

## ANALYSIS OF CROATIAN PRIVATIZATION FUND PORTFOLIO

Boris Crnković<sup>1</sup>, Željko Požega<sup>2</sup>, Ivo Mijoč<sup>3</sup>

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### SUMMARY

On the way to full membership in the EU, Croatia must, as soon as possible, complete before the economic transition. An important part of this process is the completion of the privatization of state property which is privately owned, in developed market economies, exclusively due to greater efficiency and competitiveness of the economy, higher GDP, and consequently - higher living standards for all citizens. However, public attitudes toward privatization in Croatia is still very negative, primarily due to the numerous irregularities which accompanied it and the fact that there was a disproportion between the expectations created for the privatization and its pragmatically possible ranges. Today, almost 20 years since the beginning of the privatization private sector share in GDP of the Republic of Croatia is still too small, and the Croatian Privatization Fund has in its portfolio still over 800 companies. The analysis of the entire portfolio of the Croatian Privatization Fund will be made in the paper, with two goals. The first goal is to provide guidelines for further privatization steps which are necessary. Another goal is to give guidelines for the restructuring of the Croatian Privatization Fund in an institution whose primary goal will not be privatization but effective and active management of state property.

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<sup>1</sup> mr.sc. Boris Crnković, Teaching Assistant, Josip Juraj Strossmayer *University of Osijek*, Faculty of Economics, Osijek; 31000 Osijek, Gajev trg 7, tel: +385 31 224 400, fax: + 385 31 211 604 e-mail: bcrnko@efos.hr

<sup>2</sup> dr.sc. Željko Požega, Assistant Professor, Josip Juraj Strossmayer *University of Osijek*, Faculty of Economics, Osijek, 31000 Osijek, Gajev trg 7, tel: +385 31 224 400, fax: + 385 31 211 604, e-mail: zpozega@efos.hr

<sup>3</sup> mr.sc. Ivo Mijoč, Teaching Assistant, Josip Juraj Strossmayer *University of Osijek*, Faculty of Economics, Osijek, 31000 Osijek, Gajev trg 7, tel: +385 31 224 400, fax: + 385 31 211 604, e-mail: imijoc@efos.hr

## INTRODUCTION

Throughout the last two decades of implementation of the transformation and privatization process, and due to aggression and war destruction as well as transition environment, the Croatia had to achieve three incompatible goals - economic, political and social. The privatization model in Croatia was primarily based on case-by-case method of sale, and partially served as social program, i.e. free allocation of shares to the social classes that were most affected by war. The privatization itself was conducted in accordance with the Transformation Act and the Privatization Act. The first essential step was the transformation of previously socially-owned enterprises into state owned enterprises ("no one's to someone's") followed by privatization. From 1991. to the end of 1999. the privatization process included totally 2.650 previously socially owned enterprises, 667 from industry, from the total of 3000 intended to be transformed and privatized at the beginning of the process.

In 2009., according to Commission of the European Communities (Croatia 2009 Progress Report 2009: 22) the privatization process still progresses slowly. The privatization of assets held under the State Privatization Fund made only limited progress. The private sector's share in employment has remained at around 70%; the private sector share of GDP is estimated at around 70-80%. Overall, very limited progress has been achieved in reducing the role of the State in the real sector of the economy. (Croatia 2009 Progress Report 2009: 23)

On the way to full membership in the EU, Croatia must, as soon as possible, complete before the economic transition. An important part of this process is the completion of the privatization of state property which is privately owned, in developed market economies, exclusively due to greater efficiency and competitiveness of the economy, higher GDP, and consequently - higher living standards for all citizens. However, public attitudes toward privatization in Croatia is still very negative, primarily due to the numerous irregularities which accompanied it and the fact that there was a disproportion between the expectations created for the privatization and its pragmatically possible ranges.

Croatia needs accelerated privatization and restructuring of state and local enterprises (Ott 2005:1) for which it is necessary to conduct a transformation of Croatian privatization fund as the key institution in the privatization process, not only the institution which will have privatization as a primary goal, but also efficient management of the whole state assets. (Strateški okvir za razvoj 2006. – 2013. 2006:61)

## **ORGANIZATION OF CROATIAN PRIVATIZATION SYSTEM**

The key elements of organization of every system of privatization are legislative frame of privatization, methods which apply in the privatization process and institutions which conduct the privatization.

### **Legal Framework**

Privatization in the Republic of Croatia is regulated by though basic acts, Transformation Act (1991) and Privatization Act (1993).

Transformation Act establishes the basis for the implementation of the transformation of the ownership of enterprises, meaning that its objective is to find owners for socially-owned enterprises. This is a matter of the transformation of legal persons. The goal of transformation is for the enterprise to obtain an owner, while the change in the form of ownership over what is comprised in the enterprise is simply a consequence of the change in the enterprise's new ownership regime. This is why the Act speaks of the transformation of enterprises, and not the transformation of ownership over socially-owned assets in the enterprise. (Legal framework of Privatization in Croatia 2010)

After the transformation of social ownership was largely completed (under the Transformation Act), the only thing left was for this process to be finalized in the liberated territories of the Republic of Croatia. Therefore it was necessary to legally regulate the procedures for the privatization of those assets transferred to the Croatian Privatization Fund in the social ownership transformation process, i.e. those assets which, pursuant to special regulations and in legally permissible fashion became the property of the state, counties, cities and municipalities. This legislative task was accomplished with the passage of the Privatization Act, which regulates the criteria and procedures for the privatization of those assets not privatized during the transformation process. (Legal framework of Privatization in Croatia 2010).

### **Privatization methods**

Various privatization models in Croatia had to enable the fast transformation of state entities into the private ones. Throughout the whole process the variations of almost all methods which are known in theory of privatization, were used, from worker and manager shareholding, through capon privatization to selling via public offerings.

Methods which are currently used are:

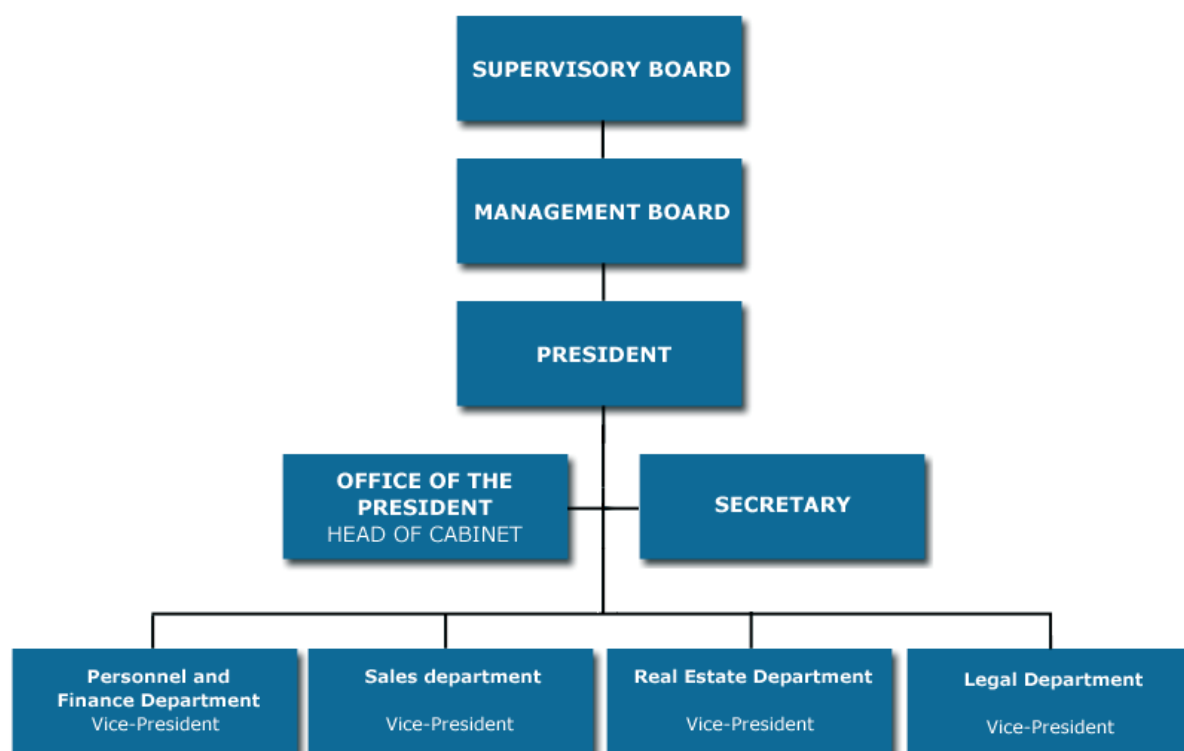
- Public tendering - privatization of companies of strategic importance where, beside the offered price, very important are the conditions which relate to the functioning and the status of the company after privatization. This method is used most for sale of majority portfolio and real estates.
- Sale on Zagreb stock exchange - auction sale of the company shares for cash at a nominal or discount price up to 25% state portfolio participation in the capital.

### *Institutions which conduct the privatization*

The Croatian Privatization Fund was established by law and it has the status of a legal person with the rights and obligations stipulated by Act (Croatian Privatization Fund Act) and the Fund's Charter (Charter of the Croatian Privatization Fund). The Fund's registered seat is in Zagreb. The Fund has been established to implement and complete the privatization of assets temporarily transferred to the Fund pursuant to the Transformation Act, or assets which became the property of the Republic of Croatia and were then transferred to the Croatian Development Fund (the legal predecessor of the Croatian Privatization Fund). (Legal framework of Privatization in Croatia 2010)

The Fund engages in the following professional and administrative operations (Croatian Privatization Fund Act):

- transformation of socially-owned enterprises into public companies;
- privatization of shares, interests, property and rights and the transfer of shares free of charge when stipulated by law;
- management of legal entities in which state institutions hold shares and interests, and other operations stipulated by law and the Fund's Charter;
- management of assets owned by the Republic of Croatia when stipulated by law or a decision of the Government;
- management of legal entities in which the Fund holds shares and interests, and other operations stipulated by law and the Fund's Charter.

**Picture 1:** Croatian Privatization Fund Organization chart

Source: (Croatian Privatization Fund Organization Chart 2010)

According to Fund's Charter management bodies of Fund, shown on **Picture 1**, are (Croatian Privatization Fund Management 2010):

- *Supervisory Board* - Supervises the legality of the CPF's operation, reviews the financial plan and annual operational statement and submits the report on the operation of the CPF to Croatian Parliament (Sabor). It has currently 8 (eight) members appointed by the Croatian Parliament.
- *Management Board* - Manages the CPF, adopts its Charter, determines the operational policy, makes decisions on the sale of shares, business interests, things and rights, restructuring, incorporation, purchase and sale of companies, prepares the financial plan and annual financial statement of the CPF, as well as other decisions of key importance for the operation of the CPF. It has 5 (five) members appointed by the Government of the Republic of Croatia.
- *Colegium of Department Heads* - Makes decisions on the sale of shares i.e. business interests in individual legal persons with registered capital up to 10.000.000,00 kn, discusses and takes standpoints on all relevant issues in the operation of the CPF, gives proposals and opinions to the Management Board

of the CPF and President of the CPF. The Colegium of Department Heads is composed of the President, secretary and Vice-Presidents. The Management Board of the CPF appoints and relieves the Vice-Presidents at proposal of the President of the CPF. Vice- Presidents report to the Management Board and President of the CPF.

- President - Manages, represents and acts on behalf of the CPF. The President has a Deputy. The Government of the Republic of Croatia appoints the President and Deputy President.

### CROATIAN PRIVATIZATION FUND PORTFOLIO

According to (Croatian Privatization Fund Enterprise Portfolio 2010) Fund's portfolio is comprised of shares and stakes in a total of 1,112 companies, and the equity base of these companies is HRK 177.6 billion, while the equity of the State's portfolio amounts to HRK 21.8 billion.

The **Table 1** depicts the structure of the CPF portfolio and shows that the State has most shareholder interests - in terms of both company numbers and equity - in the processing industry, and significant holdings in the trade, tourism, agriculture and transport and communications sectors. (Croatian Privatization Fund Enterprise Portfolio 2010)

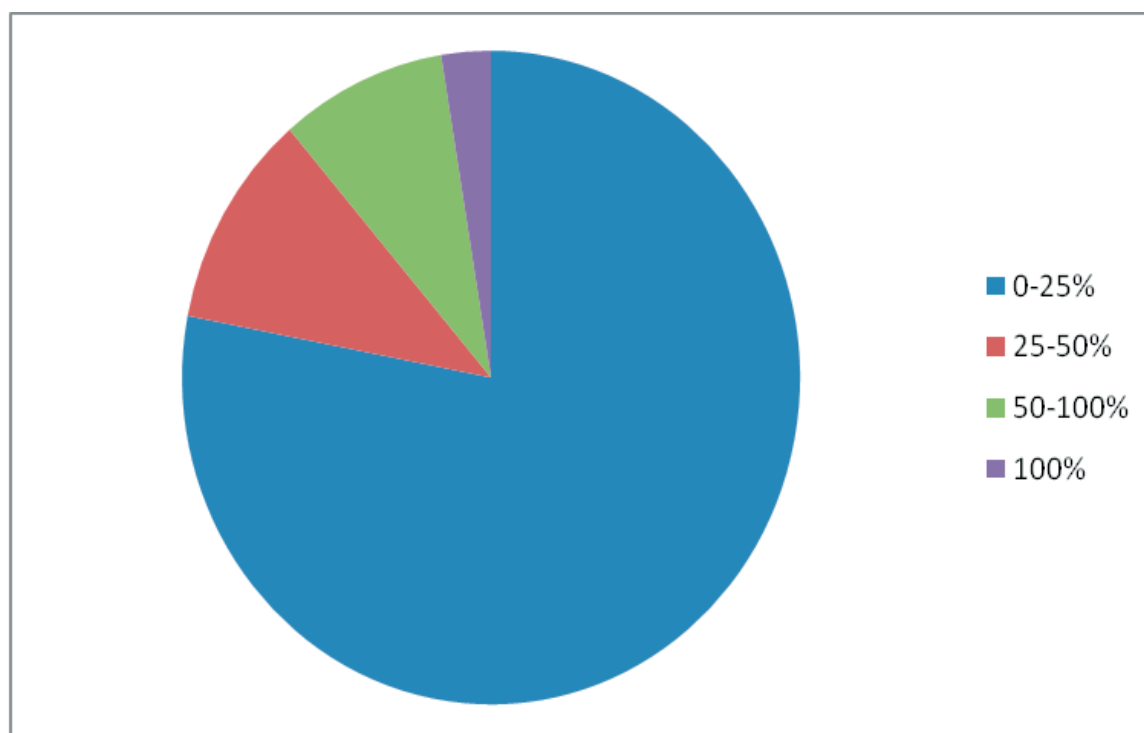
**Table 1:** Croatian Privatization Fund's total portfolio

	ACTIVITY	No. of companies	Equity (HRK)	State Portfolio (HRK)
1	AGRICULTURE, HUNTING AND FORESTRY	83	4.154.248.151	2.512.854.115
2	FISHING	5	41.946.600	9.276.240
3	MINING AND EXTRACTION	4	52.655.624	5.640.221
4	PROCESSING INDUSTRY	374	28.625.991.615	9.570.495.424
5	ELECTRICITY, GAS AND WATER SUPPLY	1	458.800	1.101
6	CONSTRUCTION	101	1.774.696.075	196.218.442
7	TRADE	179	4.067.704.892	329.073.025
8	TOURISM	153	14.156.272.555	3.876.847.727
9	TRANSPORT, WAREHOUSING AND COMMUNICATIONS	65	6.303.182.855	2.792.861.832
10	FINANCIAL MEDIATION	15	115.085.999.600	1.151.234.433
11	REAL ESTATE, RENTAL AND BUSINESS SERVICES	86	3.054.757.596	1.298.846.827
12	EDUCATION	3	4.497.000	216.727
13	HEALTH PROTECTION AND SOCIAL WELFARE	9	15.089.269	468.299
14	OTHER PUBLIC, SOCIAL AND INDIVIDUAL SERVICE ACTIVITIES	32	239.174.243	35.757.230
	Total:	1112	177.602.545.975	21.803.172.733

Source: (Croatian Privatization Fund Enterprise Portfolio 2010)

It is interesting to compare the structure of ownership of companies in the portfolio and the share of state's ownership of the companies in the portfolio. Of aforementioned companies, the state has the majority of ownership (more than 50%) in 109 companies of which 25 companies are 100 per cent owned by the state. Of companies remaining, the state has significant ownership share (over 25%) in 103 companies. The **Picture 2** shows the number of companies in accordance with state ownership share, and **Picture 3** shows the size of basic capital and share of state ownership in companies.

**Picture 2:** Number of companies in state ownership share.

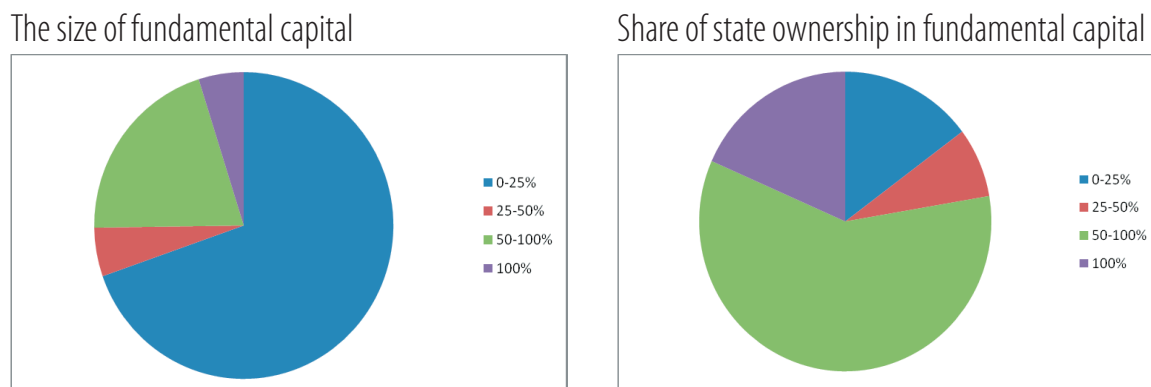


Source: Made by the authors according to data (Croatian Privatization Fund Enterprise Portfolio 2010)

From the data listed it is clear that there are a relatively high number of companies in which the state has minority shares and in which the share of state ownership in fundamental capital is over 2,5 billion Kuna. As the minority shares listed above do not provide any significant ownership rights in companies listed, it is necessary to approach the privatization of mentioned companies as early as possible, primarily because of possibility to achieve significant revenue out of those privatizations. The basic capital of companies in which the state owns 25-50 per cent is 3,4 billion Kuna, and the state ownership in the basic capital is over 1,3 billion Kuna. Approaching the privatization of portfolio mentioned, should be done carefully and keeping in mind the holding of at least 25%+1 of shares there where it is necessary because of eventual influence on key decisions in those companies.



**Picture 3:** The size of fundamental capital and state ownership share in it according to the saner of state ownership in companies.



Source: Made by the authors according to data (Croatian Privatization Enterprise Portfolio 2010)

By analyzing the portfolio in state majority ownership, it is clear that, although the number of companies is relatively small, the value of their fundamental capital of 16, 6 billion Kuna is more significant than their number. Fundamental company capital in 100 per cent state ownership is 3, 2 billion Kuna, while the fundamental capital in of companies in major ownership of the state is 13, 4 billion Kuna. In the share of the state portfolio of the companies listed, it is shown that the share in 100 per cent ownership is 3, 2 billion Kuna and the share in major ownership state companies is 10, 4 billion Kuna. The value of state portfolio in companies in major or 100 per cent ownership represents more than  $\frac{3}{4}$  of the value of the entire state portfolio.

Privatization of portfolio mentioned should be done as soon as possible and with full care. Primarily it is necessary to regain the trust of the people in the process of privatization which was deeply undermined by unsolved affairs which correlate to the process. With the privatization of portfolio which is in major state ownership, the numerous factors of privatization should be kept in mind; primarily because of the significance which some of the companies have in national economy (financial institutions, tourist companies, shipyards). However, privatization should not be conducted at any price, but it is necessary to organize Croatian Privatization Fund as well as an institution whose exclusive goal is privatization, but also efficient management of mentioned assets.

## CONCLUSION

On the way to full membership in the EU, Croatia must, as soon as possible, complete before the economic transition. An important part of this process is the completion of the privatization of state property which is privately owned, in developed market economies, exclusively due to greater efficiency and competitiveness of the economy, higher GDP, and consequently - higher living standards for all citizens. However, public attitudes toward privatization in Croatia is still very negative, primarily due to the numerous irregularities which accompanied it and the fact that there was a disproportion between the expectations created for the privatization and its pragmatically possible ranges. Today, almost 20 years since the beginning of the privatization private sector share in GDP of the Republic of Croatia is still too small, and the Croatian Privatization Fund has in its portfolio still over 800 companies. The analysis of the entire portfolio of the Croatian Privatization Fund will be made in the paper, with two goals. The first goal is to provide guidelines for further privatization steps which are necessary. Another goal is to give guidelines for the restructuring of the Croatian Privatization Fund in an institution whose primary goal will not be privatization but effective and active management of state property.

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