunity for operators to use profits from the negotiated contracts as cross-subsidies supporting very low bidding prices. This can be considered a governance failure of the

introduction of competitive tendering. However, it can also be concluded that the operators were more interested in competing for market shares than in striving for profitability objectives. Furthermore, we found that the tempo of contracting processes has slowed down slightly during the duration of the quasi-market formation. The original aim of the sub-regional authority was to use only three- and five-year contracts, but the currently applied seven-year contracts are more responsive to the hopes of the incumbent operators.

The new bill proposing the priority position of commercial bus services over publicly procured urban bus services has provided a legal challenge to the Helsinki sub-region's quasi-market. This is an institutional case of competition for a market as the national government aims to create a new market and implicates a legitimacy problem of the quasi-market as an exclusive market application in the sub-region. The

sub-regional authority opposes the bill and claims that pure market-based services could result in “cream skimming exercises,” where private operators would select the most profitable routes and leave unprofitable bus services for the sub-regional authority (Helsingin Seudun Liikenne, 2016).

## 6. Conclusion and policy recommendations

We believe that European economic integration together with neoliberal tendencies and encouraging international examples of competitive urban bus services created a new public policy framework that guided Finnish lawmakers to give up the restrictions of foreign ownership of enterprises, allow competitive tendering in public transport services, and introduce rigorous public procurement legislation. In this connection, the quasi-market concept has to be understood especially as a transitional and instrumental policy tool for local political decision-makers to open up a market that had remained effectively closed due to not only traffic licenses and negotiated contracts but also to the dominant role of in-house production.

The quasi-market format had organizational problems as it could not provide equal terms of competition between municipal and private operators, causing an incessant shortage of trust between the private agents and the municipal principal. The quasi-market has stayed as a quasi-market purely accidentally in a sense that the privatized municipal operators were replaced by a state-owned operator that was able to enter the quasi-market through a corporate acquisition. However, public authorities have considered the quasi-marketization as a success story because they could cut down service costs and make the operators more responsive to their specific hopes concerning the qualities of buses and services.

The case demonstrates that public authorities as principals are able to manage and supervise contracted out services delivered by legally autonomous agents. In this case, municipal agents were not capable of competing with private agents, but large private operators took dominant positions at a cost to their profitability as they focused on competition for market shares by bidding with very low prices.

We found that depots are limited but critical resources of the urban bus industry. City planners should take into account the need for depots in land use planning and zoning, and city governments should develop new governance models of the depots together with real estate investors to promote the easy entries and exits of bus operators. We would also recommend that the purchasing body should review alternative contractual stipulations, specifications of the calls for bids, the packages of routes, the tempos of contracting processes, and alternative quality checking methods to stimulate innovations and market structures.

If public policymakers decide to quasi-marketize the delivery of a public service, they should make a clear purchaser-provider split determinedly and quickly. As service producers rightly expect to compete on equal terms, public policymakers should promote competitive neutrality by harmonizing regulatory preconditions, unifying the terms of collective agreements, and applying well-matched ownership policies. If municipal service providers are not competitive and are loss-making organizations, municipalities should radically reorganize or privatize them quickly. As quasi-marketization may easily cause juxtapositions of economic interests, municipal councillors and managers should be prepared for active communication and reconciliation efforts in order to minimize disruptive industrial disputes between labor market organizations.

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