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CHALLENGES OF SERBIAN PUBLIC ENTERPRISES IN THE LIGHT OF POINTS C AND F OF OECD

Guidelines on Corporate Governance of State-Owned Enterprises: The Case of Public Companies

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This paper discusses the actual situation regarding the implementation of OECD Guidelines on Corporate Governance of State-Owned Enterprises (points C and F) in Serbia, through the case of public enterprises. Former and current legal solutions are compared and presented along with comments of competent bodies related to practice in order to identify positive steps towards the implementation of OECD standards. The focus is on how the state respects SOE boards exercising their responsibilities and independence, as well as whether it acts as an informed and active owner, exercising its ownership rights according to the legal structure of each enterprise.

KEYWORDS:

Public Companies, SOE, independence, active owner

State-owned enterprises (hereinafter: SOE) in Serbia are regulated by a wide range of laws and therefore a range of different solutions is applicable to different kinds of SOEs.¹ In that sense, there are public companies, as specific enterprises owned by the state on national, regional and local levels, which conduct activities of public interest. Public companies in Serbia are regulated by the Law on Public Companies (hereinafter: The New Law).² There are agencies formed directly by the law, as well as agencies formed as not-for-profit limited liability companies. There are also public funds or other institutions in which state assets are managed. Furthermore, there are remnants of former socialist state-owned enterprises, which are in the process of privatization, where the state manages their equity in full or in part. It is estimated that there are around 1400 SOEs in Serbia, which are wholly owned by the state; while the number of those where the state holds a minority interest is substantially higher.³ They employ some 250,000 people, a quarter of the total employment by companies in Serbia. Over two thirds of these employees are employed by the public companies, i.e. some 160,000 people working in 730 companies.⁴

Table 1. *State-owned enterprises in Serbia (estimated numbers)*

		Number of enterprises	Number of employees
State-owned enterprises	Total	≈1.400	≈250.000
	1. State public enterprises	≈40	≈80.000
	2. Commercial state-owned enterprises	≈10	≈20.000
	3. Enterprises under the jurisdiction of the Privatization Agency	≈670	≈90.000
	4. Local public enterprises	≈650	≈60.000

Source: *Fiscal Council of Republic of Serbia, Assessment of state-owned enterprises in Serbia*

It is estimated that a quarter of the budget of local self-governments goes to the local public companies that employ nearly half of all employees at the local level (77,000). The total number of local public companies is over 720, and among them 650 have a formal status of public company, while the remaining ones are budget users. The most important group of local public companies is a group of 350 utility companies, which employ more than 56,000 people.

1 There are companies under the control of the Privatization Agency: large public and state owned enterprises (subgroups monopolistic public companies and large state-owned enterprises operating in competitive industries) and local public companies, as well as agencies of various forms, funds and other entities.

2 Source: article 3 of the Law on Public Companies, source: Official Gazette of Republic of Serbia, No.15/2016 (hereinafter: the New Law); The New Law has substituted the earlier Law on Public Companies, source: Official Gazette of Republic of Serbia, No.119/2012, 116/2013 and 44/2014, in which the provision of the article 1 had the same definition of public companies.

3 Fiscal Council of Republic of Serbia (2014): *Assessment of State-Owned Enterprises in Serbia: Fiscal Aspects*. Belgrade, s.n., 7. Source: www.fiskalnisa.gov.rs/doc/eng/analysis_of_state-owned_enterprises-fiscal_aspect.pdf (15 July 2016)

4 *Ibid.*, 7.

These companies contribute to the economy modestly (2.4 percent of GDP is their added value), are illiquid, each year there are more loss-makers among them, and are generating and increasing losses despite significant direct and indirect subsidies. In addition, the utilities often receive indirect subsidies through “inflated” invoices for services delivered to the municipalities.⁵

Public companies, according to the law, can be established by the central state, municipalities and autonomous provinces. All but a handful of national public companies – including some of the largest ones, such as EPS, EMS, Post, Serbia Gas, Forestry Management, and Roads – and all 300 plus municipal utilities, fall under the law on public companies. A second group of companies have been corporatized into mostly joint-stock companies (JSCs) or in fewer cases to limited liability companies (LLCs), including Telekom, GALENIKA, JAT Aircraft Maintenance, Belgrade Airport, and Railroads. These companies operate under the Company Law that came into effect in February 2012.⁶ In addition to these two laws, the Founding Acts and the companies’ articles of association (except for limited liability companies) govern the rights, duties, and liabilities of the “founder” (in case of public companies) or the “shareholder” (in case of joint stock companies or limited liability companies) towards the enterprises and vice versa. The activities of both groups of companies are also regulated by sector-specific laws, although these laws focus more on sector policy-making and regulation rather than governance.⁷

In order to be able to concentrate on the topic of this article, OECD Guidelines of Corporate Governance of SOE in the light of points C and F, the study will focus on public companies as the most widespread and the most important form of Serbian SOEs. The paper will analyse how the Serbian state lets the boards of public companies exercise their responsibilities and to what extent it respects their independence. The prime responsibilities of the state as informed and active owner while exercising its ownership will also be analysed.

C. The state should let SOE boards exercise their responsibilities and should respect their independence

Up to this year, Serbian public companies were regulated by the Law on Public Companies,⁸ (hereinafter: The Former Law) which defined two types of Serbian public companies regarding their strategic and operational management: 1. unicameral management, where company bodies are supervisory board and director, and 2. bicameral management, where company

5 Fiscal Council of Republic of Serbia (2014), 51.

6 Serbian Law on Commercial Companies, Official Gazette of Republic of Serbia, No Official Gazette of the Republic of Serbia, No. 36/2011, 99/2011, 83/2014 and 5/2015.

7 The World Bank (2015): *Report No. 67435-YF on International Bank for Reconstruction and Development Program Document for a Proposed Development Policy Loan to The Republic of Serbia for a First Programmatic State Owned Enterprises Reform Development Policy Loan*. Source: <http://documents.worldbank.org/curated/en/967231468294609464/pdf/674350PGD0P127010Box385415B00OUO090.pdf> (15 July 2016)

8 Source: Official Gazette of Republic of Serbia, No.119/2012, 116/2013 and 44/2014

bodies are supervisory board, executive board and director (CEO).⁹ In both cases, however, the key body to transmit state power into operative management was the supervisory board. Its dependence on or independence of the state could be analysed following the provisions that define its formation. The executive board members were the nominated by the director (CEO), so they represented a part of his/her management team. The New Law does not differentiate between the unicameral and bicameral management, but simply defines that public company bodies are supervisory board and director (CEO).¹⁰ The New Law after defining the director and his entitlements, as the person performing a public function,¹¹ also defines the executive director as the employee of the public company, exercising the entitlements defined by the director, founding act and by-laws of the public company.¹²

The Former Law defined that the Government of Serbia nominated the supervisory boards in public companies founded by the Republic of Serbia. It defined that one of its supervisory board members needed to be independent.¹³ Independence was defined in the provision of article 14 of the Former Law, where it was said that such a member:

1. needs to be an expert in one or more activities of public interest for which the company has been founded;
2. that he/she has not been employed in any public, dependent or related company, two years prior to assuming the post of supervisory board member, i.e. that he/she has been in no way engaged by the public company, nor has been engaged in auditing financial reports of that company; or
3. is not a member of a political party.¹⁴

It can hardly be expected that one independent member of the body can ensure the whole body to act independently, however, it is an important step towards the culture of listening different opinions during the decision making process. On the other hand, it is not sure that the above mentioned characteristics of the independent member of the board are sufficient for his/her independence in acting. Furthermore, the whole body should act independently of party politics, rather they should act according to the adopted policy, strategies and measures of the government, or local self-government. However, it seems that the focus is on formal and not on essential issues, which should be to ensure the professional conduct of public enterprise officers, rather than the fulfilment of particular political interests of political parties (such as staffing or financial interests).

The New Law in relation to public companies formed by the Republic of Serbia defines that one of its members needs to be independent, while one of them needs to be an employee

9 Source: article 11 of the Former Law.

10 Source: article 15 of the New Law 2.

11 Source: article 24 and 25 of the New Law 2.

12 Source: article 27–29 of the New Law.

13 Source: article 13, paragraph 1 of the Former Law.

14 Source: article 14 of the Former Law. This complex provision insists on formal independence, persisting on criteria for particular person, who is to be nominated to be a member of the Board and not on his/her acting, i.e. decision making during his/her activity as the board member.

of the public enterprise.¹⁵ This way, the New Law requires that two of five members of the supervisory board need to fulfil additional requirements, one of them to be independent and the other to be an employee of the public enterprise. The independence of a supervisory board member is deemed to be ensured:

- a) if the member of the supervisory board has not audited financial reports of the company within the last five years,
- b) if he/she is not a member of any political party, as well as
- c) if he/she is not a state official, an employee or person on other basis engaged, by the public company or by the company, whose founder is that public company.¹⁶

As it can be seen, the independence should be guaranteed by various characteristics of the person, among which the important ones are the political engagement of the person and his/her engagement with the audit of financial reports of the public company. The third condition prevents a conflict of interest rather than ensures independence.

Which of these conditions ensures sufficiently the independence of the supervisory board member? It seems none. Being the member of a political party does not necessarily mean that such a person, with high moral integrity, will not act as an independent person when voting on a professional matter. On the other hand, a person fulfilling the above criteria might vote for all proposals on the supervisory board according to the ruling party's staffing or financial interests. It would be better to construct a legal standard that ensured independence by voting, than to select two or three characteristics of the person, which might represent, but not necessarily mean, the independence of the person. Also, one of the criteria excludes links with the public company that might represent a conflict of interest, which in itself prevents the nomination of such a person into the supervisory board.

In addition to an independent board member, the New Law requires that one supervisory board member needs to be an employee of the public company. Beside the general conditions that are valid for any person in order to be nominated for the member of the supervisory board, an employee of the public company needs to fulfil two additional conditions. It is curious that according to one of the three conditions that guarantee the independence of a person, the employee of the public company, in order to be nominated into the supervisory board, needs to fill two conditions, which are literally the same as the other two:

1. he/she has not audited financial reports of the enterprise for last five years, and
2. he/she is not a member of political party.¹⁷

As for this “semi-independence” of the employee of the public enterprise to be nominated into the supervisory board of the public enterprise founded by the Republic of Serbia, it is very interesting to see how this solution will work out in the practice.

The Former Law regulated the nomination of the supervisory board members of public companies founded by an autonomous province or a local self-government. The autonomous province or local self-government (i.e. the body defined in its by-laws) nominated

¹⁵ Source: article 17, paragraph 1 of the New Law 2.

¹⁶ Source: article 19 of the New Law 2.

¹⁷ Source: article 20, referring to Article 19, points 1 and 2 of the New Law.

supervisory boards, one member of which needed to be an employee of the public company.¹⁸ These members of the Board had to be nominated according to the provisions of the by-laws of the public company.¹⁹ At this governance level, it was not specified that an independent person should fill the post in the supervisory board, only that he/she should be an employee of the public enterprise.²⁰ Therefore, the regulations for supervisory boards of public companies formed by a lower governance level were different than the ones for public companies formed by the Government of Serbia. In addition, in article 14 of the Former Law it was suggested that the person employed in public company or dependent company cannot be treated as independent.²¹

The New Law does not require one supervisory board member of public companies founded by an autonomous province, or local self-government to be independent. However, it brings closer together persons deemed to be independent and employees of the company intermingling their characteristics. By the nomination for the supervisory board members, two conditions for nomination of an employee of the public company into the supervisory board are identical with the conditions that are set up for the independent person.²² On the other hand, in article 20. par. 2 a new condition is added, which defines that an employee of the public company cannot be put forward for the position of supervisory board member by the supervisory board itself, by the director (CEO) or the executive director of the public company.²³ Why not? The answer could be to act independently.

The legislator should choose a uniform regulation for the nomination of the bodies of both the national and local public companies. Why should by national public companies one supervisory board member be independent, while by the local ones this is not required?

As far as the director (chief executive officer) of the public companies is concerned, according to the Former law, he/she had to be nominated by the Government of Serbia, in case the public company was founded by the central state. When founders of the public company were an autonomous province or a local self-government, the director had to be nominated by the body defined in the by-laws of the autonomous province, i.e. local self-government. In addition, the director should be nominated after a public competition procedure was conducted. The New Law did not introduce substantial changes to the regulations of the Former Law, except for the more complex nomination procedures.²⁴ Furthermore, among the conditions for selection, the candidate needs to prove that he/she

18 Source: article 13 paragraph 2 of the Former Law 8.

19 Source: article 15 of the Former Law 8.

20 It was more of a remnant of the earlier Yugoslav self-governance political system, than a step towards the independent exercise of modern boards in the public sector.

21 Article 14, paragraph 2 of the Former Law. So, in the same law, depending on the level of governance (central or local), different solutions are offered in order to resolve the same problems.

22 Source: article 20 and article 19, points 1 and 2 of the New Law. See also the above comment.

23 Source: article 20, paragraph 2 of the New Law. On the other hand, the Former Law defined only that the member of the supervisory board will be nominated according to the by-laws of the public company (article 16 of the Former Law).

24 Source: article 21, paragraphs 1 and 2 of the Former Law, and article 24, paragraphs 1–3 of the New Law. As for nomination procedures according to the New Law, see below.

is does not hold any office in a political party.²⁵ This means that the director should be a professional. It is questionable, however, that somebody who holds an office in the ruling political party after suspending his political activity to become the manager of a public company fulfills the necessary conditions of being an independent professional.

Regarding the practice in Serbian public companies, the Fiscal Council of the Republic of Serbia states that it widely held view that the internal inefficiency of SOEs is the sole or main cause of their poor performance. However, the improper management of public companies goes hand in hand with inadequate government policies through which fiscal and social considerations affect the public companies. These include: mandating low prices, enforcing delivery of goods to non-paying customers, support to non-productive employment, avoidance of closure of non-productive facilities (railway lines, some mines, etc.).²⁶ There is no reason not to accept the reasoning in the report of the Fiscal Council, that the public companies in Serbia are protecting the standard of living of the inhabitants, a tradition deeply rooted in the past. Therefore, a strong political pressure on their management to ensure low energy and services for the citizens. Non-productive employment in SOEs was, and still is, the artificial remedy to decrease the real unemployment rate, as well as to ensure work places for ruling party members. On the other hand, during political debates, in particular in pre-election campaigns, there is a strong demand for public companies to get a professional management.

Although the mentioned provisions regulating public companies in Serbia to certain extent are entering the path to allow independence of these bodies from the political parties' influence, there are still a number of obstacles in practice. Indicative is the following:

- In legislation there are obvious signs that intend to show that the supervisory board members are independent and exercise their responsibility by fulfilling their function,
- However, even legislative solutions are in contradiction and do not guarantee the independence of neither supervisory board members, nor the director (CEO) of the public company, because one independent member of the supervisory board or employee of the public company in the supervisory board is not able to guarantee the independence of the supervisory board as a whole. Not to mention that by the large majority of public companies, founded by local self-governments, it is not required that an independent member of supervisory boards should be nominated. The changes introduced in the New Law did not make much difference,
- Further, the mentioned practice that was identified by the Fiscal Council of the Republic of Serbia and their reasoning we have introduced in this article are not encouraging.

F. The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise

It cannot be disputed that the state is interested in the activities of public companies in Serbia. However, how far it acts as an informed and active owner exercising its ownership

²⁵ Source: article 22, paragraph 1, point 5 of the Former Law and Article 25, paragraph 1, point 7 of the New Law.

²⁶ Fiscal Council of Republic of Serbia (2014), 15.

rights according to the legal structure of public company is questionable. In particular, unlike for public company there is no general assembly (shareholders' meeting), which is the usual ownership body in both companies and state entities.²⁷ The body whose members are directly nominated by the state is the supervisory board of the public company, into which the representatives of its founder are nominated (Republic of Serbia, autonomous province or local self-government), who hold the majority voting rights in this body. Thereby, the supervisory board brings both strategic and important operative decisions. The director (CEO) is nominated by the state, i.e. the government of Serbia, or, in case of the autonomous provinces and local self-governments, by the body, which is defined by its by-laws. It is obvious that various founding state entities that define the strategic and operative assignments of all public companies on their territory, have a substantial problem to understand and process information of various sorts and from different professional areas as efficiently as it could be done by the body acting within the public company. The supervisory board members, on the other hand, can have a little help from those who control all of them. Such outside bodies usually represent a "bottleneck" due to the overburdened agenda they have and the variety of problems they discuss. In such a situation, it is logical that these bodies pay attention only to those decisions that are the "hottest" and most acute issues on their list of priorities, and do not have time for a long-term and strategic thinking, what they actually should do.

Therefore, the statements of the Serbian Fiscal Council are critical and worrying. Evaluating current practice, the Serbian Fiscal Council states that in an environment where laws are not strictly enforced, it is pointless to discuss the quality of the legislation. The Former Law was not sufficiently implemented, and even when it was, the effectiveness of its provisions was questionable. The Law stipulated that executives should have been appointed through a public call, but during the year and a half the law was in force the deadlines for the public call and for the selection procedure were generally not met. In some cases, a public call was not announced at all (Srbijagas, Pošte Srbije [Serbia Postal Service], etc.). Concerning the weaknesses of the Law on Public Companies, the Fiscal Council evaluated the draft of the new law and pointed out the possibility of a pronounced Government influence on the selection of executives (the Government appoints three of five members of the Appointment Committee and makes the final decision on selecting the candidate to be appointed as head of a public company).²⁸

1. BEING REPRESENTED AT THE GENERAL SHAREHOLDERS' MEETINGS AND EFFECTIVELY EXERCISING VOTING RIGHTS

Having in mind the process supervisory boards are formed and the nomination of the directors (CEOs) of Serbian public companies, there is no dispute that the state is

27 Serbian Law on Commercial Companies, *op. cit. in footnote 6*, foresees such a body both for shareholding companies, as well as for limited liability companies.

28 Fiscal Council of Republic of Serbia (2014), 17.

represented in them.²⁹ However, unlike the law on commercial companies, the law on public companies does not stipulate a general shareholders' meeting for public companies as its body, instead the adequate state level (Government of Serbia, or the provincial or self-government bodies nominated by them) directly controls the supervisory board and the director (CEO) of the public company.³⁰ This solution eliminates the existence of an "owner's body" within the public company, as the top body of the public company. So, the voting rights on strategic decisions related to the public company are not distributed in accordance with the percentage in which the state controls that body, but according to the number of supervisory board members that it controls. In addition, the nomination of the director (CEO) by the state (Government of Serbia, i.e. the body nominated by the autonomous province or self-government by-laws) helps to directly exercise the voting rights of the state. Even if we look back to the legal system before 2012, there were boards of directors and supervisory boards, as two bodies through which the state exercised its voting rights in public companies.³¹

Whether it is effective, it can be discussed with arguments pro and contra. Most of the problems come from the fact that the lack of shareholders' meeting diverts the state from concentrating on strategic decision-making towards participation in operative decisions, in particular in those that are concerned with financial or human resources management issues. The current practice supports the contra attitude. Another argument in favour of the general assembly (shareholders' meeting) as a body where the owner should be represented in the public company is the fact that the same principle that applies to corporate governance (as it functions by commercial companies according to the Law on Commercial Companies) should be valid for public companies, too. That way the system of "founder's consent", which is needed for certain public company decisions, could be replaced.³² That way, the forming of a decision, which is crucial for the particular public company, is shifted to a state body (government or the defined commission), where the process is longer, with various conflicting interests and often with the participation of actors who are not too much interested in the strategic and operative problems of the particular public company.

29 Source the text under C. above.

30 Source: articles 13–15 of the Former Law, as well as article 15 of the New Law.

31 Transparentnost Srbija (2014): *Efekti novog Zakona o javnim preduzećima – politizacija ili profesionalizacija (The Effects of the New Law on Public Companies – Politisation or Professionalisation)*. Belgrade, s.n., 7. Source: www.transparentnost.org.rs/stari/images/stories/inicijativeianalyze/Efekti%20novog%20Zakona%20o%20javnim%20preduzecimapolitizacija%20ili%20profesionalizacija,%20oktobar%202014.pdf (15 July 2016)

32 National Alliance for Local Economic Development (2012): *Komentari na nacrt Zakona o javnim preduzećima (Commentaries to the Draft Law on Public Companies)*. Belgrade, s.n., 3. Source: www.naled-serbia.org/upload/CKEditor/untitled%20folder/Komentar%20na%20nacrt%20zakona%20o%20javnim%20preduzecima.pdf (15 July 2016)

2. ESTABLISHING WELL-STRUCTURED, MERIT-BASED AND TRANSPARENT BOARD NOMINATION PROCESSES IN FULLY- OR MAJORITY-OWNED SOES, ACTIVELY PARTICIPATING IN THE NOMINATION OF ALL SOES' BOARDS AND CONTRIBUTING TO BOARD DIVERSITY

The problem mentioned above, that public companies in Serbia do not have a general assembly (shareholders' meeting) hinders the establishment of a well-structured, merit based and transparent board nomination process. Currently this process occurs in the founder's organization, and happens usually after the elections, by nominating a number of representatives to the various public companies' supervisory boards. The priority of those who nominate them is often the distribution of the party's personnel to posts in public companies, which the particular party through cross-party political agreement has "gained" to fill. Such practice was often registered.³³ The particular cases varied from the nomination of exclusively ruling party members into supervisory boards and the nomination of a ruling party member as an independent supervisory board member to the nomination of the new board member according to the law that was not in force any more, as that law was substituted with a new law on public companies.³⁴ Similar is the situation with the nomination of representatives of employees into the supervisory board. There were cases where the director nominated the representative of the employees instead of the employees, or the collegium of directors nominated the employees' representative into the supervisory board, or even an outrageous one when the deputy director of the public company was the representative of the employees.³⁵

As far as supervisory boards are concerned, there seemed to be a need for a new regulation: the members of the supervisory board to be appointed through an open call. This could foster professionalization and "de-partytization" of public companies.³⁶ However, this did not happen, and legally it could be characterized, that the introduction of the principle to professionalize managers in public companies could not be deemed as obligatory for the supervisory board members.

The earlier practice of the nomination of commission members that conducted the open call for the selection of the director of the public company (which was in high degree volatile, without prior criteria to be set up) raised doubts that the open call for nomination of the director would lead to the professionalization of the management of public companies.³⁷ Beside this, it is interesting to note that the Anticorruption Agency of Serbia indicated in its earlier report that there was a risk of corruption in the nomination of directors of public companies.³⁸ It stated in particular that in the nomination process several institutions

33 *Trasparentnost Srbija* (2014), 18–20.

34 *Ibid.*, 18–20.

35 *Ibid.*, 20.

36 Fiscal Council of Republic of Serbia (2014), 17.

37 *Trasparentnost Srbija* (2014), 31.

38 *Ibid.*, 32, 33.

participated, and their unclear competence and interwoven interests gave room for abuse.³⁹ The recommendation was to define the process of nomination of the director in more details in the law itself.

The New Law accepted this approach.⁴⁰ It determines three commissions for the nomination of the director of public companies:

- the Government’s commission,
- the Commission of the Autonomous Province, and
- the Commission of the Local Self-Government Unit (article 31).

In addition, it defines the number of their members and the period for which they are nominated (articles 32 to 34); persons who cannot be members of these commissions (article 35); the procedures (articles 36 to 41) and how the director enters his/her post (articles 43 and 44). As the New Law entered into force this year, before evaluation we should wait to see how these provisions play out in practice.

However, based on the earlier practice, some experts pointed out that there is no point in defining the required qualifications for executives and members of the supervisory board and demanding great responsibility and effort without any, or with modest remuneration. In any case, regardless of any changes in the legal framework, strict budget constraints, transparency and financial discipline of SOEs should be insisted on.⁴¹

3. SETTING AND MONITORING THE IMPLEMENTATION OF BROAD MANDATES AND OBJECTIVES FOR SOES, INCLUDING FINANCIAL TARGETS, CAPITAL STRUCTURE OBJECTIVES AND RISK TOLERANCE LEVELS

SOEs have an important role in the economy, but due to poor management, they have operated unsuccessfully imposing high fiscal burden on the state. In the past few decades, public companies were misused for hidden and very expensive social policies: manifested mostly through regulated or imposed low prices and tolerance of non-payments. There was also a tolerance for poor management, overstaffing, employee privileges, inefficiency, negligence and corrupt practices, and in some cases, they were used to absorb other loss-making enterprises with no real prospects.⁴² Operational performance indicators are in most cases extremely low.⁴³

Government decisions have even supported certain bad management decisions (Srbijagas, a large loss-maker, took over other loss-makers and rescued them from bankruptcy). Social peace was bought with artificial prices (at the cost of rising debt), and overstaffing

³⁹ Ibid., 33.

⁴⁰ See provisions of articles 30–45 of the New Law.

⁴¹ Fiscal Council of Republic of Serbia (2014), 17.

⁴² Fiscal Council of Republic of Serbia (2014), 9–10.

⁴³ Ibid., 11.

was tolerated. Some of the examples of the Government inconsistency in the enforcement of its own decisions and laws: fiscal non-compliance, such as issuance of guarantees in case of exceeding the limits estimated by the Fiscal Strategy and the arrangements with the IMF; diverging from the wage policy in the public sector (with numerous exceptions and acceptance of the trade unions' demands); non-compliance with the Law on Public Companies in relation to the adoption of a business plan and the appointment of managers through a public call; ignoring the recommendations of the State Audit Institution. Failure to comply with the law in management of public companies is a signal that the state had no sincere intention to improve their performance. Once again, this is a signal that it pays out not to play by the book.⁴⁴

The analysis shows that some of the characteristics of state companies are: inadequate control, poor results, mismanagement, and lack of transparency in business operations and of management responsibility. The consequence is larger fiscal costs and continuous pressure on public finances. Given the seriousness of the problems and the need to make a quick shift in this area, it would be rational to establish a body within the Government or the Ministry of Economy. This body would be charged with monitoring and coordinating plans for public companies, initiating reports and analysis, determining the procedures for developing objectives and operational indicators, initiating and ensuring cross-sector business analysis (including financial), and engaging in other activities that would contribute to transparent, accountable and successful operation of companies. This body would deal with what is common in the operation of public companies, while the relevant ministries would remain competent in specific sector policies. In the first phase, the centralized management should certainly focus on a significant increase in transparency (financial ratios and performance of companies) and identification of any violation of the law.⁴⁵

The process of appointing the management of public companies and other state owned enterprises is much politicized. In theory board members and directors are appointed by the government, but in practice, their nomination is the outcome of cross-party negotiations and agreements.⁴⁶

4. SETTING UP REPORTING SYSTEMS THAT ALLOW THE OWNERSHIP ENTITY TO REGULARLY MONITOR, AUDIT AND ASSESS SOE PERFORMANCE, AND OVERSEE AND MONITOR THEIR COMPLIANCE WITH APPLICABLE CORPORATE GOVERNANCE STANDARDS

Public companies' reports on business plans is limited to annual plans, and the reporting usually lacks clear objectives and operational performance indicators. Business plans are adopted with delay (sometimes even at the end of the year for the previous year). Little attention is

44 Ibid., 14.

45 Fiscal Council of Republic of Serbia (2014), 17–18.

46 Arsić, Milojko (2012): Reform of State Owned and Public Enterprises. *Quarterly Monitor*, No. 28., 76. Source: <http://fren.org.rs/sites/default/files/qm/L2.pdf> (15 July 2016)

paid to the evaluation of the achieved results. In addition, some companies ignore the legal obligation to publicly disclose their business plans and financial statements, or they do so with unacceptable delay (sometimes even of several years). The relevant ministry (currently the Ministry of Finance) supervises the business plans and financial statements; however, this supervision is mainly focused on financial indicators, rather than on planning and ongoing management. The opinion of the Fiscal Council is that the public must be informed in detail, accurately and timely about the operations of SOEs in order to identify problems and provide timely and adequate responses from both the public and the Government.⁴⁷ This includes the public companies as well.

Although the Ministry of Finance supervises the business plans and financial statements of public companies, this surveillance is largely focused on the compliance with financial guidelines, and not on the quality of strategic planning and management.⁴⁸ The criteria according to which independent supervisory board members shall not have audited the financial reports of the public company in the last five years needs to be reconsidered. This criteria should be replaced with ones that ensure the real independence of supervisory board members (providing conditions for them to act independently and professionally, rather than insisting on characteristics which do not guarantee their independence).

The introduction of general assemblies (shareholders' meetings) as owner's bodies within the public enterprise would better ensure their regular monitoring. This way the evaluation of public companies, their directors and supervisory boards would be much more productive. For sure more productive than sending numerous reports to one coordination body formed by the Government of Serbia or competent body within the particular local self-government or autonomous province.

5. DEVELOPING A DISCLOSURE POLICY FOR SOES THAT IDENTIFIES WHAT INFORMATION SHOULD BE PUBLICLY DISCLOSED, THE APPROPRIATE CHANNELS FOR DISCLOSURE, AND MECHANISMS FOR ENSURING THE QUALITY OF INFORMATION

As a consequence of the relatively closed system of information flow between the public company and its founder (the Republic of Serbia, autonomous province or local self-government), the publicity of information related to activities of public companies is also limited. The transparency in publishing the results of operations is limited, especially when it comes to operational indicators, plans and results. Reporting on business operational indicators is almost entirely limited to the annual business plans, which are not publicly available. Although business plans contain plenty of detailed information, they are primarily related to short-term financial plans (i.e. annual plans for the next year), and very little attention is paid to the evaluation of the results achieved. The lack of focused and coherent results evaluation framework is also noticeable, which could, for example, consist of a small

⁴⁷ Fiscal Council of Republic of Serbia 2014, 16–17.

⁴⁸ ARSIĆ (2012), 76.

number of carefully selected financial and operational performance indicators (which should also be internationally comparable), which could be used to monitor the public enterprise by the owner (state) and would be publicly available.⁴⁹

Too much politics within public enterprises prevents the availability of wider range of information for the public. Due to the distribution of the key positions in public companies among the political parties in power, they are often the subject of attacks by political opponents, which may involve unfounded accusations. That causes the supervisory board members and executives not to reveal more information than necessary for annual reports. In consequence, they usually withhold information not to prevent the public from being informed, but rather not to give political opponents too much material to develop affairs.

6. WHEN APPROPRIATE AND PERMITTED BY THE LEGAL SYSTEM AND THE STATE'S LEVEL OF OWNERSHIP, MAINTAINING CONTINUOUS DIALOGUE WITH EXTERNAL AUDITORS AND SPECIFIC STATE CONTROL ORGANS

As far as this topic is concerned, there is no lack of communication between external auditors and specific state organs and between public companies.

According to the Serbian Law on State Audit Institution,⁵⁰ the State Aid Institution is legally obliged to conduct annual audits of public companies.⁵¹ The engagement of auditors to check the financial reports of public companies and their communication have educative aspect, too. There are reports that the capacities of the State Audit Institution has recently been increased to perform a better control of the operations of public companies.⁵²

Auditors, as well as the finance and accounting inspectors, during their visits to public companies, take the opportunity not only to control their records, but also to educate. They draw the attention of finance and accounting professionals who work in public companies to particular demands concerning operations, or how to cover such operations properly with adequate records in the books, with proper financial and accounting documentation. All these operations in public companies need to be adjusted to numerous legal provisions and international standards that need to be complied with.

On the other hand, the control organs of the Ministry of Finance of Serbia continuously follow the balances and accounts of public companies, both of those that are founded by the Government of Serbia and of those that are founded by local self-governments.

49 Arsić (2012), 76.

50 The Law on the State Audit Institution, The Official Gazette of the Republic of Serbia, No 101/2005, 54/2007 and 36/2010.

51 See in Government of the Republic of Serbia (2014): *Negotiation Position of the Republic of Serbia for the Intergovernmental Conference on the Accession of Serbia to the European Union, Chapter 32, Financial Control*, Belgrade, s.n. Source: <http://eukonvent.org/eng/wp-content/uploads/2016/05/Negotiating-Position-of-the-Re-public-of-Serbia.pdf> (15 July 2016)

52 Ibid.

Public companies also need to have external audits with a number of projects they implement. They submit project proposals to various funds in order to find additional financial resources in addition to those provided by the government, ministries or local self-governments, i.e. which are received for the services they render to citizens and companies. An auditing is also required according to the provisions of loan contracts they conclude with the World Bank, European Bank for Reconstruction and Development, or other banks when receiving loans. Similar obligations come out of contracts with international donors when public companies receive certain grants – foreign donations.

Therefore, it can be concluded that the communication with external audits and specific state control organs is not lacking.

7. ESTABLISHING A CLEAR REMUNERATION POLICY FOR SOE BOARDS THAT FOSTERS THE LONG- AND MEDIUM-TERM INTEREST OF THE ENTERPRISE AND CAN ATTRACT AND MOTIVATE QUALIFIED PROFESSIONALS

A clear remuneration policy in SOE boards that would attract and motivate qualified professionals is not established. There is also strong criticism related to the costs of improving the management of public companies. The difference in remuneration in public companies in various local self-government units is usually based on their economic strength. A lot of innovation related to the motivation and attraction of professionals could be facilitated without large resources. It is unclear why this matter is not adequately regulated, because there are no high social costs for such a measure (as it would be the case with the release of surplus employees in the public sector or increasing the prices of products and services of public companies). However, improving the management of public companies would lead to a loss of personal and political rent, and reduce irregular employment (political party, family, etc.). In order to successfully improve the management of public companies, it is necessary to take measures to prevent these illegal interests.⁵³

What has recently been happening is the introduction of a salary cap in the whole of the public sector in Serbia, which entered into force at the end of 2013 and was prolonged for a further period at the end of 2015. This encourages the deprofessionalization of the management of public companies as it prevents the adequate remuneration of executives and board members who achieve results and show creativity and talent. Further actions should be taken to decrease the number of employees in public companies. Strong political criticism is directed against the high number of managers in public companies; in particular in those founded by the Republic of Serbia. Excess in quantities, however, affects the quality of management, which needs to be addressed.

⁵³ ARSIĆ (2012), 75.

8. CONCLUSIONS

The following can be concluded:

Serbia as a country in transition and the EU accession process urges the country to harmonize the functioning of its public companies with the OECD Guidelines on Corporate Governance of State-owned Enterprises. However, there is still work to be done, both in legislation, and in the practical implementation of the law.

The key problem concerning the independence of the public companies' boards (which should be respected by the state – II C), is the lack of criteria to ensure the independence of supervisory boards and directors in implementing what they are expected to do as professionals. The problems stem from the inherited practice that the boards and management of public companies are considered to be positions to employ ruling party personnel rather than bodies to be managed by the professionals. The New Law opens space for changes in a positive way.

Regarding the State as an informed and active owner that exercises its ownership rights according to the legal structure of each enterprise (II F) one of the key problems is the lack of a general assembly, where the state, via its representatives could execute its owner's rights within the body of the public company. A further problem is the structure and formation of supervisory boards and the nomination of directors, particularly due to the vaguely defined procedures of their nomination, and how the result of their activities on these posts are to be evaluated (lack of criteria, insufficient procedural protection from corruption and abuse of rights of those evaluating their results). Therefore, monitoring is inadequate, while the transparency of their work is questionable, due to the fact that only financial statements are obligatory to be published and distributed. Auditing and the public companies' communication with auditing and financial control bodies is a bright spot, while the remuneration of boards members is not adequately regulated and quite volatile (earlier the remuneration of public company board members was high, in particular at national level, while nowadays, the remuneration cap in the public sector makes these posts less attractive, in particular at the local levels). The New Law raises hopes that this issue will evolve in a positive way.

9. SUMMARY

The author in this article analyses current challenges of Serbian SOEs with regard to the implementation of Points C and F of OECD Guidelines on Corporate Governance of State-owned Enterprises. First, the legal provisions of the earlier and current laws concerning public companies are compared, then the Serbian Fiscal Council's stance on their implementation is presented, finally some concluding remarks are offered. These remarks refer to responsibilities and independence of the public companies' boards, as well as to the conduct of the state as an informed and active owner. Several problems are highlighted: first, the lack of a general assembly within public companies; second, the problems with the structure, formation, monitoring and control of supervisory boards with a special emphasis on the disclosure policy of public companies; third, the remuneration of board members. The author points out the willingness of the state to cope with these problems, however, with poor results so far.

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