

Management of Public Enterprises in Serbia – Cases of EPS, Telekom, and Srbijagas

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Abstract

Public enterprises feature as an important field in Serbian economy. The aim of this paper is to point out the relevance of public enterprises and how their business can greatly influence the economic trends of the Republic of Serbia. The paper analyzes the operation of public enterprises Elektroprivreda Srbije, Srbijagas and Telekom in the period from 2011 to 2015. The paper is structured in four segments, with the first one focused on a theoretical and legislative approach to the explanation of the role and importance of public enterprises. Further, there are the key issues of these enterprises and a potential solution through the analysis of Fiscal Council. Finally, an empirical part is presented through the use of indicators of profitability, liquidity, indebtedness and solvency for the time horizon of 2011-2015.

Keywords

Public enterprises, analysis, profitability, liquidity, debt, solvency.

Introduction

In every economy, public enterprises have a particular role which is more or less significant depending on the level of development of the economy. Namely, in the market-developed countries, there is a proper and adequate approach to public enterprises, where it introduced a corporate principle and clearly defined state support. Observing Serbia in the last few decades, public enterprises present an important segment of the economy and their role should not be ignored. The reason lies in the fact that public enterprises employ large numbers of people, and their destiny is directly linked to the success of their business. In this connection, negligent management of public enterprises can directly affect the living standard of a certain number of people which is not small. Serbia has experienced the transition from a socialist to a capitalist system and there has been a change in the functioning of this enterprises as well as the

entire economy. In recent decades there is a significant shift from state socialism to capitalism which has led to major changes in the ownership structures of companies around the world. One of the visible aspects of this trend is the willingness of governments to sell state enterprises to private investors, and the reason is found in the fact that private property and the market can significantly improve the poor performance of public enterprises (Souza et al. 2014).

1. The role and importance of public enterprises - theoretical framework

Christiansen (2001) noticed that despite a decade of liberalization and privatization in many countries, public enterprises and state share still remain widespread. The government often uses public enterprises to promote local development and investment in sectors where private investment is strapped (Mussachio and Lazzarini, 2014). Also,

Rondinelli (2008) points out that public enterprises are established with the aim to contribute to economic and social development. After World War II, governments in Europe and North America have used public enterprises to develop economically backward regions and provide the necessary resources while protecting industries which are considered essential for future economic growth. Fall of the Berlin Wall marked the end of the functioning of centrally planned economy. Ahrend and Martins (2003) give an example in Romania that the survival of the loss-making public enterprises was financed by the state through a variety of subsidies, which in the late 1990s led to huge debts and negative impact on the state budget which is reflected in the economic efficiency on the state level. The significant expansion was seen in the countries of Western Europe and the former USSR where the socialist government nationalized industrial and service enterprises with the collectivization of agriculture based on a centralized plan to reduce or eliminate the impact of the market (Rondinelli, 2008, p. 23). Similarly, Dong and Putterman (2003) cite the example of public enterprises in the countries of Eastern Europe and Asia, where they were used to cover a large number of redundant workers to reduce social discontent. Nkechi (2013) concluded that public enterprises, particularly in developing countries, become more active in key sectors such as manufacturing, construction, financial services, utilities and transport (Heath 1999). Public ownership in industries of iron and steel, and chemicals and petrochemicals are of strategic importance in terms of providing the necessary inputs. However, the inability of the state to manage public enterprises imposes the need for their privatization, i.e. the application of corporate management. Kecman and Šušnjar (2012) highlight several reasons for the privatization of large system and public enterprises:

- a) large losses and debts of public enterprises,
- b) reduce expenditures from the budget to finance their survival and functioning,
- c) increase the economic efficiency of enterprises through market competition,
- d) realization of privatization revenues from their sales.

On the other hand, Aivazian et al. (2005) argue that public enterprises can adequately work without privatization. Their research was conducted in the case of China and concluded that corporatization has a significantly positive impact on the per-

formance of public enterprises. Madžar (2015) argues that there are several restrictions that hamper Serbian economy, as is the case with public companies while Arsić (2015) notices that public enterprises are used for the realization of fiscal and social objectives to a significantly greater extent than in the developed market economies. Most public enterprises recorded poor operating results, do not have sufficient incentives to increase the level of efficiency and are faced with pressure to keep prices of services at a socially acceptable level, which implies a low level of investment that threatens the long-term sustainability of their business. Arsić (2015) highlights the problem of EPS and the fact that more than 50% of the manufacturing plants are over 30 years old and less than a quarter of transmission lines and substations are in proper condition. Veselinović (2014) lists the biggest problems of public enterprises in Serbia:

1. expressed political influence on the election of members of management and supervisory boards, which implies poor corporate governance and weak operating results;
2. cumulative losses which narrow space for investment and development opportunities;
3. low effectiveness and efficiency of management that affect the quality of products and services of these enterprises;
4. large potential for corruption;
5. overstaffing and inadequate qualification and age structure of employees.

2. The legislative framework for public enterprises in Serbia

According to the Law on Public Enterprises, a public enterprise carries out activities of general interest, which is established by the Republic of Serbia, autonomous province or local government. In terms of this law, activities of public interest are activities in the field of mining and energy, transport, electronic communications, issuing the official gazette of the Republic of Serbia and the issuing of textbooks, nuclear facilities, weapons and military equipment, utilization, management, protection, editing and promotion of goods in general use. Public enterprises are established to provide permanent performing activities of general interest and satisfying the needs of regular users of products and services; development and improvement of the performance of activities of general interest; providing technological and eco-

conomic unity of the system and compatibility of its development; making profits and achieving other legally established interests. In addition to public enterprises, the activity of general interest can be performed by (Law on Public enterprises): a) limited liability and joint-stock companies whose owner is a public enterprise; b) capital company whose owner is the Republic of Serbia, autonomous province, local government, as well as the subsidiary whose owner is capital enterprise; c) other capital company and the entrepreneur to whom the competent authority entrusted to carry out activity. The issue of profit allocation is defined by the obligation of public enterprises to pay part of the profit to the budget of the Republic of Serbia, autonomous province or local government in the final account for the previous year. For each calendar year, a public enterprise makes annual program business that includes the following elements (Law on Public enterprises, 2016):

- planned sources of revenues and expenditures,
- planned procurements,
- investment plan;
- planned way of profit allocation or loss coverage,
- elements for a comprehensive overview of the prices of products and services,
- plan of earnings and employment,
- criteria for the use of funds for assistance, sports activities, promotion, and entertainment.

3. Corporate management in public enterprises in Serbia?

The government should refrain from intervention in the management of public enterprises and it is necessary to enable their full operational autonomy to realize the defined goals. In addition, it is important to establish a responsible and transparent business professional management and thus achieve a high level of public enterprises efficiency (OECD, 2015, p. 20).

Public enterprises	Regulated, non-market prices below the level of eligible costs	Generation of insolvency and consequences on economic activity and public revenues	Professionalization of the management and reduction of irrationality and corruption
		Tolerating delays and debts which become state obligations	
Srbijagas	Many years of low sales prices (adjusted) Assume losses Gas supplies to non-paying customers	Issue state guarantee and an increase in public debt Payment obligations from the budget	Interruption of gas supplies to non-paying customers Sale of subsidiaries Negotiation of import volumes and prices
Elektroprivreda Srbije	Inefficient decentralized organization (autonomy of subsidiaries)	The spread of insolvency on the economy	Business and financially restructuring accompanied by increased efficiency in all segments Reducing the number of employees and earnings
Telekom	Non-performing receivables for sold electricity Surplus of employees and earnings	Possible issuance of state guarantee for additional debt to cover the overdue financial obligations	The increase in electricity prices for households A turning point in the politics of collection receivables and the initiation of financial discipline
	Inefficient state governance Surplus of employees Financing various state projects which do not contribute to business success	Fewer dividends and other revenues which are paid to the budget A smaller contribution to economic growth	Privatization Reducing the number of employees, earnings, and irrational costs

Source: Fiscal Council (2014)

Table 1 Review of main public enterprises in Serbia

	Cause of problems	Impact on public finance	Solutions
	Internal inefficiency Illiquidity and growing indebtedness	The annual costs of 3% of GDP (subsidies, activated guarantees, unpaid taxes and contributions)	Regulation of employment and wages in terms of reducing

In the analysis, the Fiscal Council pointed out that the problems are not simple and the changes are inevitable in public enterprises as well as in the whole economic system. Large losses are covered by providing state guarantees which are manifested on the budget. Likewise, constant subsidization of inefficient enterprises is an obstacle

to their reform, because management relies on this ‘state support’ and it is not ready or willing to carry out corporatization of public enterprises.

On the other hand, the government has to take into account the social factor, because there are huge systems which employ a large number of people. Privatization is one of the directions of solving this problem, while many enterprises cannot survive in terms of ownership and organizational structure. Then, liberalization of market trends and the creation of prices on market principles and economic criteria should direct the enterprises toward greater efficiency and effectiveness. This can be realized with the help of corporate and professional management. Also, it is necessary to reduce the level of non-performing receivables so public enterprises could have a regular inflow of funds and provide a permanent fulfilment of liabilities from current operations. Rationalization of expenditures through lower spending on salaries of employees is an important part of this reform package while the efforts of public enterprises should be directed towards productive investment in order to improve their efficiency. On 27 November 2014, the government of the Republic of Serbia adopted a corporate restructuring plan focused on simplifying the organizational structure and management of EPS. The task is to achieve financial viability and competitiveness in the long run, and stop further deterioration of the financial situation of this enterprise as well as the elimination or reduction of the need for state help. Furthermore, as part of fiscal consolidation measures during 2016-2018, it is planned to improve the collection of receivables, reducing electricity losses, rationalization of employees, as well as the optimization of production facilities in order to improve operational and organizational efficiency. The basis for the restructuring plan of Srbijagas is determination of financial position and emphasis on the collection of receivables from main debtors (Azotara, MSK, and Petrohemija). Also, it is necessary to establish a fair principle of gas delivery fee. In fact, one possible scenario is the disruption of gas delivery to non-payers which can force them to fulfil their obligations from current operations. However, the full implementation of this principle could lead to difficulties in the functioning of many public institutions.

4. Analysis of public enterprises in Serbia

To reflect the financial condition of public enterprises in Serbia, we analyzed the key indicators of profitability, liquidity, debt and solvency in the case of Elektroprivreda Srbija, Telekom, and Srbijagas. Calculation of chosen indicators is measured by:

$$\text{Profitability} = \text{net income/equity capital} \quad (1)$$

$$\text{Liquidity} = \text{current assets/short-term liabilities} \quad (2)$$

$$\text{Debt} = \text{long-term liabilities/total capital} \quad (3)$$

$$\text{Solvency} = \text{operating assets/long-term liabilities} \quad (4)$$

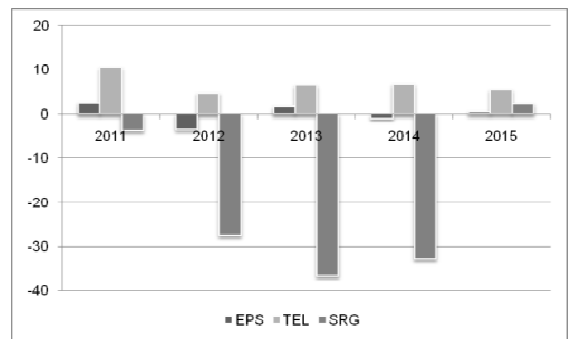


Figure 1 Profitability in public enterprises - EPS, Telekom, and Srbijagas

Source: Authors based on Elektroprivreda Srbije, 2016; Srbijagas 2016 & MTS, 2016

Figure 1 shows the movement of the profitability indicator of observed enterprises in the period 2011-2015, where it used return on equity (ROE). First, EPS recorded the highest value in 2011 from 2.49%, to the following year, recording a negative rate of 3.54%. Second, return on equity had a declining trend over the years, where it was especially pronounced between 2011 and 2012 when there was a double decrease of 5.78%. After that, there was a slight increase of 1.98% and in 2015, a decline of 1.18%, i.e. the level of profitability amounted to 5.61%. Third, Srbijagas recorded negative rates of profitability, where it is notable that enterprise had large losses in the three-year period 2012-2014, where the rate of return on equity was negative for over 30%. Specifically, in 2013 there was a maximum of 36.66% which can be attributed to the resulting loss of over 50 billion RSD. Only in 2015, Srbijagas had a positive rate of profitability of 2.29% which is much better than previous years.

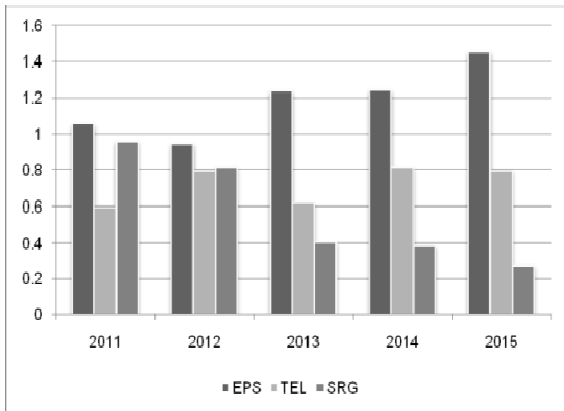


Figure 2 Liquidity in public enterprises - EPS, Telekom, and Srbijagas
 Source: Authors based on Elektroprivreda Srbije, 2016; Srbijagas 2016 & MTS, 2016

Liquidity indicators reflect the enterprise's ability to perform financial obligations on time where it is measured by the ratio of current assets and short-term liabilities. Taking into account a reference value of 1, it is evident that EPS realized the criteria, except in 2012 when the liquidity indicator was below 1 or 0.94. On the other hand, the liquidity of public enterprise Telekom was low and value of observed indicator was less than 1 throughout the whole period. In analyzed period, this enterprise is faced with higher short-term liabilities, and the inability to be covered by the funds completely. The encouraging fact is a slightly growing trend of the indicator and achieving a maximum of 0.81 in 2014. Also, Srbijagas had a declining trend in the level of liquidity in the observed period where it is pronounced in 2013 when there was a fall by 50%. In the next two years, there is a slight decrease of the indicator, where the value was 0.28 at the end of 2015.

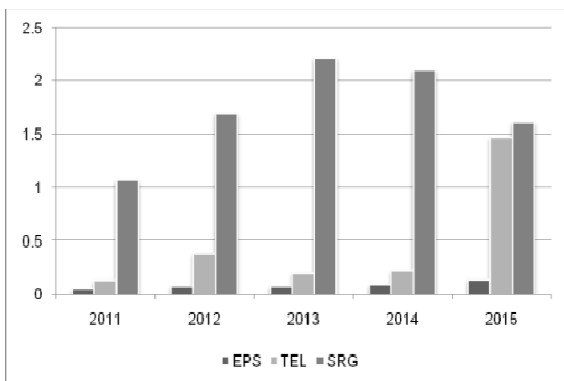


Figure 3 Debt in public enterprises - EPS, Telekom, and Srbijagas
 Source: Authors based on Elektroprivreda Srbije, 2016; Srbijagas 2016 & MTS, 2016

Figure 3 reflects the trend of debt indicator in public enterprises in Serbia from 2011 to 2015, observing the ratio of long-term liabilities and equity. There is a growing tendency in EPS which can especially be seen in the last two years when the value of observed indicator increased by 45.7%. A similar situation is in Telekom, where indicator recorded a maximum value of 1.47% in 2015 as a result of the faster growth of long-term liabilities compared to capital. When it comes to Srbijagas, it presented a growing trend of long-term obligations and their pressure on equity, where this particularly applies to 2013 and 2014 when the indicator was above 2. Based on the calculation of this indicator, at the end of 2015, the level of debt has increased by 50.24% compared to the beginning of the period.

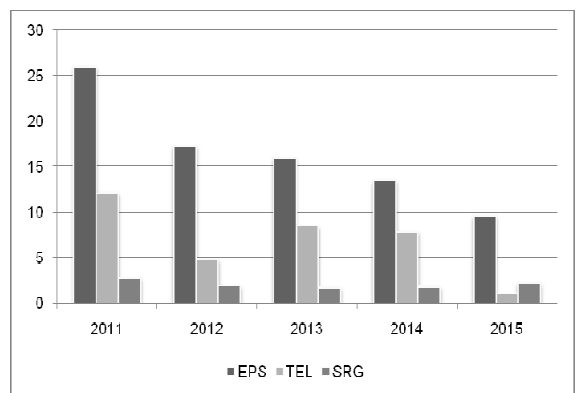



Figure 4 Solvency in public enterprises in Serbia - EPS, Telekom, and Srbijagas
 Source: Authors based on Elektroprivreda Srbije, 2016; Srbijagas 2016 & MTS, 2016

Figure 4 shows the level of solvency in public enterprises in Serbia in the period 2011-2015. Solvency can be seen as liquidity in the long term where it is analyzed as a ratio of assets and debt. EPS had a declining trend of this indicator of 37.04% over a period of five years. Also, Telekom recorded a lower value, especially in 2012 and 2015, when it reached the lowest level of 1.07. In two last years, there is a deterioration in the financial situation of this enterprise which is showed in terms of solvency and debt in the previous Figure. Looking at the value of debt in Srbijagas, the maximum value was reached at the beginning and end of the period. Specifically, in 2011 the indicator was at a level of 2.82 to the end of 2015 stood at 2.23. In 2013 the financial situation was worsened as a result of reduced profitability and liquidity, as well as increased debt and it was affected by a lower level of solvency and less ability to cover the debts.

Conclusion

Based on the analysis of public enterprises in Serbia, it can be concluded that EPS had variable results in terms of profitability, while the level of liquidity had a growing trend. Also, the growing indebtedness of this enterprise directly affects to slowing and reducing the solvency indicator which has a declining tendency. Public enterprise Telekom operated with positive financial results, but the level of profitability is decreasing every year. The same situation is with liquidity, while the growth of debt is especially prevalent in 2015, which implied the enterprise's smaller ability to cover debts. This can be seen through the movement of the solvency indicator in 2015. Finally, Srbijagas had the weakest results in terms of profitability, as well as lower liquidity. In terms of debt and solvency, the encouraging data is their improvement compared to 2013, when this enterprise achieved very poor results. The question is what to do with these enterprises. One solution is privatization and functioning on market principles. However, due to bad experiences in the past, it is important to determine the level of readiness of the government to realize this. Also, there are opinions that certain enterprises, as well as the sectors of general importance, should remain in state ownership. It is necessary to establish a corporate management and adequate organizational structure with the rationalization of operating costs in public enterprises, how they could be more efficient. 

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