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Special Issue:

The development of modern
corporate governance in Croatia

Darko Tipurić

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EDITORS

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Professor of Marketing, University of Gloucestershire, UK
bdavies@glos.ac.uk

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PRODUCTION EDITOR

Gianpaolo Vignali

g.vignali@mmu.ac.uk

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Editorial

This special edition of *International Journal of Management Cases* provides a valuable perspective into challenges towards development of modern corporate governance in Croatia. Development of good practice of corporate governance is a condition sine qua non of prosperity of modern Croatian corporations.

It took some time for corporate governance in transitional countries to become an important regulatory, business and academic issue. Owners and managers of firms in transitional countries are increasingly becoming aware of benefits that good practice of corporate governance brings along. Development of a consistent and complementary corporate governance system is a crucial issue for countries like Croatia that want to stimulate investment in private sector, attract foreign investments and create the context for higher rates of economic growth.

The first case study describes introduction of ESOP into Croatian company AD Plastik Solin. It is a positive example of its use as an insider privatization method and as a means of protection against hostile takeover threat from a Canadian company. The evidence about development of employee ownership and ownership culture among employees from transitional economies is quite scarce compared to advanced market economies contribution, but of special and specific interest. The AD Plastik case is an example which will allow us a better understanding of how the heritage of a communist system, transition to the market economy and insider privatization facilitated by creation of an ESOP can produce different consequences in terms of worker and firm outcomes.

The second case study examines the creation of ownership culture in Dalekovod. Giving employees a stake in the company's ownership can be a key that unlocks the company's full potential. Only when employees feel that they are real partners in the company's future, not merely paper owners, a true alignment between their interests and those of management is achieved, resulting in a workforce interested in company success. Ownership on its own may have little effect on performance, but companies like Dalekovod that combine ownership and participative management have an advantage

not available to their competitors. The case of Dalekovod demonstrates that ownership culture is not something that can be taken for granted.

A brief overview of deregulation and privatization of European electricity market is in the focal point of the third case. That may give the answer as to what would be the best privatization procedure for HEP, the Croatian government owned, vertically integrated company for production, transmission and distribution of electricity. What Croatian society expects from HEP in the future is a starting point for choosing privatization solutions. Optimal ownership structure, as authors suggested, follows a clear vision of which role HEP should have in Croatian economy and what are the long-term expectations about the importance of electro-energetic sector as an infrastructural economic leverage of Croatian society.

The next two articles in this issue of *International Journal of Management Cases* describe transformation of INA through privatization process since it represents a crucial part of Croatian economy. In the model of INA privatization, the first phase included partnership with a strategic investor. Authors illustrated the selling procedure, choice of strategic partner and finally the selling contract signed on 17 June 2003. MOL - Hungarian Oil & Gas Company plc signed the Contract for buying 25% plus one share of INA. By transferring its technology and knowledge, and applying its successful management and business practices, chosen strategic partner is expected to enable further growth and development, revitalization and easier access to resources, markets and innovation for INA.

The second phase of privatization of INA is a matter of discussion in the following case on INA. 15% shares were sold to Croatian citizens in the initial public offering and each of them had a chance to buy shares worth up to 38 000 kuna. First initial public offering was the most important transaction on domestic capital market since it was the largest domestic IPO ever and there was a significant participation and demand of Croatian citizens. The case includes IPO planning, implementation as well as effects in terms of movement of market prices of INA's shares on Zagreb and London Stock Exchange.

The case study of Pliva illustrates the takeover scenario of a leading regional pharmaceutical company. Authors' main objectives were to present the efficiency of market for corporate control as external mechanism of corporate governance. In the last ten years there were about 400 successful takeovers in Croatia and Pliva takeover was certainly the most exciting one. In 2006, Pliva was the subject of a bidding war between Iceland's Actavis and US-based Barr Pharmaceuticals. Scenario of Pliva's takeover offers everything that today's takeover can offer – from so called "hostile takeover", strong public and hidden pressures on management of the regulatory body for capital markets to classical business and political intrigues. In conclusion authors comment on future business perspective of integrated company of Barr Pharmaceuticals and Pliva.

T-HT is the next case offered in this issue of International Journal of Management Cases with the core objective to analyze specific phase of privatization process of the largest telecommunication company in Croatia in which they went public. 25 percent of T-HT from total number of 32.5 percent of shares which were traded within IPO was sold to Croatian citizens (remaining part of 7.5 percent was sold to international and local institutional investors). Through T-HT going public process many Croatian citizens started to invest their money in stock market and authors give distinctive point of views on perspective of the future development of Croatian financial market.

The optimal model and time dynamics of the privatization process for Croatia insurance company is presented in the following case. Fall of market share, insufficient profitability on one side and growing competition in insurance and financial market together with insurance market potentials are key prerequisites and determinants for model of privatization process and the reasons for urgent privatization of Croatia insurance company. The authors propose the privatization model and also stress the necessary changes in the system of corporate management of Croatia insurance company.

Finally, the case study of RVR describes privatization process of non-core enterprise within the Croatian Railways. The entire process with the ending on 25th October 2007, when joint proposal of 367 workers was accepted by Croatian privatization fund, was the subject of the last case

in this special issue of International Journal of Management Cases.

Seen together, these cases provide a valuable perspective for development of modern corporate governance in Croatia. Development of adequate mechanism of corporate governance in transitional countries like Croatia differs from the same process in developed economies and evidently main difference is in level of development of legal infrastructure and adequate financial institutions. Since corporate governance in transitional countries was much less a matter of research compared to developed countries, in this issue of International Journal of Management Cases we offer a concise overview of corporate governance practice in Croatia.

Guest editor

Darko Tipurić, Ph.D.

THE EFFECTS OF ESOP IMPLEMENTATION ON ATTITUDES TOWARDS WORK AND ON OWNERSHIP CULTURE DEVELOPMENT – CASE STUDY OF AD PLASTIC SOLIN

DARKO TIPURIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

SREČKO GOIĆ

FACULTY OF ECONOMICS, UNIVERSITY OF SPLIT, SPLIT, CROATIA

MARINA LOVRINČEVIĆ

FACULTY OF ECONOMICS, UNIVERSITY OF SPLIT, SPLIT, CROATIA

Abstract

Croatia is a country with the economy in transition from a specific communist system to the market economy, preparing its candidacy for the EU membership. Privatization process in the last decade brought up many problems and opened many questions. Employee ownership was one of those, undoubtedly. AD Plastic, a large manufacturing firm from Croatia, used ESOP as an insider privatization method and as a means of protection against hostile takeover threat from a Canadian company. The AD Plastic case is a framework through which different aspects of employee ownership in a transition economy can be seen and better understood in both firm and worker outcomes terms.

Keywords: ESOP, Croatia, attitudes toward work, ownership culture, employee ownership

Introduction

There is increasing, both theoretical and empirical, interest in employee ownership for a wide variety of reasons. From the point of view of the corporate governance and organizational behavior, employee ownership schemes have a great potential to booster both firm and worker outcomes. By aligning more tightly traditionally diverse interests of capital and labor owners, employee ownership should improve the bottom-line economic performance through attitudinal and behavioral changes,

most notably through greater job involvement, job satisfaction and organizational commitment, through increased employee motivation and effort provision, through higher extent of horizontal monitoring and through reduced rates of employee turnover and absenteeism.

On the other hand, employees' involvement in ownership creates a specific situation, where employees have mixed and sometimes conflicting interests. Empirical evidence on actual employee ownership economic and behavioral effects is often quite mixed and suggests that there are no automatic improvements in worker attitudes and behavior under employee ownership.

ESOP as a specific model of employee ownership development scheme has gained much popularity in various countries over last few decades. It has been employed also as one of the privatization models in many countries in transition (transition from communist to market economy). Much of the "what happens after ESOP" can be explained from motives and objectives of ESOP implementation in a specific firm, from circumstances of ESOP adoption and from expectations of various actors involved – owners, managers and employees about "post ESOP" benefits for each group respectively.

A failing firm that converts to employee ownership to save jobs is more likely to have different consequences in terms of both firm and worker outcomes, from a successful firm that introduces

ESOP to bind firm-specific human capital to the company.

Having a stake in the future of the firm is not likely to be enough in a situation where the value of the stake depends directly on the decisions made by managers. Workers will seek to protect a portion of their future income, by demanding “a voice being heard” through various mechanism of participation in decision making. The empirical evidence suggests that money matters (if participating in ownership schemes is financially rewarding to employees) and voice matters (if ownership arrangements are accompanied with participation in decision making). Thus, financial benefits, as well as opportunities for participation in decision making have a substantial influence on workers’ attitudes; an intervening variable in explaining behavioral changes which will ultimately lead to performance changes. Employee ownership is likely to be associated with positive attitudinal and behavioral changes and higher performance if employees think and feel like owners.

The evidence about development of employee ownership and ownership culture among employees from transition economies is quite scarce compared to advanced market economies contribution, but of special and specific interest. The AD Plastic (hereafter ADP) case is an example which will allow us a better understanding of how the heritage of a communist system, transition to the market economy and insider privatization facilitated by creation of an ESOP can produce peculiar consequences in terms of worker and firm outcomes, and perhaps help us to resolve the dilemma – Is strong ownership culture everything that matters?

General information on AD Plastic

This firm, which is listed on the Croatian stock market, is quite important in the local economy. It is headquartered in Solin (suburb of Split, second largest city in Croatia) and its major plants have been located there for more than 50 years. ADP has multiple plants in Croatia and a solid market niche in the plastic manufacturing industry – it produces high-quality plastic parts for the automobile industry.

During the 1980’s, when Croatia was a part of the Socialist Federative Republic of Yugoslavia

(hereafter SFRY), what is now ADP was a part of a larger group of companies (named ‘Jugoplastika’) that employed about 13,000 employees. Along with the process of transition and the disintegration of the SFRY, abolition of the self-management system took place in Croatia and its enterprises. During that process, in early 1990s the original company (‘Jugoplastika’) disappeared, and ADP emerged as an independent company. As the first step towards privatization, the ownership of the company was transferred to the state.

In 2001, as a part of the privatization process in Croatia, an ESOP was devised as a vehicle to transfer the majority of ownership to employees and management and as a means of protection against hostile takeover of the firm by a Canadian company. The management of the company was initiator and spiritus movens of ESOP creation and implementation and workers were quite enthusiastic about their new roles. Saving their company and their jobs united management and workers to act “as one”.

Today, ADP is a part of a larger group of companies, AD Plastik Group, that includes ADP and several smaller companies, some of which are located in Slovenia, Romania and Russia. Recently employment at ADP was about 1,300 employees, and it has been steady during the last few years.

About 90% of ADP’s output is exported, mainly to customers in Western Europe (Renault, Peugeot, Citroen, Ford and Volkswagen), and about 10% covers the domestic market demand (plastic products for different purposes outside the automobile industry).

The company is doing well and sales have tripled in the past three years, and data show that the company has recorded sustained growth over even longer period of time. In recent years, investment has been at the level between 12 and 30% of sales.

Before the 1990’s the competition was mainly domestic, and after the disintegration of SFRY, only a few producers survived. Currently about 30 manufacturers for automobile industry operate in Croatia, but ADP is a leader in this industry. Competitive pressure has grown from foreign competitors, and the company is dealing with extremely tough standards for product quality

from their customers, including requirements for ISO certification.

Of all employees, more than 15% hold university diploma, but, on the other hand, almost 10% of employees did not even complete grade school. Nearly 50% of all employees have high school degree. In recent years, investment in education has been at the average level of 0,2% of sales. Younger workers (40 years old or younger) make more than 50% of all employees.

ADP has developed several different practices concerning information sharing, including quarterly meetings (workers get to know confidential information on new products, new strategies and financial statements) and a monthly newsletter.

Teamwork is one of the practices allowing employees to directly participate in decision making. Most commonly teams are used to produce solutions for technical problems; as a support for new products development and new technology introduction. Team leaders are appointed by management, and the effectiveness of the team is usually evaluated by the management.

There are currently three unions at the ADP representing for about 80% of all employees.

Average wages in the firm are below national level, but ADP provides slightly higher starting wages than other comparable firms in the industry. In the local area, where the unemployment rate is significantly above national level, stability of employment is highly appreciated. The most recent collective agreement with the labor unions provides for wage increases that are about double the recent inflation rate of 3.5%.

ESOP adoption circumstances

During the 2001, an ESOP was created as to avoid hostile takeover by a Canadian firm. The whole idea was created, developed and carried out by top management, but the response of employees was magnificent. More than 90% of all employees joined the ESOP at the time.

Employees were offered two different "packages" of shares. The smaller package was worth 7,000 DM (approximately 3,500 EUR), while a larger one was worth 20,000 DM (approximately 10,000 EUR). Only a few, mostly top-managers,

acquired the larger package. This was, however, not perceived as a privilege, but more as a sign or expression of a strong commitment "to the cause".

The acquisition was supported by the 5-year loan from a large Croatian bank, with a presumption that the annual dividends would be sufficient to repay the loan. In the initial acquisition, ESOP acquired 63% share in the ADP ownership.

However, it turned out that dividends were able to cover 90% of the first annuity, and in the second year they covered only 60% of the annuity. The balance had to be taken from regular salaries of employees. That induced 41 employees to drop out of ESOP in the first year, and 290 employees to drop out during the second year. Their shares were offered to the rest of ESOP members and non-members; 41 members accepted that opportunity to increase their package, and 7 new employees entered the ESOP. Currently about 53% of the firm equity is owned by the ESOP, and individual employees and managers control other about 7% of votes (the majority of the balance is owned by another corporate entity that is a long time strategic partner of ADP).

ESOP was clearly perceived by both management and employees, as an entrepreneurial venture in saving jobs and future of over 1,000 people and their families. The idea of including employees into the company's ownership structure and therefore its future success was broadly accepted. It turned out that the enthusiasm melted away in the very first year after the ESOP introduction - for the most employee-owners, regular salaries were the only income source, so dropping out ESOP was the only thing to do.

Today, there are 518 employees actively involved in the ESOP (almost 40% of total employees).

ESOP effects – five years later

The ADP Company carries on regular surveys on employee motivation and job satisfaction. Independent researches on similar topics are performed from time to time. Such a study carried on in 2005 by a team of Croatian and US scholars was focused on employee involvement in ownership and other participative practices.

Table 1: Worker outcomes based on ESOP membership

Worker outcomes reflecting ownership culture development	ESOP members	Non-ESOP members
	Mean	Mean
<i>Job involvement</i>		
"I have a lot to say about what happens on my job."	2.38***	2.62
"My job allows me to take part in making decisions that affect my work."	2.58***	2.81
"Management is usually open about sharing company information with employees at this company."	2.72*	2.86
One-dimensional measure of job involvement (three item index)	7.67***	8.30
<i>Effort</i>		
"How much effort do you put into your work beyond what your job requires?" 1=None; 4=A lot	3.63***	3.50
Days missed in the last year	1.58	2.03
<i>Peer monitoring</i>		
"I help my co-workers when they need it."	1.82	1.88
"My effort at work is affected by the effort of my co-workers."	2.24***	2.42
"The work of my co-workers affects my pay."	2.43***	2.67
"If I saw a co-worker slacking off, I would say something to that worker."	2.24	2.28
Proportion of workers who have ever said anything to a co-worker when they saw that worker slack off (%)	27.89*	36.84
<i>Commitment</i>		
"I am willing to work harder than I have to in order to help this company succeed."	2.06***	2.28
"I would take almost any job to keep working for this company."	2.76	2.69
"I would turn down another job for more pay in order to stay with this company."	2.99	3.09
One-dimensional measure of commitment (three item index)	7.79	8.08
<i>Trust</i>		
"I am treated fairly by the company."	2.31***	2.56
"To what extent do you trust the management at this company?" 1=To a great extent; 4=Not at all	2.50	2.60
"In general how would you describe relations in your workplace between management and employees?" 1=Very good; 5=Very bad	2.98*	3.14
<i>Job Satisfaction</i>		
"All in all, how satisfied would you say you are with your job?" 1=Very good; 5=Very bad	2.22***	2.48
Number of respondents	201	214
Notes: (a) Unless otherwise indicated, each respondent is given four choices: 1=Strongly agree; 2=Agree; 3=Disagree; and 4=Strongly Disagree.		
(b) ***Mean differences significant at 1% level; **Mean differences significant at 5% level; *Mean differences significant at 10% level		

The survey clearly indicated that employee owners (members of ESOP) differed significantly (in demographics) from employees non-owners. On average, an employee-owner is 45 years old, while their non-owner colleagues are 39 year old on average, has longer tenure (working 16 years on average in the firm, while a non-owner has on average been only 12 years with the company), and works longer hours (working 184 hours monthly on average, and significant number of employee owners /20%/ even more - 200 hours or more monthly, compared to 180 hours monthly on average among employee non-owners).

Employee owners are better educated compared to their non-owner colleagues, meaning that over

30% hold some kind of university diploma. ESOP members have better positions in the firm (there is a significantly higher number of employee owners involved in management structure), and are better paid for their jobs.

An average employee-owner at the ADP is more likely to be a member of one of the three unions comparing to their non-owner fellows, and is more likely to participate in project teams.

As far as the performance aspects interesting for the firm are concerned, ESOP seems to be delivering specific results. To investigate key mechanisms through which the behavioral changes were brought up, the survey tried to examine both employee-owners and non-owners attitudes

toward different aspects of job and organizational life in general. Selected attitudes reflect could be used as indicators of a specific ownership culture development. Those results are presented in the table 1.

Conclusion

In many former communist countries, often privatization has been accompanied by significant employee and managerial share ownership in the firm at which they work. At our case, the process of insider privatization was facilitated by the creation of ESOP which is supposed to have a strong potential to booster favorable worker and firm outcomes. ESOP is expected to shape the “new” worker’s behavioral pattern through improved attitudes toward work and organization in general which will ultimately lead to improved economic performance of the firm. ADP ESOP, didn’t, however, deliver expected mutual gains; firm is doing well and employees seem not to feel any better about it. Specific circumstances in which ESOP was created, it’s characteristics as well as broader economic and legal context in which firm operates, give us only a part of explanation. The other part should be tracked “behind the scenes” of participation in ownership; in (non)existence of complementary practices of participation in decision making. Workers should think and feel like owners, and just passing a proportion of equity to employees won’t improve work related attitudes automatically. Something more is needed.

Questions for discussion

1. What were the main motives for introducing and high acceptance of an ESOP scheme in ADP, for each group of actors: managers and employees, respectively?
2. Is it possible that these actors had different expectations about benefits of ESOP scheme adoption? If so, how would you describe aspirations and expectations of each group?
3. Do you think that self-management heritage influences significantly today’s attitudes and behavior of the employees-owners in the ADP? What about possible such influence in the process of ownership restructuring process over last decade?
4. What are possible causes and explications for the differences in worker outcomes based on ESOP membership? Can part of the answer be found in demographics and firm environment?
5. How would you explain the positive effect of ESOP scheme on firm performances (having in mind individual and group attitudes changes)? Do attitudes describing ownership culture matter, and if so, how much and why?
6. Would you describe ADP ESOP as a failure or as a success?
7. What possible solutions do you suggest for improving worker attitudes and fostering ownership culture in ADP?

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OWNERSHIP CULTURE - CASE STUDY OF DALEKOVOD

DARKO TIPURIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

IVANA NAČINOVIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

DAMIR SKANSI

DALEKOVOD D.D., ZAGREB, CROATIA

Abstract

This case study has been developed in cooperation with Croatian joint stock firm Dalekovod d.d., engaged in design, production, construction and erection of transmission and distribution power projects, traffic and telecommunication facilities on the domestic and international market. Dalekovod is one of rare companies in Croatia which introduced employee ownership through Employee Stock Ownership Plan (ESOP). Consequently, a corporate culture with special features was developed – the ownership culture. This case study examines the creation of ownership culture in Dalekovod.

Keywords: ownership culture, employee ownership, Dalekovod, Croatia

Introduction

Globalization has forced firms all over the world to reorganize their structural and financial capital to achieve some competitive advantage. Many of these firms have found that the key to achieve high performance is to focus on human capital. Employees are committed to different plans and activities when they share ownership and responsibility of those plans. Since most people do not own their own business but are employed in a larger organization, schemes are developed to give employees a stake in the enterprise they work for. The ultimate objective of such initiatives is to get employees to act as owners.

Business experience shows that employee ownership can be used as a powerful tool for improving corporate performance. Usually a

certain organizational culture is developed after sharing company ownership among employees. The corporate culture where employees behave as if they own the enterprise is called ownership culture. Ownership culture is based on the belief that owners make better performers. In other words, such organizational culture rests on the opinions that if employees have a stake in the enterprise, they don't behave like pure executors of given tasks but actively participate in everyday business.

The development of ownership culture is determined by some top to bottom employee ownership program. Adequate concentration of control in an enterprise by employees-owners enables them to monitor and influence management actions. It is considered that the combination of employee ownership and employee participation can yield substantial improvement in enterprise performance. The development of ownership culture is usually a result of an enormous interest in rebuilding the employee relationship and connecting the interests of the enterprise and employees. By giving employees a stake in the value they create, they are willing to make changes necessary in order to stay competitive in the long term.

During November 2007 a research was conducted among randomly selected employees of Dalekovod – but all owners of Dalekovod stocks. The purpose of the questionnaire research was to identify employee knowledge and satisfaction with the carried out ESOP programs and to explore the features of corporate culture in Dalekovod. Implementation of ESOP in Dalekovod was the prerequisite, but also an initiative, to the changes in the existing corporate culture towards ownership

culture. The presence of different features associated with ownership culture was examined as a part of this research.

Employee ownership in Dalekovod d.d.

Dalekovod d.d. Zagreb was founded in 1949 and today employs 1606 people.

The mission of the Company is engagement in design, production, construction and erection of transmission and distribution power projects, traffic and telecommunication facilities on the domestic and international market. It is a fully customer-oriented company, which insists on high quality of its products and services based on specific know-how and skills of its labor force as well as on the ability of prompt adaptation to turbulent impacts of the environment by developing competitive competencies.

The vision of the company is to become the leading company in its field in central and south-eastern Europe with a regional head office.

Today, the company is a completely privately-owned company. Employee shareholding is an interesting phenomenon about Dalekovod. Employees in Dalekovod got a stake in the firm's capital through two Employee Stock Ownership Plans (ESOP). ESOP was conducted in years 2000 and 2001.¹

In 1999 Dalekovod management started to acquire its own stocks for the Trust with a view of selling the stocks to all interested employees. At that time the capital was divided into 127,434 stocks where the company acquired 36,691 stocks. The only intention of acquisition was to sell the stocks to the employees under equal conditions. By implementing ESOP, the company tried to come closer to the best world privatization and ownership management standards and to achieve competitive advantages from motivating its owners-employees.

The operative ESOP 2000 implementation strategy anticipated engagement of as many employees as possible in the ownership structure contribution, which at the same time provided a protective dam-effect and limiting factor to possible hostile acquisitions and created additional motivation in engaged employees, who, now from the employees' perspective and

later also from the co-owner's perspective, could have a different approach to the company, their engagement and future common prospects.

It was anticipated that the ESOP 2000 plan should be completed by the end of June 2000. ESOP 2000 was implemented in two rounds of stock subscriptions. In the first round all employees could subscribe 25 stocks at most and in the second round only those who subscribed the maximum number of stocks (25) in the first round were allowed to subscribe as many as they wished. If the total number of subscribed stocks from both rounds was greater than the available number of stocks, it had to be linearly reduced to the given number, but only for those employees who subscribed 25 stocks or more.

Some of the advantages and objectives of this ESOP were e.g.: participation of employees in the ownership structure, proving in that way their confidence in the company and management, creating team spirit and loyalty to company strategic goals, enhancement of additional employees' motivation for achievement of higher efficiency by equalizing employees' interests with stockholders' interests, participation of employees in the capital profit by means of dividends and increase of stock prices on regulated capital markets, protection from acquisition, higher productivity and decrease of labor force fluctuation.

In the first round, 845 employees responded to the Management Letter and 17,902 stocks were subscribed, so that 18,789 stocks remained to be offered in the second subscription round. In the second round 483 subscription forms arrived and 30,504 stock reservations were made. The total number of reserved stocks in both rounds was 48,406 stocks. As only 36,691 stocks were available, the ESOP 2000 Plan Implementation Commission decided to fully approve of the first round subscription and to reduce the subscription of the second round linearly for all subscribed stocks. Consequently, 845 contracts were drawn up and distributed to the employees in such a way that everyone who subscribed 50 or less stocks was allowed to effect advance payment in two equal monthly instalments. The final number of concluded contracts was 756, i.e. 53.3 % employees.

In the course of 2000, the Supervisory Board of the company made a decision about taking

actions for further purchase of its own stocks. The procedure was almost identical to the procedure of the first plan, except this time the Commission decided to carry out the subscription of the interested employees in one subscription round only. For that purpose, the guaranteed invariable amount of subscribed stocks had to be established and the maximum subscribed number limited to 1,000 stocks per employee. In this way, the employees, who paid the entire amount of subscribed and accepted stocks (single payment at the market value) until the closing date for payment of obligatory deposit were immediately granted the right to manage and dispose of the above stocks.

In the ESOP 2001 Plan 534 employees, i.e. 37 % employees took part and 6,751 stocks remained unsold in the treasury, providing that they are sold to the newly employed employees.

The ESOP Plan in Dalekovod d.d. was initiated by the Management. The implementation of the Plan several years ago has had a noted effect on the following:

1. Increase of productivity,
2. Increase of profit,
3. Increased incentive for employee's hard work and dedication,
4. Increase of market stock value,
5. Improvement of the company reputation in the public,
6. Fragmentation of ownership structure,
7. Higher engagement of employees with a view of achieving the company's objectives,
8. Prevention of brain drain from the company,
9. Prevention of "hostile tycoon" acquisition.

The Management as well as the employees, trade union and employee's council have expressed a very high level of satisfaction with the results of the implemented Plans. Although ESOP is not the only form of possible employee ownership, its implementation in Dalekovod case has proved to be fully justified.

Several aspects of ownership are especially attractive to employees. For employees it is a combination of:

1. Financial Payoff: some people see ownership as a financial benefit—as owners, they expect at some point to receive cash value.
2. Participation: some people want to be included in the decisions that affect their day-to-day work; they want to have a say over the issues that affect their working conditions.
3. Influence: some people want to have a part in broader, company-wide decisions. They want a degree of influence over strategic issues.
4. Community: some people want to feel a bond with their fellow owners; they want to feel that the whole company is "in this together."
5. Fairness: some people primarily want to be treated fairly by the company; they want sensible rules and they do not want "special treatment" for specific individuals.

As a consequence of the changed role of employees in Dalekovod d.d. their satisfaction with the position they occupy and the tasks they perform should be greater. ESOP provides owner rights to employees but also responsibilities. Satisfied employees will be an indicator of developed or developing ownership culture. Table 1 shows that employees of Dalekovod are generally satisfied with their job position and working conditions. There are none very dissatisfied employees in Dalekovod. Of course still remains the question whether satisfied employees, owners of their company, are more motivated at work and does their motivation lead to increased corporate performance.

When discussing ESOP as a prerequisite for the development of ownership culture in Dalekovod employee attitudes to ESOP must be understood and analyzed. According to the data from our research, some 56% of employees are satisfied with the amount of stocks that were available to purchase through ESOP program. Furthermore, only 14,9% of examined employees engaged in ESOP decided to purchase stocks because of the belief that this would assure their job position in long-term.

Table 1. Employee satisfaction with job position and working conditions in Dalekovod d.d.

Employee satisfaction with job position and working conditions	Percentage of employees
Very satisfied	10,53%
Satisfied	73,68%
Dissatisfied	15,79%
Very dissatisfied	0,00%
Total	100,00%

Table 2. Contrasts among ownership management and traditional management

OWNERSHIP MANAGEMENT	TRADITIONAL MANAGEMENT
1. <i>An ownership stake</i> : Employees receive and maintain a level of ownership that is financially significant to them.	Ownership is concentrated, with a single person or a small group owning the company.
2. <i>Ownership understanding</i> : Employees understand what ownership means.	Ownership issues are seen as irrelevant to employees.
3. <i>Entrepreneurship training</i> : People are trained to have the skills not just to do their own jobs, but to understand how the business works; they learn to be effective.	People are trained to do their jobs; they learn to be efficient.
4. <i>Sharing information</i> : Companies share financial and performance information with employees at the company and work team levels.	Managers guard information.
5. <i>Short-term incentives</i> : Everybody takes part in the short-term rewards of company success.	People may, at their managers' discretion, receive bonuses.
6. <i>Employee involvement</i> : Employees have structured regular opportunities to have meaningful input into decisions concerning the work they do.	Ideas come from managers. Employees are allowed to make suggestions

Source: Rosen, C. (2007) What is an Ownership Culture?, National Centre for Employee Ownership, http://www.nceo.org/library/ownership_culture.html

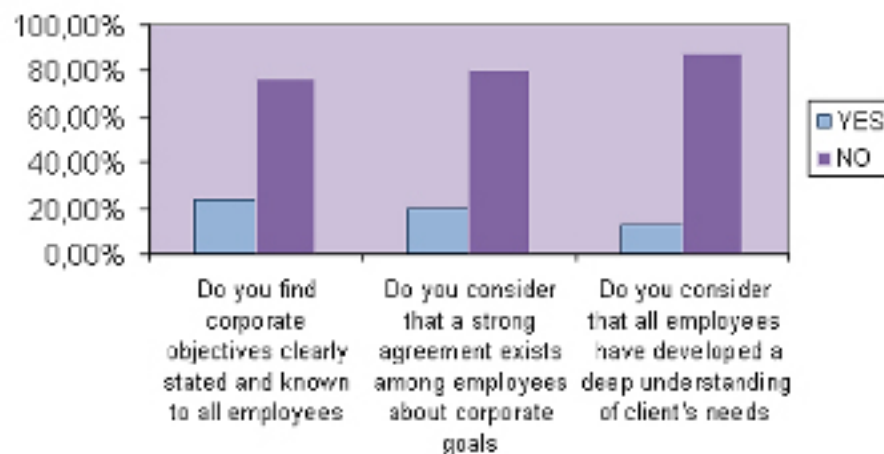
Corporate and ownership culture

Corporate culture is a model of common values and beliefs that help individuals understand the organizational functioning, at the same time setting behavioural norms for the organization. Corporate culture defines how everyone in the organization behaves and acts. Regardless of whether a firm explicitly acknowledges a certain corporate culture or not, corporate culture is constantly at work. After all, it provides boundaries for acceptable behaviour in a firm.

Corporate culture is a broader issue than ownership culture. Ownership culture is developed as a part of corporate culture or a certain type of corporate culture. Cultural effect of employee-ownership is a deep employee connection to the company,

much stronger than just a financial relationship. Ownership can give employees a reason to stay with the company and to belong to the company.

Building ownership culture asks for development of principles and values that give incentive to ownership mentality. Pre-existing corporate culture will dictate how drastic will the organizational changes be after implementing ownership culture in an enterprise. Among important changes in corporate culture after introducing employee ownership is a shift to participative management. Participation needs an atmosphere of mutual respect and trust. combination of ownership and participative management results in substantial gains. Ownership alone and participation alone, however, have limited results.³

Figure 1. Corporate culture in Dalekovod d.d.

Ownership culture is a corporate culture based on trust among management and employees. Management takes a commitment to teach everyone about the business, to reward employees when the business succeeds, to unconditionally support employees, to share information openly and honestly and to be trustworthy. In their behaviour managers must adopt consistency and each time act in accordance with stated goals and vision of the company, or with previously made promises. Apart from that, they must adopt the principle of listening to the opinions of the work force to gain an understanding of the programs that are appropriate for the company. Employees participate in the business actively.

Some general features of corporate culture in Dalekovod are shown in Figure 1. The presented data is the result of employee opinion. According to employees it seems that corporate objectives of Dalekovod are still not clearly stated and fully shared among all employees. Similarly, it is possible to further develop the agreement on corporate goals and to develop client orientation among employees of Dalekovod.

The relationship among managers and employees in Dalekovod was also explored. Employees rated manager's rapport to the workforce. The results are positive both for managers and employees as most employees rate this relationship as good (43,3%), very good (35,0%) or great (13,3%). Surely a lack of support from managers to employees would

disable the development of ownership culture, but in Dalekovod this is not the case.

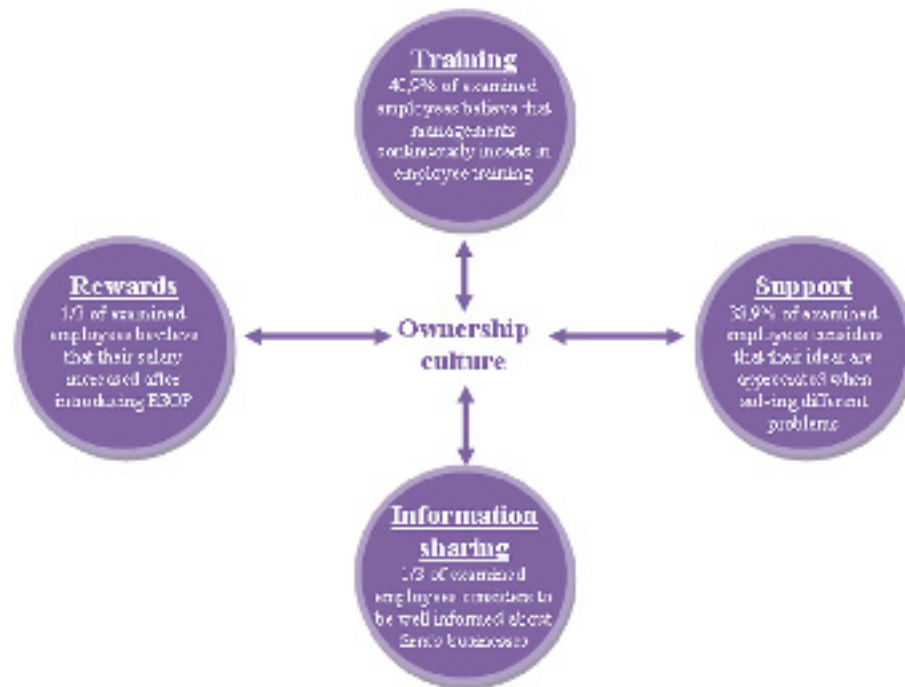
Building ownership culture

Ownership culture will be created by an incentive program that consists of several practices such as ESOP, pay for performance and variable pay, open book management and stock options.⁴ However, among mentioned the core prerequisite for developing ownership culture is sharing the enterprise ownership among employees. The second element, variable pay or pay for performance, allows rewarding employees according to their individual contribution to the enterprise's goals. Open book management emphasizes information sharing with employees, including also disclosing some important financial figures. Finally, as a part of ownership culture, stock options should be used to allow all employees to purchase additional stocks.

Corporate culture of Dalekovod d.d. started to change after first introduction of employee ownership in year 2000. It is important to note that in year 2007 some 60% of all Dalekovod employees were engaged in ESOP program. The main precondition for the development of ownership culture has thus been fulfilled.

The development of ownership culture will be enhanced with the following items:

Figure 2. Building blocks of ownership culture in Dalekovod d.d. (according to employee opinion)



1. Training – successful enterprises provide continuous training for their employees in order to assure that all employees understand the basic principles of their business. All employees must understand how their business works and how they can contribute to the success of business. Management's full responsibility is to encourage employee training.
 2. Rewards – when an enterprise is successful in its business, owners must also take part in this success. In terms of ownership culture, it means that if the business performance is high, employees need to be rewarded accordingly. The variable part of the salary or the performance reward, bonus and stock options should be used as a motivating factor for the employees.
 3. Unconditional support – employees need to believe that they have the support of the enterprise in their actions. This means that even a mistake is an opportunity for new learning and assurance that same things will not happen again in the future. It is extremely important that employees have full support in their work since this gives them confidence.
 4. Information sharing – employees need to have information about the enterprise and its business at their disposal. Information is necessary for making good decisions. Employees give higher credibility to the enterprise if they have access to all information.
 5. Trustworthy – ownership culture is based on trust, and the only possible way to build trust is for the enterprise to be credible. This means that all given promises must be fulfilled. Confidence is something that builds up over time. In the case of ownership culture, it means that enterprise must respect all the stated principles of ownership culture.
- Building or changing existing corporate culture into ownership culture is reflected in the relationship between the employee and the employer. Employees receive some additional benefits that were not assured before, such as a stake in the enterprise's capital, information about enterprise's performance or taking part in decision making process about different business activities.

Furthermore, employees need additional training in order to be able to understand enterprise's financial reports, the impact of different kinds of behaviour on business performance and participation in decision making, problem solving and communication processes. Unlike traditional enterprises, employee owned enterprises invest far more in employee skill and knowledge training.

Employees – owners are the essence of the ownership culture. Developing ownership culture means introducing changes in employee work environment. It appreciates initiative, responsibility, teamwork and client focus. However, developing ownership culture is impossible without strong leadership, open communication between management and employees and clear objectives.

The process of transformation from employees to owners seeks for the development of true sense and feeling of ownership among employees. Employees must take ownership responsibility seriously, where all their future actions should contribute to the overall success of the enterprise. It also demands a changed role of the manager. Effective manager will listen to employees, respect different opinions and tolerate resistance. Furthermore, supervisors must lead employees, assist and train them and not exercise discipline or threat them. An open relationship among employees and management will mean that employees actively participate in firm functioning with their proposals, cooperation and training.

Benefits of ownership culture for enterprise are numerous. Among others, Dalekovod could achieve benefits from building strong employee commitment, reducing employee turnover, improving on-time performance, improved customer/client service, quality (reduced scrap rates, product returns, write-offs), improved operating efficiency through put and labour utilization and improved overall project, business unit and company profitability.

In an ownership culture every single employee has the right to take part in the enterprise's

performance. The reward an employee receives is connected both with enterprise and individual performance. Therefore, a consistent reward system is necessary to motivate employees. They must understand the basis for determining overall performance and how they can contribute to giving the best performance. Employee compensation is always a sensitive issue as employees rarely feel that they are compensated at fair rates. A significant percentage of Dalekovod employees (44,9%) feel that are adequately compensated for their effort they employed.

Building ownership culture is never easy. Together with changing employee attitudes and expectations, it includes several challenges that need to be considered and resolved. All these can be divided to technical, psychological, ideological and structural issues.⁶ Technical challenges include different circumstances and issues about employee ownership, legal framework and adequate understanding of financial and managerial issues and constraints of operating a business. Psychological issues are related to resistance that can occur among employees such as resistance to changes, a need for democratic consensus building and the necessity to modify top-down autocratic processes. Different ideological issues that occur include the discussion about the desirable property concept and the cultural and legal sense of employee ownership. Finally, structural challenges include development of the institutional frameworks that will satisfy the needs of employee owners and shareholders and the development of different mechanisms and elements of corporate governance.

Creating an ownership culture can fail when allowing participation is the last in a long line of improvement wheels – all of which have been seen as failures. In such situations employees expect that the development of ownership culture will be no different.

In some cases even though employees are receptive to the development of ownership culture, they do not understand the scheme because it is either too complex or it is not written and presented in language they understand. A

possible obstacle is also middle managers that hear the words but do not change behavior at all. They see only disempowerment for themselves and mount a campaign of subtle undermining. The last obstacle is when words are not backed up with the right, and fast, actions.

Some believe that ownership culture can work effectively just for small to medium sized organizations.⁸ The reason why maybe it will not work with all large organizations like Dalekovod is that individual shareholdings can be so small that they are negligible in terms of their ownership effect. This does not imply that ownership culture is not suitable for large organizations, but just asks for additional attention in its enforcement. In fact, large organizations can use some of the benefits of smaller organizations by introducing shared employee ownership.

When practicing employee ownership it is important to bear in mind that pure employee ownership does not necessarily imply that the enterprise has developed ownership culture or will develop such culture in the future. Even after installed shared employee ownership, if the employee participation rate stays low, it means that a lot has to be done before the firm will have an ownership culture. There are some suggestions that the ideal time to develop ownership culture is during a spin-off or a merger where the groundwork is laid from the start.

The strength of ownership culture

Ownership culture is an ideal way to attract and retain employees. In this culture each employee has knowledge about how his/her workplace contributes to the overall success of the organization. Employees thus develop a strong understanding of business functioning and have the knowledge and possibility to influence business performance. The level of employee responsibility and authority increases.

Employee ownership eliminates the conflict of interest between managers and employees. It allows a focus on long-term goals. Employees work together with management on improving company performance. The owner of an enterprise knows the importance of flexibility and complying with customer's request. Thus employees-owners

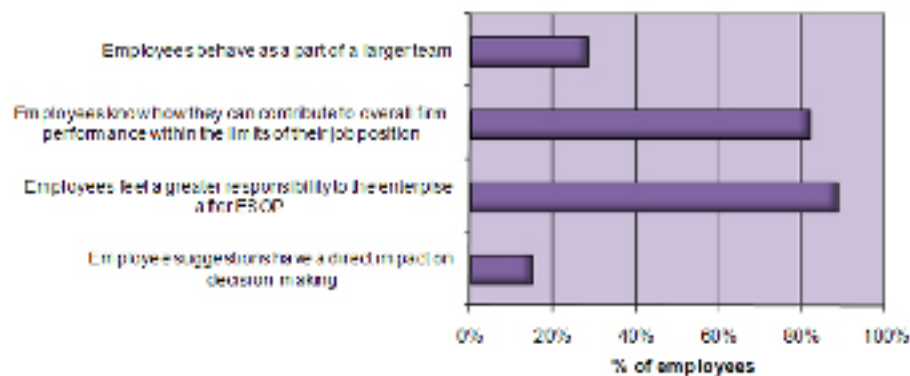
provide flexibility for the enterprise. Leadership is surely an important issue in ownership culture. Leaders must develop an empowered workforce authorized to make decisions.

When ownership makes an integral part of the enterprise's identity, created corporate culture includes an environment of shared values and goals. An ownership culture enforces the fundamental law of the entrepreneurs: What's good for the business is good for the entrepreneur. As a consequence of shared ownership, every person in the organization shares the same belief and believes in the same purpose of the business. The moment all employees share these beliefs, the ownership culture is created.

The power of an ownership culture is in its employees. They understand that when the business succeeds they'll succeed too, so they focus their energy on building a successful business. Ownership culture eventually becomes a brand that attracts people to the organization and strengthens the loyalty between employees and the firm. Employees develop entrepreneurial drive as they are given the opportunity to act like owners of the business. Employee turnover decreases, morale increases while performance is usually stable over a longer time period. Employee ownership helps attract and retain a superior workforce for decentralized growth and facilitates the alignment of key corporate constituencies.

Figure 3 shows the strengths of ownership culture developed in Dalekovod. Employees have developed a team spirit within their work groups and behave as a constituent of a larger team – Dalekovod. While working as a team can be difficult, successful employee ownership requires teamwork and participation of all employees with their skills and abilities. An ownership culture assumes that employees can have an impact on performance. Therefore the percentage of Dalekovod employees that understand how they can contribute to overall firm performance is very encouraging. Sharing performance data about how the company is doing overall and how each work group contributes to that is almost a rule for firms practicing ownership culture, and should be followed by Dalekovod as well.

Figure 3. Ownership culture in Dalekovod d.d.

Figure 3. Ownership culture in Dalekovod d.d.

A great strength of ownership culture in Dalekovod is improved employee responsibility towards the firm. Figure 3 shows that almost 90% of employees in Dalekovod feel a greater responsibility to the firm after they have purchased Dalekovod stocks. This means that employees have accepted the responsibilities related to ownership. It is the management responsibility to include responsible employees to decision making processes and consequently to increase the percentage of employee suggestions that have an influence on decision-making processes.

Conclusion

Giving employees a stake in the company's ownership can be a key that unlocks the company's full potential. However, it takes far more than just handing out stocks to people to take advantage of employee ownership. Only when employees feel they are real partners in the company's future, not merely paper owners, a true alignment between their interests and those of management is achieved, resulting in a workforce interested in company success.

Ownership culture can not develop without a strong management support. Management must work on empowering their workforce, as this is the case with Dalekovod. Ownership on its own may have little effect on performance, but companies that combine ownership and participative management have an advantage not available to their competitors. In the long run, a company must work on developing and maintaining its corporate culture. Ownership culture is not something that can be taken for granted.

Questions for discussion

1. Based on the data presented in this case study rate the development of ownership culture in Dalekovod.
2. Explain how ownership culture gives incentive to improved employee behaviour.
3. Identify other prerequisites apart from shared ownership that need to be fulfilled in order to develop ownership culture.
4. Dalekovod is today one of the best Croatian companies. In your opinion, what is the influence of corporate culture on this success.

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DEREGULATION AND PRIVATIZATION OF EUROPEAN ELECTRICITY MARKET – CASE STUDY OF HEP PRIVATIZATION

JASNA PRESTER

FACULTY OF BUSINESS AND ECONOMICS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

MAJA KLINDŽIĆ

FACULTY OF BUSINESS AND ECONOMICS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

NAJLA PODRUG

FACULTY OF BUSINESS AND ECONOMICS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

Abstract

Discussion of energy liberalization took place several decades ago between countries of Western Europe. The general belief was that with changing ownership of companies, they would become more profit oriented and thus more efficient. Through deregulation the idea was to introduce competitiveness among energy players which would further increase efficiency, lower the electricity price and therefore make the European manufacturing more competitive on a global scale. This case gives a brief overview of electricity market privatization in Europe and additionally, the case of Croatian electro energetic company HEP.

Key words: deregulation, privatization, electricity market, Europe, Croatia, HEP

Introduction (EU directive and market opening)

Discussion about energy liberalization took place several decades ago among countries of Western Europe and in practical terms privatization and deregulation commenced in 1989 with political changes in Britain. Deregulation followed in Nordic countries and then Germany and Austria followed. The main idea behind this deregulation is to stimulate growth, competitiveness and create more jobs in the European Union¹. The general belief was that with changing ownership of companies, they would become more profit oriented and thus more efficient. Through deregulation the idea was to introduce competitiveness among energy players which would further increase efficiency,

lower the electricity price and therefore make the European manufacturing more competitive on a global scale.

Croatia is an EU candidate and one of its obligations is to comply with European directives. More precisely, in the electricity sector it means complying with directive 2003/54/EC. The directive actually states that production has to be separated from the distribution, allowing each user to choose from which producer it wants to buy electricity. The directive does not enforce privatization, but since the whole question of liberalization and deregulation started with Great Britain's privatization of the electricity sector it was almost assumed that liberalization and deregulation go hand in hand with privatization.

For Croatian government privatization of the electricity sector was a favorable option. It would rise funding for other infrastructure projects and by becoming private those companies would become tax payers, meaning a new cash inflow into the government budget.

On the other hand, government, burdened with negative privatization history, wanted to ensure that this privatization would be absolutely transparent, taking into account the views from the whole stakeholder community. One of the weak points in privatization process in transition countries were the huge consumer price rise after the privatization. The Croatian negative example was with privatization of the telecommunication company T-HT. After Deutsche Telecom took over the company, it raised the prices of fixed telephony by 250%².

A study that should be mentioned is the Pollitt study done in 14 countries. Pollitt proves that in the case of producing, transmitting and distributing electricity there is no difference in efficiency between a private or a government owned company. He concludes that better efficiency is achieved through better management of the companies and not through privatization³.

The government then decided to conduct a thorough study of privatization examples in EU and transition countries. That would also give the answer as to what would be the best privatization procedure for HEP (Hrvatska elektroprivreda), the Croatian government owned, vertically integrated company for production, transmission and distribution of electricity. The Government also didn't want to repeat mistakes that happened in other countries.

The guiding principle is that electricity is actually a utility service and it is not possible to store electricity. The fact that electricity has almost no substitute means that in case of insufficient production of electricity the cost would raise immensely (10 times the initial price in Californian case⁴) which would lead to further problems for Croatian vulnerable economy. The second characteristics of electricity, as with other utilities like water or gas is its important external economy effect. That means that the consumption of electricity is more important in social sense than in profit sense. For a country it is better to facilitate the consumption then to enforce restrictive measures. Restrictive measures were enforced in Brazil in 2001 because the production plants were not built on time as planned. The restrictions had first the effect on newly privatized DISCOS (companies for distribution of electrical energy). With lower levels of consumption of electricity they came on the verge of bankruptcy and asked for tariffs raise. The Brazilian government had a huge problem because making DISCOS solvent again by increasing tariff rates would be an attack on Brazilians eroded incomes and it would be a direct attack on the Brazilian companies⁵.

Electricity sector has all the characteristics of a natural monopoly because it is capital intensive, able to profit from economies of scale and for now there are no known substitutes. The construction of the electricity infrastructure has been done by the government through large capital investments almost in every country⁶. Once the infrastructure is in place, the cost of

adding a new user or a new producer is almost negligible in comparison to the initial investments. This infrastructure has to only be maintained. It would be even irrational to build a secondary infrastructure or install more generating plants just for the sake of introducing competitiveness in the sector. Through privatization of HEP the government wouldn't be responsible anymore for maintaining this infrastructure and enduring additional investment activities.

But, in order to privatize the electricity sector, one has to be aware of five major points: (1) how to deregulate industry before the privatization, (2) what will be the tolerable price growth, (3) what is the projected ROI for any company or private entity as the new owners, (4) what and how to take care of the laid off employees, and (5) what are the necessary levels of investments by the new owners⁷.

(1) How to deregulate the industry before the privatization?

Will the whole electricity sector be divided into three distinct entities, one for production, one transmitting and one for distribution, or will the deregulation be done only on book keeping separation?

(2) What will be the tolerable price rise?

In Finland, for example, 18 months after the liberalization of their production plants, prices rose 28%. Even though the government reacted that the price rise was exaggerated by the media, the fact is that the prices rose minimally 8%⁸.

(3) What is the projected ROI for any company or private entity as the new owners?

The ROI will depend on price of the sold company and other guaranties on prices in the future. No investor will be attracted if the ROI is the lowest in the industry average. If this is not calculated, it might happen as with the Polish attempt to privatize its production facilities (BOTs) when the government had to denounce the tender offer⁹.

(4) What and how to take care of the laid off employees? Hungary, for example, asked the investors to keep the current level of employees and that the departure of the employees is done only through natural retirement. The government promised to invest 5% of the sales money into qualification of current employees in the

electricity sector. Poland asked for a guarantee from investors that they will not lay off employees during the three year period. Neither of these requirements was well taken by investors.

(5) What is the necessity level of investments by the new owners? If, for example, the concessions are given for a fixed period of time, then the concessionaire has no incentives to invest into modernization. And given the constant rise of consumption of electricity, how will the government initiate the construction of new facilities?

In order to analyze and prescribe the best procedure for the Croatian government, the following facts will be helpful.

Deregulation and privatization of European electricity market

Austria – 51% government owned

Austrian electricity market has been open since 2001 when each user was offered contract to chose their electricity supplier. The dominant company in Austria is Verbund (49%), private company but with a government share of 51% which is ordered by Austrian law. Other electricity players also have 51% local authorities or government ownership and the rest is dominated by cross holding shares. Even though the tariffs are set by an independent E-Control Commission (state owned public limited liability companies) on the market basis, the strong cross-holding structure of the electricity sector in Austria prevents entrants from coming into the liberalized Austrian market. Major players are Verbund (Austrian), RWE (German), E.ON (German), EDF (French).

Belgium – stock trading

Flandria's market has been open 100% since July 1st 2003, but approximately 70% of the market was liberalized in August 2004. Electrabel, the dominant player, with 85% of the country's generating capacity (set up from three private companies - EBES, Intercom and Unerg) is now quoted on stock market (Tractabel possesses 44% of the share, local self-government 4.7%, the rest is traded) while in Elia, municipal 30% of the ownership, while 40% is traded on the stock market.

The market opening in Belgium is a complicated process. The federal government has set the rules for the high voltage users connected to the transmission network. The distribution markets are being open by three separate authorities, the governments of Flanders, Wallonia and the city of Brussels.

In December 1996 the Council of Ministers adopted the European Directive concerning the internal electricity market within Europe. The new directive came into force in February 1997 and was enacted into Belgian Law in 1999. The market has been opened in stages between 2001 and 2005, in different proportions in Flanders, Wallonia and Brussels.

Denmark – stock trading

Danish market has been 100% open since 2003. The Electric sector in Denmark is composed of a mixture of private and municipally-owned companies. The biggest companies:

1. Elsan - owned by several companies but besides Sydvest Energi (13.13%) none possesses more than 10% of total shares
2. Elkraft – has complex ownership – two sources:
 - a) SK Power Company owns 80% of total shares
 - b) company distributed between 42 companies (only one of them possess more than 10% - Sydvest Energi 10.98%)

In Denmark, deregulation proceeded in stages, behind the other Nordic countries. The Danish electricity policy is focused on reducing the environmental impact of electricity generation and Denmark has the highest energy taxes and electricity prices in the Nordel region. Almost entirely dependent on thermal generation, coal will be phased out by 2028.

Denmark was divided into two separate grid areas each with a national grid company. ELTRA was responsible for Jutland and Funen, which in the past was connected with links to Sweden and Germany. ELKRAFT was responsible for Zealand, which is connected to the Nordic grid. The two transmission systems are not yet linked. The two companies merged in 2006, creating one

national TSO, Energinet.dk. The two grids both joined the open Nordic market under Nordpool by October 2000¹⁰.

Finland – the state owns the majority package

At the end of 2001 Fortum, the leading electricity utility in Finland, acquired the shares owned by the City of Stockholm in Birka Energi AB, the third largest electricity generator in Sweden. In 2001, Fortum announced that it will focus on its core business operations in the Baltic Rim and during the year divested its interests in the UK, Thailand and Hungary. IVS (electric energy transmission) was privatized although the state still owns 12% of the shares and the rest is owned by institutional investors (Fortum and Pohjolan Voima 25% each, insurance companies 38%).

In 1998 Fortum's (the biggest electric energy producer) stocks were handed to Helsinki stock market. Control package is held by Kauppa-ja teollisuusministerio Finland (Ministry of trade and economy - 60.43%) and the rest is owned by investment funds none of which holds more than 2%.

France – 85% owned by state

France is the second-largest electricity market in Europe after Germany. The French electricity sector is dominated by the state-owned utility, Electricité de France (EDF). EDF is the last major state-run electricity company in the EU but other companies in addition to EDF are permitted to generate electricity. EDF accounts for over 85% of electricity capacity and with energy purchases from other French producers provides about 95% of France's total electricity requirement. Under pressure, the French government approved partial privatization of EDF. However, union recalcitrance forced the French government to back down for 12 months until at least mid-2005. This may be a face-saver for the government because it may not be possible to find private investors willing to buy EDF shares with the company's current financial state. EDF is facing enormous financial problems which add to strains on the French government's budget deficit and threatens its successful privatization if that ever takes place. The company needs €15 billion in fresh capital to

restore a balance sheet ravaged by excesses of the former chairman, François Roussely.

The problems derive from a set of acquisitions which have mopped up a series of holdings; 26% UK distribution market and 10% of generation, which is profitable; 44.9% of EnBW which has a chequered profit history; a share of Edison, Italy's third largest privatized generator, and with it a possible liability of €6 billion to meet undertakings to buy the rest of it, while in the meantime the Italian government has limited EDF's voting rights to 2%. This has been complemented with a spree of acquisitions in South America, notably in Argentina. At the same time, EDF has had to make a one-off payment of €12 billion to transfer its pension obligations to the state pension fund. Finally, it is considered to be vast unfunded liabilities for nuclear decommissioning, since EDF used its provision for this to finance its overseas investments. As a result of this EDF has a debt of €24.3 billion, wiping out shareholder funds.

In November 2005 the French government sold 15% of EDF to the public.

Greece – 51% owned by the state

Greece has been opening gradually and by the end of 2004 it has opened 34% of its market. Complete process will follow in 2005 and the country was allowed to take a two-year deferment of market opening, due to its geographical location (doesn't have any EU neighbor and has many islands which are not connected into a unique network).

Greek company Public Power Corporation (PPC or DEH) was until recently 100% state-owned and before selling shares at Athens stock market, there was a restructuring carried out¹¹. Selling out began in December 2001 and ever since then a share was sold each year (2003 – 15.73%, 2002 – 13%¹²). Total revenue for the state was 3.5 trillions drachmas. The state still owns 51% of the share and it will not sell anymore¹³, but it enabled construction of new plants in order for them to compete with PPC¹⁴ and liberalize its electro-energetic market (was done only by car manufacturers that built small electric plants for their own needs, which was not a threat for PPC). Even after opening these plants it was presumed that PPC would keep 83% of the market share.

In the past, PPC was the only one in charge of transmission. However, as new producers who needed net access appeared at the market, the HSO was organized (Hellenic Transmission System) and is going to manage the transmission network and grant net access, RAE (Regulatory Agency for Electricity) is in charge of setting tariffs for net access, while PPC kept the transmission on islands. Ownership structure of HTSO is: 49% producers-owned and 51% state-owned¹⁵.

Ireland— still government owned

During 1993/4 ESB was restructured into 5 business units as a pre-cursor to privatization; Power Generation, National Grid, Customer Services, Business Services and ESB International. This restructuring was the start of a two year fundamental review of the entire operations of the company. This process was given to CCR, Cost and Competitiveness Review. The outcome of the review is a tripartite agreement between the ESB management, the trade unions and the Government. ESB calculates that when fully implemented, the review will deliver savings of nearly £60 million a year. The review was prompted by the imminent completion of EC competition directives. The structure of ESB has been adjusted for competitive supply and the CCR will ensure that the company structure is suitably lean and competitive.

In 2002, State agency for customer protection¹⁶ advised ESB to separate production and transmission and recommended selling some of their production capacities¹⁷. Same year ESB issued a yearly statement in which they stated that dividends were paid out (39.7 millions of euros¹⁸), records showed a constant growth of revenues¹⁹ and emphasizes its contribution to nominal GDP.

ESB is accountable to the Minister for Public Enterprise. ESB has no share capital. Accordingly, code provisions relating to shareholder relations and conduct of Annual General Meetings are not applicable. Appointments to the Board are a matter for Government and accordingly ESB does not have a nomination committee. Board Members, who are appointed for five and four year terms are not subject to re-election to the Board at intervals not exceeding three years. ESB's policies in relation to remuneration of Executive Board Members (Chief Executive) are

in accordance with Arrangements for determining the remuneration of Chief Executives of Commercial State Bodies under the aegis of the Department of Public Enterprise", issued in July 1999. Formal training procedures for new Board Members are being put in place²⁰.

Italy – state gradually reduces its packages

Italian market is 70% open. The Bersani Decree does not allow a single company for electric energy production to have more than 50% of the market. Enel reduced its share of generating capacity in Italy from 92% to 67%, with divestitures. The Decree also required Enel to offer shares to the public and in November 1999 Enel's privatization stock sale was Europe's largest IPO. The government floated 32% of the company, which sold for €18 billion on the Milan and New York stock exchanges. In October 2003 another 6.6% stake was sold to Morgan Stanley, reducing the government's stake to 59%. In March 2005, the government still held 41.5% of the company's shares, but it planned to reduce that to less than 30% by the end of the year²¹.

Due to European Directive, ENEL was forced to separate production, transmission and distribution by forming a new company Gestore della Rete di Trasmissione Nazionale (GRTN) which was, by the end of 2002, still in the ownership of ENEL. This loss of ownership over the transmission of electric energy was compensated to ENEL by the state.

Electric energy stock market was founded in 2003 and it is in complete ownership of GRTN.

While Enel remains the dominant generator and supplier of electricity in Italy, other companies have emerged as significant market players, mainly Edison and Spain's ENDESA and to a lesser extent, Tirreno Power (formerly Interpower) and Enipower. In order to comply with the Bersani Decree, Enel created three electricity generating companies, 5,438 MW Elettrogen, the 7,009 MW Eurogen and the 2,611 MW Interpower. Elettrogen was acquired by ENDESA-BSCH-Asm Brescia consortium in July 2001, Eurogen by Edipower, a consortium led by Edison in May 2002. Interpower was acquired by the Energia Italiana – Electrabel - Acea consortium in November 2002 and renamed Tirreno Power. In 2001 Electricité de France bought 20% of Montedison, now Edison,

at a price of €1.1 billion, a premium of 40% on the share price at that time. Montedison controlled Edison, the second largest electricity utility in Italy after Enel and the real target of the acquisition.

As Enel reduces its Italian holdings, it is becoming increasingly involved in joint ventures abroad and is expanding its interests in gas and environmental activities such as water and waste. It has purchased several water and waste treatment concessions in Italy, which are coming on the market as a result of the Galli Law, rationalizing Italy's highly fragmented water sector. Enel plans to break out of Italy with €20 billion of foreign purchases, starting with €2.5 billion for Southern Water. They are particularly interested in Germany and Spain.

There are numerous critics on ENEL's role in Italian electricity sector because energy prices are the highest when compared to the rest of the Europe²². The main critic's arguments are that ENEL is the Italian EDF²³.

Germany – a complete privatization

Germany opened its market 100% by the year 1998. German market is the biggest in Europe. Moreover, Germany is the fourth in the world by installed nuclear capacity that represents 30%

of the total production in the world. The West German electrical generation and transmission sector has been mainly privately owned, while distribution has mainly been in the hands of the municipally-owned distributors or Stadtwerke. The previously state-owned industry in Eastern Germany has been absorbed into the federal western system. There are no bars to foreign or domestic investment. The four biggest companies (E.ON, RWE, Vattenfall, EnBW) are vertically integrated and therefore responsible for production, transmission and distribution²⁴. Germany was warned by European Commission because of non-regulated transmission. Transmission is in charge of E.ON, RWE, Vattenfall and EnBW which negotiated the prices of transmission. They are obliged to make the prices public. German market is difficult to enter because of those high net tariffs. A new law that regulates the transmission was enforced in 1999 but it caused even more critics than the first law from the 1998²⁵.

Netherlands – mostly owned by the state

Dutch electric energy market was 100% opened in the 2003 and divided between: 5 producers, 1 transmission company and 7 distribution companies. Four producers are dominant:

Table 1. Producers' ownership structure

Producer	Ownership
EPON – northeast	Distributors and local authorities
EPZ - south	DELAT, PNEM, MEGA (owned by distributors and local authorities)
UNA – Amsterdam, Utrecht and north	Holding company owned by Utrecht province
EZH – Rotterdam, Hague Province (northwest)	Province Hague, city of Rotterdam, Dordrecht, the Hague, Delft, Leiden, ENECO (distributor)

Source: OECD: Background report on regulatory reform in the electricity industry, Netherlands <http://www.oecd.org/dataoecd/2/58/2497395.pdf>, pg. 6

SEP is responsible for transmission where the state owns 50%+1 share²⁶. The rest is equally distributed between EPON, EPZ, UNA and EZH.

Five companies are dominating in distribution. They are still mostly state-owned (or local authorities-owned) but the state plans to sell them on the stock market²⁷. Privatization of the

electro-energetic system began in 1998 and the completion is expected by the end of 2004²⁸.

The big five distribution companies are starting with a program to sell shares traditionally owned by communities and provinces to private investors but the outcome is uncertain. In the face of competition from RWE Energie and E.ON from Germany and EDF from France, the Dutch utilities have realized

that they are small players in a big market dominated by a number of very large companies and they need to expand their strengths if they are to compete. As yet virtually inactive abroad, they are actively seeking links with internationals. At present, there is a measure of disagreement between the municipalities which wish to sell their distribution businesses and the public, together with the political establishment, which wishes to retain control in public ownership.

Norway – 100% state-owned

Norway was the first to open its electric energy market in 1991. Norway is not in favor of privatization and, not surprisingly, the main producer Statkraft is mostly state-owned. Statkraft is divided into two independent companies (but state-owned) of which Statkraft is a producer (30% of the market) and the other is in charge of transmission. There are 70 independent electric energy producers and 180 distributors. Transmission network is regulated by the state agency NVE. Nord Pool (electric energy stock market) has a concession to interchange the electric energy²⁹.

Portugal – sold on stock market

Portuguese market has been open 100% since 2004. In the 1995 the market divided in two segments: one was privatized and the other was state-regulated. The latter, PES (Public Electricity System) is regulated through long-term contracts between producers and national transmission network REN (Rede Electronica Nacional) and is 70% state-owned. The rest is owned by EdP. Distribution is in charge of the state³⁰. The biggest Portuguese company is EDP – Electricidade de Portugal and the company was sold out at stock market and has no majority owners (Spanish Iberdola owns only 5%)³¹. EDP is both producer and distributor of electric energy, and possesses control package in Spanish Hidroelectrica del Cantabrico.

Spain – gradual stock selling

Leading roles on the Spanish electricity production market have Endesa, Iberdola, Union Fenosa and Hidroelectrica del Canterbrico. They produce all the necessary electricity in Spain. Only 4% of electricity is imported.

Transmission network is in the hands of REE (Red Electrica de Espana) which is owned by electro power industry companies Endesa, Iberdola, Union Fenosa and Hidroelectrica del Canterbrico (with 10% of the share each, 31.5% owned by the state and the rest is traded on the stock market). REE gradually buys off its shares from Endesa and Union Fenosa³². Endesa's shares were progressively sold out (24.4% in 1988, 8.7% in 1994, 25% in 1997, 33% in 1998). Spanish utilities are becoming increasingly involved in foreign power markets, especially in Latin America. ENDESA owns a controlling stake in Chile's largest power provider. Union Fenosa is involved in Guatemala and Panama while Hidrocantabrico has interests in Mexico. In neighbouring France, ENDESA acquired a 30% stake in SNET, which owns five coal-fired power plants and hopes to control the company completely in a few years.

In 2001, EnBW, Eletricidade de Portugal (EDP) and a Spanish bank Caja de Ahorros de Asturias (Cajastur) took joint control of Hidrocantabrico. However, this sale first came into controversy because the Spanish government threatened to block France's state-owned utility, Electricité de France (EDF), which has a 34.5% share in EnBW, from entering the Spanish electricity market. The European Commission has criticized Spain for allowing regulated prices to block new suppliers.³³

Sweden – 100% state-owned

Liberalization and deregulation of the market was completed in 1998. Swedish energetic companies began with separation of production and distribution business in 1995. Transmission network remained in the hands of national transmission company Svenska Kraftnatt³⁴. As for the production, two thirds of the market are held by Vattenfall and Sydkraft.

Vatefall is the largest Swedish electric energy producer that succeeded in taking 10% of the Finish market by offering lower prices. Vatefall is implementing an aggressive politics of building-up its own electric power plants all over the Finland and alliances with other regional producers. Vatenfall is state-owned³⁵. Besides production, state is also in possession of distribution.

Great Britain - stock market selling

Progressive liberalization matched with disintegration and privatization of former state monopolies in England and Wales began in 1989. British Pool for electric energy trading was founded in 1990. Ever since 1990³⁶, companies in Great Britain have undergone numerous restructurings, especially in the area of distribution and sales. In 1990, there were 5 producers of electric energy: National Power, Powergen, Nuclear Electric and Scottish Power. The last two survived on the market while the rest vanished. Innogy was set up from National Power (owned by German RWE), Powergen is owned by E.ON, and third most immanent company is French EdF. Nuclear Electric was privatized in 1996. Other nuclear power plants were transferred to Magnox Electric which later became BNFL (British Nuclear Fuels) and which is state-owned.

Distribution and supply were in the hands of 12 regional distributors are now in possession of these 5 companies: E.ON, RWE, EdF, Scottish Power and Scottish Hydro³⁷.

Soon after the privatization ended and due to oversized production capacities, a price war in electric energy wholesale took place. Such competitive fight caused a bankruptcy of the British Energy which, at that time, supplied 25% of the total demand for energy. In order to prevent the crisis of disastrous proportions, British government was forced to intervene, which actualized the question of level of responsibility regarding private and national ownership when it comes to public goods production³⁸. The other negative effect of privatization was that number of employees in the British electro energetic sector has significantly shrunk in privatization when compared to other countries of the EU³⁹.

Czech Republic – selling out stopped

The Czech Republic is a keen privatizer but the energy sector has lagged behind other sectors of the economy. CEZ has been a joint stock company since 1992 and has been offered for sale but after several abortive bids the situation remains unresolved. In addition, the government proposes to sell its shares, with an average 60% of each company in the regional distribution companies.

In 2000 Czech government decided that public share in CEZ will be sold at once like one package,

but in two stages. Package would include two 67% of CEZ, but in 2002 the only serious candidate was EDF with a 5 million € bid but the contract was never concluded. So, the first attempt of privatization failed and the government decided to make strong regional company for production, transmission and distribution and then sell it like the whole to a strategic partner. According to that plan CZE would need to buy-out distribution from foreigners and Government and in return, it has to give the government 66% share in CEPS. It was expected that in 2006 CZE should pay the Government 17 billion CZK.

Czech Government decided to privatize distribution of electric energy after 34% share was already decentralized on to local government and 15% was part of coupon privatization. The rest of the network was sold to multinational energetic giants. Also, the Government sold 33% of CEZ.

In Czech Republic, the main role was a dialogue between syndicate and Government. The influence of syndicate was formed because worker's representatives were part of the process of juristic decree legislation and negotiations with investors.

Hungary – foreigners took over the market

The reform of the electricity industry was carried in 1994-95 when the Act on the Production, Transportation and Supply of Electricity came into effect. The Hungarian Energy Office was established and in 1995 the privatization of the public concerns in the sector began. By the end of 1997, 55% of Hungarian utilities were in private ownership. Privatization took place in several phases. Since 1996 distribution and a big part of production of electric energy was sold to western multinational companies.

At present, the majority of power stations and 100% of the electricity suppliers (today called network and service provider companies as a result of privatization) are privately owned.

The spotlight was on the price growth after privatization, return on capital and ways how to split the whole industry before privatization.

Poland

Restructuring and privatization of the energy sector has proceeded slowly due to opposition

from trade unions and other interests. Some state-owned enterprises have been transformed into state-owned joint-stock companies. Polish law permits 100% foreign ownership of most corporations. However, Poland has declared that the state should retain a key role in certain strategic sectors including energy, transportation and others. In these strategic sectors, the Polish State Treasury retains a significant stake and restricts foreign ownership to less than 50%.

In September 1996, a law was passed that laid the foundation for de-monopolization and privatization of the industry. Electricity market is deregulated with production, transmission and distribution separated. According to data from 1996, Government kept 51% of the ownership in these companies, but at the same time foreign investors came to the Polish electricity market. Plans called for reducing the number of generating companies from 33 to 7 and for privatizing power generation by the end of 2001. Two distribution companies have been privatized, Stoen sold to RWE and GZE to Vattenfall and the remaining 29 distributors are being consolidated into five groups. Group 8, consisting of a merger of 8 distributors, has already been created, as well as ENEA composed of 5 companies. The three other consolidations in the pipeline are L6, consisting of 6 companies, K7 of 7 and W5 with 5. Shares in these companies will be sold. Four major power stations out of 17 have been privatized, comprising 20% of total capacity.

The Polish Power Grid Company is scheduled for privatization after 2010.

HEP background

In accordance with law which regulates the electro energetic sector in Croatia, in July 2002, HEP was transformed into HEP Group, consisting of HEP Plc as a dominant society and societies with limited responsibility in core businesses of production, transmission, distribution and supply of the electric energy and other businesses (gas distribution, telecommunications, energetic efficiency etc.). Legally speaking, HEP is a concern.

HEP Plc owns a 50% stake in TE Plomin Ltd. (thermal electric plant) together with German company RWE Power, as well as NE Krško

(nuclear power plant) with Slovenian company ELS GEN.

As for organization of the core businesses of the HEP Group, it is important to briefly describe each of the following companies with limited responsibility: HEP production, HEP transmission, HEP distribution and HEP supply. HEP production owns a permission to perform three energetic activities: electric energy production for tariff buyers, markets, and heating energy production. HEP production contains 3.503 MW of disposable energy in hydro electric plants and thermal electric plants. HEP production capacities produce approximately 70% of total needs for electric energy in Croatia and 90% of heating energy in towns. HEP transmission has a responsibility to ensure an equal access to network for all energetic subjects. Transmission network is divided into 4 areas: Zagreb, Split, Opatija, Osijek. In 2003, it transmitted 14.6 TWh of electric energy with 4.35% energy losses. HEP distribution is in charge of distribution of electric energy to tariff and privileged buyers. It is divided into 21 organizational area, with 56 805 squared km of total area. Since some bigger parts of the network are technically and informatically obsolete, a construction of capital distribution objects in Zagreb, Rijeka and Split are underway. HEP supply is in charge of businesses regarding sales of electric energy to tariff and privileged buyers.

The framework for HEP privatization

Based on the set of privatization principles, group of academics suggested a privatization of core businesses of the HEP Group solely on the HEP Plc. level, which means that companies of core businesses will be in exclusive ownership of HEP Plc. as a dominant society of the concern. A group of authors (named by the Government) suggested an accounting separation of HEP's production, transmission and distribution in order to achieve deregulation; while privatization suggested selling HEP as a legal entity according to the proposed model.

Taking into consideration the principles of HEP privatization, desirable ownership structure of HEP is moderately fragmented with Republic of Croatia being the majority owner. Optimal ownership structure, as authors of the Study suggested, is as follows:

- Republic of Croatia would remain as an owner of 50%+1 share;
- Employees would through the ESOP program indirectly acquire 7% of the shares
- Pension fund would acquire 10% of the shares
- War veterans fund (Braniteljski fond) would acquire 7% of the shares
- 20% of the shares would be sold on the capital market through the IPO process
- In the cross-shareholding process a strategic partner (elected electro energetic European company) would acquire 5% of the HEP shares (in return, HEP would acquire an ownership share package of that company)
- Suggestions to privatize the rest of the HEP shares (1% of the HEP shares minus 1 share) are as follows: restitution to previous owners, treasury shares, or possibly cross-shareholding.

Conclusion

There is no ideal model (or a strategy) that should be generally applied in the privatization process. It all depends on concrete conditions and certain economic structure and needs for capital and technology. There is a need for ownership structure and privatization model that will take into consideration specific circumstances of the economy and particular type of company, which should provide restructuring and increase in economic efficiency. In essence, ownership structure depends on 2 possible solutions: owners could be either foreign investors or employees of that company; i.e. ownership can be concentrated in the hands of a small number of individuals or divided between a greater number of owners.

What Croatian society expects from HEP in the future is a starting point for choosing privatization solutions. Namely, privatization model designed for HEP has to follow a clear vision of which role HEP should have in Croatian economy and what are the long-term expectations about the importance of electro energetic sector as an infrastructural economic leverage of Croatian society.

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Questions for discussion:

1. How would you implement deregulation of the market given that Croatia is an EU candidate and has to comply with directive 2003/54/EC?
2. Given the pros and cons of privatization, should the government privatize HEP?
3. How would you privatize HEP (IPO, public tender, ESOP programs...)?
4. How would you make sure that Pollitt's five major considerations about effects of privatization are ensured?
5. Comment on the proposed privatization model.

STRATEGIC PARTNERSHIP – CASE STUDY OF INA AND MOL

DARKO TIPURIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

ANA ALEKSIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

NAJLA PODRUG

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

Abstract

Transformation of INA through privatization has and still represents a crucial part of Croatian economy. Following liberalization and consolidation in the oil and gas industry, Croatian government decided to privatize its ownership and transfer it to public sector. Model of INA's privatization is planned to go through several phases. In this model of INA's privatization, the first phase included partnership with a strategic investor. By transferring its technology and knowledge, and applying its successful management and business practices, strategic partner enabled further growth and development, revitalization and easier access to resources, markets and innovation.

Key words: *privatization, strategic investor, partnership, INA, MOL*

Introduction

With the process of transition, it became evident that it is necessary to restructure companies in order to act in an open-market economy. Not only is it necessary to restructure the size of the companies, their organizational structure and systems in order to function in fully market oriented economy, it is also necessary to restructure their ownership structure, to diminish government impact and enable private ownership. Results have shown that restructuring which did not involve change in ownership had brought only partial, inadequate and unexpected results¹. Highlighted, active, strategic and deep restructuring was possible to achieve only through privatization. Privatization² refers to any process

aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector³.

As a result of years of planned economy and government regulation, most of the strategically important Croatian companies had or still have the state as their major owner. It is necessary to completely restructure them mostly through privatization, to move from state owned companies to private owned companies. Transformation of large state owned companies represents a major and complex process. To remain competitive in today's global and challenging environment, it is necessary to act on the rules of open market economy following liberalization and consolidation, especially in the oil and gas industry.

In this article we will present one of them – INA, and the first phase of its privatization process, which included partnership with a strategic investor.

INA Oil Industry

INA Oil Industry is a Croatian oil company with a fifty-year tradition, established in 1963 by the merger of an oil exploration and production enterprise and refineries in Rijeka and Sisak. In 1990, INA became a state-owned company and in 1993 a joint stock company. Today, INA is a medium-sized European oil company operating in the field of oil and gas exploration and production, oil processing, and gas, oil and oil products distribution. INA has a leading role in the oil industry in Croatia and a significant role in the region. Its strategic markets include the South East European markets, mainly Croatia, FYR

Macedonia, Bosnia and Herzegovina, Montenegro, Serbia, Slovenia, Albania and South Austria.

INA group comprises of the parent company INA and a number of her daughter companies, e.g. wholly and partially owned subsidiaries or associate companies.

In 2006, INA group had a profit of 883 million Kuna (approximately 158 million US dollars). Total number of employees in INA group on 31st December 2005 was 15, 989⁴. Results for the first half of 2007 show that total sale revenues increased by 4% in comparison with first half of 2006⁵.

All activities of INA group are organized in four core business divisions (1) Exploration and production, (2) Refining and marketing, (3) Retail, these presenting main business segments, and (4) Corporate process and services that don't present a basic business activity⁶.

Process of privatization

Most of the companies in South East Europe operating in the oil and gas industry are still or used to be national oil companies. Same was with INA group. As of 1990 INA became a state owned company. However, changes in business practices and requirements that were in front of companies in today's business environment led to privatization of INA. However, the privatization itself is very complex because of the strategic importance that INA has for the Croatian economy and complete functioning of the Croatian economic system and also because of the large number of interested parties involved in the privatization of INA⁷.

Law on privatization of INA was passed by The Croatian parliament on 19 March 2002. According to this Law on privatization of INA will be implemented through phases. Those phases are:

1. Transfer without compensation of 7% of shares to Croatian defenders and members of their families
2. selling at most 7% of shares to employees and former employees in companies that form INA group, under special privileges that will be determined by the Government of the Republic of Croatia

3. selling at most of 25% plus one share to strategic investor
4. selling at least 15% of shares through initial public offer, according to regulations that determine issues and transfer of securities, to: a) Croatian citizens, with the primacy rights, with privileges and under conditions determined by the Croatian government after insertion of INA's shares on official quotations b) domestic legal entities and foreign investors, without primacy rights and special privileges by selling through public offering
5. selling or replacing remaining part of shares according to market opportunities to strategic investor or on a capital market, on the basis of the decision made by the Croatian Government and with former consent of the Croatian parliament
6. from the remaining part of the shares necessary, certain number of shares will be excluded for compensation to former owners that are entitled to it according to the Law on compensation for assets taken during the time of Yugoslavian communist government.

Law also determines that the Republic of Croatia in its direct ownership retains the property over 25% plus one share of INA that will be privatized on a basis of a special law after Croatia joins the European Union.

The Croatian government executes all rights from INA's shares that are in the ownership of the Republic of Croatia, except when that is conferred to Croatian parliament.

During the period while the Republic of Croatia owns 50% and more of INA's shares, INA can make decisions that is take legal measures which refer to any sale or joint venture that exceeds the value of over 3% of INA's assets only with the approval of the Government. During the period that Croatian government owns 25% or more of INA's shares, Government can decide that their acceptance will be necessary for such decisions or actions if their value exceeds 25% of the value of INA's assets.

First phase of privatization

With the Law on privatization of INA, Croatian government brought decision to sell 25% plus

one share to a strategic partner. Government conducted the selling procedure, choice of strategic partner and concluded the selling contract. Process of sale started on 10 May 2002. It was then when CEO of INA Tomislav Dragičević highlighted the importance of that moment for INA: I am convinced that the potential investors will show a great interest. We want INA to be a strong and competitive player on the European oil and gas market. Our main goal is further development of the company, which can only be ensured by a strong strategic partner with its investments, technological development and implementation of the best international business standards.

Economic department in cooperation with Croatian Government's advisers, PriceWaterhouseCoopers and Deutsche Bank, on 10 May 2002, announced in Financial Times and domestic paper Vjesnik a call to submit declaration of intention to all interested investors. The deadline was 31 May 2002, when first declaration of intention had to be submitted. Afterwards, until 14 July 2002 interested investors had to submit detailed offers of their strategic approaches to growth and development of INA.

Selection criteria for strategic partner were oriented towards their capabilities to fulfill the goals that the Croatian Government and INA have determined for the privatization process:

1. liberalization of energetic industry which would ensure the highest quality of service for Croatian customers and in accordance to requests of the European Union
2. expansion of INA's assets and market, including development of new investments in company
3. achieving the highest standards of management and business practice
4. transfer of global technology and knowledge standards
5. creating revenues for Croatian Government
6. supporting ecologically best practices and methods

Until 14 July 2002, 10 companies have submitted their detailed offers:

1. Edison gas,
2. Emerging Market Partnership,
3. Hellenpetroleum,
4. Lukoil/konzorcij sa LATSIS group,
5. MOL,
6. OMV,
7. Petrol/Israeli consortium,
8. PKN Orlen,
9. ROSNEFT,
10. Sibneft.

After accepting certain number of offers, potential investors were asked to carry out the process of due diligence. Each of the potential strategic partners had one week at their disposal to go through the process of due diligence, during which management of INA held presentation for each of them and allowed full access to all relevant details.

On 22nd June 2002 Croatian Government announced list of the companies that would continue the process of privatization as potential strategic partners. Those were the following 5: Edison gas, Lukoil, MOL, OMV and ROSNEFT. Consortium Edison Gas- Hellenic Petroleum didn't go through the process of due diligence and therefore was excluded from the privatization process.

By opening final and obligatory offers given from the three companies, the Hungarian MOL, Austrian OMV and Russian ROSNEFT oil company entered the final phase of INA's privatization of 25% plus one share on 10 June 2003. Potential investors submitted their final and obligatory offers to the Ministry of Finance. Hungarian oil company offered 505 million dollars for 25% plus one share of INA, Austrian oil company OMV offered 420 million dollars, a Russian oil company ROSNEFT, after clear Government messages that there were no plans on selling major package of shares, gave up the further competition. Apart from the financial side, offers consisted of technical and operative conditions

On 17 June 2003, the Croatian government and MOL - Hungarian Oil & Gas Company signed the Contract for buying and selling 25% plus one share of INA in accordance with the Law on privatization of INA in the amount of 505 million dollars. After the money was transferred to the account of Ministry of finance at the Croatian national bank on 10 November 2003, the first phase of privatization for Croatian oil industry finished.

Strategic partnership of INA and MOL

Expansion of INA's assets and market, developing the highest level of management and business practice, transfer of global technological and knowledge standards and creating revenues for Croatian Government were some of the most important conditions that were put in front of the potential investors when purchased INA's shares. With such logical preconditions for partnership that would possess more resources, knowledge and capabilities from every company individually, were made.

MOL's success was a consequence of a duly exit from the frame of national oil company and their involvement into 12 privatization processes prior to INA's privatization because they saw themselves as a strong partner for companies that have state as their owners. Since the beginning of privatization ownership structure of MOL was stable. Around 65% were international investors, typical pension funds that came mostly from America, while lately more and more investors came from Europe. Hungarian government still has ownership of 1,7%, since the MOL board had offered to buy out 10% from the government, and with intention to use that share for strategic bounding.

Balance of forces in INA allows Hungarians to be corrective when that's in their interest and when they base their strategically important decisions. Their ownership share brings great power and control but at the same time the appetite for additional affirmation of their position in Croatian company.

By acquiring 25% plus one share, MOL became INA's strategic partner and INA found its way into an integrated regional oil and gas industry partnership consisting of MOL, INA, Slovnaft and TVK. The cooperation and the materialization of

synergies have continued in year 2006. In 2006 INA and MOL continued the work in upstream activities. In cross-border field operations along the Croatian-Hungarian border INA and MOL started a joint natural gas exploration program in Podravska Slatina and Zalata areas. The experts of both INA and MOL are optimizing the technology and the know how in order to bring the fields into development. INA and MOL are jointly evaluating the international upstream business opportunities for possible future cooperation on international projects. By diversifying risk and combining the financial and human resources, both companies will improve operations and efficiency. Another key area of the current cooperation between INA and MOL includes development and implementation of a full modernization program at both of INA's refineries. The comprehensive refinery modernization project has as its objective to rank INA among the most technically advanced refiners in the region by expanding the refining capacity and reaching EURO V quality standards of oil products which are expected to become effective in 2009. In this 1,000-1,100 million dollars project INA benefits from MOL's experience in modernizing its own refineries. The partners have formulated a marketing strategy for the South East European region, including the review of retail positions in the region. The coordination of market activities, the exchange of knowledge and the implementation of joint projects are intended to help INA in achieving growth targets in regional oil, natural gas and refined product markets. In addition, MOL supports INA in establishing organizational best practices in a variety of areas, including procurement, supply chain management, insurance and health, safety and environment. In September 2006 MOL/INA consortium (50% INA and 50% MOL) signed a Recapitalization Agreement with the Government of the Federation of Bosnia and Herzegovina and Energopetrol for the acquisition of a 67% interest in Energopetrol. The Bosnian company is a market leader on its domestic market and owns 65 petrol stations in Bosnia⁸.

Entering INA, Hungarian company has announced its candidacy for major market leader in South Eastern Europe. Hungarian company is speculated to become the owner of another package of INA's shares which would enable them to take control over the corporation.

In the future strategic partnership will depend on revitalization of INA's capacities necessary for distribution of oil and gas on the market and capabilities of INA's management and Croatian state to finish the rest of the privatization process.

Conclusion

For a successful functioning of Croatian economy it was necessary to start with the restructuring of large and strategically important state owned companies. It was necessary to start the privatization of INA in order to develop it into a competitive player not only on Croatian but also on the regional market of oil and gas industry. First phase of the privatization process ended. MOL and INA became strategic partners.

However, some questions arise, such as why company like INA, with an income of 150 million dollars in the time of sale, did not reach for buying share in some company with potential to grow? In the long run, that kind of investment with smart management and leadership could also earn large revenues for the government and most importantly, grow and internationalize company, simultaneously transforming it into respectable market.

Nevertheless, from the phases determined by the Law, three phases have been carried out. One in 2003, regarding selling 25% + 1 share to a strategic partner, second in 2005 by transferring 7% of shares to a special Fund of Croatian defender (Fond hrvatskih branitelja), without compensation and third in 2006 with initial public offering of 15% of shares. First initial public offering was the most important transaction on domestic capital market since it was the largest domestic IPO ever and there was a significant participation and demand of Croatian citizens. Although these three phases of privatization have finished, three still remain until the acceptance of Croatia in the European Union. Then, since the Republic of Croatia, in its direct ownership, will retain the property over 25% plus one share until entering the European Union, the remaining part will also be privatized on a basis of a special law. So, since still a significant part remains unprivatized under government ownership, great interest in the following phases is also expected.

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Questions for discussion:

1. Would you agree that the first phase of privatization of INA was successful? Explain why? Where there any steps that could have been done differently?
2. In your opinion, did the Croatian government have too strong influence in the process of privatization?
3. If INA, instead of a strategic partnership, had invested in some company with potential to grow, do you think that the INA would have the same potential for growth and development?
4. If you could, what directions for future strategic development would you give to INA's top management team?

SECOND PHASE OF PRIVATIZATION OF INA – INITIAL PUBLIC OFFERING

DOMAGOJ HRUŠKA

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

CLAUDIO VIGNALI

TOURISM, HOSPITALITY & EVENT SCHOOL, LEEDS METROPOLITAN UNIVERSITY, LEEDS, UK

FRAN GALETIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

Abstract

After the summer 2006, Croatian Government started the second phase of privatization of Croatian oil company INA. 15% shares were sold to Croatian citizens in the initial public offering. Each of them had a chance to buy shares worth up to 38 000 kunas. The first day of trading on stock exchanges in Zagreb and London showed that the decision of buying shares of INA was good. The price increase was very high and the shareholders could earn already on the first day of trading.

Key words: INA, privatization, initial public offering, Zagreb Stock Exchange, London Stock Exchange

Introduction

INA Oil Industry is one of the biggest Croatian companies, which is focused on oil and gas exploration, production, distribution and selling. Apart from Croatia, INA has many branches in other neighbouring countries. The privatization of INA started in 2005, when Croatian Government decided to sell 25% plus one share to a strategic partner. From ten companies that gave their offers to buy INA shares, the Government chose Hungarian MOL. The contract was signed in the mid 2003 and MOL paid 505 million US dollars. With this transaction ended the first phase of privatization of INA.

Planning IPO

In the middle of September 2006, Croatian Government made decision to start the second part of privatization of INA, which meant making an IPO. According to Government's decision, 13th

November the sale of 15% common shares of INA, or its 1,5 million common shares with potential option of additional sale of 2% company's regular shares by public offering started.

In the initial public offering of INA, Croatian citizens had the priority and special benefits with the limitation of maximum amount of 38 000 kunas. They made their offers according to the so called privileged offer. Apart from Croatian citizens with right of priority and special benefits, right of participation in the public offering had also Croatian citizens who wanted to buy shares in amount over 38 000 kunas and they made their offers according to the unprivileged offer together with domestic and foreign legal persons as institutional investors who had made their offers according to indicative offer. The price of shares was specified to be between 1400 and 1900 kunas.

Privileged offers could be given from 13th do 23rd November 2006, while the period for giving offers without right of priority and special benefits was from 13th to 27th November 2006. Offers were accepted in the offices of Raiffesienbank and FINA (Financial agency). Merrill Lynch International was involved as the only global coordinator, and together with RZB Group, which is represented by Raiffeisen Centrobank AG Vienna and Raiffeisenbank Austria d.d. Zagreb, they operated as the chief of the book of offers.

According to this method of privatization of state owned enterprises, the control of business is moving from the government to the capital market¹. When effectiveness of the corporate control is concerned, it is very important to notice that in the case of privatization by IPO, there were

a large number of small shareholders who couldn't supervise the management properly.

Advantages and disadvantages of going public for a company

What company gains if it goes public:

- future financing is easier, if investor's interest for corporation stays big enough to keep listed securities trade on secondary market,
- access to the capital, apart from the initial emissions there is a possibility of additional emissions,
- the company becomes well-known, the image towards potential investors is growing,
- by going public organization assets value is growing, company is more transparent and has better structure, what gives additional value,
- market value increases compared to similar private corporation because of increased liquidity, better access to information and already mentioned additional value,
- company becomes more attractive and can attract and keep high educated personnel, if it offers share options, bonuses or other incentives with well known market price,
- company credibility improved in the eyes of suppliers and clients because market exposure and easy access provide a feeling of safety,
- possibility of expansion is improved because it is easier to negotiate about acquisition and fusion if shares are traded publicly. When shares value is defined, they can become "currency" which can finance future transactions.

Challenges and disadvantages of going public:

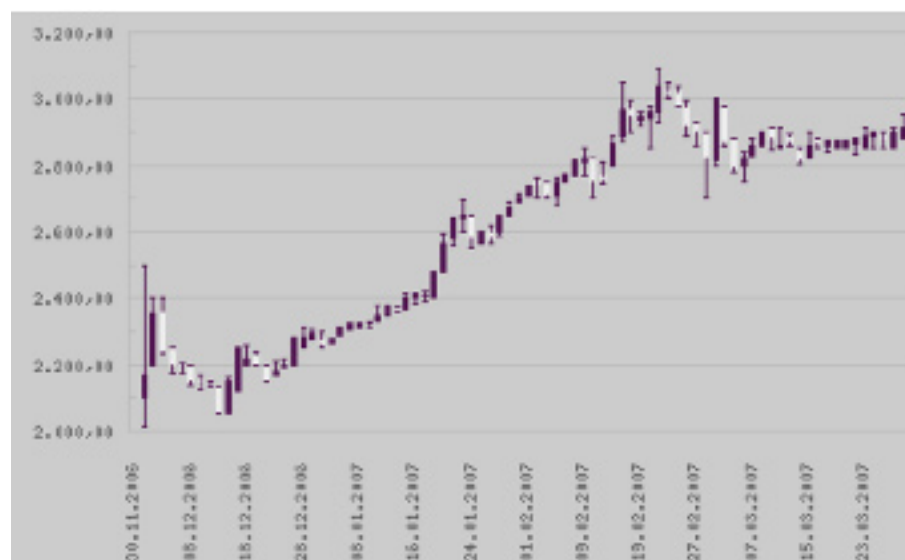
- going public is usually unilateral process, it is not easy to change the public company into private company,
- costs can be very high, but there are reasonable if emission succeeds, which it is not guaranteed,
- a significant cost is also the time invested in process - market research, presentation for potential investors, writing, printing and distribution of quarter and annual reports take a significant part of top managements time,
- the loss of privacy can be annoying, because secret details of business, transactions and contracts, are suddenly available to everyone, especially to competitors (selling costs, gross income, net income, biggest clients, cash flow, salaries and privileges of top management),
- the loss of control is a direct consequence of losing ownership, which is constantly divided by trading on secondary market,
- reduced flexibility of leadership is conditioned by getting the permission from management and shareholders for making important business decisions,
- there is a obligation of informing shareholders about business activities of the company, financial situation, costs, management, as well as about new legislative obligations,
- pressure problem in short-term results - it is necessary to balance short-term growth with the long-term business goals,
- market volatility, external economic factors and vertiginously share market have big influence on the value, but they are not under the control of the company.

The basic advantages and disadvantages for using this method in company privatization can be defined (Table 1.) as a result of going public.

Table 1. The most important advantages and disadvantages in company privatization by the method of initial public offering

Advantages of IPO	Disadvantages of IPO
<ul style="list-style-type: none"> privatization transparency - legitimating of the public 	<ul style="list-style-type: none"> reducing government's control
<ul style="list-style-type: none"> easier procedure for getting capital for investment cycle 	<ul style="list-style-type: none"> pressure from new owners and market for higher grow and dividends
<ul style="list-style-type: none"> development of capital market 	<ul style="list-style-type: none"> orientation on short term goals
<ul style="list-style-type: none"> possibility of participating of employees in the ownership 	<ul style="list-style-type: none"> obligation of following the complicated law regulations
<ul style="list-style-type: none"> value growth of the company 	<ul style="list-style-type: none"> high enforcement's cost

Graph 1. Movements of market prices of INA's shares on Zagreb Stock Exchange



Source: www.zse.hr

Graph 2. Movements of market prices of INA's shares on London Stock ExchangeSource: www.londonstockexchange.com

Trading start

After the initial public offering was completed, on 1st December 2006 INA shares were introduced on Zagreb Stock Exchange and London Stock Exchange. On Zagreb Stock Exchange, shares of INA were introduced in the highest quotation. In the first hour of trading, the turnover of those shares crossed 90 million kunas, and at one moment the price reached 2500 kunas. INA shares ended the first day with final price of 2170 kunas and recorded a turnover of 188, 4 million kunas, which just confirmed the interest for INA shares, but also attraction of those shares among domestic investors.

The trading on London Stock Exchange was also very active. The highest shares price was 420\$, and the lowest 361\$ and the turnover of the first day was 4 times bigger than on Zagreb Stock Exchange.

Second day of trading on Zagreb Stock Exchange brought expected calming, so the turnover was 37,3 million kunas and price increased for 8,5% to final 2355,02 kunas. The fall of trade was registered on London Stock Exchange also, so final volume of trade was 4 times more than on Zagreb Stock Exchange. The final price was 409\$ (about 2,270 kunas). In June 2007 the price starts falling due to the financial crisis in the whole world. But it never decreased under the initial value.

On 27th November 2006 Croatian government decided to sell INA shares for the price of 1690 kunas. Citizens who gave obligatory offer with priority and special benefits for maximum amount

of 38 000 kunas were allowed to buy 22 shares and if they keep them one year, they will get one additional share for every 10 shares they have.

In the process of privileged offer 44 640 citizens bought INA shares paying 1, 55 billion kunas, while the government earned 2,86 billion by selling INA. 747 citizens applied for buying INA shares in the amount bigger than 38 000 kunas. They had the opportunity to buy additional shares for maximum 30 000 kunas.

The total demand for INA shares was 19,6 billion kunas out of which the domestic demand was 5,3 billion kunas. The interest was 7 times bigger than the offered amount, while on the international market the interest was 9 times bigger. About 71% of the offer was allocated to the domestic market – 56% to private investors and 15% to institutional investors. The rest was for foreign investors. From 46% shares which remained after the citizens' request for shares with priority and special benefits were completed, one part was kept for bonus shares. Deducting that, 35% shares remained for Croatian citizens in the unprivileged offer and domestic institutional investors, while the rest of 65% were bought by foreign institutional investors.

Deputy prime-minister Damir Polančec said² that the allocation of the remaining shares was good and that it guaranteed the adequate allocation on domestic and foreign investors and ensured secondary liquidity of shares. He also emphasized that the initial public offering reached two strategic goals – it would contribute to capital market

development in Croatia and help motivate the citizens to participate in shares trading.

Although INA shares were traded just one month in 2006, they succeeded to enter among 4 shares with the highest trade. The turnover was 421,6 million kunas, with the first-day turnover of 188,4 million kunas.

Conclusion

The second phase of privatization of INA finished successfully. Initial public offering was very interesting for Croatian citizens and many of them participated in buying shares for the first time. The decision to buy INA shares was good. Its' price increased very rapidly on both Zagreb and London Stock Exchange.

The next phase of INA privatization is the allocation of 7% of shares to the war defenders and theirs families. The government should make decision about setting up the commission which will create the model of privatization in next three months, which means selling 7% shares to the employees under the privileged conditions. This model should include the period of time in which employees cannot sell their shares.

Endnotes

1. In the case of privatization of state owned companies, it is not rare that the government keeps a small part of ownership which gives it a special right to vote – the golden share. Those special shares are issued in intention to keep corporate control of capital market, mainly because of the fear from hostile

takeover. It is very interesting that Republic of Hungary has the golden share of MOL which allows it to influence the retail price of oil derivatives

2. On the Governments' press conference

Questions for discussion

1. What was the main motive for starting the second phase of privatization of INA? Do you think it was too early, too late or just in the right time?
2. In your opinion, is the proportion of shares offered in the process IPO high enough or should the Government have offered more since the interest of citizens was so great?
3. What do you think was the main reason for the rapid increase in the price of INA shares on stock exchanges on the first day of trading? Would you, as a shareholder, have sold the shares on the first day or not? Why?

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MARKET FOR CORPORATE CONTROL, AN EXTERNAL MECHANISM OF CORPORATE GOVERNANCE – CASE STUDY OF PLIVA'S TAKEOVER

DARKO TIPURIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

DOMAGOJ HRUŠKA

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

MARINA MEŠIN

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

Abstract

Main goals and objectives of this case are to present the market for corporate control, external mechanism of corporate governance, at work. During the summer of 2006, Pliva was the subject of a bidding war between Iceland's Actavis and US-based Barr Pharmaceuticals marking the first significant takeover of a publicly traded Croatian corporation. Scenario of Pliva's takeover offers everything that today's takeover can offer – from so called "hostile takeover", strong public and hidden pressures on management of the regulatory body for capital markets to classical business and political intrigues.

Key words: takeover, market for corporate control, corporate governance, Pliva, Barr Pharmaceuticals, Actavis

Introduction

Market for corporate control is one of the external mechanisms of corporate governance along with legal infrastructure, protection of minority shareholders and conditions of competition¹. Model of Market for corporate control was first featured, independently of one another, by Robin Marris and Henry Manne². The basic postulate of this model is that managers can govern a corporation as long as its market value can't be significantly improved by an alternative group of managers with an alternative business strategy.

Model is based on a simple explanation of market performance: if management doesn't make quality investment decisions or if it doesn't take actions that will maximize share value, the market will ensure replacement of management. Market for corporate control acts as a "threat" to management because of the possibility of losing control over the corporation.

There are two ways of taking over control of corporations without the consent of the present management. First is proxy fight, when external players challenge present management, suggesting new management team and seeking shareholders support by direct votes or proxy votes. Second is tender offer, from the side of potential Takeover Corporation and usually above the shares market value to motivate shareholders on sale³.

In Anglo-American model of corporate governance, Market for corporate control is the most important mechanism because it creates constant pressure on management. Existence of active market for corporate control is relevant for efficient allocation of resources.

Since Croatia belongs to countries of European-Continental model of corporate governance, Market for corporate control doesn't have such relevance in development of corporate governing structures as it has in countries of Anglo-American business circle. The characteristics of Anglo-American system of corporate governance are fragmented ownership structure and the important

role of institutional investors, all of which positions management in the center of corporate events. The power is shifted towards the management which makes decisions about all crucial issues in the company. In some situations, managers will use the position they have, putting their personal interest before the interests of the shareholders. If there is an active Market for corporate control this kind of behavior will be sanctioned. As opposed to Continental system of corporate governance where there is significant ownership concentration that puts owners in the center position of corporate governance. Control is concentrated in the hands of a small number of investors and blockholders have a significant role while they take an active role in supervising and governing the company. Because of all these reasons role of capital markets is less significant in Continental system of corporate governance than in Anglo-American system and stock market doesn't function as a Market for corporate control like in Anglo-American system.

In the last ten years there were about 400 successful takeovers in Croatia⁴. Pliva takeover

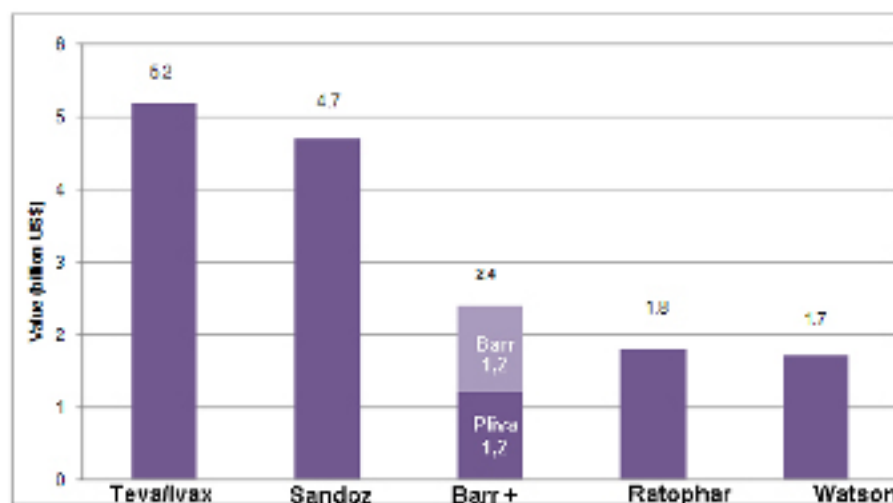
was certainly the most exciting one. In this case study we present the scenario of how Pliva was taken over and the effect of market for corporate control.

Takeover of Pliva

On October 20th 2006 Pliva Ltd. and Barr Pharmaceuticals, Inc. announced that Central Depository Agency revealed final results of the tender gathering process and that Barr Pharmaceuticals, Inc. acquired 17.056.977 shares which accounts for 93,5% of Pliva's equity.

Integration of Barr Pharmaceuticals and Pliva led to forming the third largest global generic pharmaceutical company according to total income. Integrated company will be present on more than 30 markets and will employ about 8.000 people. Annual income of integrated company will be around 2,4 billion US \$, and its stock will be listed on New York Stock Exchange under the sign BRL.

Graph 1. Market shares of global generic pharmaceutical companies



"With this transaction two companies are integrating into a unique global company with more than 120 generic and 25 proprietary pharmaceuticals in the USA and more than 550 products in West and East Europe" said Bruce L. Downey, President and CEO of Barr Pharmaceuticals, Inc. "Our future investments in R&D of new products will be more than 200

million US \$ a year and the intergraded company will have more than 200 pharmaceuticals in development. Advantage of acquiring Pliva is also the access to new drug delivery systems, production of private active pharmaceutical substances and vertical integration as well as a very strong position in R&D of biotechnological drugs. Intergraded company will have a strong

*cash flow and financial balance sheet that will allow us to pay off the loan associated with this transaction and at the same time invest in expanding of our infrastructure in Europe and US and develop new products.*⁴⁵

Temporary withdrawal of Iceland's Actavis from the competition with American Barr for Pliva resulted in final withdrawal of that firm. That would mean that in corporate, media and politically strong competition between two companies, Barr demonstrated stronger financial power and desire for taking over Pliva.

Pliva – “from a hunter to the prey”

Pliva was established in 1921 and is the leading Central and Eastern European pharmaceutical company with a portfolio of more than 1200 products competing in over 30 countries worldwide, including the key markets of Croatia, Germany, Poland and Russia. The company became one of the first global sulphonamide producers in the 1930s and went on to patent the groundbreaking macrolide antibiotic azithromycin in 1980. Pliva develops, manufactures and markets both finished dosage form branded generic pharmaceutical products and active pharmaceutical ingredients (APIs), with products including solid dose forms, injectables, creams/ointments, Over-The-Counter (OTC) products, cytostatics, and APIs.

Pliva d.d. was nationalized in 1947 and had been in public ownership since then. In 1993 the enterprise was privatized again. According to programme of privatization, Pliva d.d. became a unified stock company – through transfer of stocks to funds, without reimbursement, and in the following way: two thirds of stocks were transferred to Privatization Fund and one third to the fund of workers and the fund of farmers. Pliva d.d. and Croatian Privatization Fund signed a contract which defines possibilities of buying stocks for individuals – employees and former employees of the enterprise. At the end of privatization, employees acquired 77 039 stocks in this way, i.e. 11% of company's capital⁴⁶.

Ten years ago Pliva was in an excellent position. Regular income from royalty on Azithromycin seemed as a sufficient assurance to management for strong strategic moves.

The main goal was to globalize Pliva and it seemed as if management knew what they were doing.

They chose a strategy of combined development in two pharmaceutical industry segments: production and operation in originally produced and protected drugs (proprietary) and production and operation in pharmaceuticals that didn't have patented protection (generic pharmaceuticals). Other operations outside pharmaceuticals were disinvested (e.g. selling Neva and Cedevita to Croatian Atlantic Group Ltd.) and that seemed like a reasonable move.

It's not hard to conclude that Pliva's strategic orientation during the last fifteen years was directed at forming a completely integrated global pharmaceutical company. A different question is whether Pliva was capable for that. On one side, they developed a range of generic pharmaceuticals intended for sale on global market, while on the other side they worked on R&D projects and specific projects that will continuously meet the need of the global market.

Pliva directed most of its investments towards fast growing generic markets of Western Europe and continuous R&D of new generics, especially pharmacy and so called “new molecules” i.e. substance assumptions for creating completely new drugs.

By acquisitions in Western Europe and USA in the past years Pliva set up its business in seven out of eleven biggest pharmaceutical markets.

All until few years ago it seemed that Pliva was following the strategy that had features, to paraphrase Harvard's Michael Porter, of a “stuck in the middle” situation. Pliva was trying to compete in all segments with the biggest global players, which wasn't real. Pliva's management, it seems, forgot that the art of strategy, in most cases, is a choice of things and businesses that we won't do and not a choice of things that we will do.

Main reason for Pliva's business fall was bad development strategy that was based on the new Azithromycin and expansion into new markets. For exclusive rights for selling Sancture medicine Pliva paid 150 million US\$ and another 100 million US\$ (according to independent estimates) for analyzing the market so that, in a year, these rights would be sold for 50 million US\$. That's how, despite the income of 2,3 billion US\$ that came from royalties on Azithromycin (Sumamed), Pliva became the target for takeover a year after royalty expired.

Table 1. Companies that Pliva acquired

		Year of acquiring
Polfa Krakow	Poland	1997
Lachema	Czech Republic	1999
Pharmascience UK Ltd.	United Kingdom	2000
AWD Pharma GmbH & CO.	Germany	2001
Sidmak Laboratories, Inc.	USA	2002
Edigen	Spain	2003

Graph 2. Price of Pliva's stock on Zagreb Stock Exchange from October 2005 to October 2006Source: www.pliva.com

Management's strategic "games" could only last while Pliva's source of growth was safe and linked to incomes from Azithromycin. In November 2005 patent protection and incomes stopped and Pliva was faced with a new difficult situation. During that year management made a strategic decision to leave proprietary business and the new strategy was completely focused on generic business and expansion to the new markets in that industry segment.

In spite of cumulative incomes from royalties of 2,3 billion US \$, Pliva became a target of takeover only a year after royalties expired. The thing that made Pliva a target, apart from the position on a few markets, was also the fact that her production lines were working only at 30% of their capacities. Pliva was no longer a "hunter", it became the "prey".

Graph 3. Price of Pliva's stock on London Stock Exchange from October 2005 to October 2006.

Source: www.pliva.com

Fall of Pliva's market value and Actavis's offensive

In a statement for Financial Times, year or two ago, Pliva's CEO Željko Čović emphasized that despite the trend of concentration in pharmaceutical sector in Central East Europe Pliva remains an independent company. Pliva, as a leading regional pharmaceutical company, undoubtedly represented good 'bait' for big multinational companies. Although Čović claimed that Pliva had enough internal mechanisms to preserve the price of its stock, meaning that it can resist hostile takeover, it was shown otherwise. With the down trend of its stock value, Pliva got vulnerable by the day. To support this claim is the fact that since the invention of Azithromycin antibiotic, whose license rights expired in 2005 and which generated a third of Pliva's income, Pliva didn't launch any new product.

Let's recall the price of Pliva's stock in the past few years. In 1997 Pliva's market value was 1, 78 billion US \$ and at the end of 2005 it was around 1,24 billion US\$, which is a 30 percent fall. At the same time market value of Slovenian Krka, a pharmaceutical company that was somewhat smaller than Pliva, grew from 530 million US\$ to 2,07 billion US\$ or more than three times.

Scenario of Pliva's takeover

Scenario of Pliva's takeover offers everything that today's takeover can offer – from so called "hostile takeover", this is how Pliva's management call Actavis's first nonbinding offers, to strong public and hidden pressures on management of the regulatory body for capital markets (Hanfa – Croatian Financial Services Supervisory Agency) to classical business and political intrigues.

Everything began on March 1st 2006 when Pliva announced annual business results that clearly showed every mistake of Pliva's business policy. Just to remind, on a briefing that was organized for that occasion, to a question from one of the reporters if Pliva is expecting an offer from some strategic partner Čović answered that Pliva doesn't need a strategic partner because it is strong enough to do excellent business independently.

A few days after that Pliva's stock price increased and on March 13th Actavis sent a letter of intent to buy Pliva to Pliva's Management Board. Three days later Pliva's Management Board said that the company is not for sale. The very next day they confirmed that they received Actavis' nonbinding offer of 570 kn per share, which represented an increase of 160 kn per share in relation to average share price in the past three months.

To get rid off an unpleasant potential buyer, Pliva's Management Board and their consultants

investigated ways to defend themselves from a possible hostile takeover. From about twenty known strategies of defense from hostile takeover (when the Management Board doesn't approve a potential buyer) Pliva's Management Board decided for the strategy called the "White knight", which meant finding a buyer that is adequate and that is willing to compete with Actavis. A logical choice was: Barr Pharmaceuticals, Inc., American company without European base, with a lot of money ready for acquisitions and serious development goals.

Soon after that, on March 20th, Government said that it wouldn't sell its 18 percent of Pliva's shares. Ten days after Deutsche Bank became Pliva's consultant and Čović emphasized that Actavis should have offered at least 800 kn per share. As a result, Actavis insisted that Pliva should let them perform due diligence but in spite of that Pliva refused and they increased their nonbinding offer to 630 kn per share.

At the end of May, Financial Times published that Barr is giving a nonbinding offer of 2, 1 billion US\$, that is 705 kn per share, which was officially confirmed by the American company.

During June Hanfa got more involved in the story and warned Čović, Actavis and Barr not to go outside legal framework and that the takeover could only happen by public offer.

Contrary to Actavis' offer, Pliva's Management Board and Supervisory Board considered Barr's offer "friendly" and fair and on June 27th the Supervisory Board recommended shareholders to accept Barr's offer. On the same day the Government declared that the State will sell its shares but that the price will not be a critical factor. Actavis responded and said that by privatization law the Government could not sell the shares from HFP (Croatian Privatization Fund) during the public offer. The only way the Government could do it was to exclude Pliva's share from the Fund portfolio and give it back to HZMO (Croatian Pension Fund) to manage, after which the HZMO can deposit the shares with SDA during the time of the public offer. But, by doing that the Government would confirm media speculation of protecting Barr.

The situation got tenser and Actavis increased its, still, nonbinding offer to 723 kn per share and bought 10 percent of shares from PBZ CO Pension Fund, what will later on become a target of Hanfa's investigation because of the damage made to fund's shareholders. But, Barr gave a contra offer of 743 kn per share. After repeated media warnings, Samodol (Hanfa's CEO) warned Čović to stop routing the course of takeover that didn't ever officially start.

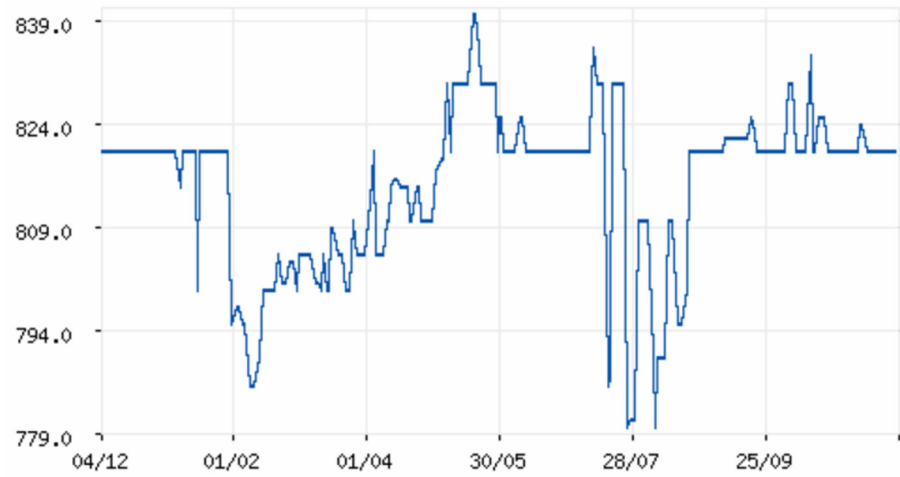
Finally, on July 3rd Barr announces the intention to give an offer to take over Pliva and Pliva's management made considerable pressure on Hanfa in fear that Actavis will get 25 percent + 1 share of the shares (in that moment Actavis had 20 percent) even before the public offer. Because of this, pressure on Samodol kept getting stronger, who at one point ever sent in his resignation. But, Hanfa's CEO didn't give up, even more; he said that Čović would have ended up in prison if Croatia had American laws. After his statement Čović stopped favoring Barr.

Process of taking over Pliva went under Hanfa's control and there were no bigger media actions till September when Barr announced first binding offer that confirmed the last price of 743 kn per share. Actavis responded with the contra offer of 795 kn per share which made Barr increase the offer to 820 kn per share. Actavis said that they will revise the situation, but even that it looked as if they wouldn't have the will to keep fighting.

"Even though we still believe that the combination of our two businesses can make one of the most exciting companies in our industry and a good foundation for achieving future growth, we don't want, despite extremely strong synergies, to jeopardize our development plans overpaying this acquisition" stated Robert Wessman, President and CEO of Actavis, when withdrawing the offer.⁷

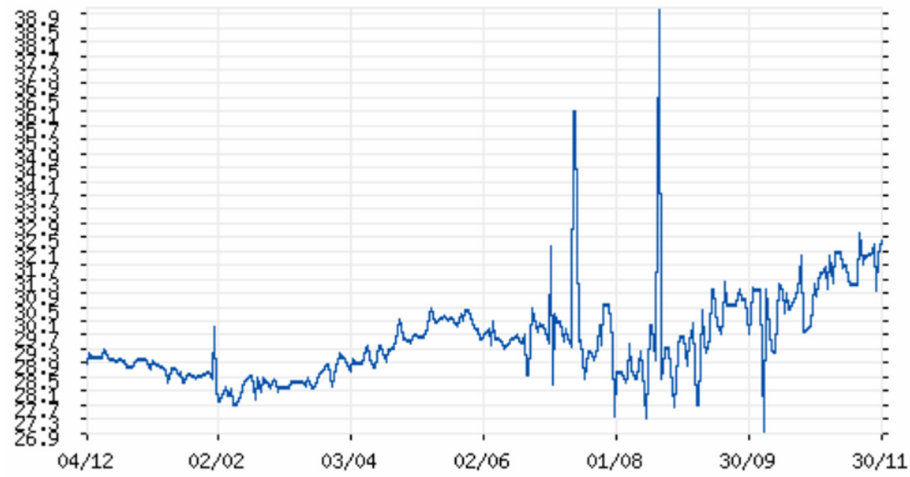
But, Željko Čović, who ended up as a loser in Pliva's strategic and business decisions, by some fortune game of the stock market, became a winner because market capitalization of Pliva increased from 1,2 billion US\$ at the beginning of the takeover to 2,4 billion \$ at the end of the public tendering.

Graph 4. Price of Pliva's stock on Zagreb Stock Exchange from December 2006 to December 2007



Source: www.pliva.com

Graph 5. Price of Pliva's stock on London Stock Exchange from December 2006 to December 2007



Source: www.pliva.com

This case points out the (ir)rationality of today's market in which premiums on takeovers skyrocket and the stock price doesn't, by far, match the price by so called fundamental analyses of company's value. This is how Pliva was, by fortune and by action of Market for corporate control, finally "estimated" at the amount that is adequate to its income made from royalties on Azithromycin – the same income that was, with bad strategy of Pliva's Management, left inadequately invested in a competition race with players in global pharmaceutical industry.

Conclusion

Headquarters of the new company are Barr Pharmaceuticals, Inc., in Woodcliff Lake, New

Jersey, while the center of European business of the new company will remain in Zagreb. Mother company, Barr Pharmaceuticals, Inc., is ran by Bruce Downey and Željko Čović runs European pharmaceutical business as the President and CEO.

Company's shares are traded on NYSE (under the symbol BRL).

Barr's goal, after the acquisition, is to become a leader in all markets that they are present on and Western Europe which was recognized as an important market. Focus will be identifying areas where synergy is possible and using knowledge of both companies to achieve maximal productivity and efficiency. There is very little overlap in products and markets between Pliva and Barr.

Table 2. Comparison of Barr Pharmaceuticals and Pliva

	BARR PHARMACEUTICALS	PLIVA
Income	1,24 billion US \$	1,17 billion US \$
Net profit	335,1 billion US \$	223,4 billion US \$
Key markets	USA, Canada	USA, Croatia, Poland, Russia, Germany, Great Britain, Italy, Spain
Number of employees	2000	6000
Divisions	New York, New Jersey, Pennsylvania, Virginia, Ohio, Washington DC	Zagreb, Hrvatski Leskovac, Savski Marof, Krakow, Brno, Goa, New Jersey

Pliva gives access to growing pharmaceutical markets of Central East Europe and Russia as well as access to West European market. Above all, recent opening of biological research center in Goa, India, will allow cheaper research than in USA.

It is expected that this combination will in short term generate certain cost savings, while in the long run possible benefits from improving production efficiency as well as lower (average) development costs will become more important. However, what this takeover will mean for Pliva's future and Croatian pharmaceutical industry is yet to be seen.

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Questions for discussion

1. In your opinion, was Pliva's management
successful in their job before the takeover?
Discuss Pliva's strategy.
2. Compare Pliva's Management Board before
and after the takeover.
3. Was in Pliva's case the market for corporate
control effective? Argument your answers.
4. Comment on Hanfa's role in the process of
taking over Pliva?

PRIVATIZATION THROUGH GOING PUBLIC – CASE STUDY OF T-HT

LOVORKA GALETIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

MISLAV ANTE OMAZIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

ANA BULIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

Abstract

Principle objective of this paper is to analyze specific phase of privatization process of the largest telecommunication company in Croatia T-HT, in which they went public when Croatian government sold 32.5 percent of total stocks. More than 358,406 Croatian citizens bought shares packages in total amount of 16,695.00 HRK, or 63 stocks, each valued 265.00 HRK, which is 25 percent of previously mentioned 32.5 percent of total T-HT stocks. Remaining part of 7.5 percent was sold to international and local institutional investors. It is very interesting how many citizens have bought their stocks for the first time, regardless the fact that they did not collect information from the capital market up to that moment and in most cases they were not familiar with Stock Exchange regulations and Laws.

Key words: share issue privatization, going public, telecommunication, T-HT

Introduction

Nowhere is the privatization debate more intense or activity more dynamic than in the area of telecommunications¹. Compared to the other Central and East European Countries, the Croatian telecommunications sector is well developed². The liberalization, i.e. the formal elimination of monopolies, was implemented in all segments of the market, while the state ownership in the incumbent operator is below 50 percent. We have three major operators (T-HT, VIPnet and Tele2) and many SME's trying to compete in diverse segments of the market. Furthermore, a stable regulatory and policy framework was established according to the European

Commission, providing satisfactory levels of autonomy for the Agency for Telecommunications (HAT) and the Central Administrative Bureau for e-Croatia, which has done hard work to increase public access to information and communication technology (ICT). Finally, the availability and quality of telecommunication services, as well as the percentage of population that uses them are among the best and highest in the region³. According to HAT 90.75 percent of Croatian population uses mobile phones in 2006⁴. The estimated size of the Croatian telecommunications market in 2005 was 1.758 billion Euros which made 5.68 percent of GDP⁵. The main objective of this paper is to describe and understand wider aspects of third phase of privatization of biggest telecommunication company Croatian Telecom Inc. (hereafter T-HT) through the process of going public with 32.5 percent stocks. T-HT has over 80 percent market share in fixed telephone services and Internet, and about 50 percent market share in mobile telephone services.

In short, we could say that privatization is a transfer of ownership from the public to the private sector, a transfer of ownership that is opposite to nationalization. Three main methods of privatization are the following⁶:

1. Share issue privatization (selling shares on the stock market),
2. Asset sale privatization (selling the entire firms or part of it to a strategic investor, usually by auction or using Treuhand model) and
3. Voucher privatization (shares of ownership are distributed to all citizens, usually for free or at a very low price).

Table 1. Advantages and disadvantages of privatization process

Advantages	Disadvantages
Scaling down direct governmental initiative	Certain businesses, natural monopolies, should be protected from market forces
Organisations are becoming more effective	There is short-term growth pressure
Executives can focus on the long term	Higher disclosure and confidentiality
Increases other financing prospects	Costs - initial and ongoing
Stronger capital base	Restrictions on management
Better situated for making acquisitions	Loss of personal benefits
Transparent lines of corporate governance	Not obligated to disclose some of their financial results
Owner diversification	
In general better reputation in public	

A very substantial benefit to share issue privatizations is that bidders compete to offer the state for the highest price, creating revenues for the state which is why Croatian Government chose that model for T-HT privatization.

The principle argument of privatization proponents is that private market can deliver goods or service more efficiently than government, because of the free market competition⁷. Apart from this, there are other advantages of privatization process (see table 1).

Regardless of the above mentioned facts, we should keep in mind that there are natural monopolies which should not be privatized at any cost and that in such sense market failures can occur. Privatization opponents, apart from disadvantages stated in table 1, believe that certain parts of the economy should be protected from market forces in certain periods of development especially in transition economies, e.g. basic health care; some utilities such as water distribution, electricity and natural gas; certain construction business; and basic education. It would be substantially costly to build another set of water and sewerage pipes. Water and gas delivery service has a high fixed cost and a low variable cost. Electricity in Croatia would be probably deregulated, so the generators of electric power would be able to compete. But the infrastructure, the wires that carry the electricity, usually remain a natural monopoly, and the various companies send their electricity through the same grid. A natural monopoly exists when there is great scope for economies of scale to be exploited over a very large range of output⁸. In that sense natural monopolies are by definition not subject to competition and are better maintained by the state.

One of the most drastic examples of what could happen if one tried to privatize natural monopoly was water resource privatisation of local company Servicio Municipal del Agua Potable y Alcantarillado (SENIAPA) by International Monetary Fund in Cochabamba, Bolivia⁹. This was to be done through a concession to one of Bechtel's subsidiaries - International Water. Soon after International Water took over the water services in Cochabamba, the monthly water bill reached 20 US\$ in a city where the minimum wage is less than 100 US\$ a month. The result was that people in poor households could not pay a charge for using water, leading to either lower consumption in the household or to the use of unsanitary water. After that through mass mobilization, citizens shut down the city for four days at the beginning of 2001. Within a month of this, millions of Bolivians marched to Cochabamba and organised a general strike, stopping all transportation. At the end Bolivian government had to revoke its water privatization legislation after which on April 10th, 2000 Aguas del Tunari and Bechtel's subsidiary left Bolivia but they filed a lawsuit against Bolivia in November 2001, demanding 25 million US\$ in compensation for its lost opportunity for future profits.

On the other side, privatization process has its own benefits, being privately owned is an advantage for some business entities. From governmental perspective the advantage is that you scale down the Government's direct initiative in economic activities and correspondingly its administrative load. It is also important that as country in transition through privatization process you promote competition and improve the efficiency of enterprise operations. Apart from this, privatized companies are in most cases more competitive therefore they offer clear competitive advantages to market such as lower prices to customers; goods or services at a higher quality level and faster delivery; better

and transparent corporate governance structures; there is less red tape which influences negatively on costs; government do not have sufficient resources and means to successfully monitor large number of companies coming from different sectors, etc. Usually privatization should signal a change in the basic philosophy and perception of business development within certain market. Again, it is important to emphasize that privatization is not always the best solution for a company, and that one should analyze each company and its role within industry separately.

Going public or Initial Public Offering (IPO) is the first sale of company stocks to the public. Common reasons for companies who used IPO in privatization process is cash pull from the market forward to new investments, modernization etc., and drawing new investors in to the company. Through IPO 25 percent of T-HT from total number of 32.5 percent of shares which were traded within IPO was sold to Croatian citizens. IPO allows company to pool stock market investors and to get large volumes of capital for future growth.

General information about the company

T-HT is a joint stock company with Deutsche Telekom AG being the majority owner with 51 percent of shares. According to the Act on Privatization of Hrvatske telekomunikacije d.d. from June 11th, 1999 the Government of the Republic of Croatia sold 35 percent of shares to a strategic investor - Deutsche Telekom AG¹⁰. In 2001, the German telecom bought additional package of 16 percent of the shares, thus becoming the majority owner. Both sales have caused great controversies in Croatian public, primarily because of the suspicions that the Government made some inappropriately large concessions to the German investor, in order to get as high a selling price as possible. For several months now there is a dispute between the state and local self-government units on one side, and T-HT on the other, about the ownership of underground telecommunications distribution channels (DTK). T-HT, in fact, considers DTK as an integral part of what it acquired with the privatization agreement. Although the final solution for this issue may require a court ruling, the very fact that the sales agreement may have opened a possibility for the corporation to own key infrastructure, is sufficient to prove that there are many circumstance which secured its preferential position on the market.

After recent third phase of privatization process other owners of the company are the following: The Government of the Republic of Croatia with 9.5 percent (7 percent of which will be distributed to the former and present T-HT Group employees that started working there after 1955), War Veteran's Fund with 7 percent of shares, and 32.5 percent of shares which are now traded on Zagreb and London Stock Exchange. The company was founded on July 10th, 1998 as a result of a demerger of former public company Croatian Post and Telecommunications (HPT) separated in compliance with the Law into two new joint stock companies: Croatian Telecom Inc. and Croatian Post Inc., which started their business operations on January 1st, 1999¹¹. The share capital of the Company reaches 8,188,853,500.00 HRK and is divided into 81,888,535 ordinary registered shares with nominal value of 100.00 HRK.

In 2002 HT Mobile Communications, was registered as a separate company T-Mobile, a subsidiary completely owned by Croatian Telecom Inc. In 2004 HT Group rebranded its trade mark and introduced a new corporate identity under which HT Group became a part of the global "T" family of Deutsche Telekom, following that former HT Group became T-Croatian Telecom or T-HT Group and two new trademarks were created: T-Com and T-Mobile.

T-HT Group is the leading telecommunication company in Croatia. They offer a complete range of telecommunication services including services of fixed telephony, Internet and Internet communications services (line installation, call routing, carrier service, tele-voting, free-of-charge universal access number etc.), mobile telephony (In 1996 T-HT introduced the first GSM network in Croatia. Nowadays T-Mobile's mobile has 53.7 percent of market share and covers over 98 percent of the territory of the Republic of Croatia, and has international roaming with more than 200 GSM operators in the world. In 2004 T-Mobile got approval for license for UMTS network.), data transmission (various data transmission services through managed lines X.25. Croline, ATM, unmanaged leased lines, as well as telex and telegraph still used by certain customers)¹².

When we look at the organization structure of the company, we can see that the group is primarily divided according to the corporate and business functions as a functional type of organization. The main role of four corporate units (CEO corporate

unit, Finance corporate unit, Human resources corporate unit and Group services corporate unit) is to make tight business relations within the company and to provide synergy effect for the whole group. T-HT has two Business Units: Business Unit for Fixed Network and Broadband Operation (T-Com), organized within T-HT as a legal person and Business Unit for Mobile Communications Operation (T-Mobile), a separate legal person organized as a limited liability daughter company

one hundred percent owned by T-HT which are organized to ensure orientation towards different products and services of the company. In 2006 T-HT made acquisition of Iskon Internet, one of the most important alternative providers in Croatia. T-HT is regionally organized through four regions: Region North (location Zagreb), Region West (location Rijeka), Region South (location Split) and Region East (location Osijek).

Table 2. Market shares of T-HT group

Business	Market shares
Mobile	49 percent
Fixed telephony	90 percent
Internet	69 percent
Data	78 percent
Wholesale	79 percent

Source: <http://www.t.ht.hr>

Table 3. Financial data for T-HT

	2006 (HRK millions)	2005 (HRK millions)	percent change
Total operating income	8,839	8,808	0,3519
Net revenues	8,630	8,605	0,2905
Operating profit	2,376	2,250	5,6000
Net profit for the year	2,058	1,921	7,1317
Total assets	16,942	15,539	9,0299
Long-term debt	769	814	-5,5282
Total shareholders' equity	13,918	12,687	9,7028
Operating margin percent	27,5	26,1	
Net income margin percent	23,8	22,3	
ROA percent	12,1	12,4	

Source: T-HT Annual Report 2006

The strategy of T-HT is based on the excellent services, customer satisfaction, additional development of broadband access and value-added services related to broadband access.

When investors buy shares, it is very important to be familiar with financial data of the company they are buying.

Table 4. T-HT Revenues by business segments 2005-2006

Revenue by business segment	2006 (HRK millions)	2005 (HRK millions)	percent change
Revenue from fixed telephony	3,558	4,020	-11.5
Revenue from mobile telephony	3,708	3,432	8.0
Revenue from carrier services	665	624	6.6
Revenue from Internet services	490	301	62.8
Revenue from data services	209	228	-8.3
TOTAL REVENUE	8,630	8,605	0.3

Source: T-HT Annual Report 2006

A brief analysis of T-HT financial data for 2005 and 2006 in table 3 show a positive trend. The net profit rose from the year 2005 till 2006 by 7.13 percent and total assets grew by 9.03 percent in the same period. It is also important to mention that in the same period, long-term debt decreased for 5.53 percent.

If we observe revenues in table 4, the most important thing is to investigate their origin. Therefore we can see that the most fast growing segment of T-HT is the revenues from Internet services. Although revenues from fixed telephony have fallen for 11.5 percent in the time period 2005-2006, in the total amount they are still the biggest and the most important revenues. Second most important revenues are revenues from mobile telephony, and they have been growing by 8 percent at the same time.

Privatization of T-HT trough going public process

On the September 24th, 2007 Croatian Government decided to sell 32.5 percent of T-HT stocks, 25 percent of which with priority reserved for Croatian citizens and 7.5 percent of shares were distributed to institutional investors. Due to large interest of the Croatian citizens and institutional investors, Croatian Government has decided to increase the package for public offering of T-HTs shares from initially mentioned 20-23 percent to 32.5 percent¹³. To encourage even further the process of privatization before starting the going public process, Prime Minister stated that his Government will not introduce capital profit tax. This was important information due to the fact that parliamentary elections in Croatia were to be held on November 25th, 2007 and main opponents of the ruling party said that they will introduce capital profit tax. According to Law on privatization of

T-HT, Croatian citizens have priority rights and special benefits regarding participation within going public process, and institutional investors do not have such rights, but they are important in this process because of stabilization of the price after the shares of T-HT are listed on stock exchanges and due to the fact that over 1.35 million HRK of citizens are members of mandatory pension funds and 150 thousand of citizens invested in about 80 recently opened investment funds. It is important to mention that financial watchdog, Croatian Agency for Supervision of Financial Services and independent regulator in London gave their approval on T-HT prospectus. Initial public offering started on September 17th with price ranging from 245.00 to 320.00 HRK, and citizens could submit their offers without priority rights and special benefits until September 27th. These are so called preferential offers up to 38,000 HRK and above this amount in the so-called non-preferential offering; institutional investors could submit their offers by October 1st. For each ten shares registered with the priority right, citizens have the right to get one additional share, if they keep shares bought under specific conditions for at least one year. On October 1st the Government decided that final selling price would be 265.00 HRK¹⁴. The decision put the stock much closer to the previously announced lower price limit (245.00 HRK) than the upper limit (320.00 HRK), and was below any predictions by local analysts. "It's a fair price, and institutional investors have not been fully satiated, so there will be room for a quick profit in secondary trading for those willing to sell immediately," wrote chief analyst at Hypo Alpe-Adria-Bank¹⁵.

The final number of citizens subscribing to the IPO since its launch on September 17th was 358,406 or around 8 percent of total population, paying a total of 12.2 billion HRK for 25 percent of T-HT's issued shares¹⁶. Following the hug e

interest of public to buy shares, citizen's packages with priority rights have been reduced for about 53-54 percent after 358,406 citizens have been subscribed to purchase shares. Average payments were 34,040.03 HRK and package was reduced to 63 shares or 16,695.00 HRK. Share packages were reduced for about 54 percent as a result of big interest of public to buy shares, and total demand exceeded the supply by 5-6 times. It is important to mention that 7.5 percent of shares for institutional investors were allocated as follows: 65 percent to foreign institutional investors and 35 percent to local institutional investors. That was less than they expected since the demand for the stocks of foreign investors exceeded the value of shares given to them 22 times, and the demand of local institutional investors exceeded the offer 9 times. 36 percent of foreign institutional investors were large American funds. Citizens also submitted 2,024 offers beyond previously guaranteed amount of 38,000 HRK, so total demand for shares was 37.4 billion HRK, which was 5-6 times higher than offer. We would like to mention that Croatian Government still owns 9.5 percent of shares, 7 percent of which will be distributed to the former and present T-HT Group employees.

One of side effects of such a huge interest of the citizens to buy T-HT stocks is that it has changed shareholder culture and strengthened the Croatian capital market. Newspapers and financial experts have warned all investors about possible risks and losses from the shares but almost entire Croatia talked only about the going public process. Another thing worth of mentioning is that amount of 3.45 billion HRK from going public process was used to repay a portion of decade-old state debt to retired citizens of Croatia with following dynamic due in December (1.45 billion HRK) and 2 billion HRK will be used to finance this year's state deficit.

When they bought their shares, many citizens were not particularly informed about things that we may consider to be threats for the company. Among these things is the ownership battle over underground telecommunications distribution channels whose net book value is 1.266 billion HRK has not finished yet. In 2006 Croatian Agency for Telecommunication (HAT) made a temporary decision according to which, starting from October 1st, 2006 HAT will take responsibility for management and common use of underground telecommunications distribution channels that were formally disputed by others when the owner of telecommunication infrastructure was

not determined. Fees should be paid in by all operators into a temporary account of HAT and after the legal decision on the real owner of the underground telecommunications distribution channels and all cash paid in will be transferred to the owner's account. No payments or provisions have yet been made in this respect, as it is still the subject of ongoing discussion and negotiations¹⁷. Therefore, we could say that majority of citizens who have invested in T-HT shares did not first analyze the market and its trends and neither have they analyzed company data. Rather than that, they invested in the shares driven by the logic: "everyone is investing, so it must be right thing to do". This kind of behaviour can be very dangerous for investors, especially for the citizens, because they can lose big amounts of money due to the lack of important information.

October 5th, 2007 was the opening day for trading with 32.5 percent of T-HT shares at London and Zagreb Stock Exchanges. The first transaction with shares on the Zagreb Stock Exchange was performed at the price of 402.00 HRK per share and price rose to its highest value of 419.00 HRK within first minutes of trade. By the end of day price at Zagreb Stock Exchange varied around 380.00 HRK with its minimum value of 370.02 HRK with a total turnover of 237, 888. 135 HRK. At the same time investors in London were not so enthusiastic about T-HT shares where trade started with 51.76 US\$ per share and ended around 72 US\$ per share.

Conclusion

Croatian capital market is still developing, and just few months ago majority of citizens were not investing in stock market. Through T-HT going public process many Croatian citizens started to invest their money in stock market. Apart from then 800,000 already existing investor accounts, Central Depository Agency (SDA) had to open more than 245,000 new ones. This is very good for the development of financial market, nevertheless we should keep in mind, that at the same time, it can be very dangerous because the majority of the citizens who invested didn't have all the necessary information and required skills to make high-quality investments. Majority of the above mentioned information are available to the public, but people are not keen to collect them before buying stocks. In our opinion, such practice is caused by the fact that mainly all big stocks sold to

Croatian citizen end up with their capital revenues and they expect that such practice will be repeated again, which, of course, does not have to be the case. It is interesting to mention, that some of the citizens took out bank loans for buying stocks, although financial experts through media advised them that it is a questionable idea. We could say that Croatian capital market is still in a developing phase; although it is growing very fast and all stakeholders especially citizens should be more careful when investing. Question to privatize or not infrastructure companies like T-HT still remains doubtful and when privatizing such companies, state should carefully overview pros and cons, before going public.

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Questions for discussion

1. In your opinion, is it good to keep controlling block of shares of infrastructural companies in state ownership? Why?
2. In your opinion, what is the main motive for third step of privatization process of T-HT?
3. In your opinion, why do citizens show such a big interest for buying T-HT stock?
4. Why did Government choose IPO to privatize 32.5 percent of T-HT stocks?
5. What is your opinion on privatization of infrastructure companies, like T-HT?

PRIVATIZATION PROCESS IN CROATIA - CASE STUDY OF CROATIA INSURANCE COMPANY

DARKO TIPURIĆ

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, CROATIA

DOMAGOJ HRUŠKA

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, CROATIA

JAKŠA KRIŠTO

FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, CROATIA

Abstract

A Croatia insurance company is the leading insurance company in Croatia according to total premium income. The Croatian government started the privatisation process twice. The first tender for the sale of 51% of share was announced on July 30th 1999 and due to inadequate offers, which underestimated the value of Croatia insurance company, was revoked. Privatization models differ in implementation models, in ownership structure after privatization and in the way the company itself functions. The choice of privatization model isn't easy and should be based on set goals and understanding relevant circumstances of the privatization process. Each model has different implications on political and other goals. The optimal time dynamics of the privatization process for Croatia insurance company should be divided in two phases: first phase in which a part of shares should be offered in a IPO by the middle of 2008 and the rest of the shares should be used for stock distribution to shareholders and second phase which should follow after five years, or after it is certain that preconditions for a further implementation of privatization are set out. One of the main goals of privatization is the increase of profitability and success of business activities. It is therefore crucial to ensure that privatization is not reduced to only forming a new owner's structure but it should also introduce changes in the system of corporate management of Croatia insurance company.

Key words: *privatization, Croatia, insurance market, Croatia insurance company*

Introduction

Privatization process has been the object of many scientific researches with an enormous fundus of practical solutions and experiences. Over the last twenty years the role of government ownership in the world economy has been decreasing continuously. Privatization came as a logical step because government or the government ownership couldn't fight against the private ownership¹. If contextual differences between privatization in transition and developed countries are ignored, and then their common denominator is – depoliticization of economy, or reduction of political involvement in economy. The control and competence transfer from profligate politicians to managers (corporatization), a reduction of ownership from the government side (treasury) to managers and external shareholders.

Privatization of government companies should be observed in a time and space context, taking into consideration also the specifics of a privatized company. But a common characteristic is that privatization is mostly used as a main (often as the only) instrument in preparing them for market game. The extent at which it solves the cumulated problems in their business is doubtful. Consequently, privatization doesn't have any spectacular results if it isn't followed by the process of a complete restructuring. Companies in government ownership, especially large business systems such as Croatia insurance company, necessarily need organizational reconstitution independent of the dynamics and method of its privatization. Though many experts think that

proprietary transformation solves organizational problems, previous results most often show the opposite. Therefore, privatization process is a relevant postulate for achieving business success but is not enough.

Universal goal of privatization can be defined in the following way: (1) increase of government income, (2) encouraging economic efficiency, (3) reduction of government influence on economic flows, (4) shareholding encouragement, (5) competition encouragement and (6) exposing government companies to market conditions. Apart from the mentioned, example of Margaret Thatcher shows that her concept of privatization also tried to harmonize financial market development as a goal of privatization process², which is one of the objectives of privatization process in Croatia .

Privatization, of course, has interdependent and often opposite political, economic and financial goals, but most often mentioned reasons for privatization of government companies are: (1) argument of efficiency and productivity – producers choose maximization of profit and minimization of costs which results in system efficiency. Together with this competition enables better harmonization of supply and demand from which consumers also have benefits; (2) fiscal profit from direct payment from sales, as also constant growth of tax incomes or through decrease of paid subsidies to a privatized economical branch; (3) institutional development in behavior changes and economy value ion whole.

Structure of insurance market in Croatia and the necessity for CO privatization

Croatian insurance market by 1990 was characterized by a monopoly position of Croatia insurance company. Croatian independence and liberalization of market created preconditions for penetration of new both domestic and foreign insurance companies.

In 2006, 20 insurance companies and 2 reinsurance companies existed in Croatia. In 2006

a continuance is seen of trend foreign companies' domination. Namely, 8 insurance companies and one insurance company in 2006 were in domestic ownership, while 13 insurance companies and one reinsurance company were in foreign ownership. In total shareholders equity of insurance companies the share of foreign investors was 40.25% and domestic 59.75%.

Insurance market in Croatia has a significant growth potential according to all indicators. In 2006 total premium income in GDP was 3.3% in Croatia, 8.8% in the USA and 9.3% in the EU. Share of life insurance premium in the total premium in the same period in Croatia was 26.5%, in the USA 45.6% and 63.6% in the EU. Insurance density in 2006 on the level of total insurance premium in Croatia was 307.9 USD, 3,923.7 USD in the USA and 3,305.1 USD in the EU. According to these indicators Croatian insurance market is undeveloped and according to insurance penetration takes 40th position and according to insurance density 41st place from 88 observed world insurance markets³.

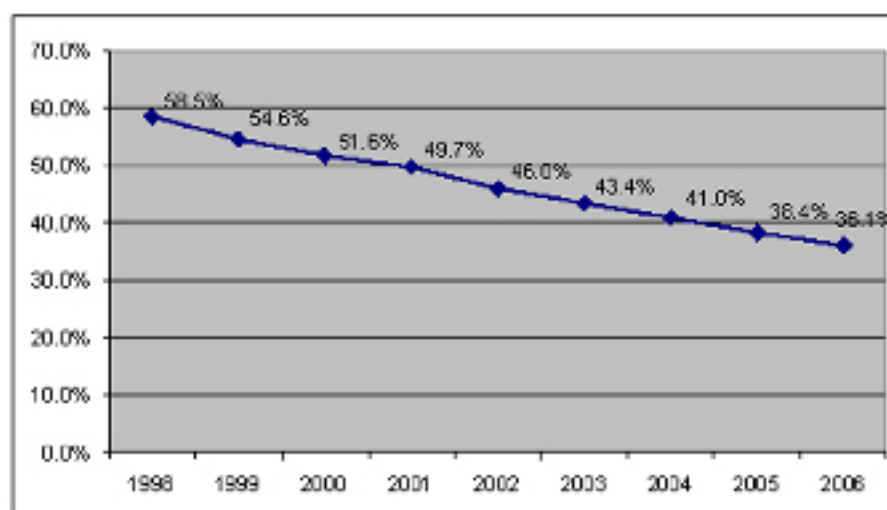
Insurance companies in Croatia have several times lower share in the structure of financial institutions than it is case in developed countries, so this indicator for 2006 in Croatia was 5.0% in the USA 10.9 % while in the EU was 12.6%.

A Croatia insurance company is the leading insurance company in Croatia according total premium income. Its market share measured with a share in total insurance premium is constantly falling. In the period from 1998 – 2006 the share of Croatia insurance company decreased by 22.53 %. Until 2004 the value of market share of the leading Croatia insurance company during the analyzed period didn't fall under 40%, according to which this insurance industry can be characterized as an industry with a dominant company. But, after 2005 the share falls under this level, which made the change in the structure of activities from tight oligopoly to a loose oligopoly.

Table 1. Comparison of chosen insurance indicators in developed countries and Croatia, 2005

	USA	EU 25	Croatia
Share of insurance companies in structure of financial institutions in %	10.9	12.6	5.0
Premiums per capita in USD	3,923.7	3,305.1	307.9
Premiums as % of GDP	8.8	9.3	3.3
Life premium in % of total premium	45.6	62.6	26.5

Source: Supervisory authorities' data

Graph 1. Share of market leader – Croatia insurance company, 1998 – 2006

Source: HANFA

The growth index of the gross premium over the last several years point to an average growth of 10% a year with a remark that growth index of life insurance premium is significantly higher than non-life insurance premium. In 2006 for example, growth of life insurance premium was 14.2% compared to life insurance premium in 2005 while the growth of non-life insurance premium in the same period was only 10.3%. The growth rate of Croatia insurance company in 2006 as in the previous period were below average, so life

insurance grew by 8.4 % and non-life insurance by 4.0 %. According to profitability indicators of Croatia insurance company, it is characterized by an average profitability which was in 2006 over the profitability of the entire market average. In 2006 Croatia insurance company's return of equity was 9.11%, while the entire market had a profitability of 8.71%. Its return on assets was 1.68% and the entire market's profitability was 1.58%⁴.

Fall of market share, insufficient profitability, government ownership, operative and organizational inefficiency on one side and growing competition in insurance and financial market together with insurance market potentials are key prerequisites and determinants for model of privatization process and the reasons for immediate privatization of Croatia insurance company.

Privatization proposition of Croatia insurance company

General information about Croatia insurance company

Foundation date: 4th June 1884	
Shareholders structure on 31st December 2006	
<i>Croatia privatization fund</i>	80.27%
<i>Other shareholders</i>	19.73%
<i>Total</i>	100.00%
Shareholders' equity	442,9 mil. HRK
Number of shares	316,348
Nominal value of share	1,400 HRK
Technical reserves	4,680.5 mil. HRK
Life insurance technical reserves	1,188.1 mil. HRK

Croatia insurance company has majority ownership in following companies:

CROATIA Lloyd d.d., Zagreb 94.64%

CROATIA osiguranje d.d., Ljubuški 52.05%

SLAVONIJATRANS-Tehnički pregledi d.o.o., Sl. Brod 76.00%

CROATIA zdravstveno osiguranje d.d., Zagreb 100.00%

VARDAR CROATIA osiguranje d.d., Skopje 36.40%

CROATIA leasing d.o.o., Zagreb 100.00%

MILENIJUM osiguranje a.d., Beograd 99.98%

PBZ CROATIA osiguranje d.d., Zagreb 50.00%

ZAGOS d.o.o., Zabok 100.00% (u likvidaciji)

CROATIA osiguranje mirovinsko društvo d.o.o. 100.00%

CROATIA Sigurimi s.a., Priština, Kosovo 100.00%

CROATIA-Tehnički pregledi d.o.o., Zagreb 100.00%

In 2006 premium income of Croatia insurance company was 2,951.4 mil. HRK as of:

- o non-life 2,654.7 mil HRK
- o life 296.7 mil HRK

Constitution of Croatia insurance company was determined by Statute, Decision of the Supervisory Board and Decision of the Board of reorganisation of business. Croatia insurance company can be divided into two basic units: General direction and the branches. GD is formed so it can perform four basic groups of activities: insurance and reinsurance business, economic financial business, corporate management business and assets management and last managing processes of compensation. Branches (22) cover the entire territory of Croatia and are divided into six regional groups. The basic communication between GD and the branches is done through executive managers of the company's Board which are in charged of a particular region⁵.

The Croatian government started the privatisation process twice. The first tender for the sale of 51% of share was announced on July 30th 1999 and due to inadequate offers, which underestimated the value of Croatia insurance company, was revoked.

Creating optimal privatization model for Croatia insurance company

One of the basic prerequisites for realization of Croatia insurance company's strategic vision is efficiency and continuity of managing structures of the company. Efficiency of management structures can be insured only by following the principle of dividing ownership from management function. Management has to have its autonomy and tasks formulated in the development strategy of Croatia insurance company and ownership shouldn't be an obstacle for accepting a consistent management system, which has not been the case in Croatia insurance company till now.

Apart from this, theoretic research offer many arguments why, in the highly competitive market, government ownership has a number of weaknesses. Efficiency of the private compared to the government ownership together with continuity

in management structures implies a necessity for Croatia insurance company's privatization.

Every model of privatization has its effects, rules and factors which contribute their success, or failure. Generally, to reach set goals several models are used. It is important that the chosen model is in agreement with the goals set and the best instrument for their achievement⁶.

Privatization models differ in implementation models, in ownership structure after privatization and in the way the company itself functions. The choice of privatization model isn't easy and should be based on set goals and understanding relevant circumstances of the privatization process. The choice of privatization model is, among everything, determined by (1) the goal government sets; (2) momentary organizational form of the company; (3) by financial conditions and company's business results; (4) by the sector in which the company operates; (5) by the possibility to mobilize private sector resources; (6) by the stage of capital market development and (7) by socio-political factors⁷.

Each model has different implications on political and other goals. Models which maximize incomes can be compatible to a strong government management but without any implications for domestic capital market. In the same way, models which encourage fragmentary ownership don't offer strong management structure. Therefore, the choice of privatization model represents for the government establishing balance and a very important strategic decision⁸. Actually, the choice of privatization model reflects different priorities, like maximization of incomes, improving government management and efficiency, introducing technologies and management know-how and experiences, development of capital market and promoting culture of capitalism⁹. According to some opinions, the choice of privatization model is based on political and ideological factors and doesn't correlate with the success in pre-transition in practice¹⁰. Apart from this, the choice of privatization model can have a direct impact on macro-economy through effects on government incomes and from there on government possibility of infrastructure investments, which can stimulate economic growth.

In relation to presence of different privatization models, economic analytics think that the biggest chances for success have programs which combine different methods, dependant on specific

circumstances of every company or industry (sector). They emphasize that the prevailing method of privatization depends on institutional structure which includes proprietary rights, different organizational structures (government, proprietary and human rights, customs) and system of values of a society where relation between equality and efficiency has a central position. The chosen method of privatization influences management structure of a company, different structure and influence of stakeholders (their power, motivation and legitimacy) and with this on efficiency. This stands also for Croatia insurance company.

The real authority for implementation of privatization process of Croatia insurance company has Republic of Croatia as the majority owner of the company. However, following the principle of stakeholders approach to relevant economic and social issues in the EU and other developed countries, it is legitimate that management of Croatia insurance company, as the best expert of circumstances in their business, initiates development of an expert background/basis for discussion and decision on conception and implementation of privatization and development of adequate corporate management system.

Preservation and development of a unique and strong business system capable of development of values in the regional insurance industry is a part of vision of Croatia insurance company privatization. Privatization model has to insure organizational framework which will enable the reduction of unnecessary expenses with a simultaneous increase of operative business efficiency and strengthening of Croatia insurance competences, building synergy and unique capabilities in insurance industry and others, and profitable enough for active industries. Such vision of privatization is a deposit for developing the company as a "regional player" in its basic business. Efficiency is a necessary condition for competitiveness. Independently on the level and intensity of the future competition on the markets accepting market based standards is a basis for creating competition abilities of Croatia insurance companies.

Privatization has to help Croatia insurance company in improving management quality of its potentials both in and outside of its core business. The goal is to form a shallow, flexible and restricted decentralized structure, which has to be a rational strategic management move because of the

desired goal, or orientation towards a firmly set goal of survival and future profitable business in the expected competitive surrounding.

Privatization should also lead to: increase of business transparency, improvement of management at all levels, turning Croatia insurance company into an "organization that is learning", building a model which will be oriented on building human potentials to raise sales, developing quality relations with the clients, introducing scenario approach in long-term business planning and a reasonable diversification of business activities of Croatia insurance company in business segments where the return of capital is higher than opportunity cost of capital which will enable competitive advantage in the future.

In our opinion, accepting stakeholder management can contribute to long-term survival and the success of Croatia insurance company. This should be recognized in the privatization concept. Positive and mutually supportive stakeholders' relations build up trust, stimulate joint efforts and the increase of value of the organizational capital which is the result of closeness and team work.

Because of the necessity of developing an adequate system of corporate management and with choosing a model of privatization of Croatia insurance company the following goal should be achieved: (1) insuring the activity of a special mechanism which would protect private (part)owners, which refers especially to the cases where the government remains the majority owner; (2) encouraging relevant and timely informing of the shareholders and encouraging their participation at the shareholders general meeting; (3) preventing procedural and other obstacles which interfere with the voting of shareholders at assemblies; (4) ensuring a timely dividend payments to all shareholders under the same conditions; (5) when changing ownership structure, especially with company takeovers, discrimination of certain groups of shareholders should be enabled by ensuring the right of the first buy of the shares, or a strict implementation of certain takeover regulations; (6) following the procedures connected to making key business decisions and relevant transactions, without bypassing the interest of minority owners; (7) building mechanisms of conflict of interest between managers and members of the board, which especially refers to insider trading.

It is necessary to start from the mentioned facts when developing the concept of privatization.

This means that privatization model should be connected to implementation of the stakeholders' management in Croatia insurance company.

The optimal time dynamics of the privatization process should be divided in two phases:

1. first phase in which a part of shares should be offered in a IPO by the middle of 2008 and the rest of the shares should be used for stock distribution to shareholders and
2. second phase which should follow after five years, or after it is certain that preconditions for a further implementation of privatization are set out.

First phase of privatization refers to an IPO and shares' distribution to stakeholders according to moderate fragmentary privatization model:

- 25 % of Croatia insurance shares would be sold at an IPO on the capital market;
- Employees would get 7% of shares;
- The pension fund would get 4% of shares;
- Military fund would get 4% of shares;
- The rest of the share would be left in the ownership of Croatian government till the second phase.

This model assumes the sales of 25% of shares on the capital market. Public offer can be used as a way of acquiring extra capital as well as for transfer of ownership of the company.

IPO advantages compared to other privatization methods are easier acquiring of capital, possibility for employers to participate in ownership, easier business combinations, growth of value for the founders and transparency. However, the loss of control by the founders can be a direct consequence, since in the case of government companies there is still a risk of process failure. The disadvantages are the pressure from the new owners and the market for a higher growth and dividends, changes in management style and employees' expectations, obligations of complying with complicated government regulations and high expenses.

It is important not to perceive the IPO as a one-time transaction, but as a long term process of business transformation and having in mind a

strong connection between planning and preparing the IPO and the success of the company after its implementation.

Croatian capital market showed with INA and T-HT IPOs that it has enough absorption potential for an adequate use of this privatization model. A special attention should be paid to the role of institutional investors, especially domestic obligatory pension funds, which would be the main bearers of demand for shares of Croatia insurance company. From the total share which would be offered to the market a bigger part could go to institutional investors and a smaller to small investors, to the citizens of Croatia.

This model assumes that employees will participate with 7% share in the privatization. Such participation of employees in the ownership structure is very affirmative in the process of changes and business improvement and should be realized as soon as possible. With programs of employees' shareholding, the discrepancy between interest groups tries to be prevailed and in a special way, the stakeholders' company model is emphasized, in the same time keeping the direction for maximization of value?? which the company makes for its owners. A number of researches conclude that a combination of a participating management and a program of employee shareholding increase the business efficiency of the company. Programs of employee shareholding can improve company's success by decreasing conflicts between the workers and the management. Workers who participate in ownership are perceived more as a component of the company rather than the production factor. These are all reasons why the fastest growing European companies introduce different programs of employee shareholding. The same should be done in the case of Croatia insurance company, whose main goal of the implementation of employee shareholding program should be convergence of different interest: public interest, growth and success of the company with a long-term profit for the workers and improvement of their life standard in the long run.

The privatization model anticipates transfer of 4% shares to the Pension fund. The way, economy transition, bankruptcy of many companies and inadequate legal regulations are the basic reasons of an accelerated rise in number of retired people. The reasons for including the retired population are connected with the existing and long-term interest

and needs of the retired population in Croatia, together with the need for repaying a part of the debt to the retired from the government.

The third interest party which would get 4 % without any fee are the Croatian soldiers and the members of their families. The transfer is conditioned by the decision of the Croatian Parliament to pass the Law that will define establishment of a special fund where the shares will be transferred together with all the regulations of shares transfer to the fund and the scope of activities of the fund. The premise of the authors of the Study is that this fund will have the character of an investment fund, with a specific characteristic. The fund wouldn't invest in other securities and sell fund shares (if it is a closed fund), or documents on shares (if it is an open one), but it would obtain Croatia insurance shares ex lege and Croatian soldiers and their families would get these shares or fund shares for free.

The rest of the shares should be left in the government ownership until all preconditions for the increase of market value of Croatia insurance company are fulfilled through implementation of new business strategy.

The suggested privatization policy of Croatia insurance would enable a hibernation of the ownership structure in the next mid-term period which would create preconditions for direction to strategy implementation. According to this scenario, government would after market consolidation of the company and fulfilling strategic vision continue with the privatization from better positions than it has today.

One of the main goals of privatization is the increase of profitability and success of business activities. It is therefore crucial to ensure that privatization is not reduced to only forming a new owner's structure but it should also introduce changes in the system of corporate management of Croatia insurance company.

Conclusions

Financial sector and financial institutions are in the process of convergence toward model of full service financial institutions. This trend is recognized by global insurance companies. In order to stay national and regional leader in insurance industry, Croatia has to adapt changes

in dynamic financial environment. The necessary postulate for openness of company towards all reasonable business options is privatization since continuity business and increasing whole efficiency of business is very difficult to achieve with country as titular of the ownership.

Privatization as itself is not a key to improve the business of Croatia insurance, i.e. privatization isn't a guarantee that the company is going to be better in business after it is done¹¹. For the success of privatization process is necessary to adjust a lot of factors which directly or indirectly affect on implementation of the process¹². In the end, independently of level and intensity of future competitive forces on the insurance market that is in the whole financial market acceptance of established standards on the market is the base of building competitive capability of privatized Croatia insurance company in the future.

Endnotes

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12. Some factors which are necessary to consider while desining process of privatization are: (1) insurance of political support at the highest level, (2) identification and definition of goals which we want to achieve with privatization at the beginning of the process, (3) insurance of transparency and integrity of the process, (4) insuring the necessary resources, (5) consider competitiveness of the company which is privatized, as the level of regulation in the industry, (6) providing an effective communication of privatizing strategy towards all key stakeholders, , (7) consider that sales order can affect the program, (8) designing the post-privatization control instruments. Organization for Economic Co-operation and Development (2003): op. cit., pp. 18.

Questions for discussion

1. Is privatization through IPO good approach for Croatia insurance company? What are major benefits and what are major pitfalls of this approach?
2. Major strategic issues in Croatia insurance company was lack of continuity in strategic decision making. Which privatization method would be most suitable in respect to development of consistent corporate governance system?

PRIVATIZATION IN CROATIA – TRANSITION INTO THE FREE MARKET COMPETITION – CASE STUDY OF RVR

DOMAGOJ HRUŠKA, M. SC.

GRADUATE SCHOOL OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

MILIVOJ MARKOVIĆ, B.SC.

GRADUATE SCHOOL OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

NAJLA PODRUG, M. SC.

GRADUATE SCHOOL OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB, ZAGREB, CROATIA

Abstract

Privatization process in Croatia started 15 years ago. However, certain companies, due to their size and importance for the economy still remain in the state ownership. These are mostly utility companies and companies which provide major infrastructure services. One such company is Croatian Railways (Hrvatske Željeznice). Privatization process in Croatian Railways started with privatization of non-core enterprises within the Railways. These are mostly service companies. The process is rather slow due to organizational complexity and social impact of privatization on employees, as well as lack of marketing knowledge within recently privatized companies.

Key words: Privatization, Croatia, Croatian Railways, RVR

Introduction

Although privatization process in Croatia started some 15 years ago there is still much debate about its' success. The fact is that many companies which have entered the privatization process no longer exist and have left behind thousands of unemployed. The main reasons for such disastrous results are often seen in mismanagement (inexperienced management), completely new market surroundings, poor employee productivity and often crime related activities. Majority of companies in Croatia are in private ownership today, but few socialist giants, with thousands of employees, still stand to face the perils of free market competition. These are mostly major

utilities companies and expected monopolies. With privatization wounds from the 1990s still fresh, steps taken towards new privations are closely watched by syndicates, employees, general public and government as well.

New momentum in privatization of these companies is involvement of institutions like World Bank in the process. Mostly because of loans for reconstruction of outdated equipment, which are measured in hundreds of millions of dollars, these institutions have certain conditions that must be satisfied in order to use the funds.

Privatization process in the 1990s, among others, resulted in substantial loss of jobs, therefore every new privatization today is under strong public scrutiny with special interest in social impact of privatization on employees.

Croatian Railways is among those giants mentioned earlier and is currently undergoing reconstruction in order to increase competitive capabilities. A year after Croatia enters the EU, foreign railway operators will be able to freely compete in Croatian market for railway services which puts considerable pressure on Croatian Railways to speed up the process. Years 2009 and 2011 are most often mentioned as the years when Croatia will join the EU.

Currently Croatian Railways have approximately 13000 employees in various business units, many of which are not core-related. The process of privatization of Croatian Railways is taking place with sequential detachment of non-core related activities into separate business entities (many of

those activities are already organized as separate legal entities but in 100% ownership of Croatian Railways). Main characteristics of these businesses are, among others, their great dependence on Croatian Railways (measured by stake of sales to CR in total sales), lack of experience in open market competition, inadequate human resource, out of date equipment and financial problems.

The World Bank is helping the reconstruction of Croatian Railways with total of 300 million Euros through the PAL 1 and PAL 2 programs. That being the case the World Bank is a strong stakeholder and is trying to influence privatization of non-core business regarding certain clauses of the contract between Croatian Railways and those businesses.

As mentioned earlier, the privatization process in the 1990s resulted in substantial lose of jobs and shutdowns of companies, therefore a lot of pressure is put on Management Board of Croatian Railways to enable high job security for employees after the business are being sold. Some of the demands are the following:

- Moratorium on layoffs for every business in next five years,
- If employees in those business would to lose jobs after five year period ends they will have an option of returning to mother company – Croatian Railways
- Employees of those privatized businesses would to keep all benefits for domestic and international transport they previously had as employees of Croatian Railways
- Long-term contract between newly privatized companies and Croatian Railways securing them work under favorable conditions.
- Long-term lease of assets businesses currently use and which are in ownership of Mother Company under favorable conditions.

The World Bank is clearly against these demands and threatens to pull back the funds much needed for the reconstruction if the employee demands (syndicate demands) are not cut back.

Dead lines for the privatization of non-core business are already missed. Railway Law dated from 2003 was put in use by the beginning of 2006 and it predicted certain dynamics as well as milestone

dates to start the process of privatization for non-core business which clearly, can not be met.

After negotiations over the terms, first three businesses were ready for privatization. First public bidding was made by the beginning of April 2007. So far, only one business, RVR – Uslužne djelatnosti d.o.o. (RVR – further on), out of those three (out of total 17 under 100% ownership of Croatian Railways) managed to complete the privatization process and is no longer in the ownership of Croatian Railways.

Two businesses for which public bidding was made are near the privatization however no buyer is willing to pay the demanded price. Price is certainly going to be lowered and hopefully a valid bid will be presented.

Terms under which the three companies were selling, among other, include:

- Buyer must not change the core business of the companies,
- No employee can be laid off for the three following years,
- 5 – year business and investment plan must be presented

RVR was sold under the conditions mentioned here and for a slightly higher price then demanded. The fact that puts this privatization in the whole new perspective is that the buyers of the company were their employees, precisely 367 out of the 474 totally employed.

RVR – Uslužne djelatnosti d.o.o. – Company profile

RVR today is fully privatized company in ownership of its' employees. Its main businesses are:

- Keeping internal order and providing service of protection on the whole territory of Croatian Railways,
- Maintenance of fixed fire prevention systems, fire extinguishers, and hydrants,
- Chemical and Mechanical maintenance of railway tracks and nearby territory,
- Production of various plants for interior and exterior decoration.

As can be seen from above, RVR has three main areas of activity and according to those activities RVR consists of three divisions. The divisions are:

- Security division ,
- Fire security and maintenance division,
- Gardening division

RVR headquarters are located in Zagreb but it has three branches which cover entire Croatia. These branches are in Rijeka, Split and Vinkovci.

Security division

Main activities in the security division are those of technical and physical protection of people, goods and buildings. Security officers hold a license according to the Law of Private Protection.

Special area of their activity relates to security of passenger transport. What is known as British Transport Police, or Railroad police (Railway police) in some countries, RVR is in Croatia.

This division employs most of the employees - 377 out of 474, and has the greatest contribution in total sales of approximately 71%.

All the data here and further in division analysis (segments 2.1. to 2.3.) refer to fiscal year 2006.

Fire security and maintenance division

This division's main activity is maintenance of fire extinguishers, fixed fire prevention systems and hydrants.

Division employs 9 people and contributes only about 3.25% to total sales.

Gardening division

Main activities in this division relate to production of various plants for interior and exterior decoration as well as interior and exterior decoration of houses and parks. One special feature of this division is maintenance of the railroad track and surrounding territory. The maintenance of railroad track and surrounding territory is conducted by the use of so called Chemical Train. This is the unique equipment and specific competitive advantage

that RVR possesses, not just in Croatia, but in the neighboring countries as well.

This division contributes to total sales approximately 24.4% and employs 62 people.

Main strengths of RVR are the following:

- Excellent geographic coverage of entire Croatia,
- High quality standards,
- Trained and equipped personnel,
- Experience in railway territory maintenance – unique quality in the entire Croatia.

Main weaknesses are:

- Enormous dependence on Croatian Railways – for the time being,
- Inadequate structure of employees – there is a shortage of high educated employees,
- Lack of marketing experience.

ESOP program in RVR

By the decision of Croatian Government from 9th of June, 2005, concerning the privatization of dependant enterprises of Croatian Railways (HŽ), preconditions for defining the new ownership structure of RVR d.o.o. have been met. According to that decision, during the privatization of dependant enterprises of HŽ, it is necessary to enable employees to become stakeholders. Based on government decision, board of directors has initiated the implementation of ESOP program.

Proposed ESOP program is based on group holding of shares for employees, which encourages the development of market structures and ensures transparency of execution of privatization, to the mutual satisfaction of employees and wider community. Implementation of privatization of RVR d.o.o., through the program of employee shareholding, should be observed not only in organizational sense, but in the context of time and space as well. Especially worrying are the issues of transition and privatization, which have encountered great obstacles and showed numerous problems which Croatian society fights with at all its levels. The process of transition and privatization in Croatia, although not accomplished

fully, has contributed to fraying of Croatian society in an unexpected manner. Consequences have been increased poverty and unemployment, as well as other negative trends, which all together points to a critical evaluation of progress made and acquired experience in those complex processes.

Privatized state property, that is to say social capital, later named state capital, was created on the model of creating and distribution of created income. In reality social or state capital was work transformed into physical manifestations. In that context, created and inherited assets of a company should be transferred – at least for the most part – to those who created it. Opposite to this, what happened was a process of taking the property from the workers. As we know, Croatian privatization model did not stimulate ESOP programs similar to the original iteration so they appeared relatively late: with the goal of weathering difficulties caused by the initial privatization model.

In the last several years diverse programs of employee shareholding are more and more a reality in Croatian companies, although there is no systematic legal framework of their use. Today in Croatia there is about hundred of diverse ESOP programs that are initiated for different reasons and which have been prompted by outer and inner interest groups. Instead of being prevalent, employee shareholding in Croatian economy, after the end of privatization, characterizes in appreciable measure only a handful of companies.

By ESOP we mean a model in which workers collectively enter into the ownership structure of the company in which they work, if there exists a way of coordinating such process. Employee shareholding can motivate employees of RVR to work more efficiently and improve company performance. Connection with the company and work dedication comes directly from participation in decision-making that concerns their everyday job, work conditions, and alike, but also from financial benefits of the program. Strategy of implementing ESOP program in RVR d.o.o. is based on specifics of RVR d.o.o. organization and on consensus about basic decisions concerning the future of business system.

ESOP program, among other incentives, needs to create a context in which boosting operative productiveness will be imperative to all interest groups, and especially to workers and

management. Privatization process needs to prompt the management to shape both radical and incremental changes, depending on business segment and area. Aside from that, privatization can indirectly imply additional activities, for instance redesign of basic business processes with the goal of minimizing total costs, and prompting of organizational adjustment as well as adjustment and training of employees to future conditions of Croatian and regional market.

RVR was privatized on 25th October 2007 when joint proposal of 367 workers was accepted by Croatian privatization fund.

Conclusion

In the past few years different programs of employee share ownership are increasingly becoming a reality of Croatian companies, although there is no systematic legal framework for their use. Croatian privatization model did not stimulate ESOP programs similar to their original variant; consequently they appeared relatively late: for the purpose of overcoming difficulties caused by the primary privatization model, the consequences of which have led to serious economic and social problems. Future will show if privatization through employee ownership will bring desired results.

Questions for discussion

1. What do you think about the pressure put on the Management Board by the syndicates regarding the social clauses and the standings of the World Bank regarding this matter? How much is the social importance relevant in privatization of these businesses?
2. In your opinion, is privatization of companies that were part of Croatian Railways good approach or should these companies remain within Croatia Railways. What is your opinion about privatization of companies that function as natural monopolies?
3. What are major benefits for privatization through employee ownership schemes? Are there any pitfalls of employee ownership?
4. What are major determinants of developing governance structures in companies with ESOP privatization?