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Financial performance of state-owned enterprises

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Croatia is one of European countries whose share of state-owned enterprises (SOEs) in GDP is exceptionally high. Such companies are present across all economic sectors and their share in budget revenue is inconsiderable due to poor financial operations. The aim of this paper is to determine the financial performance of state-owned enterprises and draw attention to issues arising from the way their business operations are monitored. Given the statistical discrepancies in data, this analysis focuses mostly on the 2008 – 2016 period. The primary sources of the data used herein are the Financial Agency (Fina), the Ministry of Finance and the Ministry of State Property.

Publicly-owned enterprises

According to IMF classification, publicly-owned enterprises are *owned or controlled by the state*, which means that enterprises which are minority-owned by the state are also *publicly-owned enterprises*. According to Croatian legislation, publicly-owned enterprises are enterprises majority-owned and controlled by the government *producing goods and services for the wider public*.

The operations of publicly-owned enterprises should integrate the elements of *public responsibility and market approach*. *Elements of public responsibility* are manifested in the fact that major business decisions are made by the government, that the profit (as well as the loss) goes into the state budget, while the enterprise, in performing its operations, is accountable to the society as a whole, i.e. to the Parliament as the custodian of public interest. *Elements of market approach* are primarily manifested in the fact that publicly-owned enterprises are expected to maintain financial health in the long run, that they undergo constant market valuation, and that the prices they set are based on operating costs.

This paper classifies publicly-owned enterprises in the Republic of Croatia in accordance with the Fina and OECD classification¹, defining publicly-owned enterprises as those *owned* by the government (central, federal, local or regional) and those in which the state *has significant control through full, majority, or minority ownership*². There are enterprises in Croatia and other transition countries that fall into the category of enterprises undergoing transformation of the ownership structure, as well as those in which this process has not commenced. These enterprises are facing unresolved ownership rights issues and have not finished the process of transformation in the course of transition from planned to market economy.

¹ Defined in: PWC (2015)

² Categorization according to: Fina (2017)

Publicly-owned enterprises can be joint stock companies or limited liability companies, and they comprise financial and non-financial enterprises. *Financial state-owned enterprises* are mostly public finance institutions such as the central bank, government development bank and other financial institutions performing financial and fiscal services for the state. *Non-financial state-owned enterprises* provide services on a non-commercial basis, undermining price competition.

In 2013, the Government established enterprises and other legal entities of strategic and special interest, their purpose being the realisation of economic and strategic goals by the state as a shareholder. The main objectives of such enterprises are: the legal and effective exercise of transferred public authority, security, health insurance, ensuring critical infrastructure, regular supply of public goods and services and securing economic activities in the interest of citizens and the state. Publicly-owned enterprises generate revenue based on the delegation of public authority, with the state participating in the pricing of products and services.

According to the operational plan for the management of government assets, enterprises of special interest are divided into three categories. The first category comprises *enterprises which were not due to be privatized by the state*, mainly enterprises dealing in energy, transport, water, games of chance, and development banks. The second category comprises *enterprises for restructuring, privatization, sale or initial public offering*. These include the railways, airports, companies operating in the tourism sector, and one enterprise specialized in IT support for the government. The third category includes *enterprises for sale* – mainly companies minority-owned by the state. Enterprises and other legal persons of special interest are legal entities majority-owned by the state (except enterprises operating in the infrastructure, energy, and other sectors), which are in need of restructuring, recapitalization, or (complete or partial) privatization, but have high profits and value added.

The size and structure of the government portfolio

According to the Fina Register of Annual Financial Reports, 1,149 enterprises in Croatia were majority-owned by the state in 2016. In 2017, out of all enterprises (2017 *Draft Plan for the Management of State Assets*) more than 600 were controlled by the general government, but majority-owned by local and regional self-government. Among enterprises controlled and majority-owned by the state, 49 are classified as being “of strategic interest” or “of special state interest”. The distinction between the two types of enterprises, however, is not very clear. “Enterprises of strategic interest”, in principle, operate in sectors in which the state participates in the pricing or which the state sees as being of strategic interest. Therefore, the state does not plan to privatize these enterprises. They comprise companies pertaining to the transport sector – road transport, railways, infrastructure – as well as companies involved in marine technology and military trade. Enterprises “of special state interest” differ greatly among themselves and operate in many different economic sectors, including the banking and insurance sector, maritime transport, food, chemicals and pharmaceuticals production, engineering, IT services, and hotel management. Approximately one third of enterprises of strategic or special state interest are listed companies. Most mixed enterprises are minority-owned by the state, as opposed to majority-owned. The total number of state-owned enterprises is on the rise, and most of these are fully owned by the state. The state is more inclined to sell companies that are in joint public/private ownership (see Table 1).



Table 1 Ownership structure of state-owned companies, 2008 – 2016

Period	Enterprise owned by the state and local self-government units	State-owned enterprise		Mixed enterprises –majority public capital	Enterprises majority-owned by the state, total	Mixed enterprises –majority private capital
		Transformation of ownership is ongoing	Transformation of ownership is pending			
	I	2	3	4	I+2+3+4	5
2008	638	59	81	267	1,045	434
2009	666	45	76	272	1,059	430
2010	705	46	67	242	1,060	439
2011	714	48	69	219	1,050	432
2012	749	57	69	199	1,074	421
2013	740	24	63	178	1,005	408
2014	819	22	43	170	1,054	390
2015	849	24	47	144	1,064	369
2016	925	43	42	139	1,149	340

Source: Authors' systematization according to Fina (2017)

Judging from the data contained in the table, the prevalent perception that **the state is increasing the rate of privatization and reducing the number of state-owned enterprises is incorrect.**

In 2016, the Ministry of State Property was established and the State Administrative Office for the Management of State Assets (DUUDI) was abolished. Corporate management goals as defined in the 2013 – 2017 *Public Asset Management Strategy* are the following:

- Effective exercise of the state's ownership rights through the Government and centralised ownership entities responsible to the Government
- Legal, transparent, responsible, professional and efficient management of state-owned enterprises
- Listing of a part of or all shares of enterprises of special state interest on the stock exchange.

To put it briefly, **corporate goals** entail bringing to a close the transformation of ownership process by determining the legal owners of all state-owned enterprises while increasing transparency in management and increasing the share of JSCs. The Strategy mentions the sale of enterprises minority-owned by the state. All the goals can be considered relevant and are in line with EU best practices; however, the question remains whether their execution will be successful.

In 2013, the central government's strategic part of the portfolio was divided into three categories:

- Enterprises and other legal persons of strategic interest for the Republic of Croatia
- Enterprises of special interest majority-owned by the Republic of Croatia
- Enterprises of special interest less than 50% of which is owned by the Republic of Croatia, listed on the stock exchange.

Still, the difference between the first and the second category is not clear. For instance, the first category comprises enterprises *of strategic interest*, such as the HEP Group, Croatian Forests, Croatian Railways and Croatian Highways, which are in charge of the management of public goods, from which it would follow that the government did not plan to privatize these companies, being of strategic importance. However, in 2017, the Government noted, on several occasions, the possibility to partially privatize the HEP Group, which goes against the theory that first-category enterprises are not to be privatized.

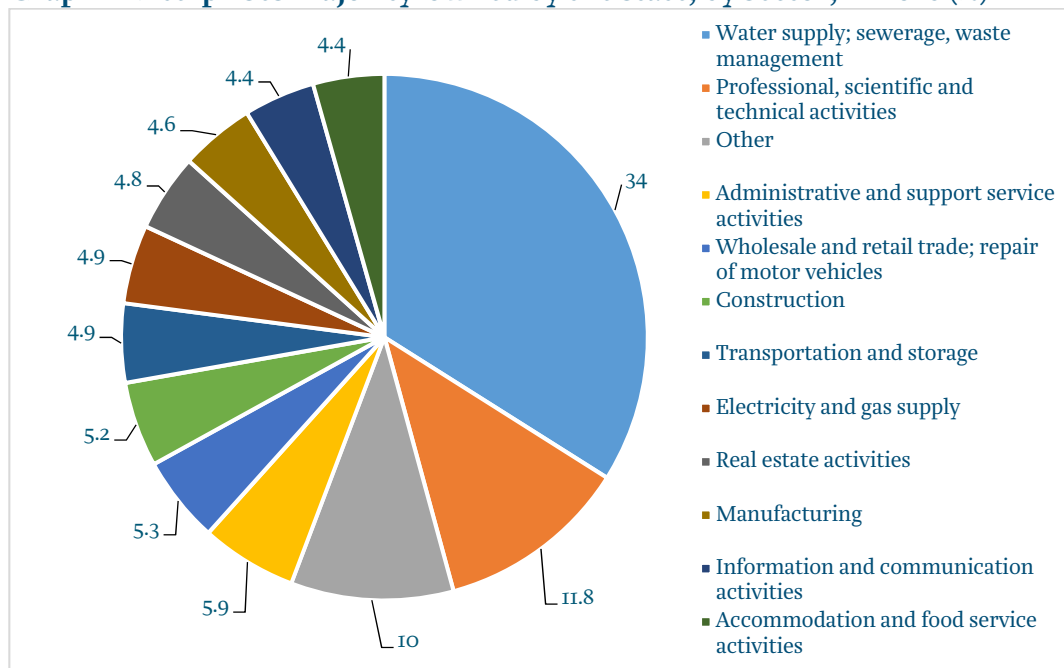
The second category comprises enterprises *of special interest* majority-owned by the state in the form of joint-stock companies, with the option to be partially or completely privatized, such as Croatia Airlines, Croatian Post, Narodne novine and limited liability companies such as airports and some institutes. These are mostly fully owned by the state and are not intended to be privatized in the near future, even though they pertain to different sectors, from traffic and transport to banking and insurance.

The third category covers those enterprises that are minority-owned by the state. They are considered to be of high importance to the economy, and the state guarantees the stability of their operation by exercising strict control. The activities of these enterprises, such as the Sunčani Hvar hotels, the mechanical engineering company Đuro Đaković, the Podravka food company, etc. could hardly be said to be of public interest.

Presence of enterprises majority-owned by the state in various sectors, in 2016

The “professional and scientific activity” category comprises a range of different enterprises, such as parts of the HEP Group and Croatian Forests, some shipyards, as well as business incubators, development agencies and various institutes. Less common activities such as public administration and defence, mining and extraction, financial activities, and health protection and social care services pertain to the category “other”.

Graph 1 Enterprises majority-owned by the state, by sector, in 2016 (%)



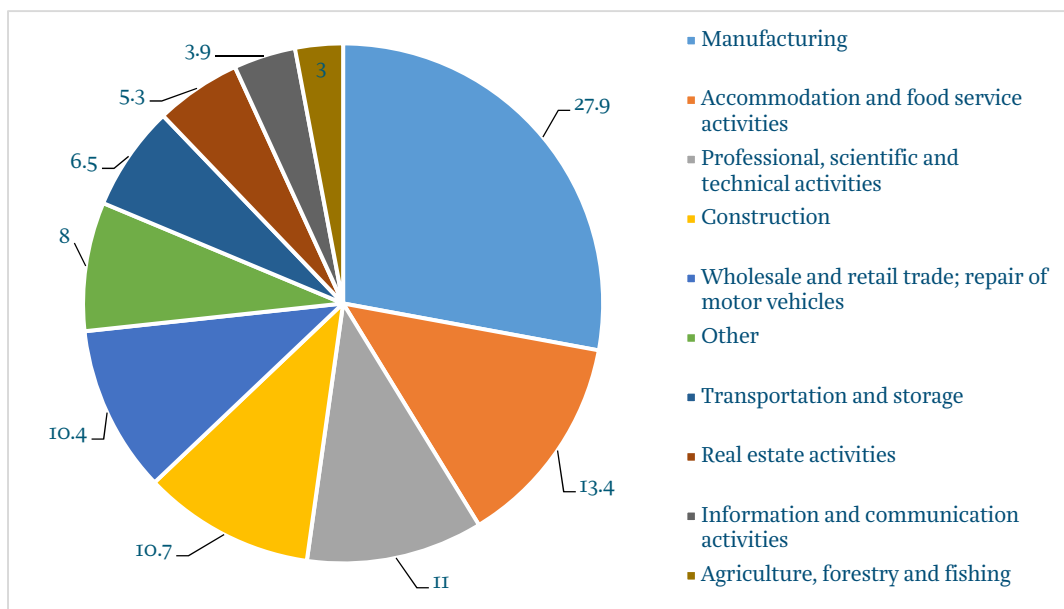
Source: Authors' systematization according to Fina (2017)



To put it briefly, **the state portfolio lacks focus and diversity**. Half of the enterprises majority-owned by the state pertain to three sectors – **water supply and waste management, professional, scientific and technical activities, and administrative and support service activities**. Interestingly, the other half of the portfolio is **almost evenly divided** among various industries and sectors – from motor vehicle repair to hospitality and accommodation services.

The largest share of enterprises minority-owned by the state (up to 28%) pertains to manufacturers, such as **Ledo, Jamnica, Končar, 3. maj, Zagrebačke pekarnice Klara** etc. The construction category includes, e.g., **Dalekovod**, whose main focus is on public transport infrastructure; the retailers and wholesalers include **Pevec, Kraš** and **INovine**. A similar part of the portfolio pertains to accommodation and hospitality services – some 40 hotels and holiday resorts minority-owned by the state.

Graph 2 Enterprises minority-owned by the state, by sector, in 2016 (%)



Source: Authors' systematization according to Fina (2017)

A minor part of the portfolio pertains to relatively successful enterprises from all sectors, from retail and wholesale, through food production, to shipyards and electrical transformer manufacture. *This leads to the impression that the state is trying to maintain its presence in all successful enterprises, without it being clear in which way it contributes to the enterprises' budgets or business operations.* In fact, when it comes to many such enterprises, the state's ownership comes from converting its receivables into shares in the course of bankruptcy proceedings and pre-bankruptcy settlements. *The state is thus a minority owner of enterprises in a number of various sectors not providing public goods or services.*

Since only the profits of enterprises of strategic and special interest go into the state budget, it is relevant to know what sectors are involved in this part of the state's portfolio. Most strategic enterprises in 2014 belonged to the transport and communications, services, trade, and tourism sectors; manufacture and trade were twice as present as the energy sector. Such sectoral dispersion shows that state ownership exist present across a number of economic sectors. Do enterprises pertaining to the tourism, hospitality, trade, and banking sectors deserve the status of enterprises of *strategic* interest to the Republic of Croatia?

Financial performance of publicly-owned enterprises of strategic and special interest, 2005 – 2016

The number of state-owned enterprises is considerable; however, only enterprises of strategic and special interest are obliged to remit their profits to the state budget. Pursuant to the Croatian State Budget Execution Act and the decision on the amount of funds of enterprises and other legal persons of strategic and special interest to be paid into the state budget and the manner of and deadlines for their payment, the state determines, on an annual basis, which companies are obliged to remit their profits to the state budget. In the pages that follow, the analysis of the operation of only those enterprises is provided.

It was only in 2009 that the Government passed the *decision on determining a list of enterprises and other legal persons of strategic and special interest to the Republic of Croatia* (prior to that, a similar decision was passed only in 2004, when 210 strategic state-owned enterprises were listed), on the basis of which it was determined which enterprises were obliged to pay their profits into the state budget. Assumably, prior to 2009, it was the Government and the Ministry of Finance who decided which enterprises would pay their profits into the budget.

Table 2 shows a summary of the financial performance of enterprises of strategic and special interest pertaining to the state portfolio for the 2008 – 2016 period. However, the data for each year are not equivalent since the Government's categorization per year changed. We can therefore divide the observed period into three sections:

- 1) 2005 – 2009 – The category of enterprises of *strategic importance* was non-existent; the operation of those enterprises that the Ministry of Finance listed as the most important state-owned enterprises on its official webpage is therefore analysed.
- 2) 2009 – 2010 – A list of enterprises of strategic and special interest exists, but they are impossible to categorize under the main three categories into which the portfolio was divided in 2013.
- 3) 2011 – 2016 – Enterprises can be classified post facto into the three main categories pertaining to the strategic part of the state portfolio.

Table 2 shows the number of strategic enterprise in each year, their performance, their share capital, and the modified ROE (return-on-equity) coefficient. In this case, the ROE coefficient is much higher than the accounting return on capital since methodology restrictions only allowed it to be calculated as the ratio between total gross profits and total share capital of the enterprise. Due to the fact that the total capital of an enterprise far exceeds its share capital and the use of gross performance data, the modified ROE coefficient showed in the table exceeds real profitability. However, this indicator can still enable the comparison of performance. It should be noted that table 2 shows *gross performance* in order to give the reader a better insight into the enterprise's real performance (minimizing the effect of accounting policies). For instance, in 2015 the Rijeka Port operated at a gross loss; however, tax relief allowed it to present a net accounting profit. In order to minimize the impact of such accounting policies, gross profits have been used overall to show the performance of the enterprises.

During the period under observation, enterprises of strategic and special interest spent four years (2008, 2009, 2012, and 2013) operating at a loss, for the most part due to the losses of Croatian Railways (particularly in 2012 and 2013) and due to the losses of enterprises minority-owned by the state which do not operate in the sectors in which state-owned enterprises



typically operate. ROE values increased significantly in 2011 due to the reduction and restructuring of the state portfolio (mostly because shipyards and hotels were no longer included in the strategic part of the portfolio). Despite that, return on capital values were far from those which most investors would find acceptable (except in 2016). The main factor contributing to profitability growth in 2016 was INA, an enterprise minority-owned by the state. It should be noted that INA had been amassing losses amounting to several billion HRK per year from 2013 on; in 2016, it finally made a profit amounting to billions, thus contributing to a reduction of the total losses of state-owned enterprises, showing that a large enterprise can exert significant impact on the profitability of the state portfolio as a whole in the context of a small economy.

Table 2 Gross operating results of enterprises of strategic interest pertaining to state portfolio, 2005 – 2016 (in HRK m)

	Number of companies	Enterprises of strategic interest for the Republic of Croatia	Enterprises of special interest majority-owned by the Republic of Croatia	Enterprises of special interest less than 50% of which is owned by the Republic of Croatia	Total profit/loss of enterprises of strategic interest in the portfolio	Total share capital	Modified ROE (%)
2005	9	-	-	-	1,811	39,122	4.63
2006	8	-	-	-	1,619	39,122	4.14
2007	20	-	-	-	1,661	128,288	1.29
2008	19	-	-	-	-265	119,288	-0.22
2009	69	-	-	-	-3,260	145,058	-2.25
2010	63	-	-	-	2,258	143,323	1.58
2011	49	-171	399	2,755	2,983	49,015	6.09
2012	49	-656	-519	1,089	-86	49,015	-0.18
2013	49	1,068	-314	-2,194	-1,440	49,015	-2.94
2014	49	3,804	-1,065	-2,491	249	49,015	0.51
2015	49	2,947	421	-1,224	2,144	50,785	4.22
2016*	49	4,426	294	967	5,687	50,785	11.20

* A report on the operating results of enterprises pertaining to state portfolio has not been made public in 2016; the authors have thus systemized the operating results of publicly-owned enterprises marked as enterprises of strategic interest in 2015. Vukovar Port) has not made public its operating results for 2016 and was thus exempt from the analysis.

Source: Authors' systematization based on Ministry of State Property's report on the management of state assets, publicly-owned enterprises' financial reports, and Government report on the implementation of the state asset management plan.

It is also interesting to take a look at profits realized in various years. In 2005, only nine companies made a gross profit amounting to HRK 1.8 bn. In the years that followed, the number of such companies increased to 50; in 2014, they made a gross profit amounting to approximately HRK 250 m. This clearly shows that the absolute profit does not grow proportionally to the number of strategic enterprises in the state portfolio.

Table 3 Profit of publicly-owned enterprises, 2008 – 2016 (HRK m)

Enterprise	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
Adriatic Croatia International	14.2	23.1	29.1	31.0	24.8	5.0	33.5	35.1	14.1	209.8
Aeronautical Technical Centre	n/a	n/a	n/a	0.0	0.0	0.4	0.5	4.1	1.1	6.0
Agency for Commercial Activities	n/a	n/a	20.5	32.9	39.2	42.9	32.2	42.5	57.3	267.6
Alan Agency	n/a	n/a	3.3	2.4	19.1	110.0	99.7	26.1	101.5	362.1
APIS IT	n/a	n/a	n/a	18.5	19.9	20.8	17.9	9.8	0.0	86.8
Brijuni Riviera	n/a	0.0	0.1	0.0	1.8	2.9	2.1	0.3	0.5	7.7
Capital Fund	n/a	18.8	24.7	n/a	n/a	n/a	n/a	n/a	n/a	43.5
Club Adriatic	n/a	0.0	0.0	0.5	0.0	0.1	0.0	n/a	n/a	0.6
Croatia Airlines	0.0	0.0	0.0	0.0	0.0	1.6	8.9	12.8	7.7	31.0
Croatia Bank	n/a	0.0	0.0	0.0	0.0	0.0	5.1	2.3	2.7	10.1
Croatia Control	n/a	n/a	25.5	15.6	6.0	3.1	25.2	61.3	85.6	222.3
Croatia Insurance	68.5	198.5	119.1	158.3	166.3	0.0	0.0	72.3	94.0	876.8
Croatian Energy Market Operator	n/a	n/a	14.1	4.6	3.2	0.0	0.3	0.9	0.0	23.1
Croatian Forests	21.8	20.9	35.3	9.3	20.8	114.2	151.1	235.2	222.7	831.3
Croatian Lottery	29.6	45.1	6.2	4.9	0.0	15.7	22.0	41.7	49.5	214.8
Croatian motorways	0.0	0.0	0.0	0.0	0.0	6.6	0.0	0.0	0.0	6.6
Croatian Post	0.0	0.0	35.1	21.2	0.0	32.9	84.8	185.9	141.2	501.1
Croatian Postal Bank	n/a	0.0	58.1	80.4	101.9	36.4	0.0	126.6	161.7	565.1
Croatian Railways – Cargo)	n/a	n/a	n/a	3.1	0.0	0.0	0.0	0.0	0.0	3.1
Croatian Railways – Passenger Transport)	n/a	n/a	n/a	0.0	0.0	0.0	3.6	9.5	1.7	14.7
Croatian Shipbuilding Corporation	n/a	n/a	n/a	0.3	4.7	4.9	0.3	n/a	n/a	10.1
Croatian Technology Institute	n/a	n/a	0.1	n/a	n/a	n/a	n/a	n/a	n/a	0.1
Dubrovnik Airport	n/a	20.0	29.3	26.7	25.7	35.0	43.0	56.5	86.0	322.2
Đuro Đaković	n/a	n/a	n/a	1.5	0.0	0.0	0.0	5.6	1.8	8.8
Franjo Tuđman Airport, Zagreb	n/a	18.1	28.2	0.0	0.0	0.0	0.0	1.3	1.4	48.9
HEP Group	47.8	227.1	1.837	96.1	64.3	1.562	3.077	2.395	2.590	11.899
Imperial	n/a	2.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a	2.7
Ina	n/a	0.0	1.318	2.376	1.067	0.0	0.0	0.0	461	5.222
Jadrolinija	1.0	2.1	1.2	2.7	4.4	1.7	8.2	0.0	0.0	21.3
Janaf	67.5	152.2	134.5	75.7	101.8	113.3	118.2	292.2	338.2	1.393.7
Končar	n/a	158.4	201.6	210.8	200.0	179.3	176.1	169.6	196.1	1.491.9
Liburnia Riviera	n/a	1.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1.4
Motorway Rijeka – Zagreb	0.0	0.0	0.0	0.0	0.0	20.2	76.0	135.6	589.7	821.5
Motorway Zagreb – Macelj	n/a	n/a	n/a	0.0	0.0	0.0	0.0	56.2	62.7	118.9
Narodne novine	25.1	7.1	2.3	10.2	9.5	15.7	12.2	1.2	0.0	83.3
Osijek Airport	n/a	0.7	0.0	0.0	0.1	0.0	0.0	0.0	0.1	1.0
Petrokemija	n/a	0.0	0.0	106.5	0.0	0.0	0.0	0.0	0.0	106.5
Pleter Services	n/a	n/a	7.0	n/a	n/a	n/a	n/a	n/a	n/a	7.0
Plinacro	144.9	240.2	166.7	70.1	84.7	152.8	131.8	130.9	247.8	1.369.7
Ploče Port	n/a	4.1	15.6	n/a	n/a	n/a	n/a	n/a	n/a	19.7
Plovput	4.5	2.7	12.7	9.4	6.9	8.8	1.7	1.9	4.9	53.4
Podravka	n/a	0.0	109.3	59.7	30.1	69.8	104.3	161.7	215.6	750.6



Pula Airport	n/a	0.0	2.0	1.8	0.0	0.0	0.1	0.4	4.5	8.8
Rijeka Airport	n/a	0.0	0.0	0.8	0.0	0.0	1.2	0.0	0.0	2.1
Rijeka Port	n/a	4.2	0.4	133.0	6.5	5.1	0.0	0.0	6.4	155.8
Shipbuilding Institute	n/a	0.0	0.1	0.1	0.0	0.1	0.2	0.0	0.0	0.5
Split Airport	n/a	26.0	42.3	40.0	46.5	47.4	64.3	85.0	107.7	459.3
State-owned Real Estate	n/a	n/a	n/a	n/a	n/a	n/a	n/a	25.5	27.1	52.6
Sunčani Hvar	n/a	n/a	n/a	1.0	0.0	0.0	22.3	n/a	n/a	23.2
Transmitters and Communications	18.9	15.6	11.2	0.0	17.4	17.4	12.7	25.9	45.7	164.7
Uljanik Group	n/a	23.4	76.1	n/a	n/a	n/a	n/a	n/a	n/a	99.4
Underground Gas Storage	n/a	n/a	44.5	46.9	48.6	52.4	74.9	70.1	83.3	420.8
Viktor Lenac Group	n/a	7.2	8.0	n/a	n/a	n/a	n/a	n/a	n/a	15.1
Vjesnik	2.5	0.0	0.0	n/a	n/a	n/a	n/a	n/a	n/a	2.5
Vodoskok	n/a	n/a	n/a	n/a	n/a	n/a	n/a	5.3	8.6	13.9
Vranjica Belvedere	n/a	0.8	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0.8
Vukovar Port	n/a	0.0	0.0	0.3	1.1	0.3	0.0	0.0	0.0	1.7
Zadar Airport	n/a	1.6	3.6	3.8	7.4	8.2	3.6	1.3	3.9	33.5
Total	446	1,222	4,423	3,656	2,130	2,688	4,415	4,488	6,024	29,492
No. of profit-making enterprises	12	27	35	36	28	33	34	37	38	
No. of enterprises of strategic/special importance	19	69	63	49	49	49	49	49	49	

* n/a = the enterprise was not included in the strategic part of the portfolio in the given year.

More than one half of the profits in the portfolio were generated by two publicly-owned enterprises – HEP Group and INA – while as many as 15 enterprises have made less than HRK 10 m in profits in the last nine years. What is even more worrying is the fact that some enterprises which have been owned by the state the longest are nowhere to be found among profitable enterprises – the Institute of Immunology, Croatian Railways – Infrastructure, or the Marine Electronic Centre, while traditionally publicly-owned enterprises such as Petrokemija and Croatian Railways – Cargo are mentioned only once. The most substantial profits are made by enterprises from the energy sector that have state monopoly. The weak performance of the majority of SOEs suggests that detailed audits are required and decisions regarding their future in the state portfolio must be made.

Table 4 lists the SOEs that have sustained the most significant losses in the 2008 – 2016 period, specifically those whose annual losses **exceeded HRK 100 m**. Some of them have been operating at a loss continuously and pose a significant burden on the state budget, even though the **number of enterprises operating at a loss is falling** due to cost-cutting, restructuring or redistribution of the same activities among various state-owned enterprises.

Table 4 Net losses of the largest SOEs, 2008 – 2016 (HRK m)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total 2008 –2016
Croatian Railways – Infrastructure					-245	-838				-1,083
3. maj		-455	-243							-698
Borovo		-146								-146
Brodosplit		-129	-427							-556
Brodotrogir		-175	-253							-428
Croatia Airlines		-199	-157	-113	-488					-957
Croatia Bank					-104					-104
Croatia Insurance						-229	-466			-695
Croatian Post	-254	-207								-461
Croatian Postal Bank		-449					-630			-1,079
Croatian Railways – Cargo)					-249	-198	-170		-121	-738
Croatian Railways – Passenger Transport)					-146	-362				-508
Đuro Đaković						-189				-189
INA		-631				-1,508	-1,897	-1,418		-5,454
IPK Osijek		-153								-153
Kraljevica Shipyard		-128	-258							-386
Motorway Rijeka – Zagreb)	-246	-213	-325	-371	-239					-1,394
Petrokemija		-268	-136		-187	-327	-364			-1,282
Podravka		-381								-381
Sunčani Hvar						-176				-176
Total	-500	-3,534	-1,799	-484	-1,658	-3,827	-3,527	-1,418	-121	16,868

Source: Author's systematization in accordance with the publicly-owned enterprises' reports on the Ministry of Finance website, the Ministry of State Property website, and the report on the execution of the 2015 Plan on the Management of State Assets.

Note: The table only contains the enterprises that have sustained the most significant losses.

SOE losses in the period under consideration amounted to approximately HRK 16.8 bn. Notably, significant losses were suffered by INA, Petrokemija, all companies in the Croatian Railways group, Croatian Postal Bank (which was supposed to be privatized) and the Zagreb – Rijeka Highway (the enterprise had been operating at an annual loss for five years in a row, only to make a small profit in 2013 due to restructuring and passing tolls and maintenance activities over to Croatian Highways). Croatia Airlines had also been operating at a loss up until 2013 when it cut personnel costs and cancelled airplane leases. Croatian Railways have been amassing losses since 2012, even though the company has continuously been undergoing restructuring, and infrastructure maintenance and modernization have been financed by the state. There is also the case of Petrokemija which has been amassing debt since 2008 and is still short of a positive performance even though it reduced its losses in 2015 and 2016.



Profit/dividends and payments into the state budget, 2011 – 2016

The Government is obliged to issue annual decisions on the payment of last-year's companies' profits into the state budget, while enterprises must comply with that decision and make it part of their annual profit distribution plan. Based on the Government's profit distribution decisions in the 2010 – 2016 period for all state-owned enterprises of strategic and special interest, an estimation has been made as to the amount of profits they are liable to pay into the state budget. Budget revenue stemming from profit and dividends in the period between 2011 and 2016 has been analysed and amounts for payment according to Government decisions have been determined (Table 5).

The state has never succeeded in collecting the planned amount, for the most part due to HEP – most of the remaining due amounts are HEP's liabilities.

A number of factors contribute to the low amounts collected from company profit payments. Some responsibility is borne by the Government whose decisions on profit payment are made too late – usually only after the enterprises have adopted their decisions on profit distribution and issued their profit and loss statements; as a consequence, they sometimes pay a part of their profits into the state account without adjusting the documents already issued.

Table 5 Comparison of profit/dividend payment obligation and budget revenue from SOE profits, 2011 – 2016 (HRK m)

Year	Liabilities according to Government decision	Amount paid	Amount due	
			Total	HEP Group
2011	1,015	924	91	0
2012	1,181	682	499	235
2013*	971	577	394	155
2014	1,319	1,107	211	164
2015	1,650	884	766	731
2016	2,645	1,469	1,176	470

Source: Author's systematization according to data on the financial reports of publicly-owned enterprises found on the Ministry of Finance website, Government decisions on the payment of profit/dividend into the state budget and the Decision on profit distribution available on the Fina (2017).

* The 2013 Government decision was not found; therefore, an estimation was made as per the 2012 decision, according to which 50% of net profits are to be paid into the state budget.

Some enterprises fail to comply with the obligation of paying their profits into the state budget without justifying this in their annual reports. For instance, according to Alan Agency's official 2015 decision on profit distribution, all profits were channelled into reserves. However, according to the Government's 2016 Decision on payments into the state budget, Alan Agency was supposed to pay 100% of its 2015 profits into the state budget, which the Agency in fact did, meaning that **official decisions on SOE profit distribution available on the Fina webpage sometimes fail to correspond with actual cash movement of state funds.** This is but one such case, which calls into question the credibility of SOEs' official decisions.

Pursuant to the *Decision on the amount of funds of enterprises of strategic and special interest to be paid into the state budget and the manner of and deadlines for their payment in 2016*, enterprises of strategic and special interest for the Republic of Croatia (Official gazette NN 120/13 and 74/15) – apart from those exempt from the Decision – should pay 60% of profits after tax for 2015, the only exemption being Alan Agency, liable for 100% of profits after tax. Prior to paying the profits into the state budget, enterprises must first cover their operating losses from the previous year. Enterprises minority-owned by the state are liable for a portion of profits corresponding to the state’s ownership share.

Annex 1 lists the companies that fall under the scope of the 2016 Decision. Some of them, such as Croatian Lottery and Croatian Highways, are exempt, while some use their profits to cover loss brought forward, which again means that they are exempt from the obligation of transferring profits into the state budget. **A total of HRK 2.6 bn was to be paid into the state budget in 2016, but actual payments amounted to half as much, or only HRK 1.5 bn.** Some enterprises possibly carried forward some of their liabilities or offset government claims; however, **no valid explanation has been made public.**

The discrepancies between the amounts to be paid into the state budget listed in the **decision on profit distribution and the actual amounts paid into the budget by enterprises** are considerable, and the amounts to be paid stated in the decisions of a number of enterprises exceed the actual amounts paid into the budget, without offering any explanation as to when the payment of the remaining amount is due (such as in the case of Janaf in 2015).

Some enterprises, such as in the case of the Alan Agency in 2015, do not mention their liabilities towards the state in their decisions on profit distribution, but nevertheless make a timely payment. Others do not make good on their payment obligation and channel all profits into reserves without any justification (Transmitters and Communications, 2015). This is a true administrative mess, in spite of the fact that the law clearly states which companies are liable and for which amounts. At the same time, some enterprises’ decisions on profit distribution differ completely from what is required by the Government, without legal consequences. Clearly, mechanisms to have enterprises **transparently account for their actions are lacking, as are legal sanctions for the failure to act in accordance with Government decisions.**

Table 6 lists enterprises (from Annex 1) that failed to pay 60% of profits into the state budget and those that paid a lesser amount without offering an explanation to the public.

Table 6 Enterprises of strategic interest that have failed to act upon the Government’s 2015 Decision on the payment of profit into the state budget (HRK thousand)

Partial payment	Liability	Paid	No payment	Liability
HEP Group	925,873	455,641	Transmitters and Communications	11,987
Janaf, Zagreb	133,145	63,816	Adriatic Croatia International	16,365
Narodne novine	651	619	Croatia Airlines	8,297
Croatian Postal Bank	30,774	16,512	Rijeka Port	759
Brijuni rivijera	176	93	Croatian Post	114,442

Source:
Author’s
systematization
according to
Ministry of
Finance data



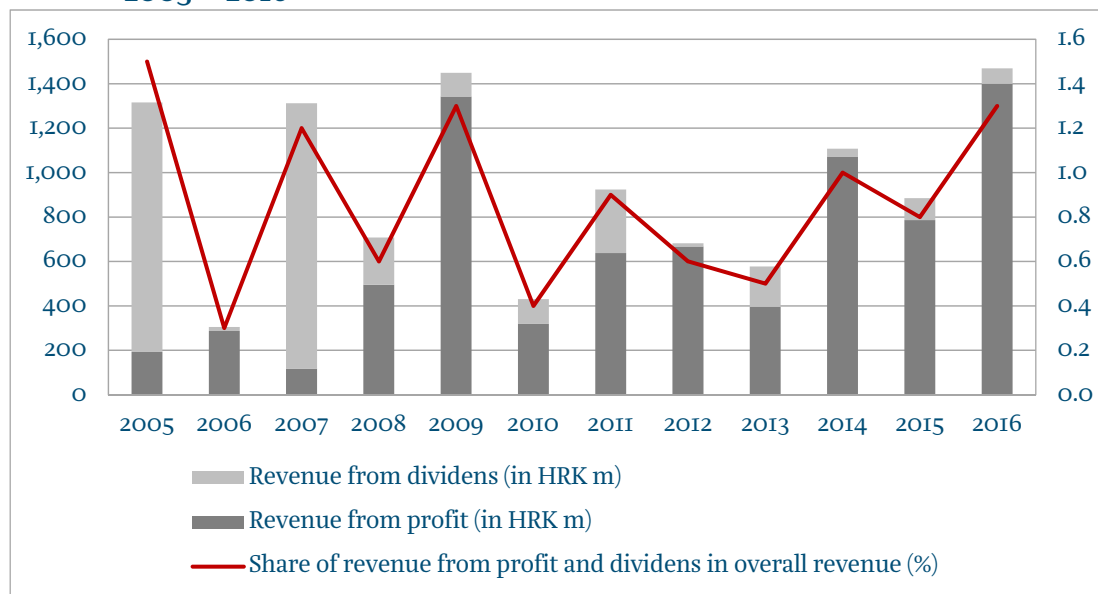
The first part of the table lists **enterprises that paid less into the budget** than the amount imposed by the Government decision³. Unfortunately, they *offer no explanation for their partial payments to the public*, creating the impression that the legally imposed payments into the budget are mere recommendations, while the boards are not obliged to publicly justify their decisions.

The second part of the table lists **enterprises that made no payments into the budget**, and were not exempt from doing so, either. These enterprises, rather, decided to channel their profits into own reserves. Even though the possibility that operating conditions required that profits be retained by the enterprise exists, this requirement was not mentioned in any of the decisions on profit distribution.

Revenue from the profits of publicly-owned enterprises, 2005 to 2016

Revenue from profit is an unstable revenue source, its amounts fluctuating from only HRK 117 m in 2007 (which is probably connected to the privatization of Croatian Telecom), to HRK 1,342 bn in 2009. The primary factor influencing such fluctuations is the number of enterprises of strategic interest in a given year (there were 69 such enterprises in 2009, and 49 in 2011), but they also depend on the enterprises' financial performance. It is quite unusual when the best state-owned enterprises operate at a loss, but this happened as many as four times between 2005 and 2016.

Graph 3 Revenue from profit and dividends, and share in total revenue, 2005 – 2016



Source:
Author's
systematization
according to
Ministry of
Finance data

If we add revenue from dividends to revenue from profits, the overall situation stays more or less the same. The largest share of revenue in the 2005 – 2009 period was income from dividends, while in 2009 the largest share came from profits, due to the fact that the state owned a larger number of joint-stock companies that paid dividend regularly before 2009. This puts

³ HEP Group paid 50% of the due amount, while channelling the rest into reserves. Janaf and Croatian Postal Bank published decisions where they listed exact amounts, which are still to be paid into the state budget, possibly in the course of 2017.

the burden of responsibility for the poor development of financial markets on the state, since it still owns a large number of unlisted enterprises.

Revenue from dividend is unstable. In the period since 2011, there have been approximately 50 enterprises of strategic interest that pay their profits into the state budget, meaning that the revenue reflects the state of the economy somewhat better. Apart from the absolute amounts of profits and dividends paid into the budget, their percentage in overall budget revenue (0.87% on an average) is indicative as well. In the years when the enterprises operated at a profit, the high absolute amounts of profits and dividends paid into the budget were accompanied with a higher share of revenue from profit and dividends in overall budget revenue, while this share shrinks when revenue from publicly-owned enterprises is low.

The state's revenue from assets is very low (it comprised only 1% of GDP in 2016), revenue from profit and dividends making up only 0.43% of GDP, the rest being revenue from concessions. At the same time, shares and equity made up 30.6% of GDP, and total financial assets made up as much as 55% of GDP. Revenue from profit is usually inversely proportional to revenue from dividends.

Conclusion

In the context of the transition process, the Croatian government has committed to the transparent management of state assets as well as to the opening of the economy to private investment and the market. Unfortunately, the state still plays a leading role in the market due to having (either majority or minority) shares in all major companies, which have not been subject to market valuation since they are not listed on the stock exchange. Many publicly-owned enterprises earn low profits, and their payments into the state budget are not made public.

Key issues:

- The number of SOEs has been growing continuously for the last nine years
- The state owns enterprises pertaining to many different sectors of economy without having a clear strategy on how and why a particular enterprise is chosen
- SOEs are, for the most part, not joint stock companies, which is one of the reasons for the underdevelopment of the financial market and the inability to obtain market valuation
- The state's ownership portfolio lacks a strategic-level direction and is divided among a number of sectors, without making it clear which are of higher importance for the state
- Even though there are more than a thousand SOEs, only some fifty are enterprises of strategic interest bound to pay a part of their profit (and dividends) into the state budget
- The performance of enterprises of strategic interest is unpredictable; in many cases they operate at a significant loss, this leading to the conclusion that they are not profitable for the state (pursuant to return on ROE analysis)
- The payment of profits/dividends into the state budget is not made public, while many enterprises are late or in default
- Decisions on profit distribution that are made public are not always consistent with actual payments into the state budget, making statistical analysis impossible
- Revenue from profit and dividends is an unstable source of revenue. Prior to 2009, the majority of revenue from publicly-owned enterprises came from dividends, and after 2009 from profit.



Key recommendations:

- The state portfolio should be reduced, especially minority shares in companies which are majority privately-owned
- The state portfolio should be focused on strategic sectors of the economy (energy, transport, water supply, etc.) rather than being present across almost all sectors. Croatia must determine its priorities when it comes to SOEs
- The Government should disclose a list of enterprises defaulting on their payment of profits into the state budget (like it did in 2012 with defaulting taxpayers, which encouraged many of them to pay their debts due to public pressure)
- The Government should determine and disclose the deadlines to be met by publicly-owned enterprises when making payments into the state budget
- Boards of companies that do not comply with their legal obligation to make a timely payment should face legal consequences
- Companies should disclose the annual amounts of profit they paid into the state budget or the reasons they were unable to do so
- The Government should exert its influence on the development of the domestic capital market by obliging public enterprises majority- and minority-owned by the state to be listed on the Zagreb stock exchange in order to have a better insight into the value of assets and evaluate the potential to reduce deficit and public debt.

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Appendix

Table 1 Enterprises of special and strategic interest in 2015 – profits, obligation to pay 60% of the profits into the state budget pursuant to Government decisions, and the amounts paid in 2016 (in HRK thousand)

Company	Profit	Amount due	Amount paid	Explanation
COMPANIES OF STRATEGIC STATE INTEREST				
Agency for Commercial Activities*	29,586	17,752	13,141	Just under 60% of the company's profits were paid into the state budget
Alan Agency*	20,810	20,810	20,810	Overall profits were channelled into company reserves pursuant to the decision on the distribution of profits, but 100% of the profits was in fact paid into the budget
Bina-Istra	-18,543	0	0	No profits made
Central Depository & Clearing Company	6,157	3,694	5,203	60% of the profits were paid into the budget, pursuant to Government decision, plus HRK 1.5 m in dividends
Croatia Control	48,640	-	-	Exempt by virtue of the Decision
Croatian Energy Market Operator	480	288	288	
Croatian Forests*	186,390	111,834	111,834	
Croatian Highways	-	-	-	Exempt by virtue of the Decision
Croatian Lottery*	29,297	17,578	29,297	Overall profits were paid into the state budget
Croatian Motorways	-	-	-	Exempt by virtue of the Decision
HEP Group	1,543,122	925,873	455,641	The majority of profits was retained by virtue of the decision on the distribution of profits
HŽ Infrastructure	-22,844	0	0	No profits made
HŽ Passenger Transport	2,496	0	0	Covering losses carried forward, by virtue of the decision on the distribution of profits
Janaf, Zagreb	221,908	133,145	63,816	By virtue of the decision on the distribution of profits for 2015, dividend is to be paid in the amount of HRK 133.2 m; half of that amount was paid
Marine Electronic Centre, Split	-4,402	0	0	No profits made.
Motorway Rijeka – Zagreb	135,631	0	0	Covering losses carried forward
Motorway Zagreb – Macelj	39,494	0	0	Covering losses carried forward
Plinacro, Zagreb	108,737	-	-	Exempt by virtue of the Decision

Company	Profit	Amount due	Amount paid	Explanation
Plovput Split	1,212	727	727	
Transmitters and Communications	19,978	11,987	0	Overall profits were channelled into company reserves pursuant to the decision on the distribution of profits
Underground Gas Storage*	56,195	0	0	Profits transferred to Plinacro by virtue of the decision on the distribution of profits
LEGAL ENTITIES				
Croatian Bank for Reconstruction and Development	206,265	123,759	206,265	Overall profits were paid into the state budget
Croatian Compulsory Oil Stocks Agency	-20,822	0	0	No profits made
Croatian Waters*	53	32	0	Overall profits were channelled into company reserves, by virtue of the decision on the distribution of profits
Fina	-101,029	0	0	No profits made
Restructuring and Sale Center*	-152,476	0	0	No profits made
Shipbuilding institute*	-6,595	0	0	No profits made
State Agency For Deposit Insurance and Bank Resolution	910,218	0	0	Profits were retained by the Croatian National Bank pursuant to the decision on the distribution of profits
COMPANIES OF SPECIAL STATE INTEREST				
Adriatic Croatia International	27,275	16,365	0	Overall profits were channelled into company reserves, pursuant to the decision on the distribution of profits
Aeronautical Technical Centre*	4,122	0	0	Covering losses carried forward
APIS IT d.o.o.	9,172	2,807	2,806	
Brijuni rivijera	294	176	93	The majority of the profits were retained for current investment maintenance pursuant to the decision on the distribution of profits
Croatia Airlines	13,829	8,297	0	Overall profits were channelled into company reserves, pursuant to the decision on the distribution of profits
Croatia Bank*	-15,134	0	0	No profits made
Croatian Post*	190,736	114,442	-	The profits were paid into the budget and no decision on profit distribution was made available
Croatian Postal Bank*	123,217	30,774	16,512	Pursuant to the decision on the distribution of profits, the amount due was HRK 30.7 m. Half of that amount was paid



Company	Profit	Amount due	Amount paid	Explanation
Croatian Railways Cargo	-12,505	0	0	No profits made
Dubrovnik Airport	55,261	-	-	Exempt by virtue of the Decision
Đuro Đaković Group	5,583	0	0	Overall profits were channelled into company reserves, by virtue of the decision on the distribution of profits
Franjo Tuđman Airport Zagreb	753	414	414	
Institute of Immunology*	-25,754	0	0	No profits made
Jadrolinija	8,323	4,994	5,833	HRK 5,833 were paid into the state budget, pursuant to the decision on the distribution of profits
Narodne novine d.d.	1,085	651	619	Just under 60% of profits were paid into the state budget, the rest was channelled into company reserves
Osijek Airport	-253	0	0	No profits made
Petrokemija	-92,512	0	0	No profits made
Port of Rijeka	1,265	759	0	Overall profits were channelled into company reserves, pursuant to the decision on the distribution of profits
Pula Airport	445	147	147	
Rijeka Airport	50	0	0	Covering losses carried forward
Split Airport	67,660	22,328	22,328	
State-owned Real Estate*	20,404	12,242	12,242	
Technical Service of Rail Vehicles*	241	145	145	
Tersus eko	10	6	6	
Vukovar Port*	-880	0	0	No profits made
Zadar Airport	985	325	325	
COMPANIES IN MINORITY STATE OWNERSHIP AND FINANCIAL INSTITUTIONS				
Croatian Financial Services Supervisory Agency	7,771	7,771	7,771	Overall profits were paid into the state budget by virtue of a discretionary decision of the company
Croatian National Bank	2,031,811	483,048	483,048	
Končar	151,320	720	720	Dividend proportional to ownership was paid into the state budget
Vodoskok	4,125	397	397	Dividend proportional to ownership share was paid into the state budget
TOTAL	5,818,657	2,645,247	1,460,429	

Source: Author's systematization according to decisions on profit distribution, 2016 Government Decision on the amount of funds of enterprises of strategic and special interest to be paid into the state budget and the manner of and deadlines for their payment (pursuant to the list of strategic enterprises available in the official gazette NN 120/13, 74/15, and 44/16) and data about publicly-owned enterprises available on the Ministry of Finance website.

Fiscus


Fiscus is an analytical serial publication of the Institute of Public Finance. It aims at analyzing current economic issues that affect the stability of public finances or are related to the production of goods and the provision of services of broader public interest. The topics concerned have not received adequate attention in the academic and professional community and relate to economic sectors in which the public interest is concerned, directly or indirectly. On scientific and professional foundations, Fiscus seeks to empower and encourage public debate on the establishment and preservation of the stability of Croatian public finances and the economy in general by promoting transparent, prudent and responsible management. Therefore, the topics focus on the identification and quantification of potential risks that could threaten the stability of public finance, market development, the competitiveness of the Croatian economy and the economic position of the citizens.

The vision of Fiscus is to become a reliable source of sectoral analyses through the prism of interaction between the public and private sector.

The mission of Fiscus is to identify the key challenges faced by certain economic sectors and offer suggestions for the improvement and preservation of the long-term stability of the Croatian economy.

The main objectives are:

- to provide in-depth analysis of the financial operations of public sector institutions and those institutions that are in any way associated with the production of goods and the provision of services of a broader public interest;
- to improve understanding of the financial consequences of their operations and increase accountability;
- to provide objective information on their business operations to the broader professional public and to investors;
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