CHAPTER 14.

UPGRADING CORPORATE GOVERNANCE PRACTICE OF STATE OWNED ENTERPRISES IN PROCESSES OF EU INTEGRATION – COMPARATION OF SERBIA AND SLOVENIA[1]

Dejan ERIĆ[2], Ivan STOŠIĆ[3]

Abstract

The aim of this work is to analyze the outstanding issues and opportunities for upgrading corporate governance in state-owned enterprises - (SOEs) through a comparative analysis of this type of enterprise in Serbia and Slovenia. This is a very remarkable group of companies that have a major role in the overall economic life of both countries. Increasing efficiency and effectiveness in their management can contribute to raising the overall level of competitiveness and meeting the economic criteria for the integration of some countries in the European Union. In this paper we will try to identify several areas and examples of good practice which lead to improved corporate governance, and thus the better performance of this type of enterprise. In a variety of areas in which the corporate governance may be improved, we focused our analysis on the three areas, as follows: policy of ownership, regulations in terms of increasing transparency and functioning of the boards of directors.

Key words: *state owned enterprises, public enterprises, corporate governance, restructuring, structural changes, EU integrations*

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[2] Dejan Erić, PhD, Institute of Economic Science & Belgrade Banking Academy, Belgrade, Serbia

[3] Ivan Stošić, PhD, Institute of Economic Science, Belgrade, Serbia

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INTRODUCTION

The Republic of Serbia expects to gain the candidate status for membership in the European Union (EU) by the end of the year 2011. On its way to the EU, apart from fulfilling the political and legal criteria, Serbia has to pay special attention to meeting the economic criteria. To remind you, the economic criterion consists mainly from the need to develop market economy, able to cope with pressures imposed by the competitors on the EU market. To achieve that it is especially important to increase the competitiveness of all businesses, regardless of their size (small and medium-sized companies vs. large companies) or the ownership structure (private, joint stock companies and state owned enterprises - SOEs). As one of the fundamental issues that will be discussed in this paper is whether the SOEs sector in Serbia is capable of such challenges.

The main objective of this work is to analyze the unresolved issues and opportunities for upgrading corporate governance in SOEs, primarily through comparative analysis of this type of business enterprises in Serbia and Slovenia.

The Republic of Slovenia has successfully completed the transition processes and is the first ex-Yugoslav republic which became a full member of the EU and the European Monetary Union (EMU). It is a country that had identical economic system as Serbia, with a specific form of ownership (public property), enterprise self management, market oriented and open to foreign competition (*M. Simonetti, A. & M. Rojec Gregoric, 2004, pp. 224-243*), making it significantly different from the other former socialist countries of the so-called Eastern Block. Although there were differences between the two former Yugoslav republics in the structure of the economy and the achieved level of development, they shared the common economic space and faced more or less similar problems. Positive experiences in the field of corporate governance in Slovenia can be of great importance in completing the restructuring of the SOEs sector in Serbia and increase its overall competitiveness.

Improvement of corporate governance in SOEs is a significant challenge to many economies in the world. The countries which have already started reforms of corporate governance in this type of enterprise share the same experience which proves that it is an important, but also a complex undertaking. The main challenge is to find a balance between the responsibilities of the state to actively exercise its ownership functions, such as the appointment and election of board members, at the same time restraining from imposing excessive and improper political interference in the operation and management of the company.

Among a great number of corporate governance principles defined by the OECD (*OECD, 2004*), our analysis will focus mainly on the three principles: providing a basis for an effective regulatory framework of corporate governance especially in the domain of ownership policy, transparency of business operations and functioning and responsibilities of the board of directors.

In this paper the two basic ideas, i.e. hypotheses will be analyzed, as follows:

- Management of SOEs should be professionalized and depoliticized, as the examples of good practice show that the competent management is able to organize the successful operations of these companies, regardless of the legal framework and the nature of ownership.
- Improvement of SOEs operations largely depends on the way in which operational and strategic (investment) decisions have been made in this type of the enterprise.

During the development of this work we encountered many problems and burning issues. In the first place we can point out different approaches to defining this type of enterprise, and the different terms used. Common terms which could be found in different places and different sources are the following: State Owned Enterprises (SOEs), Public Enterprises (PEs) or Government Controlled Enterprises (GCEs).

At the ICPE Expert Groups gathering dedicated to corporate governance practice in the SOEs, which took place at the beginning of September 2011 in Ljubljana, the following definition was given: "*Any commercial, financial, industrial, agricultural or promotional undertaking – owned by public authority, either wholly or through majority share holding – which is engaged in the sale of goods and services and whose affairs are capable of being recorded in balance sheets and profit and loss accounts. Such undertakings may have diverse legal and corporate forms, such as departmental undertakings, public corporations, statutory agencies, established by Acts of Parliament or Joint Stock Companies registered under the Company Law*" (*Basu, 2008, pp.10).*

A special group of problems which is closely related to terminological discrepancies results from the availability of the data. We tried to combine several sources of data. The National Institutes of Statistics certainly are one of those sources, but heterogeneity of sources and methods also limits a unique approach. The data obtained by the Organisation for Economic and Cultural Development (OECD) can be used, but it does not cover all EU Member States. The same goes for the data of the World Bank. The International Labour Organisation (ILO) can also be used, but this concerns only the number of employees for each sector and not for their sub-sections according to the NACE classification, thus giving only a broad overview.

In this research we have discovered that these types of enterprises are not so open for co-operation. Apart from that, there is a relatively modest literature, especially regarding the operation of the SOEs nowadays.

Besides the introduction and conclusion, this paper consists of five basic parts. First, a brief overview is presented of trends in the development of corporate governance in the SOEs sector in the world and the EU. The third part is devoted to analyzing the challenges of restructuring and upgrading corporate governance in SOEs in Slovenia and Serbia. In the fourth section the outstanding issues of corporate governance are analyzed in the SOE sector in Serbia. The fifth part is dedicated to the analysis of best practices to improve corporate governance, both at the country level and through examples of some SOEs. The last, but not the least, at the end of the paper the list of references and literature used in developing of this paper is stipulated.

TENDENCIES IN THE DEVELOPMENT OF CORPORATE GOVERNANCE IN THE STATE OWNED ENTERPRISE (SOES) SECTOR

SOEs still represent a significant share of gross domestic product, employment and market capitalization in many countries. Moreover, SOEs are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunications, whose business is of great importance to broad segments of the population and other parts of business sector.

The importance of this sector varies from country to country. In many countries SOEs represent an important source of government revenue (China: 7%, Thailand: 7%, Turkey: 6%) and regions such as North Africa (Algeria: 60%, Egypt: 12%, Morocco: 4%, Tunisia: 7%), the Middle East (Jordan: 14%, Lebanon: 17%, Syria: 24%) and Eastern Europe (Czech Republic: 2%, Hungary: 3%, Poland: 4%, Slovakia: 5%, Slovenia: 3%). In terms of employment, SOEs employ 34.3% of the total workforce in Ghana, 25.1% in Gabon, 12.2% in Sri Lanka, 8.1% in India, 7.7% in Kenya and 7.4% in China (*Basu 2008, Khan 2008*).

In recent years significant changes have been identified in the sphere of state-owned business enterprises (SOEs). While many countries carried out the privatization process during the 1980s and 1990s by reducing government ownership of business entities (*Becht, 2003, pp. 8*), the early 21st century brought about the opposite trend, which became particularly evident after the outbreak and strengthening of the negative impact of the global economic crisis. In all these processes the key issue still refers to the efficiency and effectiveness of management (*Khan, 2008, pp. 6*). Awareness is growing that changes are necessary in corporate governance. These changes are demonstrated in several areas, among which we point out the three - ownership policies, regulations related to increased transparency and disclosure standards and functioning of the board of directors.

Within the changes in ownership policies, a greater “centralisation” of the ownership function has been noted. This tendency seems to reflect, first, a shrinking portfolio of SOEs and, secondly, a greater tendency to list SOEs on stock exchanges – both of which tend to make a coordinated ownership function more feasible and more useful. In addition, a long-term fiscal squeeze in many countries may have induced governments to rethink their ownership practices purely on efficiency grounds. Various solutions can generally be found. As for example, two countries have moved to a central ownership model, with the ownership henceforth the responsibility of a specialised unit (Finland) and the Ministry of Finance (New Zealand). Some countries have established a dual ownership model or strengthened the role of the Ministry of Finance in pre-existent models (the Czech Republic; Switzerland). Finally, there are countries, like Hungary and Korea, which have established interministerial committees to obtain a better coordination of SOE ownership.

Many EU countries in the period before the global crisis had a trend to reduce the number of SOEs, which was generally enforced through privatization. Thus, they solved the problems of inefficient management and reduction of state influence in the economy. On the other hand, certain income was made. For example, in the Netherlands some 50 SOEs were privatized in the period 1980-2005 and the state had revenue of about EUR 14 bill (*Habets, 2011*).

After the year 2007 and the outbreak of the global financial and economic crisis concerns have grown about the efficiency of the market and new solutions have been sought for the development of the SOEs sector. In the Netherlands, the government was particularly interested in protecting the public interest in the energy sector (GasUnie & TenneT - energy transportation), as well as some other participants (Holland Casino de Staatsloterij - gambling). The role of the Ministry of Finance have changed, and it has become an active shareholder thereby predominantly focusing its SOE ownership on 4 core issues - corporate strategy, investment policy, capital structure and executive’s remuneration policy.

A good example of the changing attitude of the state towards the management in this type of company is Finland, where in 2008 legislation was changed through ratification of the new State Company Act. The main difference as to the 1991 Law refers to provisions concerning decision-making powers and the legal norms governing the arrangements made in respect of the State's holdings in corporate entities. Duties relating to state ownership steering are carried out in the Ownership Steering Department within the Prime Minister's Office. The department is responsible for state ownership steering in companies operating on market terms.

Even the most developed EU countries have reviewed their attitudes towards the ownership of SOEs. For example in Germany there are not many SOEs and there is a specific legal form called the Federal Government Holdings. The Government can participate in the founding of a private-law enterprise or in an existing enterprise only if there is an important interest on the part of the federal government and the purpose intended by the federal government cannot be achieved better or more economically in any other way. Germany belongs to the group of countries such as the Czech Republic and Switzerland which have a dual model of holding administration. Sector ministries exercise ownership function: representing state in general assembly of shareholders; determining responsibilities influencing the strategic goals of Federal Government holdings. Determining strategic goals is part of ownership function the sector ministries execute, partly in coordination with the Ministry of Finance (*Offer, 2011*)

Another important area where the major changes in corporate governance of SOEs take place are related to regulatory changes, particularly to achieve greater transparency and compliance with the disclosure standards. These are issues that are of particular importance for the Republic of Serbia because still there are many problems in this area. In recent years some countries, such as Switzerland and Turkey implemented the system of aggregate reporting. Germany has strengthened the accountability mechanisms around the annual reporting that they had in place. Many countries have changed rules for SOEs' disclosure of material information. All the changes go in the direction of greater disclosure, but the subject areas concerned differ greatly across countries – from regular annual accounts (Turkey), to sustainability reporting (Sweden), to a continuous disclosure regime for the largest SOEs (New Zealand). In other words, governments are increasingly aware of a need to enhance transparency and accountability in order to enhance SOE efficiency and gain public support for their ownership practices.

The third area of change in corporate governance is related to the functioning of SOE boards of directors. That is the area where there are several different aspects, starting from the appointment of the candidates, eliminating the influence of politics, to the question of rewards and responsibilities. Further in this paper, we will see that regarding this issue, the example of Serbia is particularly sensitive and is associated with testing our first hypothesis. Examples of several countries and many successful companies suggest that if the management of SOEs is professionalized and depoliticized their efficiency and effectiveness are greatly increased, which leads to growth of competitiveness of the country at the international level.

Generally, there are many examples which confirm the attitudes stipulated above. For example, in Malaysia there is a Government Linked Companies sector (GLCs), which employs about 5% of the national workforce (400,000 employees). In 2004, GLC Transformation (GLCT) Programme was launched with the dual aims of enhancing economic performance and accelerating the country's social and economic developments. One of the five elements of the program was the upgrading the effectiveness of boards and reinforcing the corporate governance of GLCs. Also, as one of the goals which appeared was adopting best practices within GLCs (*GLCT Programme, 2011*). After several years of application of the program 20 largest companies in this group achieved very tangible results, some of which stand out with total shareholder return which grew by a compounded annual growth rate of 16% over the past seven years, outperforming Kuala Lumpur Composite Index (KLCI) by 2.1%

Many EU countries used the conditions of crisis to carry out changes in legislation and introduce some improvements in the system responsibilities of the boards of SOEs. Thus, the changes were made in the following countries:

- The Government of the Czech Republic issued Principles for remuneration to management and board members of corporations with state shareholding above 33% Including SOEs and other state institutions established by Law or Ministry. The aim of the Principles is to prevent inappropriate remuneration practices and increase transparency. The Principles establishes standard structures of remuneration, as well as accountability mechanisms to ensure their implementation.
- In Italy, the company bylaws of unlisted SOEs were modified to introduce respectability and professional requirements among the criteria for nominating board members. A limit was also introduced to the number of board positions (executive as well as non-executive) that any individual may hold at the same time.
- In Sweden, the Government introduced new guidelines for terms of employment for senior executives in state-owned companies in April 2009 replacing the previous guidelines which were adopted in July 2008. According to the guidelines, the remuneration of the CEO is the responsibility of the board as a whole. The board should also ensure that the remuneration of both the CEO and other senior executives remain within the guidelines decided upon by the annual general meeting. In case

of any deviation from the government's guidelines, the board is expected to report on the special reasons with respect to any particular case.

Even the countries which are not known for importance of this sector have made certain changes. For example, the United Kingdom was known as a country that had a very small number of SOEs. However, in 2003 the problem of the effectiveness of the corporate governance has been recognized and the decision was made to appoint members of the management team regardless of political influence. This decision was accompanied by the desire to find more quality people for managerial positions, which resulted in a significant increase in performance. This has helped in overcoming one of the problems which SOEs encountered in the United Kingdom, which is providing the necessary capital and adequate capitalization of SOEs. Since these companies are often associated with public finance there is always fast and proper recognition of their needs for capital, which contributed to making certain decisions in a slow manner.

Apart from these three roles, some countries, such as Egypt, have the new governmental strategy for public sector enterprises, which does not emphasize their economic role first. They are seen as one in social-economic development, i.e. employment, capacity / capability of government to intervene to ensure social justice, etc. (*Ashraf*, 2011). It should be noted that there are several countries that have completed the privatization process but retained ownership of SOEs in order to achieve specific and significant goals that could not be achieved economically in some other way. On the other hand, there are countries that have recognized the need for significant involvement of various levels of government in the economy. They retain the larger share of SOEs in order to achieve social justice or higher level of employment.

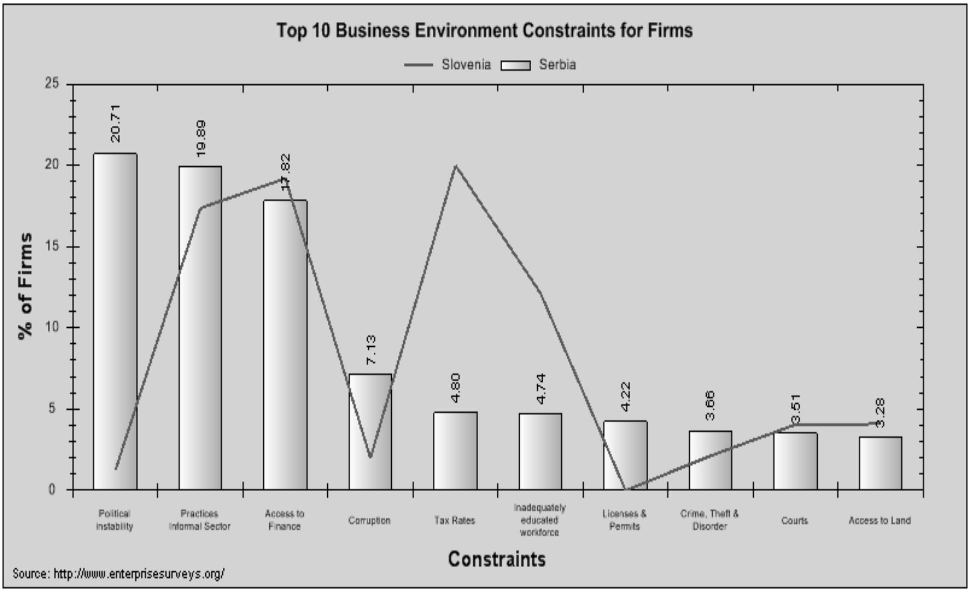
However, despite the significant differences in views on the role and governance models, crucial precondition for successful governance of the SOEs is clear setting of the objectives which government wants to achieve by using SOEs. Clearly defined objectives, together with introduction of corporate governance principles, could make SOEs either powerful tool for achieving different goals of economic policy or competitive players in the market game with private sector enterprises.

CHALLENGES OF RESTRUCTURING AND IMPROVEMENT OF CORPORATE GOVERNANCE IN SOES IN SLOVENIA AND SERBIA

In order to examine the challenges of restructuring and upgrading corporate governance practices, Slovenia and Serbia have been chosen because both countries have certain common characteristics. Companies used to belong to a single economic system, based on public ownership and a special management system - self-management. There is a relatively similar national culture in both countries, as well as many similarities in the elements of organizational culture. Transition was implemented in completely different ways. Slovenia successfully completed transition during the 1990s, has met all requirements and became a full member of EU and EMU. Serbia significantly lags behind; it is faced with great challenges not only of European integration, but also structural problems in the economy.

Nonetheless, current business problems which companies in Serbia and Slovenia encounter are quite different, as illustrated by the data provided by Enterprise Surveys conducted by the World Bank, as follows:

Graph 1. Top 10 Business environmental Constraints for Firms



However, we believe that benchmarking with Slovenian experience can help in seeking possible solutions to many problems and challenges which SOEs in Serbia encounter. In addition, some problems that Slovenia encountered fifteen years ago can still be found in Serbia.

One of the important features of the restructuring, particularly of unprofitable enterprises in Slovenia, was to "*install a system of corporate governance, with boards of (nonexecutive) directors responsible for monitoring the performance of management" (Simonetti, Rojec & Gregoric, 2004, pp. 227)*. In addition, activities have been taken to reduce redundancies, providing the necessary liquidity and only after that they implemented privatization. In order to make a comparison, in Serbia the most profitable companies were rapidly privatized, and for those which had problems there were no clear vision and strategy of restructuring. Unfortunately, many of these companies belong to the group of SOEs.

Defining the enterprise in which the Republic of Slovenia has the property is determined according to whether they are directly state-owned (fully or partially), indirectly (through the Pension Fund - Kapilaska Druzba – KAD or the Restitution Fund – Slovenska odškodninska druzba - SOD) or through a combination of the previous two methods. By the end of the year 2010 there were 50 companies in Slovenia in which the state had direct ownership, of which in 19 of them it was a sole owner. The number of companies where the state is an indirect owner totals 96, of which 20 of them with 100% ownership. Considering that in the Republic of Slovenia currently operates more than 110 000 companies, the participation of this sector with 146 companies is not huge by the total number. However, their total contribution to the creation of gross value added is moving at about 16-17% *(OECD Economic Surveys: Slovenia 2011).*

KAD is a quasi-governmental fund and its main function is to manage pension schemes for civil servants in Slovenia. In addition, it offers additional and compulsory pension insurance in the private sector. However, during the privatization KAD became a "co-owner“of over 1,200 companies. During the time, the strategy has changed, so that KAD reduced its portfolio from over 1,000 enterprises which it had after the first wave of privatization to only 80 by the end of 2009. The scope of work does not allow us to enter into a deeper analysis of the privatization process in Slovenia. From the concept of mass privatization in the late 1990s the process went towards increasing concentration of ownership. The strategy of the state was to retain ownership in large enterprises of strategic importance for the Slovenian economy.

Another important institution, SOD, was formed to provide restitution to previous owners of privatized firms. By comparison, in Serbia there were more laws on privatization and a number of the privatized companies has been given to the pension fund, but it was a passive shareholder. Restitution Law was enacted in the mid 2011, under the pressure by the EU to meet the requirements for obtaining the status of the candidate, so there is no institution similar to SOD.

SOEs that are directly owned by the state in Slovenia are in the field of energy, ports, telecommunications, postal services and railways, banking and insurance. Many large companies quoted on the Slovenian Stock Exchange are effectively controlled by KAD and SOD, such as Petrol, Triglav insurance, Sava or Gorenje.

In addition, two other companies - Telekom Slovenia and New Credit Bank of Maribor are directly controlled by the state. In terms of economic activities, the situation is more or less similar with SOEs in Serbia, with the exception of the ports which were privatized in the early years of transition. The state sold its ownership share in the banking sector, where he remained a minority shareholder in several banks (Commercial Bank, Jubmes, Privredna Bank), as well as in insurance, where it remained present only in Dunav insurance company.

Some of the outstanding issues and problems faced by SOEs in Slovenia could be summarized as follows (based on *OECD Country Reports*):

- Dissatisfaction with relatively low revenues from privatization - Between 2000 and 2007 the income from privatization in Slovenia amounted to less than 5% of GDP. This is significantly lower than in other countries in transition, such as Hungary (which also had a very comprehensive program of privatization in the 1990s and where the revenues were made in the amount of 7% of GDP, the Czech Republic - 9% and Slovakia - 14% (*OECD , 2009*)
- Low productivity and profitability – especially in the banking sector and utilities
- Slow development of corporate governance
- Lack of incentives to management to make more significant changes in the process of company restructuring – due to a much dispersed ownership structure which was made after the first wave of privatization (*OECD 2002, OECD 2011*).
- Selection of the members of the board of directors – although they seem independent from the government, both funds, KAD and SOD, are not completely independent, and the members of the boards of directors are appointed under the influence of the governing political structures.

For faster transformation and restructuring of SOEs Slovenian Government has decided to change the ways of managing these types of enterprises. Until September 2010 the management of SOEs directly owned by the state was the responsibility of line ministries, and then a new Agency was formed to manage capital investments, which represent property rights based on the Act regulating corporate governance of state capital investments. It is an autonomous and independent institution whose powers consist of the following:

- Control of the total assets directly owned by the state,
- Use of property rights which refer to all direct and indirect shares in property, including appointments of the members of the boards of directors
- Collection of centralized information on assets owned by the state,

- Follow up, measuring and reporting on performance,
- Development and application of the Code of corporate governance which will be applied in SOE.

In this way the Government of the Republic of Slovenia is trying to eliminate certain perceived weaknesses in the management of state assets, and raise standards of corporate governance, which was an integral part of the program of reforms in order to access the OECD. The intention is to increase the protection of rights of minority shareholders, increase capacity of judicial and regulatory authorities for monitoring and acting in accordance with corporate laws, restructure the funds' portfolio, all with the aim to raise the competitiveness and efficiency of this sector of the economy. Through the Agency the government tried to define a new strategy for management of the state assets. The Agency is required to prepare a strategy for at least 3 years which must be approved by the Parliament. The Strategy itself is concretized through the annual plans which have to be approved each year by the government.

Compared with what Slovenia has done so far to promote the principles of corporate governance in SOEs, Serbia considerably lags behind. In Serbia there is a decentralized or "sector ministry model" where state-owned enterprises are under the responsibility of relevant sector ministries. A specific ministry plays a co-ordinating role, in addition to the main role played by sector ministries. The co-ordinating Ministry organizes cooperation between the various ministries and is in charge of elaborating the overall ownership policy as well as specific guidelines. Ministry of Finance and Ministry of Economy and Regional Development play an important role. A particular problem in Serbia is the fact that heads of some ministries are the representatives of certain political parties, which do not always have fully synchronized activities. Therefore, there are different interests and influences. Insufficient coordination between ministries and the pursuit of the greater influence in some companies creates the picture that there is no clear government policy.

The public enterprise sector in Serbia encounters huge challenges which can be summarized as follows (*Eric, Stosic, Redzepagic, 2011*):

- According to Stabilisation and Association Agreement (SAA) which was enacted in the Republic of Serbia on 1 January 2009, all SOEs were supposed to be prepared for the application of the European competition rules by the end of 2011. It was expected that corporization of big public enterprises established by the Republic of Serbia would have been faster, but it did not happen. Excuses that these are consequences of the negative effects of the global economic crisis do not seem quite convincing.

- In addition corporatization and creation of professional management, deeper organizational and structural changes are expected.
- Increasing levels of competition, particularly in the areas of infrastructure, natural monopolies and public utilities. Public enterprises in infrastructure sectors that have the character of natural monopoly will not be privatized, such as rail infrastructure, power transmission, international gas and oil pipeline.
- Many problems arise in SOE operations at the local level, due primarily to the technical and technological obsolescence, many of these companies being oversized, tendencies to irrational consumption with simultaneous existence of high debt, the loss and high budget dependency and inability to finance participation in large investments.

OUTSTANDING ISSUES OF CORPORATE GOVERNANCE IN SOES IN SERBIA

SOEs in Serbia exist on three levels - republic, republic public agencies and local. Taking into consideration their importance and role in the overall economic life, their business attracts the attention of the general public, but not sufficiently the attention of the researchers. According to the recent data there are currently 695 SOEs in Serbia, which are referred to as public enterprises, which is methodologically not most correct (*National Bank of Serbia*). By the number SOEs represents 0.7% of economic entities, employing 166.337 workers (16.2% of total employment), has over 1 / 3 of the value of fixed assets, generate 10.1% of total revenue, 9.3% of profit and 9.9% of loss in the economy. Public enterprises in 2010 had EUR 2.2 bill. gross value added (16.7% GVA of the economy). In comparison to 2009 GVA of public enterprises decreased by 1.8% (growth in the economy by 3.3%)

It is generally believed that the entire process of transition in Serbia lasts for a very long time. In the area of SOEs operation certain positive effects have been achieved, especially in the field of economic and financial consolidation, which is achieved through modernization of production and technological processes, rescheduling of debts, subsidies, grants, pricing policies, etc. There was a significant decrease in the share of loss of public enterprises in GDP (from 7.6% in 2001 to 1.0% in 2010) and a slight increase in the share of profit (from 0.1% to 0.8%, respectively). A greater share of profit of loss of GDP was achieved in 2006 and 2009. Also, there was a reduction in the number of employees for more than 57.000 employees (from 148.962 in 2001 to 91.580 in 2010) with severance payments from the budget and based on allocations form side businesses. In comparison to 2001 the number of employees was reduced by about 40%. In

2010, the total profits of this sector amounted to about EUR 170 mill, while there was a loss of 500 million, which gives a negative aggregate score of around EUR 330 mill. (*www.apr.gov.rs*).

The global economic crisis has further slowed the process of restructuring and transformation of SOEs, which is indicated by the EBRD indicators.

Table 1. Transition indicators for Serbia according to EBRD

Period	Large scale privatisation	Small scale privatisation	Enterprise restructuring	Price liberalisation	Trade & Forex system
2006	2.67	3.67	2.33	4.00	3.33
2007	2.67	3.67	2.33	4.00	3.33
2008	2.67	3.67	2.33	4.00	3.67
2009	2.67	3.67	2.33	4.00	4.00
2010	2.67	3.67	2.33	4.00	4.00

- table continuation -

Period	Competition Policy	Banking reform & interest rate liberalisation	Securities markets & non-bank financial institutions	Overall infrastructure reform	Total Average
2006	1.67	2.67	2.00	2.00	***2.70***
2007	2.00	2.67	2.00	2.00	***2.74***
2008	2.00	3.00	2.00	2.33	***2.89***
2009	2.00	3.00	2.00	2.33	***2.89***
2010	2.33	3.00	2.00	2.33	***2.93***

According to the EBRD indicators, Serbia lags behind most countries in the region in terms of privatization of large systems, management and restructuring, capital markets, the implementation of competition policy and infrastructure reform.

Compared with other countries in the region, according to EBRD estimates, Serbia does not take a particularly favourable position in regard to the implementation of transition reforms. Namely, Serbia was ranked in 2010 worse than Croatia (3.55), Slovenia (3.41), Albania (3.07) and Macedonia (3.26), and somewhat better in comparison with BH (2.82) and Montenegro (2.89)

The issue of restructuring SOEs in Serbia is still very topical. The draft Strategy of restructuring public utility companies (PUC) it is claimed that it is "... *prepared with the aim to transform PUC, which are the responsibility of local governments,* *step by step into financially sustainable, market-oriented businesses that provide high quality services to its customers. Efficient provision of utility services is important for the economy and for the benefit of all citizens of Serbia* (*Strategy for restructuring of public utilities, 2009, pp. 3*)." The strategy is aimed at helping state and local governments to implement reforms, which will improve the provision of utility services while reducing costs. PUC perform activities of general interest so it is not possible to transform PUC in the same way as other privatized companies. Complete privatization of PUC will not be possible, even in a mid-term plan. Therefore, the directions of reform are considered in order to make their organizational transformation and develop alternatives for private capital involvement in this sector.

The key recommendations of the Strategy are as follows:

- Reform of ownership and management structure of PUC – in terms of negotiating ownership rights to local self-government
- Defining relationships between municipalities and PUC – which would mean eliminating political influence
- Improving operational performance of PUC – where the state provides technical support, while the financial support depends on total business performance.
- Introducing methodology for determining tariffs and business standards – which means change of prices and tariffs for the services provided by these companies.
- Preparation of the PU sector for the integration into the EU.
- Improving and increasing capital investments – which would mean establishing responsibilities of PUC for defining and implementing long-term investment plans, which are transformed into annual business plans.
- Enabling participation of private capital – attracting private capital through the concept of public-private partnership (PPP).

The main problems SOEs encounter in Serbia are as follows (*Eric, Stosic, Redzepagic, 2011*):

- Extremely high political influence –refers to appointment of the members of boards of directors and supervising boards, who are changed with the change of political power, often regardless of the results achieved. As a negative consequence of such practice, corporate governance is bad and business performance is weak.
- Very low effectiveness and efficiency of management, which reflects on the quality of products and services of these companies.

- Bad financial results and accrued losses – e.g. Serbian Railways suffered loss in 2010 of about EUR 170 mill. Public Enterprise "Putevi" suffered loss of about 40 mill, several companies from the electric power system incurred loss of more than 30 mill, and so on. Only in 2010 losses in this sector amounted to about EUR 500 mill. They are socialized and finally paid by tax payers.
- The losses are incurred and accumulated for years, hampering investments and development opportunities of this type of enterprise
- The financial imbalance - public companies operate in the conditions of illiquidity (below-average and low qualitative liquidity ratios) and debt (9.3% of liabilities of the economy), which is partly due to insufficient capability of SOEs in the area of financial management.
- Big possible sources of corruption – especially in the domain of public procurement.
- Too many employees and inadequate qualification and age structure.
- Limited use of Public-Private Partnership (PPP).

Apart from the aforementioned, it should be pointed out that the achievement of the European standards in infrastructure activities requires significant investments, improving regulations and strengthening the independence of regulatory bodies. Taking into account the European standards in the energy sector (oil industry, electricity), major environmental problems are still present in Serbia whose settlement requires large financial resources. Apart from meeting the ecology standards, there is a problem of quality standards of products and services. SOEs face huge challenges in these fields, especially given the problems with losses and unfavourable financial structure.

If we look at the stipulated problems in the three dimensions of corporate governance that we analyzed in this paper (ownership policies, transparency and board of directors), the following conclusions can be drawn:

- Still there is no clear policy in relation to the issue of ownership in SOEs. On the one hand there are ideas to make privatization of many SOEs at national and local level in particular, while on the other, there is a lack of the real willingness to do that.
- Very little effort has been done to increase transparency and public disclosure of data and maintenance of accounting in accordance with the International
  Accounting Standards. There is no awareness of the need for the state (central or local government) to transparently management its assets.
- The need has been identified to implement changes in the system of the functioning of board of directors. However, in practice very little has been

done on professionalization of SOEs management in Serbia. SOEs remain an area of great political influence.

EXAMPLES OF IMPROVEMENT OF CORPORATE GOVERNANCE

We have to remind that corporate governance is a part of a broader economic context in which firms operate, which includes, for example, legislation, macroeconomic policies and the competition in the market for goods and services and factors of production. The corporate governance framework largely depends on the regulatory and institutional environment. In addition, factors such as business ethics and common awareness on environmental issues and social interests of the communities in which companies operates can also have an impact on its reputation and long-term success.

The examples of the successful corporate governance can be analyzed at two levels. The one is related to the effort of the state to provide the necessary framework and respect of certain principles. On the other hand there is a level of the business entities that behave in a certain way. The extent to which corporations observe basic principles of good corporate governance is an increasingly important factor for many strategic decisions, especially those referring to investments. Of particular importance is the relationship between corporate governance practices and the growing international character of investment. International flows of capital enable companies to have easier access to all international funding sources. Besides, the level of the development of corporate governance is taken as one of the key criteria as well as the level at which companies respect accepted principles. If countries want to fully use global capital markets and attract long term investors who will not soon look for exit strategy, development of corporate governance should be credible, well understood in other countries and should respect internationally recognized principles. Even if corporations do not rely primarily on foreign sources of capital, compliance with good corporate governance practices will help increase the confidence of domestic investors, reduce the cost of capital, support good functioning of financial market and ultimately lead to more stable sources of funding.

The example of Slovenia as to when to start privatization of some SOEs is one of the first examples of good practice at national level. Relatively soon after the disintegration of the former Yugoslavia, the process of corporatization was carried out in Slovenia, the principles of corporate governance were introduced, restructuring processes initiated and only after a certain period of time these companies were sold. It very often coincided with the growth of share prices on the market. In this way, efficiency and effectiveness of management was raised as well as the level of competitiveness of many enterprises. In addition, higher income was made in the state budget and economic criteria were faster met for the integration into the EU.

Unfortunately, in Serbia there was not enough wisdom and patience. During the 1990s, privatization was very slow. The model of free distribution of shares to employees was used, which did not prove too effective. Following political changes in 2000, the method of sale was introduced, which proved to be somewhat effective, but there was no clear sales strategy. Sometimes it seemed that everything that could be sold was actually sold, without too much thinking or analysis of whether something can wait.

As another example of good practice we emphasize the fact that in Slovenia the Agency was formed to manage capital investment which has a very broad intervention in decision making about state ownership. In that way, Slovenia joined the group of countries that started to question the attitude of the state towards the state assets.

Contrary to this approach, in Serbia there is still a lot of wandering in terms of the relationship between the state and the state-owned assets. However, one of the most recent examples proves that there are some changes. Amendments to the Law on Public Property have created preconditions for the transfer of ownership of local SOEs to local governments. At the same time, municipalities will be eligible to transfer a part of the property or the whole property to the PUC, which serves to perform public utility services. Establishing clear property relations between the founders and local SOEs should enable easier implementation of the process of regionalization of services and simplify private sector participation in providing public utility services. In this way the participation of the private sector that was reduced to a "pilot approach" should become greater.

In an effort to analyze good practice we will try to point out the efforts that are made in the Republic of Serbia in order to resolve some of the SOE problems and raise their efficiency and effectiveness. In terms of evaluation of the effects of restructuring activities undertaken in SOEs, we can conclude that the higher efficiency of the implementation of the restructuring process has been achieved in the following areas:

- In many of the SOEs on the national level, the progress has been made by applying certain measures of organizational, financial and production restructuring (such as the separation of non-core activities, the settlement of old debts, the modernization of production and technological processes), which have improved the economic and financial performance.

- So far, the change of legal form was made (from public enterprise into Public Limited Company) in JAT Airways (2008) Nikola Tesla Airport (2010) and the Serbian Railways.
- The number of employees has been reduced through the application of passive and recently active measures in employment policy, which provided for more favourable qualification structure of employees.
- In some SOEs the process of corporization has started and their development performances have been improved
- Liberalization of infrastructural activities has been completed by introducing competition in the manufacturing and distribution of electricity, telephony, transport of passengers and goods by rail, postal services, air transport and imports of oil.
- Financial consolidation of some SOEs was carried out.

Along with the restructuring of large state systems, additional steps were undertaken that mark the beginning of the restructuring and privatization of local SOEs in certain municipalities in Serbia. Unfortunately moves in this area in most municipalities in Serbia are still insufficient, and involve outdated business organization (often of conglomerate type), insufficient inter-municipal cooperation, the lack of investment planning, the need to settle losses out of local budget, the lack of modern information systems , and the lack of serious monitoring, etc.

As another example of good practice example we can cite the SOEs that are owned by the City of Belgrade. These are two companies that are 100% owned by the city. These companies are “Javno osvetljenje” (Public Lightening) and “Elektroizgradnja”. The management of both companies decided in early 2011 to initiate the creation of the Development strategy. Detailed due diligence was conducted which indicated that both companies do not have major problems in business and that they are managed economically. Although they have limited prices at which they charge their services, as defined by the decision of the founder - the City of Belgrade - both companies are profitable, without any long-term liabilities. The example of these two companies confirmed that a quality management when professional and depoliticized is able to successfully organize business operations of these companies, regardless of the legal framework and the nature of ownership.

However, the appointment of the boards in Serbia (selection of representatives of the state, directors at SOEs, etc.) remains an outstanding issue, and the examples of good practice in this area are not so numerous. One idea that could possibly be seriously considered would be the inclusion of employees in the board of directors or supervisory board. There are many such examples in the EU, especially in Germany and France. For example, the experience of France - SOEs still have large boards compared with other OECD countries, but since 2005 the normal size has come down from 30 to 18. The composition of the boards remains the same - one third of the employee representatives, one third of the state representatives and one third of independent directors.

In order to discuss this idea we need to consider that on that occasion in Slovenia the problem of "employeeism" was identified and referred to as *"the tendency for woker-owners to use their decision-making power to influence decisions in the direction of excessive wages and employment"* (*Simonetti, Rojec & Gregoric, 2004, pp. 227.*), which was an obstacle to even more active restructuring of companies. Studies of individual authors in Slovenia have shown that employee participation in management has weakened managerial power in the implementation of strategic plans and accepting the necessary steps to increase competitiveness at the international level (*Prašnikar & Gregoric, 2002*). Given the high degree of similarity between the economies of Slovenia and Serbia fifteen years ago we are not sure that this idea would be cost-effective.

One of the ideas for good practice can be related to selection and selection of managers who would manage SOEs. In Slovenia, professional managers are often selected, who are not entirely immune from politics. An example of Serbia, unfortunately shows that the professionalization of management is still more the exception than the rule. There are plenty of examples in the world, which indicate that the best managers can be selected and developed. For example in India there are separate Civil Services, like the Central Administrative Pool and the Industrial Management Pool of India as successor to the Commerce Finance Pool, where the selection is made and the most capable human resources are chosen to perform managerial functions (*Basu, 2008*). Selected candidates are worked with through internal training, but they are also sent to the best business schools in the world. They are expected to achieve certain specific strategic and financial objectives. If they are successful, they can expect rewards and bonuses. The result is that the SOEs sector in India, due to such approach to selection of managers, is more profitable that the private enterprises sector.

CONCLUSIONS

The analyses indicate that the global crisis in many countries in the world has changed the practice when it comes to companies in which the state owns the assets (SOEs). While in the 1980s and 1990s the tendency prevailed to reduce state ownership of business entities (mainly through the privatization process), the early 21st century shows to a certain extent opposite trend, which is particularly evident after the outbreak and strengthening of the negative impact of the global economic crisis . At the same time changes have been introduced in corporate governance of SOEs in order to increase efficiency and effectiveness in business, but also to achieve other, not only economic, but social goals as well.

Experience shows that there is no single successful corporate governance practice that can be applied to all situations and legal systems. The pattern of successful corporate governance of SOEs varies from country to country. However, examples of good practice can serve as good guidelines for improving corporate governance. Starting from that, in our research comparative method of analysis was used where we focused primarily on understanding the specific challenges and problems of SOEs business in Slovenia and Serbia.

There are huge and significant differences between the two countries in terms of macroeconomic parameters, the degree of economic development, structural characteristics of the economy and many other features. On the one hand, Slovenia is a member of the EU and EMU, and Serbia has yet to acquire the status of a candidate with a very uncertain date of commencement of accession negotiations. However, on the other hand, there are certain characteristics that connect the two countries and where the experience of Slovenia can be very instructive to improve corporate governance of SOEs in Serbia.

It should be noted that in Serbia upgrading corporate governance is one of the key steps necessary for raising the levels of competitiveness of enterprises in which the state owns a certain amount of assets. These companies need to be able to provide better services, be efficient and be able to compete at international market. In that way they can help the country to meet the economic criteria for the integration into the EU. At the same time, raising standards of corporate governance can lead to more rapid structural changes of the Serbian economy and resolution of many accumulated problems.

Analyzing individual areas, we found out that a lot has been done in some segments of corporate governance in Serbia. However, a number of outstanding issues and challenges show that SOE sector is still lagging behind, especially in terms of ownership policy, transparency and functioning and responsibilities of the boards of directors.

Namely, in Serbia still there is no clear policy regarding the issue of ownership in SOEs. On the one hand, there are ideas to do privatization of many SOEs at national and local level in particular, and on the other hand there is a lack of the real willingness to do so. At the same time, insufficient results are achieved on increasing transparency and public disclosure of data, while management of SOEs is still heavily influenced by political factors. The example of Slovenia shows that establishment of a special agency enables clear definition of the ownership policy in terms of the state ownership in economy. The issue of transparency still should be discussed and worked on, and professionalization of management is strongly required.

The example of the Republic of Slovenia, as well as the cases of good practice in the Republic of Serbia, emphasize the importance of competent management. This confirms one of the starting hypothesis stated in this paper that the competent management is capable, regardless of the legal framework and the nature of ownership, to organize a successful business in SOEs. At the same time, the improvement of SOE operations largely depends on the way in which operational and strategic (investment) decisions are made, as a direct result of people selected for managerial positions. Yet at the same time, it should be taken into consideration that operational and strategic decision-making in SOEs does not depend exclusively on internal factors but is also influenced by external factors, primarily economic environment, and that the effectiveness of these decisions is largely determined by existing economic conditions. Therefore, the improvement of the current conditions for doing business in Serbia is one of the key assumptions of efficiency and effectiveness of corporate governance.

Having in mind that SOEs in Serbia represent, and they will represent for some time in future, a significant group of companies which have a large role in the overall economy, the improvement of the corporate governance in them can be estimated as being critical for raising the general level of competitiveness and fulfilment of economic criteria for the integration of certain countries into the European Union.

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