

## Leadership and Economic Efficiency of Public Enterprises in Romania

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**Abstract:** The place and role of SOEs in a national economy was debated many years ago from the collapse of socialist economies when it came to the former communist countries to make a transition from the planned economy to an economy of free market, and even back in time to the early 80s, an example being the Thatcher government in the UK. The subject remains as important nowadays for Romania, given that there are still many problems in connection with the responsibility of the state towards various fields of economic activity, the leadership and the involvement of public authorities and, not least, the economic performances brought by this type of enterprise. This paper try to make a review of the scientific literature in order to reveal significant researches in the domain, a short presentation of Romanians SOEs and their economic environment in 2014 and an analysis of the economic efficiency of public enterprises in Romania that focuses on the evolution of the 2012-2014 period of the number of public companies, of the major financial indicators, of the number of insolvencies, of the outstanding payments and of the state subsidies, as well as correlation between these results and the type of management and leadership applied in public enterprises, and that reflects the importance of this study for actual research in Romania.

**Keywords:** state owned enterprises, corporate governance, leadership, economic efficiency, financial indicators

**JEL Classification:** H54, H83, I32, I33

## 1. Introduction

The place and role of SOEs in a national economy was debated many years ago from the collapse of socialist economies when it came to the former communist countries to make a transition from the planned economy to an economy of free market, and even back in time to the early 80s, an example being the Thatcher government in the UK. The subject remains as important nowadays for Romania, given that there are still many problems in connection with the responsibility of the state towards various fields of economic activity, the leadership and the involvement of public authorities and, not least, the economic performances brought by this type of enterprise.

This paper tries to make, first of all, a little review of the scientific literature in order to reveal significant researches in the domain, as a starting point for the subject developments. Secondly, the author makes a short presentation of Romanian SOEs and their economic environment in 2014 to have a brief overview about the economic and social importance of Romanian SOEs in the national economy. Another issue addressed in this study relates to aspects of the legal framework that regulate the functioning of such public entities, the introduction of private management and possible benefits it may bring to the economy, and also the possibility of privatization of some SOEs to relieve the national economy from the financial loss they have obtained from their underperforming activity. As the central objective of the work, the analysis of the economic efficiency of public enterprises in Romania focuses on the evolution of the 2012-2014 period of the number of public companies, of the major financial indicators, of the number of insolvencies, of the outstanding payments and of the

state subsidies, as well as correlation between these results and the type of management and leadership applied in public enterprises, and that reflects the importance of this study for actual research in Romania.

The research methodology is based on a comparative analysis of economic and financial indicators of Romanian SOEs during a period of three years (2012-2014) in correspondence with changes in PE legislation and government actions regarding the PE corporate governance. This comparative approach on several years in time is meant to reveal positive and negative issues about the management and leadership impact on economic performances of an Romanian SOE, data useful for the public authorities, for the country citizens and last but not least for the international financial institutions and markets.

## 2. Literature review

In scientific literature, there are multiple approaches regarding the place and role of state owned enterprises (SOE) in a national economy, starting from the characteristics related to the state's participation in the company's capital, the mechanisms of corporate governance, and legislation reaching to economic and financial performance and transparency of information.

In his well-known book "Bad Samaritans. The Myth of Free Trade and the Secret History of Capitalism" (Chang, 2012), the economist Ha-Joon Chang shows some arguments that rely the plea against state enterprises (public property) versus private enterprise: a) the citizens do not have the capacity nor the desire to control the managers appointed to lead SOEs; b) managers do not maximize the company's profits and it is

impossible for citizens to compel them to do so due to lack of information on the behavior of agents; and c) state ownership favor the survival of this type of enterprises in particular on the basis of political lobbying and less on economic performance.

Contrary to these believes, in his book the author makes a plea for SOEs and shows a number of success stories in developed or emerging economies, showing that “two important things [...] are the critical review of the company goals and setting some clear priorities [...] [besides] increasing competition [which] can be an important factor in improving the performance of state enterprises” (Chang, 2012).

In a publication of the Department of Economic and Social Affairs of United Nations Organization (UN, 2008) they say about PE leadership: „Leadership requires not only clarity of objectives but also the commitment to follow through on these objectives (Otobo). [...] Re-inventing PE necessitates an informed and committed leadership (that adheres to a framework of good governance) to design and present development priorities and argue for state investment via Public Enterprise.” The publication also reveals that „Within the realm of economic theory, efficiency is the point where marginal revenue is equal to marginal cost - or where the difference between total revenue and total costs is the greatest. [...] Hence, where efficiency is tantamount to profit maximization, monopolistic PEs (without competing rivals) can always be “economically efficient” and derive profits without satisfying the criterion of social optimality which would incorporate serving all potential consumers. (Katsiaouni)” (UN, 2008).

In this respect, the authors point solutions in terms of economic efficiency of

state-owned enterprises: “Governments can and must manage the financial, regulatory, and coordination frameworks to facilitate more efficient PE management. 1. There must be clarity over the government’s role in economic development in order to prevent politicization of the PE strategy; and 2. Legal and institutional devices to monitor PEs’ efficiency and productivity will also contribute to the establishment of good governance in PEs.” (UN, 2008).

The issue of economic efficiency of public enterprises was researched also in a paper from the OECD Journal on Budgeting (Curristine et al., 2007) showing that, in order to improve the PE efficiency, most OECD countries have conducted reforms which “can be classed under three broad headings: making the budget process more responsive to priorities; making management practices more flexible, such that defined priorities are easier to achieve; strengthening competitive pressures among providers of public services and, where not incompatible with equity considerations, containing the demand for public services.”

A study on SOEs efficiency in South Korea (Kim & Chung, 2009) approaches the possibilities of privatization as a believable measure to enhance the competitive environment in a free-market economy: „[...] many researchers have asserted that state-owned enterprises (SOEs) should be privatized while others have favored more gradual reform approaches. At the early stage of this debate, researchers were interested in (governance) ownership structure which they believed was the cause of SOEs’ inefficiency. [...] While supporters of privatization argue that privatization is the only way to bring about changes in managerial goals and towards

competitive environment, others maintain that it can be accomplished by more gradual approaches.”

### 3. Brief overview on Romanian Public Enterprises

A brief overview of state-owned enterprises in Romania needed to be done based on data from Ministry of Public Finance for the end of 2014. Thus, there are a huge number of state-owned enterprises (SOEs), significantly higher than the OECD countries, as a result of a privatization process unfinished or in progress. Central and local authorities hold majority stakes in 1,525 Public Enterprises, of which 232 operating PE are subordinated to different institutions in central administration and 1,051 operating PE are in the local administration portfolio, the rest being nonoperational. Most PE operates as companies and only a limited number (around 100 local and 15 at central level) are autonomous (M.F.P., 2014).

The value of assets / capital held by the state to public enterprises was 27.83 billion lei in 2014. The PE net turnover recorded a value of 33.78 billion lei, while gross profit has a value of 3.93 billion RON. PE equity totaled 56.45 billion RON, while the number of employed persons was 210,795 people in 2014.

In the final report “Evaluation of the implementation of the Emergency Ordinance no. 109/2011” (Dochia et al., 2014) they show that the PE sector in Romania has a complex structure characterized by a great diversity of industries in which they operate, different corporate structures and sizes, as contrasting financial statements and results. Current situation reflects a significant number of

insolvent, bankrupt or with restructuring needs of Public Enterprises, and a good part of them have a low level of performance so that they constitute a burden for public finances.

The same report highlights that there are corporate governance issues linked with the low performance of PE, such as: the limited capacity of government institutions to properly exercise the functions of owner / shareholder and poor quality of governance. Those issues are bound by “politicization of corporate governance structures” because “boards of public companies and executive management positions were frequently used as a tool to reward and encourage political affiliations” (Dochia et al., 2014). As a result, people in charge with corporate governance of PE are less qualified and are deprived of decisional independence against the minister who put them in office. There is also a correlation between corporate governance of PE stability and political stability as “periods of political unrest grow the instability of the board of directors and management of PE”. “The politicization of appointments to management positions and board members is associated inevitably with nepotism, bribery, corruption, abuse” (Dochia et al., 2014). The recommendations in this report refer to: further reducing the number of companies owned by the state and public sector restructuring, improving the incentives for managers and the accountability to citizens, completing the institutional frame with amendments to OG 109/2011.

A phenomenon associated with poor corporate governance is the emergence and development of “tick” type companies that managers / directors of public companies have done business on the basis of preferential

contracts and dubious financial and economic operations that have undermined the economic situation of public enterprises.

#### 4. Legal framework for SOEs management

There are a lot of law regulations regarding the corporate governance and management in PE sector, the most important being the following:

- Law no. 31/1990 on companies, with subsequent amendments;
- Law no. 15/1990 on the reorganization of state economic units as autonomous and commercial companies, with amendments;
- Law no. 111/2016 approving Government Emergency Ordinance no.109/2011 on corporate governance in public enterprises;
- Government Ordinance no. 26/2013 on strengthening financial discipline at the level of economic operators where the state or administrative-territorial units are majority or sole shareholders or hold directly or indirectly a majority;
- Government Ordinance no. 64/2001 on profit distribution to national societies, national companies and companies owned by state, with subsequent amendments;
- Ministry of Public Finance Order no. 41/2014 on regulating the procedure for reporting financial indicators by the economic operators with equity / patrimony wholly or majority owned directly or indirectly by central or local public authorities;
- Law no. 85/2014 on procedures to prevent insolvency and insolvency.

In a Memorandum of Romania's Government named „State participation in the economy. Guidelines on the State

Ownership Management in public enterprises. The role of the state as owner and expectations” (M.F.P., 2016), there are highlighted issues like:

- increase the transparency of state enterprises and cooptation of professionals as PE managers;
- imposing letter of expectations as informal working tool in the selection process of managers and directors of PE;
- imposing statement of intent as informal work document, drawn up on the basis of the letter of expectations and public information related to the activity of public enterprise by the candidates for the post of manager / director, selected and enrolled in the shortlist presented his vision / program on PE development;
- unifying the management plan and developing a single management plan by executives with the trustees;
- determining remuneration for directors and executives by considering the targets and the performance indicators established according to the letter of expectations.

According to Law no. 111/2016 which was approved by GEO no. 109/2011, the Ministry of Public Finance will have an important role of monitoring and interlocking focused on monitoring implementation of the legislation on PE corporate governance by public authorities. Besides monitoring function, MFP has an important role to create and ensure a homogeneous regulatory framework at national level in terms of corporate governance by developing together with ministries the methodological standards, the guidelines and the best practices.

It regulates also the general framework of targeting relevant objectives to public enterprises and the responsibility of public



authority, the regulations on performance measurement, the classification of performance indicators and the possible regulation for public guardianship authorities to establish additional indicators.

### 5. Economic efficiency of SOEs and leadership influences

The present study proposes an analysis of economic indicators obtained from public

enterprises in correlation with the decisions and actions of management and leadership.

The Annual Report for 2014 of the Ministry of Public Finance of Romania express the evolution of economic and financial indicators for active PE for the period 2012-2014, as they can see below (MFP, 2014).

Table 1 Financial indicators for active PE

Year	2012	2013	2014
<b>Financial indicators</b>	RON thous.	RON thous.	RON thous.
<b>No. of SOEs</b>	218	215	232
Turnover	35,199,090	35,373,044	33,783,282
EBIT	1,398,750	3,491,682	4,217,300
EBITDA	7,139,398	8,896,962	8,673,136
EBT	652,277	3,292,585	3,929,893
Net Income	-131,405	2,103,253	2,976,134

Source: Ministry of Public Finance, Annual Report 2014, p. 36

The data presented in the table have discounted the privatization of SCDFEE - Electrica S.A. and removing this company together with its subsidiaries from the monitoring action of state authorities.

During the year 2014 it has registered an improvement in the financial performance of public enterprises compared to previous years, by reducing operational losses and arrears registered by them.

In 2014 compared to 2012 (without SCDFEE - Electrica S.A. and subsidiaries), there is an improvement in the following financial indicators:

Earnings Before Interest and Taxes (EBIT) increased by 725,618 thousands RON in 2014 compared to 2013 (20.78%) and 2,818,550 thousands RON in 2014 compared to 2012 (201.5%);

Earnings Before Taxes increased by 637,308 thousands RON in 2014 compared to 2013 (19.36%) and 3,277,616 thousands RON in 2014 compared to 2012 (502.48%);

Net profit increased by 872,881 thousands RON in 2014 compared to 2013 (41.5%) and 3,107,539 thousands RON in 2014 compared to 2012 (2,364.85%).

Also, debt reduction was recorded a total amount of 6,070,585 thousands RON and

the arrears - an amount of 2,880,784 thousands RON.

Thus there is an improvement of the economic and financial indicators in 2014 compared to 2012,, which shows that leadership and managerial activities carried out in years 2012-2014 led to an overall performance of active PE and that the structural measures to improve the financial position and efficiency in exploiting PE or restructuring, reorganization, privatization and insolvency / liquidation / bankruptcy measures, led to the desired result.

The increase of economic and financial indicators such as net turnover, equity, revenues, net profit led to an increase of profitability indicators in 2014 compared to 2013 and to 2012. There is also an increase of liquidity and solvency indicators due to an increase of net sales and a decrease in assets and liabilities. We also notice a decrease in indebtedness in 2014 compared to 2013 and 2012 due to a lower of total assets and total liabilities.

At the same time, the measures taken in order to reduce arrears have contributed to their reduction by the end of 2014 versus the end of 2013 with a share of 48.53%, from 6.8 billion RON to 3.5 billion RON, both due to measures taken in accordance

with international financial institutions and measures for restructuring, reorganization, privatization, including measures to trigger insolvency proceedings provided by Law 85/2006 on insolvency proceedings.

Among the actions taken in this regard they have included legislative measures, measures trigger insolvency proceedings and actions undertaken by PE management, for example: resorting to loans to pay the arrears or rescheduling of arrears and collection of outstanding receivables which were used for settling outstanding payments. However, the arrears recorded by public enterprises in 2014, did not achieve the target of 3.4 billion RON agreed with international financial institutions, so they exceeded by only 0.1 billion RON (MFP, 2014).

In 2014 compared to 2013, the size of state subsidies to public enterprises increased by 14.80%, representing an amount of 1,027,851 thousand RON. In total subsidies, amounting to 7,972,595 thousand RON, the highest share in the proportion of 57.73% was granted for investments, while for operating activities was awarded a percentage of 42.27%. Thus, there is a reduction in 2014 (57.73%) of the share of general subsidies for investment in total versus 64.74% weight given to 2013 (MFP, 2014).

Table 2 Financial ratios for active PE

Ratio	Formula	Years			Variation	
		2012	2013	2014	2014-2013	2014-2012
E B I T margin	EBIT/Turnover	3.90%	8.77%	12.48%	3.71%	8.58%
E B I T D A margin	EBITDA/Turnover	18.17%	22.23%	25.67%	3.44%	7.50%
ROE	Net Income/Equity	-0.14%	3.19%	5.27%	2.08%	5.41%

ROA	Net Income/Total Assets	5.14%	6.38%	8.80%	2.42%	3.66%
C u r r e n t Ratio	Current Assets/ Current Liabilities	96.59%	138.21%	176.14%	37.93%	79.55%
Quick Ratio	(Current Assets – Inventory)/ Current Liabilities	84.00%	118.55%	154.15%	35.60%	70.15%
I n t e r e s t C o v e r a g e Ratio	EBIT/Interest	N/A	797.00%	1,194.01%	397.00%	N/A
Total Debt Ratio	Total Liabilities/ Total Assets	29.42%	22.46%	20.31%	-2.15%	-9.11%

Source: Ministry of Public Finance, Annual Report 2014, p. 48

The profitability ratios have, generally, acceptable values, but, instead, the liquidity ratios have values well above acceptable limits in economic theory and practice. High values for liquidity ratios indicate an inefficient use of cash and other short-term assets, and a failure to use money for investments that are so necessary in Romanian economy. On the other hand, high values for leverage ratios show a good debt service for active PE, meaning a high debt service coverage. There are also some big gaps between the values for 2014 and 2012.

The increase of financial indicators lead to the conclusion that active PE have deployed a profitable activity in the past years due to their management and leadership, in spite of multiple negative aspects regarding corporate governance of PE highlighted by economic analysts.

## 6. Conclusions

The analysis made by the author and based on data from the Ministry of Finance and the analysis of Romanian researchers in the field (Dochia et al., 2014) yielded the following conclusions:

- PE sector has a low financial performance, despite the results presented above, although there are some large state companies in the energy and natural resources that are among the most profitable businesses in Romania;

- Debts are a recurring problem for PE sector; half of the total debt of the PE has past due and for many companies, especially locally, payment obligations to cover debt is a difficult task;

- There are a large number of PE that are technically bankrupt and completely protected from bankruptcy only by their status as a public entity and which survive thanks to regular compensation or conversion of debts into shares.

- In recent years, arrears to the state budget decreased compared to arrears to banks and other creditors. The bulk of the debt is due to PEs to other PEs;

- It is necessary to recruit consultants specialized in restructuring enterprises which are viable but under-performing;

- PE with the best performance requires listing on the stock exchange to ensure a better funding of them in order to achieve their business targets;



- Putting into practice the latest legislative regulations concerning the PE corporate governance should be done in an unbiased manner, without favoring members of the Board of Directors, by improving the incentives and accountability of managers and through a selection process which eliminate candidates poorly professional trained;

- The state administration at central and local level need to be aware that should increase its leadership responsibility and control within these public enterprises and the role of the political factor in this area should be reconsidered and, if necessary, assumed.

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