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PRIVATIZATION IN CROATIA

Privatizacija u Hrvatskoj osmišljena je u godini 1991. kao kontrolirana i decentralizirana privatizacija, zasnivala se na prodaji bivšeg društvenog vlasništva, ali je taj proces bio mnogo manje decentraliziran i mnogo manje se temeljio na prodaji društvenog vlasništva. Politička je moć bila koncentrirana u rukama jedne jedine političke stranke, a pravni i institucionalni okviri nisu bili izgrađeni kompleksno, konzistentno i operativno. U procesu privatizacije nisu poštivani postojeći zakonski propisi i procedure, već je privatizacija često pobivala i kriminalne osobine. Dosadašnji rezultati pokazuju da ciljevi privatizacije nisu postignuti, već da je ona dovela do negativnih učinaka s političkog, društvenog i ekonomskog gledišta.

Croatian economy prior to the privatization

The politico-economic situation of Croatia at the end of the 1980's was not much different from other countries with the centrally planned economies in the Eastern Europe. Having exhausted the attempts of the face lifting in terms of the reforms leading to the "new socialism", it was evident that a new politico-economic system ought to be built up in order to promote an overall progress in the country, i.e. the transition from the planned to a market economy was inevitable. The following key elements of this new system were anticipated in the economic sphere: open market economy, dominant private ownership, economic stabilization, restructuring of the economy. Thus, the privatization was looked upon as one of the mutually dependent key elements in the process of transition.

Even though many ideas were spoken out and individual actions undertaken in late 1980's, the process of transition in Croatia formally began in 1990 by passing the Law on Croatian Agency for Restructuring and Development(CARD)¹ and the

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Law on Croatian Fund for Development(CFD)². These two institutions were supposed to monitor the process of privatization in Croatia, CFD being in charge of capital formation and allocation, while CARD giving the technical support. The process itself actually started in 1991, but the year 1990 may be considered as the starting point of privatization in Croatia. Table 1 presents some information related to the Croatian firms in 1990 and casts more light on the start of privatization.³

Table 1

CROATIAN ECONOMY IN 1990

Form of ownership	Firms		Labor employed		Social capital	
	Number	%	Number	%	Millions of DM	%
1. Social firms	3 637	35.5	1 105 873	97.6	57 609.3	1100.0
1.1 Public social firms	98	2.7	123 097	11.1	18 089.3	31.4
2. Private firms	6 785	62.5	19 602	1.7	-	-
3. Cooperative firms	284	2.6	5 290	0.5	-	-
4. Mixed firms	153	1.4	2 001	0.2	-	-
Total (1+4)	10 859	100.0	1 132 766	100.0	57 609.3	100.0

Source: "Report", Croatian Agency for Restructuring and Development, Zagreb, November 1992, p.1.

Hence, at the beginning of the privatization the Croatian economy was organized in 10 859 firms in total, with the dominant social firms, not so much in the number of firms, but in the number of the people employed and the capital engaged. However, there was a large number of the small private firms, which were not supposed to employ more than five persons. Their contribution to employment and social capital formation was modest, but they did promote the entrepreneurship in the country and created to some extent an entrepreneurial climate in the economy. Therefore, the favorable climate already existed at the very start of the privatization, since the idea and the results of the private entrepreneurship were known in Croatia.

On the basis of the legal obligation for privatization, the social firms (3 637 firms) with the exclusion of the public social firms owned by the local communities

¹"Zakon o Agenciji Republike Hrvatske za restrukturiranje i razvoj", Narodne novine, No. 47/1990.

²"Zakon o Hrvatskom fondu za razvoj", Narodne novine, No. 42/1990.

³Data on the social capital in the private, cooperative and mixed firms in 1990 were not available.

(98 firms) and the mixed firms (153 firms) were subjects to privatization. Thus, 3 692 or 34% of the Croatian firms were subject to privatization in 1990.

The social capital in the firms to be privatized amounted to the part in the social firms (57 609.3 millions of DM), excluding the capital in the public social firms (18 089.3 millions of DM) and including the social capital in the mixed firms that is unknown. Thus, the value of social capital to be privatized in Croatia starting in 1990 was not less than 39 520 millions of DM or 69% of the capital in the economy.⁴

Legal and institutional framework of the privatization

Stages of privatization

Prior to 1990 the social ownership was the dominant form of the ownership in Croatia, the private, cooperative and mixed ones being much less represented. The essence of this form of the ownership was, that it gave no property rights to those who invested. So, formally it was neither private nor state ownership, or formally it was "everybody's and nobody's" at the same time, but in reality it was the ownership of those who ruled the country.

Considering the ambiguous notion of the social ownership, the process of privatization in Croatia was conceptualized in two stages:⁵ (1) transformation of the social ownership into a private and/or state ownership, no matter what the legal form of the firms would be, (2) privatization of the state ownership formed during the stage of the ownership transformation, with the idea that the private ownership becomes a dominant form of the ownership in Croatia.

Law on Transformation of Social Enterprises

The legal and institutional framework to carry out these stages had to be built up. The first major step in this respect, which determined the model of privatization in Croatia, was passing the Law on Transformation of Social Enterprises in 1991.⁶ The essence of this law, which was amended April 30, 1991 and thus marked the actual beginning of the privatization in Croatia, is presented below:

⁴The value of social capital was taken as the book value of the assets in dinars and converted at the official exchange rate in 1990, which amounted to 1 DM = 7 dinars.

⁵One may add that the social ownership was in fact the state ownership in reality. So, it could have been transformed quickly by a single legal act to the state ownership to be privatized subsequently. Such an approach would avoid a tedious and time consuming process of ownership transformation and would limit a possibility of fraud present very much in the process of privatization in Croatia.

⁶"Zakon o pretvorbi društvenih poduzeća", Narodne novine, No. 19/1991.

- (1) The Law regulated the ownership transformation and privatization only in the social and mixed firms in some sectors of the economy, leaving out the social public firms established by local communities, the social services (health, research, culture, education, sports,...), the financial sector (banks, insurance companies and other financial institutions), the infrastructure and the nationally strategic firms and associations.
- (2) The ownership transformation was autonomous by nature, meaning that the firm was independent in deciding when and how to be transformed, but June 30, 1992 was set up as a deadline to finish this process.
- (3) A firm subject to the ownership transformation had to be transformed into the form of either joint stock company or company with limited liability.
- (4) The potential owners of a firm after its transformation included eight entities
 - The employees currently employed and those previously employed in the firm, having a right to buy the shares at the basic discount of 20% and an additional discount of 1% for every year they have been employed in the firm.
 - The employees in all other firms not being subject to the ownership transformation and the civil servants under the same conditions as above.
 - The persons with no right of discount, if they buy a firm or a part of it.
 - The investors who invested or are investing their capital in the firm.
 - The former creditors who become the owners through a debt-equity swap.
 - The former owners who are given the shares by the CDF to compensate them for their property nationalized after May 15, 1945.
 - 2 national pension funds.
 - CFD.

The part of the ownership that is not transformed through the first five ways, should be transferred to the funds, i.e. 2/3 of it to the CFD and 1/3 to the national pension funds.

- (1) Together with the formal Decision on ownership transformation, the firm was obliged to submit to the CARD the following seven documents:
 - Transformation program presenting the anticipated model of transformation.
 - Auditing report by the Social Accounting Service of Croatia.
 - Assessment of the firm indicating its production features, organizational set up and the position in the market.
 - Strategic plan of the firm.
 - Proof of the rights to use the firm's real estate.

- Excerpt from the Court Register of the firms.
 - Report on the valuation of the firm, stating the book and the market value of the firm.
- (2) The ownership of a firm may be transformed in four different ways:
- By selling a firm or a part of it.
 - By investing a capital in a firm.
 - By debt-equity swap.
 - By transferring the shares to the national pension funds and to CFD with no compensation.

Of course, any combination of the four ways of transformation was possible.

- (3) Selling of a firm or a part of it may be done in four different ways:
- The call to the public to sign up the shares of a given firm.
 - The public auction.
 - The public offering.
 - The direct agreement of the parties without calling for the offers, if the value of the firm does not exceed 5 millions DM or the firm was not sold otherwise.

As mentioned earlier, when buying a firm only its present and former employees, the employees of the firms not being a subject to the ownership transformation and civil servants were granted a discount. Other entities mentioned above had no discount. However, not more than 50% of a firm's value could have been sold at discount. The maximum total value of the shares to be bought at discount was limited to 20 000 DM per one single entity, paid in cash or in 5 year installments. The voting rights depended on the capital signed up, but the right to draw a dividend depended on the amount of the capital paid in. The capital acquired through selling of the firms should have been accumulated in CFD.

- (4) Investing a capital in a firm was done through issuing and selling new shares in case of the joint stock companies and through paying in the capital in case of the companies with the limited liability. Local and foreign civil and legal persons were entitled to buy these shares and/or to pay in the capital with the idea to raise an additional capital needed for the firm. Such investors were granted the same conditions of discount applicable to the selling of a firm, but the total value of discount was limited to 40% of the firm's value.
- (5) Debt-equity swap was decided upon eventually by the management of the firm being transformed and the creditors of the firm. The creditor's share of the property depended on the amount of the unpaid balance of the loans, as well as on the value of the firm.

- (6) Transferring of the shares to the national pension funds and to CFD with no compensation for the firm was decided upon by the management of the firm being transformed. Out of the capital to be transferred 1/3 was supposed to be transferred to the national pension funds and 2/3 to CFD.
- (7) Rights and duties of the national pension funds and CFD related to the property acquired during the ownership transformation were specified as follows:
- CFD is obliged to sell out all the property acquired with or without discount.
 - CFD may transfer a part of its share of ownership of a firm to the employees of this firm in order to stimulate their performance, but only according to the Government of Republic of Croatia.
 - CFD may draw only 5% of the part of annual net profit allocated to CFD, the rest should be invested in the firm to increase CFD's part of the ownership in the firm.
 - CFD is obliged to invest at least 50% of the capital acquired in the local community where the transformed firm is located.
 - National pension funds may use the capital acquired through the transformation to finance their activity and to invest to increase their capital.

So, the basic legal and institutional framework for privatization in Croatia was set up in 1991, but some changes were introduced over the subsequent years in line with the overall political and economic situation:⁷

- CFD and CARD were integrated into a single institution Croatian Fund for Privatization (CFP) at the end of 1992 to monitor and to finish the privatization in a more efficient way.
- Additional discount was granted if the signed up capital was going to be paid in less than 5 years and the victims of the war were given the shares
- Deadline to complete the autonomous ownership transformation was extended to
- December 31, 1992 and further for the firms located on the occupied territory.
- Firms are obliged to pay to CFD the dividends on the signed up and not paid in capital.
- CFD is obliged to transfer the capital received into the budget of Republic of Croatia, out of which this capital will be invested in the infrastructure of a local community where a firm is located.

⁷ See "Uredba o izmjeni i dopuni Zakona o pretvorbi društvenih poduzeća", Narodne novine, No. 45/1992; "Zakon o izmjenama i dopunama Zakona o pretvorbi društvenih poduzeća", Narodne novine, No. 83/1992; "Zakon o Hrvatskom fondu za privatizaciju", Narodne novine, No. 84/1992; "Uredba o dopuni Zakona o pretvorbi društvenih poduzeća", Narodne novine, No. 16/1993; "Zakon o dopuni Zakona o pretvorbi društvenih poduzeća", Narodne novine, No. 94/1993; "Zakon o izmjenama i dopunama Zakona o pretvorbi društvenih poduzeća", Narodne novine, No. 2/1994; "Odluka o imenovanju ministra privatizacije i upravljanja imovinom", Narodne novine, No. 7/1995.

- Workers' councils, e.g. the former system of management, were put out of power on December 2, 1992 and temporary business boards appointed by CARD introduced to manage the firms until their registration in the court register.
- Ministry of Privatization and Property Management (MPPM) was established and the first Minister appointed on January 27, 1995 with an aim to formulate and to implement the strategy of privatization, especially the free distribution of shares and the privatization of the public enterprises.

Law on privatization

Finally, in March 1996 the Law on Privatization was passed.⁸ The original model of privatization from 1991 was not changed, but the right of a free distribution of the shares was farther extended, the firms to be privatized according to the special laws were identified and the distribution of the capital acquired through selling the firms determined was determined.

Law on Privatization confirmed fully the basic concept of privatization in Croatia introduced in 1990, i.e. controlled and decentralized privatization based on the sale of the state capital.

Five major issues related to the privatization process were regulated by the Law on Privatization: allocation of shares; privatization of the assets held by the Croatian Fund for Privatization (CFP); privatization of the state firms owned by the Republic of Croatia; rights related to the purchase of shares with a discount; rights related to the free of charge shares.

Allocation of shares

Out of the total value of the shares in hands of the state 2/3 are allocated to CFP and 1/3 to other national pension funds. The later is farther allocated as follows:

- (1) Republički fond mirovinskog i invalidskog osiguranja radnika Hrvatske (60%)
- (2) Republički fond mirovinskog i invalidskog osiguranja poljoprivrednika Hrvatske (30%)
- (3) Republički fond mirovinskog i invalidskog osiguranja samostalnih privrednika Hrvatske (10%).

Besides, the shares amounting to the total value of 500 million DM are to be transmitted from CFP to Republički fond mirovinskog i invalidskog osiguranja samostalnih privrednika Hrvatske on the day when Law on Privatization is enacted.

⁸ "Zakon o privatizaciji", Narodne novine, no. 21/1996.

CFP is entitled to exchange the shares with other national pension funds and with other owners of the shares, subject to the conditions specified by MPPM.

Privatization of the assets held by CFP

All the property acquired by CFP during the transformation of the social ownership (equity stock, shares, tangible assets and rights) ought to be privatized either through a sale or through a free of charge distribution. The sales are made through the public offerings and/or the public bidding. CFP is obliged to privatize all the legal persons whose equity capital was transferred to CFP during the transformation of the social ownership. Only the Government of the Republic of Croatia is entitled to make the exceptions to this rule in case of the special legal persons. When transferred to CFP the capital was quoted at its book value, but now its market or going-on concern value has to be determined in order to assess the real value of the capital to be sold or given away.

Three entities are entitled to make decisions related to the sales of the assets. The Business Board of CFP takes decisions related to the sales not exceeding 3 million DM of value, the Board of Directors of CFP up to 30 million DM and finally the Government of the Republic of Croatia decides on all the sales whose value is higher.

When choosing the best offer, the Business Board and the Board of Directors of CFP, as well as the Government, are supposed to respect the following criteria: to keep the productive jobs; to promote new investments in a firm and in the economy; technological modernization brought by a potential buyer; good will of a potential buyer; price offered; to stimulate the investments done by the Croatian emigrants; to stimulate the development of the Croatian entrepreneurship.

The capital obtained through the sale of assets and through the profits of the public firms in which CFP is a shareholder, is to be transferred to the Croatian Bank for Reconstruction and Development. This capital is used: to cover the costs of closing down the legal persons (dismantling, cleaning, training, social program,...); to support the rehabilitation and financial restructuring programs through extending the loans; to finance the repair and reconstruction of the firm partly destroyed by the war; to stimulate the workers previously fired to start and develop their own business; to finance the development of infrastructure; to offer the loans for housing; to promote the small and medium scale private entrepreneurship.

CFP is entitled to reinvest the capital obtained through the profits of the public firms back to these firms in order to increase its share of capital or to help the restructuring program of the firm.

Privatization of the state firms owned by the Republic of Croatia

Law on Privatization regulates the privatization of the property owned by the Republic of Croatia, irrelevant of its legal form: the state firms or shares owned by the state.

However, not all the equity capital of the state owned firms is subject to the privatization. It should be noted that 30% of the equity capital of a state firm should not be eventually sold, but kept in reserve to be distributed to the national pension funds later, when the reform of the pension insurance will be finished.

Also, the privatization of the state firms in the infrastructure is not a subject to this law, but to a series of the special laws to be enacted later. These firms are:

- INA - Industrija nafte (oil industry).
- Hrvatska elektroprivreda (generation and distribution of the electric energy).
- Hrvatska radio-televizija (radio and television).
- Hrvatske željeznice (railroad transportation).
- Hrvatska pošta i telekomunikacije (post and telecommunication).
- Hrvatske ceste (road transportation).
- Hrvatske šume (forestry).

Furthermore, Law on Privatization is not relevant for the health care sectors, since its privatization will be regulated by the special acts to be passed later.

The Government of the Republic of Croatia is entitled to take decision to privatize the state firms or the shares owned by the Republic of Croatia, e.g. at the national level. The local governments decide about the privatization of the firms and shares at the local level.

The valuation of the firm is the first step in the process of privatization. The value of the firm is determined as a difference between the total assets and the total debt on the day of valuation. The valuation should be done by the chartered valuers licensed by the Ministry of Privatization and Property Management (MPPM). The professional work related to the privatization of a state owned firms or shares is done by CFP. The selection of the best offer and the final decision related to privatization is taken by the Government of the Republic of Croatia.

The capital obtained by the sales of the state firms and shares is an inflow to the budget of the Republic of Croatia.

Rights related to the purchase of shares with a discount

The right to purchase the shares with discount is granted to the Croatian soldiers that were in the war at the time of the transformation of the social ownership and could not participate in it. The maximum discount amounts to 50% of the nominal value of a share of the state firm being privatized.

The shares with a discount may be purchased for cash and on credit with no interest and the repayment period of 20 years. In order to account for the inflation, the outstanding debt is revalued yearly using the retail price index. The arrangement is called off if the three due yearly installments are not paid and the rest of shares not paid for is transmitted to CFP.

The buyer of the share with a discount gets a right to vote taking in account all the shares bought. But, the right to draw a profit from the firm is applicable only if minimum 5% of the total value of the shares bought is paid in.

In addition to the Croatian soldiers the repayment period in case of the shares bought on credit is extended from 5 to 20 years for all other owners of the shares.

Rights related to the free of charge shares (the coupon privatization)

Law on Privatization did not change substantially a position of the shareholders, but they were granted additional discounts. Since the process of privatization got slowed down after the first push in 1991 and 1992, in order to accelerate it the law introduced a possibility of a free of charge distribution of shares to specified categories of population, commonly referred to as a "coupon privatization".⁹

The coupon privatization ought to be understood as a free of charge distribution of shares by the CFP to the specified categories of population in Croatia.

As mentioned earlier, the basic outline of its model was determined by the law, but the operational rules were set up somewhat later on June 5, 1996.¹⁰ Thus, the institutional framework for the coupon privatization was completed by the mid 1996 and it was expected that the process itself would start soon.

In brief, specified categories of the Croatian citizens will be given a certain number of privatization points to be converted into shares offered in course of auction and they will finally get the shares free of charge. Keeping in mind its role in the process of future privatization in Croatia, on the pages to follow the coupon privatization in Croatia will be presented in details.

Finally, it should be pointed out that the law originally obliged the Croatian Fund for Privatization (CFP) to pay the capital, obtained through the sales of the state owned shares and through the profit sharing in the firms where the state has shares, to the Croatian Bank for Reconstruction and Development with the idea to be reinvested in the economy. On July 9, 1997 the law was amended introducing the provision that CPF should pay this capital to the state budget in order to finance

⁹ For details see: J. Bendeković: "Privatisation and Foreign Investment" in "Process of Privatisation in Croatia", Open Society Institute - Croatia and Central European University, Zagreb, 1997, pp. 46-50.

¹⁰ See "Pravilnik o dodjeli dionica bez naplate (Rules of Free Distribution of Shares), Narodne novine, no. 44/1996.

the reconstruction of the liberated areas and the restructuring in the economy.¹¹ No other amendments were passed and the legal framework of privatization got its final form to be applied in the future.

The coupon privatization

Demand for shares

The following ten categories of Croatian citizens are entitled to take part in the free distribution of shares:

- The families of the Croatian soldiers who died, got imprisoned or lost in the war (the first and the second order decedents).
- The families of the civilians who died, got imprisoned or lost in the war (the first and the second order decedents).
- Disabled war veterans.
- Croatian soldiers who were imprisoned.
- The army personnel disabled in the peace time.
- Civilians who were imprisoned (after September 17, 1990).
- Civilians disabled during the war.
- The citizens of the Republic of Croatia who were employed in the firms located in the occupied or formerly occupied areas, lost their jobs and kept living in the Republic of Croatia without getting status of a refugee or of a displaced person.
- Refugees and displaced persons coming back to their homes.
- The former political convicts.

The above mentioned categories of the potential shareholders are split further into sub-categories and each of a sub-category is entitled to get a determined number of privatization points.¹² The number of points one may get by applying one single criterion ranges from 1 000 to 20 000. It should be pointed out that one single person is entitled to get the points on the basis of all criteria applicable to him/her in order to reach his/her total number of points to be represented by his/her coupon. Taking into consideration the number of persons in each category, it was anticipated

¹¹ See "Zakon o izmjeni zakona o privatizaciji (Law on Changes of the Law on Privatisation), Narodne novine, No. 71/1997.

¹² For instance, in the category "the families of the Croatian soldiers who died, got imprisoned or lost in the war" a husband or wife together with the children are entitled to 20 000 points, but mother and father of a victim 10 000 points each.

that roughly 270 000 persons might participate in the coupon privatization. Each of the participants will be given a coupon with a certain number of the privatization points and in total 1.75 billion privatization points will be assigned to the potential shareholders. So, it is estimated that the total exchange power on the demand side for shares in course of auction will amount to 1.75 billion privatization points.

Coupon

Coupon is nothing else than a certificate giving a right to its owner to take part in the auction for the shares offered with the total number of points obtained. So, the sole purpose of a coupon is to be exchanged for a share, which gives a right of property. It can not be sold or transferred to other persons. In case of death or disability the coupon becomes a property of the legal decedents.

Thus, an owner does not have a full freedom in dealing with a coupon. In addition to the transfer to their legal decedents, the owner may decide: trade the coupon himself directly for the shares of a one single company, or to trade the coupon for the shares of one single Privatization Investment Fund (PIF) and this PIF will be involved in further trading with the coupon¹³.

Of course, it is expected that the majority of the stakeholders will not be willing to trade their coupons directly and that they will try to get the shares of a PIF in order to leave the coupon trading to the professionals.

Registration

The Ministry of privatization has set up a special commission for monitoring the process of the coupon privatization. The centers for collecting the offers were established in order to carry out the operational activities and play a role of executing agencies of the commission. The registration of the potential stakeholders is done by the centers and its procedure may be split into three steps: every potential stakeholder is supposed to fill in a registration form including all the information and certified documents relevant to the status of a participant in the coupon privatization and to submit his/her registration form to one of the centers; controll of the registration forms submitted is done by the centers; formation of a coupon for each stakeholder to be put into central register of the coupon owners at the national level administrated by the CFP.

So, the list of potential stakeholders was prepared and the central register of the coupon owners was established at the national level.

¹³ See "Pravilnik o sudjelovanju privatizacijskih investicijskih fondova u kuponskoj privatizaciji (Rules of Privatisation Investment Funds Participation in the Coupon Privatisation)", Narodne novine, No. 125/1997.

Auction

Formally, the auction to determine the conversion rate of exchange of the privatization points to the shares will be carried out in not more than three consecutive rounds. But, Round 0 will be carried out before the start of Round 1 and one may understand that the total number of rounds is four.

The Ministry of privatization is supposed to set up for each round of auction to draw a list of the companies, whose shares will be exchanged for the coupons in this round. The key criteria for selecting these companies are their solvency and profitability. Exceptionally, an insolvent company may be included in the list, if the public is informed about its insolvency, if more than 50% of the company shares are offered and if the potential shareholders by getting the shares have a right to sell the land and other assets of the company.

Round 0 includes the shares of the companies located in the liberated areas, which were not subject to other ways of privatization since these areas were occupied during the Croatian Homeland War. This is why the individuals from these areas are given a priority in the auction and no PIF is entitled to trade in this round. As mentioned earlier, each individual may trade the coupon for the shares of only one single company.

Round I will include the companies whose shares were not distributed in Round 0 and other companies from the whole country selected for the Round I. The companies whose shares were not distributed in Round I will enter Round II at the adjusted price, and by the same token the companies with undistributed shares in Round II will enter the closing Round III. All the shares of all the companies have to be distributed in Round III no matter what the demand for them will be and Round III is a closing round of the auction.

Supply of shares

Having got a coupon with a given number of privatization points, the potential investor is supposed to exchange it for a certain number of shares of one single company. Since the value of a share and the net asset (equity) value of a company are expressed in money terms, while the value of a coupon is stated in the privatization points, the crucial issue is the conversion rate between a unit of value in money terms and a unit of value in privatization points¹⁴. Or, the crucial issue is to determine the price of a share and the net asset value of a company in terms of the privatization points, since the potential shareholders dispose with the privatization

¹⁴ The net asset value is equal to the total asset value minus the value of debt, which means it is to the value of equity.

points registered and stated on their coupon. The value of a share and the net asset value expressed in the privatization points are calculated for every company on the list separately, since the potential shareholders are supposed to compete for and to get the shares of only one single company.

When calculating the price of a share and the net asset value of a company expressed in terms of the privatization points, one has to take in account the following:

- Ministry of privatization decided to distribute free of charge the shares of 500 companies.
- It was estimated that the total net asset value of these 500 companies amounts to 3.5 billion DEM¹⁵.
- Ministry of privatization determined for every single company on the list a percentage of the net asset value to be included into coupon privatization, which differs depending very much on the location, size and profile of the company.
- Taking into account the number of persons in each category of the potential shareholders, the total number of the potential shareholders taking part in the coupon privatization was estimated to 230 000 - 250 000 persons and the total of 1.75 billion privatization points to be distributed to them.
- Ministry of privatization decided that 1 privatization point is equal to 1 unit of the currency in which the value of a share is expressed and used DEM as a stable currency to avoid the impact of eventual inflation, i.e. 1 privatization point is equal to 1 DEM.

However, it turned out that the firm application of the rule 1 point = 1 DEM would produce the total of 3.5 billion privatization points, which is definitely too much if the criteria for allocation of privatization points to different categories of the potential shareholders are going to be kept. This is why the index of relative demand for shares was applied to adjust the conversion rate of DEM to a privatization point. This index is defined as

$$\text{IRD} = \text{TS} / \text{TD} = 3\,500\,000\,000 / 1\,750\,000\,000 = 0.5,$$

where

IRD = the index of relative demand for shares,

TS = the total supply of shares in DEM,

TD = the total demand for shares in privatization points.

So, the index of relative demand for shares determines an average conversion rate of DEM to a privatization point, when the sum of the net asset values of all the companies taking part in the coupon privatization is considered. Thus, an expected

¹⁵ DEM is the abbreviation for the German mark.

average conversion rate of 1 DEM to 1 privatization point in Round 0 equals 0.5, showing that on an average 1 DEM is equal to 0.5 privatization point or 1 privatization point equals 2 DEM.

Supply value of shares and companies

The prices of shares and the net asset value of a company ought to be quoted in privatization points, because the potential shareholders dispose only with these points. In order to illustrate how to convert the value of a share and of a company expressed in money terms into their values in privatization points, the following data will be used¹⁶:

- The value of the company amounts to 31 847 000 HRK¹⁷.
- The number of shares of the company is 318 470 HRK.
- Ministry of privatization decided to distribute 50% of the shares of the company in course of coupon privatization.

The calculation starts with finding out the nominal price of a share expressed in HRK for each company on the coupon privatization list in Round 0 and Round 1 as follows

$$NP^{0,1}_i = TV_i / TS_i = 31\,847\,000 / 318\,470 = 100 \text{ HRK},$$

where

- $NP^{0,1}_i$ = the nominal price of a share in HRK in Round 0 or Round 1,
- TV = the net asset value in HRK¹⁸,
- TS = the total number of shares,
- i = the company on the privatization list in Round 0 and Round 1,
when $i = 1, \dots, m$.

In the example the nominal price of a share is 100 HRK. Since the Ministry of privatization decided to express the value of a share in DEM, the nominal price of a share in HRK is converted to DEM using the exchange rate 1 DEM = 3.5303 HRK, i.e.

$$NP^{0,1}_i = 100 \text{ HRK} / 3.5303 = 28.33 \text{ DEM}^{19}.$$

¹⁶These data are relevant for the company "Agroprerada", Knin being the first company on the list for the coupon privatisation in Round 0.

¹⁷HRK is the abbreviation for the Croatian kuna.

¹⁸The net asset value of a company is determined during transformation of the social ownership in 1991 and 1992 or equals to the market value of a company, if its shares are traded in the regulated markets.

¹⁹The rate 1 DEM = 3.5303 HRK is the official exchange rate used by the Central Bank of Croatia (Hrvatska narodna banka) on March 25, 1998.

Keeping in mind that $IRD = 0.5$, i.e. an average conversion rate of DEM to the privatization point equals 0.5, the supply price of a share in Round 0 or Round 1 ($SP^{0,1}$) amounts to

$$SP^{0,1}_i = NP^{0,1}_i * IRD = 28.33 \text{ DEM} * 0.5 = 14.17 \text{ points,}$$

but for the practical purposes the amount of 14 privatization points is taken. This is to say that the nominal price of a share of the company used as an example is 100 HRK or 28.33 DEM, but its supply price in Round 0 of the auction is 14 privatization points.

In order to compute the supply value of a company in a given round, one may multiply the opening price of a share in this round by the number of shares to be included into auction in the same round. As mentioned earlier, the number of shares depends on the Ministry of privatization which determines for every single company on the privatization list the percentage of the net asset value to be included in a given round of auction and

$$AS_i = TS_i * G_i = 318\,470 * 0.50 = 159\,235,$$

where

- AS = the number of shares of a company included in a given round of auction,
- TS = the total number of shares of a company,
- G = the percentage of a company's net asset value to be included in a given round of auction,
- i = the company on the privatization list in a given round, when $i = 1, \dots, m$.

So, out of 318 470 of the company's shares only 159 235 of them will be included in the coupon privatization and offered for bidding in Round 0.

Finally, the supply value of a company in any round of auction is obtained simply by multiplying the number of shares included in this round of auction by the supply price of a share in the same round in terms of the privatization points, i.e.

$$SV_i = AS_i * SP_i = 159\,235 * 14 = 2\,229\,290,$$

where

- SV = the supply value of a company included in a given round of auction stated in the privatization points,
- AS = the number of shares included in a given round of auction,
- SP = the supply price of a share in a given round of auction stated in the privatization points;
- i = the company on the privatization list in a given round, when $i = 1..m$.

The supply price of a share and the supply value of a company are stated separately for every single company on the privatization list in a given round. In such a way the supply side of the auction for a given company is taken care off.

In the example, the supply price of a share of 14 privatization points and the supply value of the company of 2 229 290 privatization points are to be offered to the potential shareholders for bidding in Round 0.

Demand value of shares and companies

The essence of the auction is that the potential shareholders, who obtained a coupon with a given number of privatization points, compete for the shares of a company by offering their coupons. They represent the demand side for the shares of a given company. At the end of each round of the auction, Ministry of privatization computes the total number of the privatization points the potential shareholders offered for a given company, i.e. the demand value of a company, as follows

$$CV_i = \sum_{n=1}^i N_i^n * Q_i^n,$$

where

CV = the supply value of a company in a given round of auction stated in the privatization points,

N = the coupon offered to be exchanged for shares of a company in a given round of auction,

Q = the number of privatization points of a coupon offered to be exchanged for shares of a company in a given round of auction,

i = the company on the privatization list in a given round, when $i = 1..m$,

n = the number of coupons offered to be exchanged for shares of a company in given round of the auction, when $n = 1..t$.

If the demand value of a company is divided by the number of company's shares, one may easily get the demand price of a share.

Auction price

The relation between the supply value (SV) and the demand value (CO) of a company and/or of a share is the crucial issue, since it indicates to what extent the market has approved the estimated values of companies and shares.

If in Round 0 the supply of shares for a company is larger than the demand for them, i.e. if $SV > DV$, the shares will be distributed to all the owners of coupons who took part in auction in proportion to their percentage share in the total number of privatization points offered for shares of a company. If the demand is higher than the supply, i.e. if $SV < DV$, the shares will be distributed according to the

priority criteria defined by the Ministry of privatization²⁰. In both cases maximum of 10% of the shares of a single company being offered may be distributed to one single participant in the auction and the rest of shares is transferred to Round 1.

In Round 1, having computed the total number of privatization points the potential shareholders offered for a given company, the Ministry of privatization is supposed to determine the rate of demand in the auction for every company on the privatization list as

$$RD^1_i = SV^1_i / DV^1_i$$

where

RD^1 = the rate of demand for shares in Round 1,

SV^1 = the supply value of a company (net asset value in points) in Round 1,

DV^1 = the demand value of a company (number of points offered) in Round 1,

i = the company on the privatization list in Round 1, when $i = 1..m$.

It is obvious that the situation is ideal when the condition $RD^1 = 1$ is met. In this case the supply and demand values are equal, meaning that the opening prices of shares were perfectly estimated to reflect their auction prices. More realistic case implies that RD^1 will be different from 1, but the question is: how much of this deviation is acceptable to reflect the true market value of shares and companies?

The auction in Round 1 is considered successful, if the rate of demand (RD^1) for shares of a given company does not depart more than 0.33 from 1 or if the condition

$$(1 - 0.33) RD^1 (1 + 0.33)$$

is satisfied. If this is so, the shares are distributed to the participants in the auction for a given company proportionally to the number of points they offered. The price of a share in this case is

$$AP^1_i = SP^1_i * RD^1_i,$$

where

AP^1 = the auction price of a share at which it will be distributed to the participants in Round 1,

SP^1 = the supply price of a share in Round 1,

RD^1 = the rate of demand for shares in Round 1,

i = the company on the privatization list in Round 1, when $i = 1..m$.

²⁰ See "Pravilnik o dodjeli dionica bez naplate (Rules of Free Distribution of Shares), Narodne novine, No. 44/1996, Articles 24 and 25.

The number of shares distributed to a single coupon (participant) in Round 1 rounded to a next higher integer number may be determined as

$$T_i^1 = Q_i^1 / DP_i^1,$$

where

T_i^1 = the number of shares distributed to a coupon (participant) in Round 1,

Q_i^1 = the number of privatization points on a coupon of a participant in Round 1,

DP_i^1 = the demand price of a share in privatization points in Round 1,

i = the company on the privatization list in Round 1, when $i = 1..m$.

If the condition $(1 - 0.33) RD_i^1 (1 + 0.33)$ is not met, the auction in Round 1 is not successful and the shares are not distributed, but transferred to Round 2.

In Round 2 all the shares transferred from Round 1 are priced at the adjusted price which may be considered as the supply price of share in Round 2 and is determined as

$$SP_i^2 = DP_i^1 * RD_i^1 * I^2,$$

where

SP_i^2 = the supply price of a share in privatization points in Round 2,

DP_i^1 = the demand price of a share in privatization points in Round 1,

RD_i^1 = the rate of demand for shares in Round 1,

I^2 = the index of demand in Round 2 determined by the Ministry of privatization²¹,

i = the company on the privatization list in Round 2, when $i = 1..m$.

The auction for a given company in Round 2 may be either successful or unsuccessful according to the same criteria as in Round 1. Also, all other elements (prices of shares, values of companies, number of shares to be auctioned, number of shares to be distributed,..) from Round 1 are applicable to Round 2, except the way of adjusting prices for the shares which were not distributed in Round 2 and are transferred to Round 3, since the auction in Round 2 was unsuccessful.

In Round 3 the auction is successful no matter what the rate of demand might be and all the shares are supposed to be distributed at the price determined as

$$AP_i^3 = DP_i^2 * RD_i^2,$$

²¹ The purpose of the index is to control the equilibrium between supply and demand of shares. Its ideal value is 1, meaning that the supply of shares is equal to their demand.

where

DP^3 = the demand price of a share in privatization points in Round 3,

DP^2 = the demand price of a share in privatization points in Round 2,

RD^2 = the rate of demand for shares in Round 2.

i = the company on the privatization list in Round 3, when $i = 1..m$.

Of course, the absence of the index of demand indicates that all the shares will be distributed at whatever price.

All other elements of the auction in Round 3 correspond to those of Round 2, but Round 3 is the closing round of coupon privatization and the shares are supposed to be distributed to all the participants in this round.

Results of the privatization

The privatization in Croatia started in 1991 and it is still going on. After its push in 1991 and 1992 the process slowed down and practically stopped in the fall 1995. The years 1996 and 1997 were devoted to the preparation of the coupon privatization and to the privatization of the large public enterprises, but the implementation was practically negligible. So, the basic results in the privatization in Croatia were achieved by the end of 1995 and one may say that the period afterwards was lost for this purpose. Of course, the Croatian Homeland War made the whole situation more difficult, but it can not be taken as the only reason for this delay.²²

The summary of the privatization results by the end of October 1995 is presented in Table 2.

Table 2

THE OWNERSHIP TRANSFORMATION IN CROATIA OVER THE PERIOD 1991-1995

Item	1991		1995		Difference	
	Number 2	% 3	Number 4	% 5	Number 6=2-4	% 7=3-5
1. Number of the firms	3 692	100	2 553	69.15	1 139	30.85
2. Capital in millions of DM	39 520	100	24 336	61.58	15 184	38.42

Source: "Privatizacija", Croatian Fund for Privatization, No.12/1995, Table 1, p. 60.

²² During the war one third of the Croatian territory was occupied and a large part of population was engaged in the war. It seems logical to suppose that in such circumstances the privatization should have been postponed until the end of the war in order to offer an equal chance to everyone of its citizens.

Therefore, the ownership transformation was finished in 2 553 firms by the end of October 1995. This makes roughly 70% of the total of 3 692 subjects to the ownership transformation in 1991. So, this process has to be completed in 1 139 firms or roughly in 30% of the total number of the firms. In terms of the capital roughly 62% of the social capital were transformed, either into private or state ownership.

How far did the privatization come as an implicit part of the ownership transformation? The basic data related to the effects on privatization by the end of October 1995 may be seen from Table 3.

As it may be seen from Table 3, CFP and the pension funds have no property in less than half (45.99%) of the firms subject to the ownership transformation, i.e. these firms are fully privatized. In terms of the capital, the full privatization accounts for only 8.81% of the total. The fully privatized firms are small, as their average equity capital amounts to 1 824 992 DM and the average firm is owned by 88 shareholders.

The situation is different in the larger firms. CFP and the pension funds are minor owners, i.e. their share in the equity capital of a firm is less than 50%, in 43.83% of the firms accounting for 54.94% of the total capital. The size of these firms is larger, an average firm having 11 946 982 DM of the equity capital and 350 shareholders. CFP and the pension funds are major owners in 10.18% of the firms, covering 36.26% of the total capital. These are the firms of the large size with on an average 33 940 380 DM equity capital and 361 shareholder.

Thus, the privatization was more successful in the smaller firms, but in terms of the number of firms and equity capital, the most important in the medium size firms. It should be noticed that there are 589 343 shareholders in Croatia or 13% of its population, which reflects the genuine positive feeling towards the entrepreneurship existing prior to the privatization. The firms that have undergone the ownership transformation are of a medium size, with 9 532 314 DM equity capital and 231 shareholder on the average. So, the process of privatization was slow in the large enterprises and much faster in the smaller firms.

There is no doubt that the proper measure of the progress of privatization is the break-down of the equity capital during the ownership transformation shown in Table 4.

The equity capital of the firms whose ownership transformation is finished by the end of October 1995 was formed mainly through the sales of capital (39.87%), debt/equity swap (6.02%), provisions for the former owners (4.71%) and transfer to the state funds (45.95%), while other ways are of a minor importance. The buyers of the capital were mostly employees of the firms and the banks became the owners through a debt/equity swap, since many firms could not service their debt. The provisions for the former owners appeared and were transferred to the state funds, as no regulation had been passed related to a denationalization of the property nationalized since May 15, 1945. All the capital not privatized were transferred to the state funds to be sold out and privatized later on.

Table 3

RESULTS OF PRIVATIZATION IN CROATIA

Item	Share of the funds in equity capital						Total	
	0%		Less than 50%		More than 50%		Number	%
	Number	%	Number	%	Number	%		
1	2	3	4	5	6	7	8=2+4+6	9=3+5+7
1. Number of firms	1174	46	1119	44	260	10	2553	100.00
2. Equity capital in million DM	2143	9	13369	55	8824	36	24336	100.00
3. Number of shareholders	103403	-	392108	-	93832	-	589343	-
4. Equity/firm in DM	1824992	-	11946982	-	33940380	-	9532314	-
5. Number of shareholders/firms (3/1)	88	-	350	-	361	-	231	-

Source: "Privatizacija", Croatian Fund for Privatization, No.12/1995, Table 1, p. 60.

Table 4

BREAK-DOWN OF THE EQUITY CAPITAL IN 1995

Item	Share of the funds in equity capital			Total
	0%	Less than 50%	More than 50%	5
	2	3	4	
1	2	3	4	5
1. Equity capital	100.00	100.00	100.00	100.00
2. Bought	85.32	48.39	15.94	39.87
3. Additionally invested	2.47	1.29	0.67	1.17
4. Debt/equity swap	4.30	9.49	1.17	6.02
5. Government bonds	0.46	2.06	2.34	2.03
6. Partners' capital	0.17	0.34	0.15	0.25
7. Provision for the former owners	7.28	5.01	3.64	4.71
8. Transfer to the state funds	-	33.42	76.09	45.95
8.1. Transfer to CFP	-	23.01	51.21	31.21
8.2. Transfer to the pension funds	-	10.41	24.88	14.74

Source: "Privatizacija", Croatian Fund for Privatization, No.12/1995, Table 1, p. 60.

Therefore, a half of the capital was not privatized and finished up in hands of the state to be taken care of in the future process of privatization. Sectoral distribution of the capital transferred to CFP included:²³

Industry and mining	45.71%
Tourism	15.36%
Transport and communication	14.87%
Other sectors	24.06%
<hr/>	
Total	100.00%

The above percentages reflect to a large extent the importance of these sectors in the national economy in terms of output and employment.

How did CFP manage the capital transferred and formed its latest portfolio? Table 5 offers the information related to the formation of CFP portfolio and its value on October 31, 1995.²⁴

CFP managed to sell only 8.45% of the capital acquired during the ownership transformation. However, CFP reduced additionally the value of its portfolio by covering the losses in the government sectors of the economy and social services (4.10%) and by distributing the shares free of charge to the victims of the war (2.89%). This is why on October 31, 1995 the value of CFP portfolio amounted to 84.56% of the total capital transferred in the course of the ownership transformation, i.e. this capital was not privatized yet.

As far as the foreign capital inflow during the process ownership transformation and privatization is concerned, one may generally say that Croatia had a specific disadvantage due to the high war risk over the period 1991-1995. However, some foreign investors were present in Croatia and Table 6 presents the foreign investments over the period mentioned.

²³ "Privatizacija", Croatian Fund for Privatization, No.12/1995, Table 2, p. 72.

²⁴ Some brief explanation might help to understand better descriptions of the items in Table 5. "Transferred to CFP during the ownership transformation" indicates the assets which were not privatized and hence had to be transferred to CFP. "Cancellation of the contracts" contains the assets of the firms whose ownership transformation was cancelled due to some irregularities and their assets had to be transferred to CFP. "Public offerings" comprises the assets sold by CFP through the public offerings. "Stock exchange and swap" are the assets sold by CFP mostly at the Zagreb Stock Exchange and paid in fresh money, but also those sold by CFP and paid by the personal foreign exchange savings from the period prior to 1990, which were otherwise not disposable. "Transfer from CFP portfolio" includes the capital transferred from CFP to cover the losses of the state owned oil company INA and other firms, as well as those in the public sector of health and care. "Free distribution" indicates the capital distributed free of charge to the invalids of the Croatian Homeland War and to the families of the killed soldiers.

Table 5

FORMATION OF THE CFP PORTFOLIO

Item	CFP portfolio	
	DM	%
1. Transferred to CFP during the ownership transformation	7 594 720 270	97.51
2. Cancellation of the contracts	193 765 405	2.49
3. Total transfer to CFP (1+2)	7 788 485 675	100.00
4. The capital sold out	657 905 405	8.45
4.1. Public offerings	193 685 405	2.49
4.2. Stock exchange and swap	464 220 000	5.86
5. Transfer from CFP portfolio	319 771 081	4.10
6. Free distribution	225 123 514	2.89
7. CFP portfolio on 31.10.1995 (3-4-5-6)	6 585 685 675	84.56

Source: "Privatizacija", Croatian Fund for Privatization, No.12/1995, Table 3, p. 74.

Table 6

FOREIGN INVESTMENTS IN CROATIA OVER THE PERIOD 1991-1995

Country	Number of investments	Capital invested	
		DM	%
1. Austria	7	100 808 500	21.90
2. Belgium	1	40 415 800	8.78
3. Germany	8	38 021 690	8.26
4. Sweden	1	70 000 000	15.21
5. Switzerland	7	97 059 006	21.08
6. USA	6	37 399 687	8.13
7. Other countries	31	44 369 986	10.11
8. Total (1..7)	61	460 369 268	100.00

Source: "Banka - International Edition", Zagrebačka banka marketing, Zagreb, No. 6/1996, p. 28.

Foreign investors have carried out their projects first through debt/equity swaps and additional investments to the existing firms, while in 1994 and 1995 the dominant type of investment was a purchase of a company or of its part. Although the foreign investors come from a relatively large number of countries (15), a majority of capital invested (58.19%) comes from just three countries Austria, Sweden and Switzerland.²⁵ The breweries, cement plants and telecommunications are of the prime interest to them.

The tendency observed shows that the foreign exchange inflow was the most important during the initial stage of privatization, when the large foreign investors invested in the cement and glass industry and later in the breweries. This is why the amount of the foreign capital invested in Croatia was high especially in 1992, 1994 and 1995²⁶. In the year 1996 foreign investors made only five investments in Croatia and the total amount invested was 22.91 millions of DM.²⁷ By the end of 1997 only one additional foreign investment was made increasing the total foreign capital invested to 470 884 958 DEM. In addition to this, the Croatians living abroad invested 161 772 946 DEM and the total foreign investment over the period 1992–1997 reached the figure of 632 657 904 DEM.

It is obvious that the most attractive investment opportunities for the foreign investors are not in the present CFP portfolio. However, it is estimated that the amount of foreign capital invested in Croatia is somewhat larger, since with the purchase of shares the foreign investors invest the additional amounts of capital in order to rehabilitate the newly acquired firms.

So, over the last two years shows that the foreign investors are reluctant to invest in Croatia, due to the risky political and economic situation. However, the geo-political position, existing infrastructure, qualified and relatively low cost labor in Croatia seems to be attractive enough to attract the foreign investors, especially when the privatization of the infrastructure starts.

Such a situation, as well as the lack of purchasing power in the financial market, slowed down the privatization and its results in 1996 are modest. The major moves were made by large exchanges of shares between CFP and other investors in order to solve some of urgent economic problems in the country:

²⁵ The Swedish investor Ericson made a single capital investment of 70 millions DM into the Tesla company, Hofmann & Pankl of Austria invested 57 054 200 DM into the Straža company and Société Suisse de Ciment Portland of Switzerland invested 55 000 000 DM into Tvornica Cementa Koromačno.

²⁶ The foreign investments in 1992 amounted to 132.2 million DEM, in 1994 to 132.6 million DEM and in 1995 to 120.9 million DEM. See J. Bendeković: "Privatization and Foreign Investments" in "Process of Privatization in Croatia", Open Society Institute - Croatia and Central European University, Zagreb, 1997, Table 2, p. 54.

²⁷ BOMAN-AG, Vaduz, Liechtenstein bought the hotel complex Haludovo, Malinska for 14 millions of DM and this was the largest foreign investment made in 1996. See "Privatizacija", Croatian Fund for Privatization, No. 25/1997, p. 63.

rehabilitation of large companies of the national importance, rehabilitation of the banks, reconstruction caused by the war, promotion of a new pension system, etc.

Right from the beginning of privatization CFP has been selling the shares against a public debt, which the state could not pay out. So, instead of getting back their savings deposited in the banks, the people could buy the shares and pay with these savings. The final result was a large number of small investors and an important reduction in the public debt.

In summer 1996 Zagrebačka banka and Privredna banka, two largest banks in Croatia, exchanged their shares of the hotels along the Adriatic coast for the shares in large hotel enterprises in Istria owned by CFP. It is argued that this swap will facilitate farther privatization of hotels, because instead of having a large number of small shareholders they now have one single majority owner. This facilitates the management of the hotels, as well as the eventual resale of the shares, leaving the free hands to CFP for further privatization of the hotel industry. This kind of swap started in the hotel industry, but it is expected to appear in other sectors, too.²⁸

The disabled war veterans and the families of soldiers who died in the war got the free shares from the CFP portfolio. Roughly 3.7 million of shares from 604 most profitable firms amounting to 269 million DM of the nominal value were handed over to 36 500 shareholders. It is estimated that roughly 90% of these shareholders already sold their stock at a price equal to 75% of its nominal value, but CFP did not have anything to do with these transactions. It is obvious that these small shareholders selling their shares have served as an efficient means for a take-over of some companies mostly by the existing management.²⁹

By the end of 1996 CFP has made a list of the firms whose shares will be transmitted to the pension fund *Republički fond mirovinskog i invalidskog osiguranja samostalnih privrednika*. These are the firms in which CFP has less than 50% share in their equity capital. The total nominal value of the shares to be transmitted amounts to 482 millions of DM, which is roughly 20% of the equity capital in these firms.³⁰

Also, CFP prepared a list of the firms whose shares will be transmitted to the Ministry of Defense in order to be distributed free of charge to the war veterans and their families. The amount of this transfer is 229 millions of DM.³¹

Similar transfers of the shares from the portfolio of CFP have been made to the Ministry of Reconstruction and it is estimated that roughly 30% of the reconstruction costs will be paid by these shares. This is an important means of

²⁸ See "Privatizacija", Croatian Fund for Privatization, No. 21/1996, pp. 64-66.

²⁹ See "Privatizacija", Croatian Fund for Privatization, No. 21/1996, p. 70.

³⁰ See "Privatizacija", Croatian Fund for Privatization, No. 23/1996, pp. 60-61.

³¹ See "Privatizacija", Croatian Fund for Privatization, No. 23/1996, pp. 62-63.

privatization, since the large majority of the firms taking part in the reconstruction works are private and the shares will end up in private hands.

All these actions have resulted in an additional reduction of the CFP portfolio. At the end of 1996 the situation was as stated in Table 7.

Table 7

CFP PORTFOLIO ON DECEMBER 31, 1996

CFP share in the equity capital	Equity capital millions of DEM	CFP portfolio millions of DEM	Free CFP portfolio millions of DEM	Share of portfolio in equity capital
1	2	3	4	5 = (4/2) 100
1. Less than 50%	17 013	4 183	3 950	23.22%
2. More than 50%	1 892	1 156	1 138	60.15%
3. Total (1+2)	18 905	5 339	5 088	26.91%

Table 7 shows that the total equity capital in the firms in which CFP is a shareholder amounts to 18 905 millions of DM and CFP has 5 339 millions of DM worth of shares. But, it should be noted that CFP had reserved 251 million of DM to compensate the owners whose property was nationalized after the Second World War and the rest of 5 088 millions of DM is free to be distributed or traded by CFP. This means that 26.91% of the total equity capital belongs to CFP and is free for further privatization.

CFP has a different share of the total equity capital in different companies. In most cases its share is less than 50% and the total equity capital of these firms amounts to 17 013 millions of DM, CFP having 4 183 millions of DM and out of it 3 950 millions of DM free to dispose with. So, CFP has a share mostly in small firms and on an average has 23.22% share of the equity capital.

The total equity capital of the firms in which CFP has more than 50% share amounts to 1 892 millions of DM. Out of this amount CFP owns 1 156 millions of DM worth of share and 1 138 millions of DM worth of share is free to be distributed or traded. In these firms CFP has on an average 60.15% share and is definitely a majority owner and not being forced to make compromises with other owners.

There is no doubt that the dynamics and success of the privatization in Croatia will be fairly well indicated by the value of CFP portfolio over the years. The total value of the assets subject to the privatization was 39 520 millions of DM in 1990.³² Five years later on October 31, 1995 the value of CFP portfolio was 6 586 millions

³² See J. Bendeković: "Privatization in Croatia" in "Process of Privatization in Croatia", Open Society Institute - Croatia and Central European University, Zagreb, 1996, pp. 66.

of DM, which means that the portfolio was reduced to 16.66% of its starting value³³. At the end of 1996, as seen in Table 1, the value of portfolio was 5 339 millions of DM or it was reduced farther to 13.51% of its starting value in 1990. It is obvious that after a rapid and massive privatization over the period 1990-1995 the whole process was slowed down, in spite of all the organizational efforts made by CFP and MPPM. There is no doubt that the crucial answer to this is a low level of domestic savings and a lack of capital to be invested.

What was the impact of privatization on the savings in the country? The total receipts from the privatization over the period 1991-1997 amount to roughly 2.7 billion DEM or only 22% of the value privatized.³⁴ The difference of 78% includes the sale of shares on credit and the free distribution of shares. Therefore, the process of privatization did not contribute very much to direct the local savings to the productive sector, since their level generally speaking was low and furthermore a substantial part of the net asset value was sold out with deferred payments or freely distributed. In addition to this, the privatization model did not succeed to attract the foreign investors to invest in Croatia on a larger scale.

Thus, after the initial push over the years 1991-1995 the process of privatization in Croatia slowed down with a result that only a smaller part of the total net assets in the economic sector is privatized as stated in Table 8³⁵.

Table 8

PRIVATE OWNERSHIP IN THE NET ASSETS IN THE ECONOMIC SECTOR

Year	Share in %
1993	9.4
1994	12.8
1995	17.6
1996	21.6

Source: "Information on Entrepreneurs' Financial Results", Agency for Payments Transactions, Zagreb, 1998

³³ See J. Bendeković: "Privatization in Croatia" in "Process of Privatization in Croatia", Open Society Institute - Croatia and Central European University, Zagreb, 1996, Table 5, p.75.

³⁴ N. Dremel: "Process privatizacije u Republici Hrvatskoj od 1991. do 1997. (Process of Privatization in the Republic of Croatia from 1991 to 1997)", Informator, Zagreb, No. 4594/1998.

³⁵ For details see V. Lasić: "Realisation of Privatization Economic Goals in Republic of Croatia", in "Process of Privatization in Croatia", Open Society Institute - Croatia and Central European University, Zagreb, 1998.

Therefore, after five years of the privatization in Croatia only 21.6% of the net assets in the economic sector were privatized. Such a small part of the private sector could not substantially increase the efficiency of the economy, being the main reason for privatization. The economic sector taken as a whole is non-profitable, the real value of its net assets is constantly decreasing, the equipment productivity is low due to a lack of new investments and the and the asset's management is unsatisfactory.

The coupon privatization was supposed to speed the privatization up and to increase the overall efficiency, but its implementation was delayed for the administrative inefficiency and started at the beginning of 1998 by: establishing the centers for collecting the offers³⁶, opening the registration procedure, publishing the list of the companies whose shares were supposed to be exchanged for the privatization points³⁷.

The registration of the potential shareholders was carried out from January 15 to February 2, 1998 and its results are stated in Table 9.

Table 9 shows that the total number of the registered participants or potential shareholders in the coupon privatization is 227 882 and the total number of privatization points distributed is 1 727 589 022³⁸. So, on an average one participant got 7581 privatization point to be used for bidding in course of auction. These results confirmed to a large extent the estimations made a year ago.

³⁶ Since Round 0 includes only the companies in the liberated areas, the offers in Round 0 were collected by 6 centers in counties affected by the war: Gospić, Karlovac, Požega, Sisak, Šibenik and Zadar.

³⁷ The privatisation list of the companies in Round 0 was published in daily newspapers, for instance "Vjesnik", March 30, 1998.

³⁸ The refugees and displaced persons coming back to their homes got roughly 1.4 billion of privatisation points and represent by far the most important category of participants in coupon privatisation.

Table 9

**DISTRIBUTION OF THE PRIVATIZATION COUPONS AND POINTS
BY THE COUNTRIES**

Center for registration registered	Number of the participants points	Number of the privatization per participant	Average number of points
1	2	3	4=3/2
Bjelovar	1 444	11 778 021	8 157
Dubrovnik	18 260	134 790 794	7 382
Čakovec	1 197	9 287 699	7 759
Gospić	2 853	21 818 867	7 648
Karlovac	16 027	116 564 019	7 273
Koprivnica	1 270	10 022 600	7 892
Pregrada	800	7 516 100	9 395
Osijek 1	14 605	106 991 728	7 326
Osijek 2	20 944	156 863 955	7 490
Požega	8 041	59 547 492	7 405
Pula	4 379	38 641 832	8 824
Rijeka	5 782	46 773 325	8 089
Slavonski Brod	4 945	38 139 357	7 713
Šibenik	16 293	118 948 299	7 301
Sisak	16 431	119 659 901	7 283
Petrinja	13 701	97 075 711	7 085
Split 1	7 881	59 255 456	7 519
Split 2	2 775	23 470 756	8 458
Varaždin	1 317	11 329 665	8 603
Vinkovci	16 686	127 942 705	7 668
Rokovci	4 538	35 050 800	7 724
Virovitica	2 751	22 478 200	8 171
Zadar	19 352	139 806 938	7 224
Zagreb	25 610	213 834 802	8 350
Total	227 882	1 727 589 022	7 581

Source: "Privatizacija", Croatian Fund for Privatization, No. 39/1998, p. 62.

The lack of knowledge and experience stimulated the owners of coupons to hand them over to the investments funds in exchange for the shares of these funds. So, the further trading with these points will be done by the investments funds. The strong and aggressive promotion campaigns were carried out by each fund in order to collect as much coupons as possible. The competition in the market is

strong, especially since 100 million points is the legal minimum for the fund to a licence to take part in the auction. The number of privatization points collected by each fund is presented in Table 10.

Table 10

PRIVATIZATION POINTS COLLECTED BY INVESTMENTS FUNDS

Investment fund	Points in 000
1. Dalbank	127 000
2. Epic	430 000
3. Expandia	265 000
4. Fima	53 000
5. Kaptol	160 800
6. Slavoinvest	120 000
7. Sunce	44 300
8. Total	1 200 100

Source: "Privatizacija", Croatian Fund for Privatization, No. 39/1998, p.61.

Therefore, out of 1.7 billion privatization point distributed to the potential shareholders 1.2 billion or 70% were handed over to the funds for further trading, which is definitely going to push the activity and development of the funds as new institutions in the Croatian financial market.

The supply side in Round 0 was made publicly know on March 30, 1998 and the list of companies included 56 companies with the 272 011 109 shares and 38 305 023 privatization points in total. On an average 55.07% of the net asset value of companies was included into Round 0. Round 0 of the auction was closed at the end of May and its results are presented in Table 3.

Table 11

THE RESULTS OF ROUND 0 OF THE COUPON PRIVATIZATION

No.	County	Demand for shares.		Coupons accepted		Coupons returned	
		Number of coupons	Number of points	Number of coupons	Number of points	Number of coupons	Number of points
	1	2	3	4	5	6	7
1.	Ličko-senjska, Gospić	56	403 900	52	370 900	4	33 000
2.	Karlovačka, Karlovac	381	2 739 400	294	2 112 600	87	626 800
3.	Požeško-slavonska, Požega	56	405 800	54	393 800	2	12 000
4.	Sisačko-moslavačka, Sisak	2 179	16 530 361	1 875	14 171 228	304	2 359 133
5.	Šibensko-kninska, Knin	249	1 793 733	200	1 446 753	49	290 000
6.	Zadarska, Zadar	176	1 263 800	167	1 200 800	9	63 000
	Total	3 097	23 136 994	2 642	19 695 181	455	3 383 933

Source: Croatian Fund for Privatization, June 1998 (preliminary report).

Table 11 shows that the supply value of shares offered was 37 451 470 privatization points. Or, the CFP decided to distribute free of charge in Round 0 roughly 75 million DEM out its portfolio. The demand value of shares amounted to 22 989 994 privatization points or 61.39% of the supply value of shares. So, the gap between supply and demand was 38.61 percentage points. The main reason for this gap is a fact that many of the coupon owners exchanged their coupons for the shares of the investment funds, which were not allowed to take part in bidding in Round 0, but in the subsequent rounds. The demands to exchange the points for shares were submitted by 3 076 potential shareholders. Not all of these demands were accepted, i.e. 446 coupons were given back to their owners to be included in Round 1 of the auction.

The situation by the centers is different, but the most important is Sisačko-moslavačka county with the largest number of demands, since there is a large number of refugees and displaced persons coming back to their homes.

Round 1 of the auction was announced started on June 15, 1998 and was over by the end of June 1998. All the shares that have not been distributed in Round 1 were transferred into Round 2 and finally into Round 3. The later is the closing round of the auction and by the end of 1998 the coupon privatization was over.

Table 12

THE RESULTS OF ROUND 1, ROUND 2 AND ROUND 3 OF THE
 COUPON PRIVATIZATION

Item	Successfully auctioned firms in Round 1	Successfully auctioned firms in Round 2	Successfully auctioned firms in Round 3	Successfully auctioned firms in total
1	2	3	4	5=2+3+4
1. Number of firms in total	116	68	287	471
2. Equity capital in total - DEM	2 451 284 741	3 388 169 735	6 443 650 921	12 283 105 397
3. Capital for the coupon privatization - DEM	865 014 926	847 451 104	1 945 494 465	3 657 960 495
4. Capital for the coupon privatization in % of item 2.	35.29	25.01	30.19	29.78
5. Equity capital in total - points	432 507 497	423 726 338	972 748 138	1 828 981 973
6. The initial auction value - points	432 507 497	693 796 033	582 803 846	1 709 107 376
7. Number of offers made by individuals	1 119	3 123	6 891	11 133
8. Value of offers made by individuals - points	8 690 265	25 963 714	54 350 968	89 004 947
9. Number of offers made by investment funds	130	138	1 267	1 535
10. Value of offers made by investment funds - points	334 086 455	577 951 888	696 626 102	1 608 664 445
11. Number of offers in total (6+8)	1 249	3 261	8 158	12 668
12. Value of offers in total (7+9)	342 776 720	603 915 602	750 977 070	1 697 669 392
13. Index of relative demand - %	79.253	87.045	128.856	99.331

Source: "Privatizacija", Croatian Fund for Privatization, No. 46/1998, p. 44.

Table 12 shows that the total number of firms auctioned and privatized in the coupon privatization was 471 with 3 657 960 495 DEM of capital or 29.78% of the equity capital.

The number of offers made by individuals (11 133) exceeded by far the number of offers made by the investment (1 535), but in terms of capital the situation was

reversed, i.e. 89 004 947 DEM of private offers versus 1 608 664 445 DEM of offers by the investment funds.

The index of relative demand, i.e. the total supply over the total demand for shares, differed over the rounds of the auction. Its values were below 100 in Round 1 (79.253%) and Round 2 (87.045%), but went well above in Round 3 (128.856%). Thus the index of relative demand, when taking into consideration all three rounds of the auction, reached the value of 99.331% and reflected the fact that practically all the shares were auctioned and allocated.

Assessment of the privatization

The privatization in Croatia was conceptualized in 1991 as a controlled and decentralized privatization based on the sale of the former social capital.

Why such a model and not any of the others was accepted in 1991 and implemented later on? It seems that two reasons were decisive in this respect:³⁹

- The absolute majority of the ruling political party in the national parliament, which was able to identify the former social ownership as the state ownership and to manage the privatization process according to its own criteria with the main idea to preserve the economic and political power.
- Deficit of the state budget and a constant need of the government to find the additional receipts to finance the large government spending imposed by the war, the presence of refugees and the reconstruction of the country.

The course of the events proved that the process of privatization was definitely controlled by the government, but much less decentralized and based on the sales of the social property.

The legal and institutional framework, as a necessary precondition for a successful privatization, was not complete, consistent and operational.⁴⁰ So, there was a large freedom for subjective judgments and decisions, which could have been always justified on the legal ground⁴¹.

³⁹ "Izvješća Hrvatskog Sabora (Reports of Croatian Parliament)", Zagreb, No. 130, p.4.

⁴⁰ For instance, the legislature related to the denationalization and anti monopoly law do not exist. So, during privatization a part of a firm's capital was arbitrarily left to the former owners, even in the absence of their claims. Many government purchases were done without a formal bidding and a normal insight of the public. A number of laws was passed regulating directly and/or indirectly the issues of privatization in an inconsistent way.

⁴¹ For instance, the valuation of the firms and the investment analysis were done by non-professionals under a strong influence of the politicians. The results in both cases were ordered and paid for to protect the interests of those in power. Finally, as late as 1997 the Croatian Association of Investment Analyst and the Croatian Association of Valuators were founded as the professional associations independent of the state.

In addition, the existing legal acts and procedures were not respected and often the privatization was mixed with the criminal acts. Some of the usual cases are:⁴²

- Sales of the firms at lower prices by CFP.
- Running business with an intentional loss in order to decrease its value and price.
- Transfer of the firm's capital to abroad by the owners in order to pay for the shares bought on credit.
- Transfer of the firm's capital from a "mother firm" to a local "daughter firm" in order to accumulate a capital to repay the shares.
- Purchase of the shares through a newly founded financial consulting firm, which gets a relatively large loan from the bank and the very same day deposits this capital back in the same bank, starts earning the interest on deposit and thus makes money to buy the shares.
- Fictitious additional investments, which were promised at the time of purchasing the shares in order to increase the property rights and to gain the control over the firm, but were not made.

In brief, the results achieved suggest a general conclusion that the objectives of the privatization were not reached having a negative impact from the political, social and economic point of view.

Politically, this model of privatization is not accepted by a majority of population, since it redistributed the national wealth in hands of a few individuals and the government. The share of the assets obtained through privatization, in addition to the assets in the existing public sector, made the state the largest owner in the country and increased its influence, instead of decreasing it. So, the final result is a stronger role of the state, becoming a constraint for a farther development of democracy.

Socially, the privatization process provoked a conflict of interests and goals among the state as an owner, the private investors, the managers and the employees of the firm. But, the minimum level of justice anticipated and expected by the majority of population, especially by those employed in the past and now, was not reached. They have expected to get a stake of property they had created and to be rewarded in one way or another, but instead a new wealthy class of civil servants, investors and managers appeared. The answers to this were the strikes and other forms of resentment.

Economically, at the macroeconomic level the privatization brought a disguised and open nationalization of the country's resources leading to a new type of a centrally managed economy, instead of creating an open market economy with a

⁴² "Izvešća Hrvatskog Sabora (Reports of Croatian Parliament)", Zagreb, No. 111, pp. 28-37.

dominant private ownership. The primary and secondary financial markets have not been functioning due to the lack of shares in the private hands and purchasing power of the potential investors, as well as to the not developed investment banking. Equally, the labor market was not regulated until the beginning of 1966. So, the ownership transformation and privatization were accompanied by a centralization bringing again a monopolistic market structure, low mobility and misallocation of resources.

At the microeconomic level the impact of privatization varies primarily depending on the size of firms. In small and fully privatized firms the efficiency increased due to a better productivity and management. In very large firms, which stayed in the state hands, the situation did not change much. The major changes occurred in the medium size firms, which were the most attractive targets in the course of privatization. The new owners and managers, for the most of times, did not introduce new modern style of management with the intention to increase the efficiency of business and to keep developing it over longer period of time. Instead, they have been satisfied with the full control of business in order to be able to transfer the firms resources to abroad and finally to the their owned hands. Basically, the private ownership did not bring by definition an improvement in management and profitability. The efficient firms continued to be efficient and those which were inefficient earlier stayed inefficient after the privatization, as well. It seems that the mere privatization is not sufficient to increase the economic efficiency, but ought to be supplemented by the democratic structure of power, the rational long-term economic policy, the continuous upgrading of the professional knowledge of the owners, managers, consultants and the state bureaucracy.

Finally, the success or the failure of the privatization in the years to come will determine the level of economic efficiency and the level of political democracy in Croatia.

PRIVATIZACIJA U HRVATSKOJ

Sažetak

Privatizacija u Hrvatskoj osmišljena je u godini 1991. kao kontrolirana i decentralizirana privatizacija, koja se zasniva na prodaji bivšeg društvenog vlasništva. Nema sumnje da je Vlada kontrolirala proces privatizacije, ali je on bio mnogo manje decentraliziran i mnogo se manje zasnivao na prodaji društvenoga vlasništva. Politička je moć bila koncentrirana u rukama jedne jedine političke stranke, koja je zemljom upravljala autokratski. Pravni i institucionalni okviri nisu bili izgrađeni kompletno, konzistentno i operativno. U procesu privatizacije nisu poštivani postojeći zakonski propisi i procedure, već je privatizacija često poprimala i kriminalne osobine. U takvim je uvjetima postojala velika sloboda za subjektivne sudove i odluke, što se uvijek moglo opravdati pravnim interpretacijama. Dosadašnji rezultati pokazuju da ciljevi privatizacije nisu postignuti, već da je ona dovela do negativnih učinaka s političkog, društvenog i ekonomskog stajališta.