STATE OWNERSHIP AND CORPORATE GOVERNANCE OF ENTERPRISES IN CROATIA

Boris Crnković, Ph.D.[1], Željko Požega, Ph.D.[2], Goran Sučić, Ph.D.[3]
[1]Faculty of Economics, Josip Juraj Strossmayer University of Osijek, Republic of Croatia, bcrnko@efos.hr
[2]Faculty of Economics, Josip Juraj Strossmayer University of Osijek, Republic of Croatia, zpozega@efos.hr
[3]Faculty of Philosophy, University of Split, Republic of Croatia, goran.sucic@ffst.hr

Abstract

Views towards state-owned enterprises on the one hand and private property on the other side through history have changed often. However, strengthening the role of the state in the economy, which is driven by a major economic crisis in the late twenties to thirties of the last century, and continued with the completion of the Second World War led to a significantly more active role of state ownership in many economies. In the late seventies state enterprises began to fade in importance due primarily to overcome the perception of their inefficiency. It has been listed perception and source of many of the privatization process which culminated at the beginning of the transition. Privatization process, which took place in Croatia back the last two decades through the transformation and privatization, was very complex due to the fact that it took place in transitional and war environment, and today, two decades since the beginning of the privatization private sector share in GDP of the Republic of Croatia is still too small with a large number of enterprises that have remained in state ownership. It is clear that due to political and economic reasons huge progress in the privatisation process in Croatia cannot be expected soon and therefore it is necessary to ensure efficient management of the whole state portfolio. Focus of a large number of scientists is the question of microeconomic (in)efficiency of state-owned enterprises. Exactly with this purpose this paper will analyze the financial performance Croatian state-owned enterprises.

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Introduction

The role and importance of state-owned enterprises have changed throughout history, from the period in which there was almost no state-owned enterprises, to the period in which it is played a significant role in the economy. Historically, state enterprises began to play an active role since the Great Depression in 1929. year as an active agent of economic recovery. The above trend continued after the Second World War, when in many countries SOEs wore foundation of the entire post-war reconstruction. In the seventies of the twentieth century, due to raising awareness about the inefficiency of state-owned enterprises have begun trends of privatization of state enterprises that continued at the beginning of the transition of the former socialist countries.

In addition to political and ideological motivation for the establishment of state-owned enterprises, according to Toninelli (2000), there are three key reasons for their existence: market failure, promoting economic growth based on long-term planning; industrial and financial rehabilitation as a consequence of the economic crisis.

Megginson (2005) also states that the role of state ownership often changed through history, and contemporary economic theory supporters justify the existence of state ownership through three key arguments: The first reason is the fact that state ownership is considered a good way of ensuring balance between economic and general social goals in companies and avoiding the orientation of afore mentioned companeies on solely maximizing profits; Second, state ownership is motivated as a response to problems and questions of market faliure, especially the challenges of the economic feasibility of natural monopolies and challanges of internalization of externalities (such as pollution, for example); And third, state ownership is justified in circumstances where there is information asymmetry between the principal (society as whole) and agent (company leadership), when complete and quality contracts cannot be made and carried out.

The assumption justification of state ownership in all three cases is that the governments act benevolently and accordingly with the goal to increase the general social welfare, and that consequently the property of the state is economically efficient. Certainly, the state property was also imposed a lot of times in history with stances of certain political parties or ideologies especially as a precondition for the redistribution of wealth and income from less to more “deserving” members of society, but this issue is primarily a question of political power and the justification of an ideology, not issue of serious economic analysis.

However, the global financial crisis in the second half of the last decade (since 2008. onward) stops the trends of privatization on the one hand, and on the other hand is forcing many states to enter the ownership of numerous private companies affected by the crisis, thus the importance of state-owned enterprises becoming increasing. Accorting to Pargendler (2012) this is best shown by the fact that SOEs are now responsible for approximately one-fifth of global stock market value, which is more than two times the level observed just one decade ago. Even before the crisis in many countries, SOEs had a significant share in the gross domestic product and employment. The crisis has aforesaid share further increased. The importance of state-owned enterprises is further emphasized by the fact that they are still dominant in infrastructure sectors such as water, energy and transport and therefore their business is not only important for themselves but it affects the entire economy and the general population of a country. Consequently, the governance of SOEs will be critical to ensure their positive contribution to a country's overall economic efficiency and competitiveness (OECD, 2005).

This paper is organized as follows. Section 2 through literature review describes the latest scientific knowledge of corporate governance in SOEs. Section 3 presents the development and current state of the portfolio of state-owned enterprises in the Republic of Croatia. Section 4 describes the current state of corporate governance in state-owned enterprises in the Republic of Croatia. Finally, Section 9 presents our conclusions

Corporate governance of state owned enterprises – theoretical owerview

The globalisation of markets within most industries, technological changes and liberalisation in many infrastructure sectors has made readjustment and/or restructuring of the state-owned sector often necessary. The need to clearly separate state ownership from the regulatory role, and the necessity to put in place more efficient decision making processes and governance structures have been highlighted in many instances, including when it has been necessary to avoid failures or restructure after failures. (OECD, 2005)

According to World Bank (2010) SOEs face significant corporate governance challenges, driven by a wide separation of ownership (by the state on behalf of the citizens of a country) from control (by the directors and managers that run the company). Many government bodies influence SOEs (one or more ministries, cabinet, an ownership entity specifically created to oversee SOEs, the Parliament), and each may potentially use the companies to achieve short-term political goals, undermining their efficiency and opening the door to corruption. SOEs and their owners typically face five corporate governance challenges (World Bank, 2010:1):

- *Unclear ownership objectives*: Although there is general acceptance of "shareholder value" as the goal for privately held companies, SOEs have been given a wide range of goals and objectives. SOEs may face price controls, output targets, requirements for comprehensive service (e.g., rail, telephony, mail), employment goals, community development targets, pressures to correct past social injustices, requirements to provide social services, and financial targets such as returns on capital.
- *Weak owners*: In many or most countries the state exercises its ownership role through weak institutions, sets inconsistent goals, does not monitor company performance, is unable to make changes to correct poor performance, and cannot supply capital. Increasing the professionalism and capability of the state's ownership function is a major corporate governance challenge.
- *Low levels of transparency and disclosure*: Although "publicly owned," many SOEs lack transparency. They tend to have no public reporting requirements, and their accounts and other information may be treated as a state secret. Opacity undermines performance monitoring, limits accountability at all levels, conceals debt that can damage the financial system, and creates conditions under which corruption can flourish.
- *Unprofessional boards of directors:* SOE boards rarely play a true corporate governance role. Boards tend to act as a "parliament" representing various stakeholders. SOE boards in many countries include elected officials, civil servants, and employee representatives, all of whom may have agendas that conflict with the interest of the company as a whole. Unsurprisingly, SOE boards are weak, and decision-making is heavily influenced by the government. Improving SOE boards requires many of the same steps as in private companies, including increased authority, autonomy, and professionalism.
- *Poor relationships with other shareholders and stakeholders*: SOEs face powerful stakeholders, including consumers or communities, state-owned creditors and employees. SOE employees may have a greater say in governance than

employees in the private sector do. Many SOEs also have minority shareholders. As with other controlling shareholders, the state may abuse minority rights.

In order to carry out its ownership responsibilities, the state can benefit from using tools that are applicable to the private sector, witch is especially true for listed SOEs. However, acording to OECD (2005:3) SOEs also face some distinct governance challenges. One is that SOEs may suffer just as much from undue hands-on and politically motivated ownership interference as from totally passive or distant ownership by the state. There may also be a dilution of accountability. SOEs are often protected from two major threats that are essential for policing management in private sector corporations, *i.e.*, takeover and bankruptcy. More fundamentally, corporate governance difficulties derive from the fact that the accountability for the performance of SOEs involves a complex chain of agents (management, board, ownership entities, ministries, the government), without clearly and easily identifiable, or remote, principals. To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge. (OECD, 2005:3)

Fundamental principles for ensuring efficient decicions making and goog corporate governance in SOEs are according to OECD (2005):

- *Ensuring an effective legal and regulatory framework for state-owned enterprises*: The legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions.
- *The state acting as an owner*: The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.
- *Equitable treatment of shareholders*: The state and state-owned enterprises should recognise the rights of all shareholders and ensure their equitable treatment and equal access to corporate information.
- *Relations with stakeholders*: The state ownership policy should fully recognise the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders.

- *Transparency and disclosure state-owned enterprises should observe high standards of transparency*: The co-ordinating or ownership entities should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.
- *The responsibilities of the boards of state-owned enterprises:* The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management.

Evolution of state ownership in Croatia

Privatization process, which took place in Croatia back the last two decades through the transformation and privatization, was very complex due to the fact that it took place in transitional and war environment, and the fact that it had to take into account the achievement of three types of objectives: economic, political and social. The model of privatization in Croatia was based primarily on privatization "from case to case", and it had a large role serving as a social program: for example, through free allocation of shares to social groups that have suffered most in war (soldiers, exiles, refugees).

The entire process started with the adoption and implementation of the Law on Transformation of Socially Owned Enterprises of 1991, and continued with adoption and application of the Law on Privatization of 1995. The first crucial step in the process of privatization was the conversion of former socially-owned enterprises into companies with known titular ownership (which was essentially the state, which led to significant natonalization of social assets), after which privatization followed. Since 1991 until now the process of transformation and privatization covers slightly less than 3000 of former socially-owned enterprises. However, despite the large number of companies included in the transformation and privatization, the overall progress of Republic of Croatia in the entire process is extremely weak.

Although data on the number of state-owned enterprises change almost on a daily basis, according to available data on the date 15.03.2013. in the portfolio of the Republic of Croatia there were 631 enterprises. 555 of these 631 enterprises 555 is in the minority state ownership (up to 49.99% of shares), 61 enterprise is in majority state ownership (over 50% of shares), while 15 companies are not active. From the analysis of the portfolio is evident (Strategija, 2013):

- In March 2013. the share of state ownership exceeds 50% in only 61 company or cca. 10% of the active portfolio In remaining 555 enterprises the state's share is below 50% of the shares, which represents about 90% of the active portfolio.
- From a total of 555 companies in 420 minority-owned enterprises are stocks that are fully or partially available for sale, while 135 enterprises there are no shares available for sale, which makes about 24% of the total active state portfolio.
- Majority the portfolio can be divided into enterprises available for sale (total 36 enterprises), companies "under the reservation that are currently not available for sale" (a total of 2 companies) and enterprises of special state interest (total 23).
- According to FINA in 2011., 85 leading enterprises in Croatia had revenues of 228.7 billion kuna, of which 50.1% realized enterprises in foreign ownership (or 114.5 billion kuna), 25.4% domestic private enterprises (58,1 billion kuna), and the rest is revenue of state owned companies (56 billion kuna).
- On the list of 85 largest companies operating in Croatia, 35 are foreign owned, 29 in domestic private enterprises while 21 are state-owned.

Thus in Croatia state-owned enterprises represent a significant portion of the gross domestic product, employment and market capitalization. Companies owned by the state prevailing in the energy and transport, and are very important for employment and significantly contribute to the overall economic activity. Exactly therefore an effective corporate governance is of utmost importance.

Corporate governance of state owned enterprises in Croatia

The global economic phenomena and economic crisis affecting the world economy, especially the Croatian economy, put new challenges for the holders of corporate governance of state owned enterprises. That is why the Croatian Government adopted a new strategy for the management of state assets (Strategija, 2013) in which there is one special section dedicated to the management of state-owned enterprises. The strategy was made for a period of four years and with it are determined medium-term objectives and guidelines for managing the assets of Republic of Croatia. The strategy was made with the aim to ensure long-term efficient and transparent management and disposition of assets Republic of Croatia whose sustainability is important to the life and work of current and future generations, and in order to ensure that the state assets of will bi at the service of economic growth and the protection of national interests.

In accordance with the Strategy main task of managing and disposing of the assets of state-owned enterprises is to realize economic growth, development, employment and financial benefits, and existing portfolio of companies in which the government holds shares in the future will be organized into three groups (Strategija, 2013):

1. *Enterprises of strategic and developmental importance which are determined by the strategy (owned by state 50% or more):*
   a. *Strategic enterprises that generate revenue from use of public authority and in which the state participates in the pricing of products and services:* Enterprises of strategic importance which generate revenues based on the assigned public powers in which the state participates in the pricing of products and services are those in which the state as a shareholder, except economic, achieves strategic objectives: legal and effective exercise of the transferred public powers, security, health insurance, critical infrastructure, uninterrupted supply of population and businesses, and commercial insurance services in the interest of the citizens and the state. For such companies exists long-term social need.
   b. *Enterprises of developmental importance in which state has a majority stake:* In this group are enterprises that are of importance in the developmental role in which state has a majority stake, and which are not from the sector of infrastructure, energy, etc.. Specified enterprises need restructuring, recapitalization and privatization, in whole or in part. Shares in these companies are government investments reaching high added value and profits. It is expected that these enterprises invest in above-average investments, research and development. Those enterprises with its production potential must contribute to the stability and development of countries and regions, and their profits will be an important revenue of the state budget.
2. *Enterprises whose shares are listed on the regulated market of the capital, in which stete has total ownership of less than 50%.:* For enterprises whose shares are listed on the regulated market of the capital, in which the state has total ownership of less than 50%, the government is trying to reach the primary

goals of economic and usually along with other private investors, ie, under the same conditions as the other investors, and driven by the same interest.

3. *Other enterprises in which the state holds shares and stocks (state share less than 50%).*
   a. *Enterprises with a state share to 25%:* For enterprises in the state portfolio in which the state has less than 25% of the shares (which do not have greater developmental significance), is planned within two years carry out the restructuring, their public listings and selling, donation and / or the formation of a venture capital fund.
   b. *Enterprises with state share of more than 25%:* For companies that are owned by the state more than 25%, predict the same objectives and procedure as in the previous group, but over a period of three years

Conclusion

Views towards state-owned enterprises on the one hand and private property on the other side through history have changed often. However, strengthening the role of the state in the economy, which is driven by a major economic crisis in the late twenties to thirties of the last century, and continued with the completion of the Second World War led to a significantly more active role of state ownership in many economies. In the seventies of the twentieth century, due to raising awareness about the inefficiency of state-owned enterprises have begun trends of privatization of state enterprises that continued at the beginning of the transition of the former socialist countries. The global financial crisis in the second half of the last decade (since 2008. onward) stops the trends of privatization on the one hand, and on the other hand is forcing many states to enter the ownership of numerous private companies affected by the crisis, thus the importance of state-owned enterprises becoming increasing.

Exactly therefore increases the importance of effective corporate governance in state-owned enterprises, which induces five constraints: unclear ownership objectives; weak owners; low levels of transparency and disclosure; unprofessional boards of directors and poor relationships with other shareholders and stakeholders. Therefore, corporate governance in state-owned enterprises should be based on the following fundamental principles: ensuring an effective legal and regulatory framework for state-owned enterprises; the state acting as an owner; equitable treatment of shareholders; transparency and disclosure state-owned enterprises should observe high standards of transparency; the responsibilities of the boards of state-owned enterprises.

In Croatia state-owned enterprises represent a significant portion of the gross domestic product, employment and market capitalization. Companies owned by the state prevailing in the energy and transport, and are very important for employment and significantly contribute to the overall economic activity. Croatia should speed up the restructuring and privatization of remaining state portfolio, however, that privatization should not be a goal but a mean of raising the efficiency of state enterprises, and thus the economy. Exactly therefore an effective corporate governance is of utmost importance.

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