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INSTITUTE OF PUBLIC FINANCE
ured@ijf.hr | www.ijf.hr
TEL: +385 (0)1 4886 444

PRESS RELEASES

Restructuring of public companies – the key to successful public sector reforms in Croatia

ANTO BAJO, PHD, Institute of Public Finance, Zagreb

MARKO PRIMORAC, PHD, Faculty of Economics and Business, Zagreb

On September 24, 2014, four years after the first report on the operations of companies of special national interest[1], discussed by the Government and Parliament, a Report on the Operations of Companies and Other Legal Entities of Strategic and Special Interest to the Republic of Croatia in the First Half of 2014 appeared on the website of the State Office for State Property Management. The Report was prepared by the Ministry of Finance. A comparison was made between the semi-annual business results for 2013 and those for 2014, as well as between planned and outturn figures. The data revealed that the observed companies were markedly lagging behind in the reform implementation and execution of the defined plans.

Issues and dilemmas. Along with the national budget, the report on the operations of companies and other legal entities of strategic and special interest is probably the most important report on public sector operations. Nevertheless, the Report has failed to attract the attention of either the Government and Parliament or parliamentary committees, which have on their agendas even less significant individual reports on public institutions, but not a consolidated report on the operations of major companies. The 107-page Semi-annual Report presents figures on the business operations of 54 companies. It is incredible that it does not include data for two companies: Autocesta Zagreb-Macelj (Zagreb-Macelj Motorway) and Bina Istra d.d., because these two companies have labelled their business information as business secret.

At the very beginning, a few essential questions may be put to the Croatian Government: What are the criteria for achieving the status of a strategic company, i.e. a company of special national interest? To what extent must the operations of such companies be transparent and subject to public oversight? How is it possible that certain companies are not included in the Report, or that they fail to submit complete data?

A step forward. The Ministry of Finance and State Office for State Property Management deserve to be commended for publishing the Report. While its format and content still need some polishing, the Report is a useful tool for profiling candidates for privatisation and restructuring, identifying the drivers of economic growth and defining measures to improve their financial position. Potentially the most important goal of the Report is to demonstrate that the government monitors these companies' operations, which may improve their management, increase the credibility of the country towards domestic and foreign creditors and change the public perception of government as a bad manager. A

[1] Anto Bajo commented on that Report in the Institute of Public Finance's *Press Release* No. 25.

lack of public discussion and weak interest on the part of the Government and Parliament are bad signs, which may call into question the legitimacy of the strategic classification of these companies. Such a lack of interest discourages the companies' management boards from implementing the reforms and improving their business operations.

Transparency of the Report. It would have been very good if the Ministry of Finance, as the proponent of the Report, had provided a breakdown of employment by company and a breakdown of key financial data and indicators, both from the balance sheets and the income statements. At the beginning of the Report, users should have been informed that the analyses were based on the data provided by companies which applied three different accounting procedures: one group applied accounting for companies, the other one accounting for non-profit organisations and the third group accounting for financial institutions. All the companies have been audited by different, mostly private audit firms. Furthermore, the operations should have been presented by means of aggregate tables showing detailed changes in the number of employees, since the majority of the company restructuring measures involve changes in the number of employees and limitation of their rights.

Why are the companies' operations not audited by the State Audit Office (SAO)? The operations of the companies are audited by various private audit firms, although there is no reason why these majority state-owned companies would not be audited by the SAO. This reopens the question of why the companies, not audited by the SAO within its annual programme of regular or special audits, are given a special status. The Government can make, and the Parliament can accept a proposal that the SAO should include in its annual audit plans the semi-annual and annual audits of those companies of special national interest which are in majority state ownership.

Business performance. The highest revenues were reported by energy companies INA and HEP Group (HRK 10.5bn and HRK 6 6bn respectively), followed by the regulatory agency HANDA and Končar Electrical Industry, Inc. (HRK 1.23bn each). INA and HEP also reported the highest expenditures, together with Petrokemija and Končar. Overall, 34 companies generated net profits of HRK 2.42bn in the first six months of the current year, up 17.3% on the last year (about HRK 2bn). Nineteen companies incurred losses in the amount of HRK 731.6m. The biggest loss-makers were INA, Petrokemija, Croatian Railways Infrastructure Ltd. and Croatia Airlines. It should be pointed out that the losses were partly due to delayed restructuring and waiting for notification from the European Commission regarding the Commission's clearance for the implementation of proposed restructuring measures. Investments fell short, amounting to HRK 3.1bn (as little as 29.9% of the planned amount for six months). This was caused by either bad planning or inability to invest due to high current expenses.

Growth in subsidies and salaries. Subsidies stood at about HRK 1.23bn in the first six months (HRK 1.15bn in 2013) and were paid to 15 companies in both observed periods. The semi-annual amounts of the subsidies already accounted for 84% of the plan for the whole of 2014. The bulk of the subsidies continued to go to Croatian Railways, Jadrolinija and Croatia Airlines. Overall, staff costs were cut, as the number of employees fell (to 78,274). The highest average net salary (HRK 20,864) and the lowest net salary (HRK 3,839) paid by the companies continued upwards. The restructuring process was obviously too slow, and it was further postponed in some of the companies.

Liabilities. Extremely high liabilities of the companies still posed a serious problem. Due to sluggish restructuring, they did not fall, standing at HRK 85.8bn at mid-year, almost the same as last year. Liabilities to credit institutions amounted to HRK 53.5bn, down from the first half of 2013 (HRK 56.3bn). The highest credit liabilities were reported by Croatian Roads, Rijeka-Zagreb Motorway and INA. However, considerable increases in liabilities to banks were recorded by Rijeka Airport, Đuro Đaković Holding and Croatian Railways Infrastructure.

Total semi-annual financial liabilities to credit and other financial and non-financial institutions stand at HRK 69.6bn, down only slightly (0.8%) from the first half of 2013. Some companies are exposed to serious financial risks, threatening the stability of public finance. These are primarily companies in the transportation sector (railway, road and air transport companies) with huge credit debts guaranteed by the government through issued and called-upon guarantees.

Further steps. According to business results, the operating costs of the companies are still so high that they threaten the fiscal stability of the state. Motorway monetisation seems to be a reasonable measure by the government to catch breath. But without a complete restructuring of all the public companies and government agencies, based on clear-cut strategic commitments regarding the number and types of companies of special national interest, and without the continuation of the privatisation process, the influence of these companies on the country's fiscal position will remain strong. The companies' contingent liabilities may continue to undermine the credibility of the country. One of the greatest challenges to public finance is the successful restructuring of state and local government owned companies, and regulatory agencies, in order to provide a sound basis for a public administration reform.