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## **PRIVATIZATION OF REAL SECTOR ENTERPRISES IN SERBIA - RESULTS, PROBLEMS AND PERSPECTIVES**

***Abstract** - The process of privatization of the real sector of Serbian economy has not been completed after 17 years of implementation. In spite of certain results, the privatization in Serbia has been accompanied with numerous problems and opposings. It is hard to believe that privatization could be successfully finished in planed period. So, it is obvious that renewed institutional framework is necessary for concluding privatization in short time period.*

***Key words** - privatization, restructuring, real sector of Serbian economy.*

### **1. Introduction<sup>1</sup>**

While the majority of countries of Central and Eastern Europe has already carried out structural changes, improved significantly business environment and quality of economic activities (and are joined to EU or are about to be joined to EU), Serbia (together with the majority of other countries of Western Balkan), is still in the process of transition. Many changes, immanent to the process of transition develop with slower than desired pace. Among these changes is the process of privatization and restructuring of enterprises that has key importance for improvement of performances of economic activities and change in economic structure.

In Serbia, not even after 17 years of implementing privatization, according to several different basic models and laws, this process has not been successfully completed. For this reason, supports of international financial institutions of this process are not surprising. The focus of IMF missions, from reforms in monetary and fiscal sector, has been directed to implementation of structural reforms, before all the process of privatization and restructuring of enterprises.

Since a large number of non-privatized socially owned enterprises has remained in Serbia by the end of 2006, and that privatization public state enterprises (at Republican and local level) hasn't in fact even begun, a question arises, what has brought to this situation in privatization field and what are possibilities for this process in the real sector of the economy of Serbia to be completed finally in relatively short term?

### **2. The results of privatization of the real sector of the economy of Serbia**

- In Serbia, with the outset of implementation of intensive transitional changes (in fact since the beginning of 2001.) processes of privatization in the real sector of the economy were intensified.

It is noticeable that prevailing share of up to now privatization revenues (around 81%) and number of privatizations (around 76%) was realized in 2002 and 2003. Namely, efforts in privatization were initially directed to the most attractive parts of the economy (industry of tobacco, cement, beer, medicines, rubber, construction materials, then sugar refineries, chemical industry, oil derivates distribution...) and successful enterprises. Concerning the attractiveness of these enterprises (large market and/or significant property), a greater number of investors were interested in buying them, which influenced on the results in privatization to be initially very

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favorable. With the privatization of only 14 most attractive enterprises, the revenue of around €869 millions or somewhat less than half of total realized privatization revenues. In the acquisition of enterprises in Serbia, a large number of reputable big world companies was included: "Philip Morris", "Bat", "La Farge", "Holcein", USS, "Lukoil", "Tarkett Somer", "Titan", "Tondah", "Pharmaco", some reputable foreign investment funds ( e.g. "Salford") and many others.

- In 2004, a certain slowdown became evident in privatization in the real sector of the economy of Serbia. To a significant extent this was caused by the fact that the corpus of enterprises attractive for privatization was noticeable decreased, i.e. that some market attractive public enterprises have not entered the privatization process. At the same time, for majority of remaining "business controversial" enterprises, in difficulties and problems there was no great interest from potential investors. Considering a immense number of these enterprises, a question was imposed in which method to access to the privatization and transforming of enterprises, which can very hardly find new owners due to their current performances

For those reasons, by the middle of 2005, do amendments of the Law on Privatization were introduced, with which a new incentive was given to the process of privatization. By the Amendments of the Law on privatization, basically, the government (and public enterprises) has written of their debts towards non-privatized enterprises. In that way, indebtedness has been reduced considerably and remaining socially owned enterprises have been made more attractive to potential investors. That has put revenues from the sale of enterprise and their support to the budget of Serbia into the second plan, and the priority was given to speeding up and finishing the process of privatization.

Besides, the government has taken over to itself financing the redundancy, with which a great number of enterprises burdened by enormous of employees in relation to current production and market possibilities, has been made more attractive for potential buyers.

- In 2005, 190 enterprises were sold by auction, with around 22 thousand employees, and revenue of €173.1mn was realized. Through tender privatization 15 enterprises were sold, with around 8.8 thousand employees, and revenue of €96.6mn was realized. In 2005 activities in sale of minority packages were intensified, and Share Fund of the Republic of Serbia realized the best results in number of sold shares of the companies (more than 294) as well as in financial result (more than €125,5mn). All that indicates to certain acceleration of the process of privatization compared to previous year.

- In 2006, 206 enterprises were sold by auction, with around 22 thousand employees, and revenue of €161mn was realized. Through tender privatization 25 enterprises were sold, with around 21.6 thousand employees, and revenue of €101.2mn was realized. In 2006. Share Fund of the Republic of Serbia sold shares of the 306 companies for €70.1mn.

- In the field of privatization through restructuring, modest results were realized until 2005. Through processes of financial and organizational restructuring (mainly fragmentation of enterprises), the government i.e. the Privatization Agency has been trying to prepare a certain number of once large and/or significant enterprises for local self-government for privatization and more successful business operating in forthcoming period. Unfortunately, in around 70 economic entities that have initially been in the process of restructuring, until the alteration of the Law on Privatization in 2005, this process was implemented in a small number of enterprises ("Livnica" Kikinda, "Sever" Subotica, parts of other enterprises, like "Zmaj" Zemun, etc.). Therefore, visible effects of implemented processes of restructuring to total business operating of domestic

economy were not noticeable. But the recovery of these enterprises is of key importance for adding dynamics of business activity in some cities, regions and on the level of the country as a whole.

After the amendment of the Law on Privatization (since 2005), visible moves in restructuring field were realized, and some big enterprises were privatized, like “Azotara“ Pančevo, “FVK“ Kraljevo, “Hisar“ Prokuplje, “Nitex“ Niš, “Partizanski put“ Beograd, “Hipol“ Odžaci, etc. Reducing indebtedness and number of employees, as well as stabilization of total economic ambient are key reasons that influenced on adding dynamics to the process of privatization and restructuring of the real sector of the economy of Serbia since 2005.

### Results in the process of privatization real sector of Serbia in 2002 –2006.

|                                    | Tenders  | Auctions | Share Fund | Total    |
|------------------------------------|----------|----------|------------|----------|
| Number of enterprises sold         | 76       | 1 343    | 433        | 1 852    |
| Number of employees in enterprises | 67 776   | 127 547  | 94 710     | 290 033  |
| Selling price (in mil €)           | 1 004,63 | 691,75   | 398,26     | 2 094,64 |
| Total investment (u mil EUR)       | 926,44   | 189,37   | 5,9        | 1 121,72 |
| Redundancy programme (u mil EUR)   | 278,02   | -        | -          | 278,02   |

Source: Bulletin of public finances of the Republic of Serbia

The EBRD in Transition report 2006 do not estimate the results of large-scale privatization and enterprise restructuring very highly in comparisons with other selected countries of former Yugoslavia. On the other hand the results of small-scale privatization are estimated much better:

### Transition indicators in privatization

| <b>Large scale privatization</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|
| BOSNIA AND HERZEGOVINA           | 2,33        | 2,33        | 2,33        | 2,67        | 2,67        |
| CROATIA                          | 3,00        | 3,33        | 3,33        | 3,33        | 3,33        |
| FYR MACEDONIA                    | 3,00        | 3,00        | 3,33        | 3,33        | 3,33        |
| MONTENEGRO                       | 2,67        | 2,67        | 2,67        | 3,33        | 3,33        |
| SERBIA                           | 2,00        | 2,33        | 2,33        | 2,67        | 2,67        |
| <b>Small scale privatization</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> |
| BOSNIA AND HERZEGOVINA           | 3,00        | 3,00        | 3,00        | 3,00        | 3,00        |
| CROATIA                          | 4,33        | 4,33        | 4,33        | 4,33        | 4,33        |
| FYR MACEDONIA                    | 4,00        | 4,00        | 4,00        | 4,00        | 4,00        |
| MONTENEGRO                       | 3,00        | 3,00        | 3,00        | 3,00        | 3,00        |
| SERBIA                           | 3,00        | 3,00        | 3,33        | 3,33        | 3,67        |
| <b>Enterprise restructuring</b>  | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> |
| BOSNIA AND HERZEGOVINA           | 1,67        | 2,00        | 2,00        | 2,00        | 2,00        |
| CROATIA                          | 2,67        | 2,67        | 3,00        | 3,00        | 3,00        |
| FYR MACEDONIA                    | 2,33        | 2,33        | 2,33        | 2,33        | 2,67        |
| MONTENEGRO                       | 1,67        | 1,67        | 2,00        | 2,00        | 2,00        |
| SERBIA                           | 2,00        | 2,00        | 2,00        | 2,33        | 2,33        |

Source: Transition report EBRD 2006, EBRD. The measurement scale for the indicators ranges from one to 4+, where one represents little or no change from a rigid centrally planned economy and 4+ represent the standards of an industrialized market economy

### 3. Problems and opposings to changes in privatization and restructuring process

- The process of privatization of the real sector of Serbia has been followed by numerous opposings and problems. The problem of opposing to changes often presents the main obstacle to successful privatization and restructuring process, and the most often leads to significant dragging

out in implementation of necessary changes. Opposing is present when a concept of implementing changes is concerned, as well as proposed implementation method.

Namely, changes affect the management and employees, that is, their positions, responsibilities and existing forms of behavior. Therefore the majority of employees, including there manages too, not only are not interested in changes, but also with hostile attitude towards them. There is no readiness in the management to enter into the privatization and restructuring, i.e. alter the gloomy present of business operating “of their enterprises“with uncertain, maybe even better future. Instead of working on enabling their enterprise for business activities in completely different conditions of business operating, efforts of management are still directed to a great extent to keeping obsolete methods of business operating (not rarely based on renting capacities to private entrepreneurs) or to searching for different aspects support from the government. Besides all that, it is not rare a domination of temporary private interest of some managers over the interests of the whole enterprise and the employed in them.

Unfortunately, neither the employees are too much interested in the privatization and restructuring, because they do not see direct interest in that. In addition, the majority of the employed is very scared for their work posts and wages and opposes to strategic changes due to fear from future, although they are unsatisfied with their current status as well.

- The processes of privatization, especially of big enterprises of the real sector of Serbia are burdened by objective business problems with which these economic subjects meet. Although great differences exist from an enterprise to an enterprise, however numerous mutual problems are characteristic for all these enterprises, which cannot be systematized to presented SWOT matrix.

**SWOT matrix of large non-privatized enterprises in difficulties**

| <b>Strengths</b>   | <b>Weaknesses</b>  |
|--|--|
| <ul style="list-style-type: none"> <li>▪ Long tradition and production experience</li> <li>▪ Experienced and trained labour force</li> <li>▪ Large surface of building facilities</li> <li>▪ Significant production capacities</li> </ul>  | <ul style="list-style-type: none"> <li>▪ High indebtedness</li> <li>▪ Obsolete production equipment and technology</li> <li>▪ Obsolete production programme</li> <li>▪ Narrowed market</li> <li>▪ A great number of employees, inadequate qualification and age structure of employees</li> <li>▪ High fixed costs and non-competitiveness</li> <li>▪ Unsolved property-legal relations</li> <li>▪ Numerous court disputes</li> <li>▪ Chronic lack of own working capital</li> </ul> |
| <b>Opportunities</b>   | <b>Threats</b>   |
| <ul style="list-style-type: none"> <li>▪ Written of debts through financial restructuring</li> <li>▪ Implementation of redundancy programmes</li> <li>▪ Investments in state-of-the-art production technologies and development of products</li> <li>▪ Possibilities for increase of sale on domestic and European market through privatization by strategic partners</li> </ul> | <ul style="list-style-type: none"> <li>▪ Intensification of competition by smaller domestic and big foreign producers</li> <li>▪ Liberalization of import regulations</li> <li>▪ Non-understanding of a part of creditors for existing situation</li> <li>▪ Inefficient system of solving litigations</li> <li>▪ Political instability</li> </ul>  |

Presented matrix indicates to a conclusion that mainly enterprises are considered, in which weaknesses and threats prevail over advantages and chances that exist. The privatization of these enterprises, in particular without abundant processes of restructuring and implementation of major changes, is extremely difficult. One of the main reasons is the fact that there is no

expressive great interest of potential investors for their privatization, particularly not in present form, existing level of competitiveness, business performances and market currently available to them.

- Numerous controversies related to new owners and their behavior forms are present in Serbia. In a certain number of enterprises, the privatization was mainly motivated by speculative reasons, in the first place by the acquisition of property that those socially owned enterprises possessed. Therefore, new owners and management are not interested in development of a business of enterprise, but to buy the property. The new owners frequently create conditions, with different measures, and before all low wages and introducing rigorous working discipline, for employees to give notice and leave enterprises (in spite of social programme of adopted plan). In such manner the existing property remains on disposal of new owners, which they will offer after the term anticipated by law (related to a ban of alienation of privatized enterprises' property) for sale on the market (probably at considerably higher prices in comparison to those at which they had bought the capital of those enterprises).

A number of "annulated privatizations" in which purchase contracts were cancelled due to the method of business operating of new owners is relatively small and amounts around 9% (the most famous is the case of "Putnik" Beograd). Nevertheless, a number of enterprises in which even after implemented privatization there was no visible improvement of performances is considerably higher, which emphasizes opposition of the management and employed in up to now non-privatized enterprises.

- In Serbia practically everybody speaks in favour of privatization, but new owners disturb almost everybody. For many people, privatization by multinational foreign companies presents sale of national property (so called "family silver"). Even more undesirable are domestic private, especially substantial entrepreneurs (Delta M, MK Commerce, East Point...). Though it is shown that the privatization by multinational companies, and even large domestic entrepreneurs by rule, in middle term, brings to an increase of efficiency of economic operating and raising the competitiveness and volume of operating (e.g. "USS Serbia", "VB" Sevojno, "Juhor" Jagodina) almost all serious strategic investors are subject to numerous criticisms and demands for revision of purchases done. A concept of workers' shareholding, at one time applied, was abandoned in Serbia (which was incorporated in legal provisions until July, 2001) and it is obvious that overall consensus has not been realized in regard of existing concept of privatization, in particular when new owners are considered. In addition, negative examples of behaviour of some new owners do not contribute to overcoming the opposition to privatization and restructuring process.

- The privatization (and restructuring) of enterprises is not the aim by itself, but means for improvement of performances of business operating of the real sector and entire economy. That should result with an increase of production volume, export, then decrease of inflationary pressures, inflow of foreign investments, and increase in wages of the employed, etc. Although relatively satisfactory results of key macro economic trends in Serbia have been realized in previous period, it could not be stated that all expected effects efficiently have been realized up to now. Although the production, export, real wages, investment inflow has been increased... all initial expectations have not been fulfilled until now. Serbia with GDP per capita of somewhat more than 3.5 thousand US\$ falls into, even henceforth, the lowest in the region.

Negative effect on employment presents key problem in the implementation of privatization and the process of restructuring. Unfortunately, the number of unemployed in Serbia is still very high and during the implementation of privatization and restructuring it has increased for around 200 thousands. According to available data for the end of 2006, the number of unemployed amounted

1.081 million persons, and official unemployment rate has reached the level of around 27% (according to survey on labour around 20.8%), which presents one of the greatest economic and social problems of Serbia. Namely, as a consequence of the process of privatization and restructuring of public and other enterprises, it comes to increased lay off of workers, which at low level of economic activity and still insufficiently broad fan of incentive measures for development of small and middle enterprises influences on high unemployment rate in Serbia.

#### **Basic macroeconomic indicators for period 2002-2006**

| Period | GDP growth in % | Industrial production growth in % | Inflation growth in % | Export in mil. US\$ | Import in mil. US\$ | Real wages growth in % |
|--------|-----------------|-----------------------------------|-----------------------|---------------------|---------------------|------------------------|
| 2006   | 5.8             | 4.7                               | 6.6                   | 6 428               | 13 172              | 11.4                   |
| 2005   | 6.5             | 1.3                               | 16.5                  | 4 553               | 10 570              | 5.7                    |
| 2004   | 9.3             | 7.1                               | 10.1                  | 3 701               | 11 139              | 10.1                   |
| 2003   | 2.4             | -3.0                              | 11.7                  | 2 755               | 7 473               | 13.6                   |
| 2002   | 4.5             | 1.8                               | 19.5                  | 2 075               | 5 614               | 29.9                   |

*Source: Republic Bureau of Statistics*

#### **4. Outlook of the process of privatization**

- By the Law on Privatization, it was determined that se by the end of March 2007 should be finished the process of privatization of socially owned enterprises in Serbia, which had begun even in 1990. However, in the portfolio of Agency of privatization in the March 2007 were more then 1200 non-privatized firms. In addition to that there are a great number of stocks socially owned enterprises within Share fund.

Majority of non-privatized enterprises are small enterprises, which due to their business performances, small property and/or unsolved legal problems were not attractive for privatization and the interest for them has not been shown by potential buyers up to now. But there are more then 300 large firms or around somewhat less than 1/3 of all large enterprises among non-privatized enterprises. These enterprises employ many persons, possess immense property and are of a great significance for the economy of state and local self-government. Nevertheless, as a rule (with exemption of large public enterprises), these non-privatized enterprises will objectively be very difficult to be successfully privatized, even with a precondition decreasing indebtedness through writing off debts and a reduction of the number of employees through implementation of social- redundancy programmes.

- Therefore an issue imposes, in what way will finally be successfully completed the process of privatization in Serbia that had begun long ago, which in majority of other countries in transition in Central and Eastern Europe has practically been finished?

According to current legal provisions, the possibility of fast privatization of such a great number of enterprises in anticipated term is practically unfeasible. Namely, there are no capacities to prepare in so short-term corresponding sale documentation for such a great number of enterprises, in particular concerning numerous legal problems (immanent to business operating of these enterprises), as well as unwillingness (or incapability) of the management to work actively on preparation for privatization.

Apart from that, it is hard to believe that effective domestic and foreign demand exists for so great number of such enterprises. At last, an offer of a great number of enterprises for

privatization in short term will inevitably lead to inadequate privatization revenues and other negative effects.

Special issue is the privatization of public state enterprises. After significant pressures by international financial institutions processes of restructuring of some big public enterprises and their preparation for privatization have begun. It regards in the first place parts of gas and oil industry, then railway, post, airways company, etc. Nevertheless, processes of privatization and restructuring of these enterprises (which possess around 50% assets of the total economy) are in a very outset and they have ahead of them approaching implementation of huge transitional changes. Although due to its attractiveness buyers for this sector of the economy exist surely (before all NIS - gas and oil industry, EPS - electrical power complex), there are still numerous opposings in the privatization of these enterprises, a threat of social tensions, as well as a lack of consensus (in political and economic circles) about which of these enterprises and in what method should be privatized.

## **6. INSTEAD OF CONCLUSION**

Although processes of privatization and restructuring had initially negative effect in other countries in transition (so called transitional crisis), the data indicate that the countries characterized by intensive restructuring processes come faster out of the crisis and realize faster economic growth monitored in longer term period. Namely, the sooner it comes to change in economic structure and changes in a method of operating of the real economy sector, the faster assumptions are realized for faster and more stable economic growth, improvement of competitiveness and increase of export, living standard, and even growth of employment. All that indicates to necessity of implementation intensive processes of privatization and restructuring, regarding the fact that with obsolete economic structure and ancient history method of business operating more successful results of business operating in the real sector of the economy of Serbia cannot be achieved.

Privatization and recovering of non-privatized, especially large enterprises (including there also big public enterprises, as well as numerous public enterprises at local level), will present one of the greatest challenges for economic policy in forthcoming period. Nearly all business performances of the economy of Serbia will essentially depend on the success of solving this issue in forthcoming period.

The role of government, through (not so big) subsidies for employees' wages and contributions and/or providing short-term credits for prolongation of existing, mainly unprofitable, production is not sustainable in the long term. It is effective solution. Although the restructuring is often "painful" process followed by a row of undesirable effects, which includes leaving certain productions, "cutting" of the number of employees and closing numerous non-propulsive enterprises or their parts, the privatization and restructuring of the firms in real sector of the economy of Serbia is inevitable. The sooner it comes to change in economic structure and alterations in a method of operating, the faster assumptions are realized for greater economic growth, improvement of competitiveness and increase in total effectiveness and efficiency of business operating. Therefore the process of privatization must be speed up and accomplished with firmer carrying out the bankruptcy procedures that are the only feasible way for privatization of large number of non-attractive firms. Only, by larger scale bankruptcy procedures then in previous period, the privatization proces could be implemented and finally to be ended.