SLOVENIA: ENTERPRISE SECTOR RESTRUCTURING AND EU ACCESSION

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Introduction

The Slovenian enterprise sector entered the process of economic transition with a specific quasi-market socialist economic system based on self-management and social ownership of enterprises. Slovenia was, in a certain sense, a manufacturing platform for the former Yugoslavia with an import-substitution economic development concept. This has resulted in a relatively broad and sophisticated industrial structure, different than the one which would develop in circumstances of an open economy with an outward looking, export-oriented development concept. The disintegration of the former Yugoslavia led to a loss of easy and protected markets. The basis for the import-substitution development paradigm collapsed.

Manufacturing industry was hit the most and Slovenia has been faced with a decreasing share of manufacturing industry in the economy. Manufacturing output fell from 38% of GDP in 1988 to 29.9% in 1990 and to only 23.8% in 1996. In 1990-95 the share of industry in value added fell from 36.9% to 32.1%, while that of the service sector increased from 52.8% to 57.9%. Large scale manufacturing industries, in many cases involving basic products, have tended to be harder hit by the adjustment process. The same is not true for some of the more labour intensive industries. Nevertheless, since 1993 industrial growth has been positive.

Increasing foreign competition on the Slovenian market (the effective rates of protection were reduced from 53.0% in 1986 to 7.03% in 1993) and the collapse of the former Yugoslav market forced Slovenian companies to turn to export markets, predominantly the EU. In 1990-95 sales to other republics of the former Yugoslavia decreased from US$6,662m to US$1,209m, while exports to other countries increased from US$4,118m to US$7,107m. The accommodation to the pressures of more competitive domestic and export markets has, as a rule, been achieved by short-term rationalization measures within companies, predominantly by reducing costs via lay offs and an intensive process of early retirement paid for by the state.

Enterprise sector reform is at the heart of the economic transition and EU accession process in Slovenia. It basically means enabling and fostering an accelerated restructuring of the enterprise sector along the lines of an outward-looking, export-oriented development concept and to make it a viable and competitive participant in the internal market of the EU.

Until now, major components of enterprise sector reforms were (1) establishing a legal and institutional framework for private sector development and promotion of entrepreneurship, (2) government-led rehabilitation of selected enterprises, (3) privatisation of the main part of the enterprise sector. These reforms have been going on in the framework of successful macro-economic stabilisation and institutional changes promoting internationalisation of the economy (membership in WTO, membership in CEFTA, Europe Agreement, etc.).

Private sector development. Encouraging private sector development through the introduction of a regulatory framework adopted to the private market economy and the transformation of socialist companies into commercial companies have been the primary aims of enterprise sector reform. The Companies Act from 1988, the Small Business Act and foundation of the Fund for the Development of Small Business from 1991 and the Commercial Companies Act from 1993 have all brought about a process of intensive creation of new companies while old socialist enterprises were transformed into commercial companies. Thus the company structure in Slovenia is now nearer to the situation in the EU than in other transition countries: Slovenia already has a high proportion of small companies; the role of very large companies (i.e. with 5,000 or more employees), which generally have major restructuring problems is less significant whilst the number of "dormant" or "dead" companies is under the average level of transition countries. Small and medium sized companies constitute the large majority of the Slovenian enterprise sector.

Government-supported rehabilitation. Programmes of company rehabilitation have been implemented in four ways: (i) a company is restructured by itself with the assistance of state subsidies (subsidisation of interest rate, state guarantees for loans and debt restructuring); (ii) restructuring via the Bank Rehabilitation Agency (debt restructuring and debt conversions); (iii) passive/short-term restructuring via the Development Fund; (iv) nationalisation and active/long-term restructuring of selected state-owned companies (notably, ironworks and mines). The major part of the budgetary funds devoted to company restructuring had a stabilisation purpose and was spent for the restructuring of some large industrial plants. The most relevant rehabilitation programme has been the Development Fund, now transformed into the Slovenian Development Company, whose task has been to implement pre-privatisation, short-term restructuring (with instruments such as short and long-term loans, guarantees, writing-off old debts, conversion of debts into equity, appointment of new managers) or to close industrial companies that could not be privatised. In 1992 the Fund had become the owner of 98 companies and later additional troubled companies entered into its portfolio which currently consists of nearly 250 companies.

Enterprise privatisation. Privatisation, more exactly the establishment of responsible owners, is a necessary first step with long-term company restructuring.

It was the accepted view in Slovenia that in principle only the new owners could and should undertake long-term restructuring of companies. Due to political reasons, quite some time had passed before the Ownership Transformation Act (OTA) was adopted and privatisation began. The Slovenian privatisation concept has been a mixture of free distribution, internal buy-outs with discount for employees and commercial privatisation. OTA, which covered 1,340 companies, has given companies the possibility to select among various models of privatisation and to select the combination of methods which they want to adopt. A favouring of internal buy-outs has been the major characteristic of Slovenian privatisation. Foreigners were practically excluded from the privatisation process which, in its administrative phase, is now more or less completed. Shares of privatised firms are mostly owned by two types of owners: insiders employed in the companies and outsiders represented mostly by privatisation funds and small shareholders.

The final goal of privatisation is to increase the efficiency of privatised companies and thereby ensure greater efficiency of the national economy in new and more restrained market conditions. Formal completion of the process of privatisation under the OTA by itself does not mean necessarily that the actual performance of companies has undergone any marked changes. Nevertheless, there have been some essential changes in the ownership structure of the economy. While general macro-economic conditions for the enterprise sector in Slovenia are the same, different ownership groups of enterprises still face *de facto* different conditions for their operation due to the current regulatory and policy framework, or because the new owners of privatised enterprises do not yet function as real owners. There are differences in access to equity financing, foreign and domestic borrowing, government contracts and guarantees, import and export markets, and possibilities for hiring or firing labour and wage policies. The operational characteristics of foreign-owned enterprises in the trade sector and start-up private firms in the non-trade sector, both of which already operate in a truly private and competitive environment, provide the benchmarks for the required adjustments of other privatised or non-privatised enterprises in Slovenia.

Ownership Structure in the Enterprise Sector (1995)

This analysis is based on financial statements,[1] with 1995 as the base year because most companies had already decided on their type of privatisation by the beginning of 1995. Although final approval of privatisation programmes came only much later, the valuation of companies was not changed once a privatisation programme had been submitted. Therefore, it was in the best interest of companies' insiders as major owners to perform as "private" immediately upon the decision on the method of privatisation.

According to the majority ownership (50% and more) or dominant influence on a company's governance, companies have been divided into the following ownership categories: (1) private companies which did not undergo privatisation under OTA; (2) foreign companies, i.e. majority owned by foreign persons; (3) internal companies privatised under OTA which have in their programme of ownership transformation decided for majority ownership of employees, former employees and pensioners; including their subsidiary companies; (4) external companies privatised under OTA which have in their programme of ownership transformation decided for majority external ownership (funds, small investors from public sales) including their subsidiary companies; (5) non-privatised companies - which comprise three types of companies: (i) social companies, to be privatised under OTA, but have not yet received approval for their ownership transformation programme; (ii) companies owned by the Slovenian Development Company and their subsidiary companies; (iii) companies in majority state ownership which do not perform any public service whatsoever nor are they in a monopoly situation in the market; (6) state companies in majority state ownership performing public services or in a monopoly situation in the market.

Companies in various ownership categories differ greatly with regard to various indicators: (i) by the number of companies, where internal, private and external companies prevail; (ii) by equity and assets, where state, external and internal companies prevail; (iii) by the number of employed, sales, exports and value added, where internal and external companies are predominant, and by exports alone where foreign and non-privatised companies are to the fore (see Table 1).

Table 1: Ownership Structure of Slovenian Enterprise Sector in 1995

		% share of individual ownership categories in all companies					
	All companies	Private	Foreign	Internal	External	Non-privatised	State
Number of companies	2,023=100%	27.4	7.6	30.5	19.2	10.7	4.6
Equity	2,639,287=100%	3.4	5.0	17.3	28.9	9.0	36.4
Assets	4,567,212=100%	6.4	5.6	17.2	27.0	12.8	31.0
Number of employed	380,315=100%	8.3	5.4	33.0	27.9	13.4	12.0
Sales	3,502,148=100%	11.2	11.9	25.4	29.6	18.0	3.9
Exports	981,299=100%	8.4	18.2	22.1	29.7	17.8	3.8
Value added[1]	697,639=100%	8.7	7.1	30.4	29.7	9.9	14.2
Net profit(+)loss(-)[2] **(in mill, SIT)**	-12,492=100%	+5.109	+6.110	-5.992	-122	-20.801	+3.204

Source: Agency for Payments, calculations made by authors

1. Sum of labour costs, provisions and net profit/loss
2. Operating profit and loss balance.

We can draw three general conclusions from these facts.

- Although internal privatisation was the most frequent type under OTA, internal companies represent a less important category than external companies (except in the number of employed and value added).
- Although social ownership of companies is in fact gradually disappearing, non-privatised and state companies retained an important position in the Slovenian economy.
- Different ownership categories of companies with given assets and number of employed obviously realize different level of sales, exports, value added and eventually also profits.

Enterprise Performance and Operating Indicators (1995)

In 1995, the analysed companies on the whole recorded a net operating loss of SIT 12,492m. Of the six ownership categories of companies, net profit was generated by foreign, private and state companies, a negligible net loss was recorded by external companies, whilst considerable net loss was recorded by internal and, notably, non-privatised companies. If it were not for the non-privatised companies, the analysed companies on the whole would generate a net profit. Of course, a net loss of non-privatised companies has been expected as these are the companies which were transferred to the Slovenian Development Company due to severe problems and companies which for the same reason did not submit to the ownership transformation programme.

In relative terms of return (measured as net operating profit/loss) on equity, the best results in 1995 were achieved by private (5.7%) and foreign (4.6%) companies, whilst the worst were the non-privatised (-8.8%) and partially internal (-1.3%) companies (see Table 2 and Figure 1). The results are virtually identical as regards the value added (measured as sum of labour costs, provisions and net operating profit/loss) per employee. An above average value added per employee was recorded by foreign (index 131 compared to the average of all companies), state (118), external (107) and private (106) companies, whilst this indicator was below the average in internal (92) and, notably, non-privatised companies (74).

The indicator of profitability (net operating profit/loss per equity) has been further disaggregated into three indicators: profit margin (net operating profit/loss to sales ratio), total assets turnover (net sales to assets ratio) and assets to equity ratio. We have come to the following conclusions:

- Those ownership categories indicating the best/worst return on equity results achieve the same results also as regards profit margin. If the latter is low this means that the company has problems with costs. Similarly, the best total assets turnover ratio is achieved by the most profitable categories of companies, namely private and foreign, whilst results are less favourable for the least profitable category - the non-privatised companies.

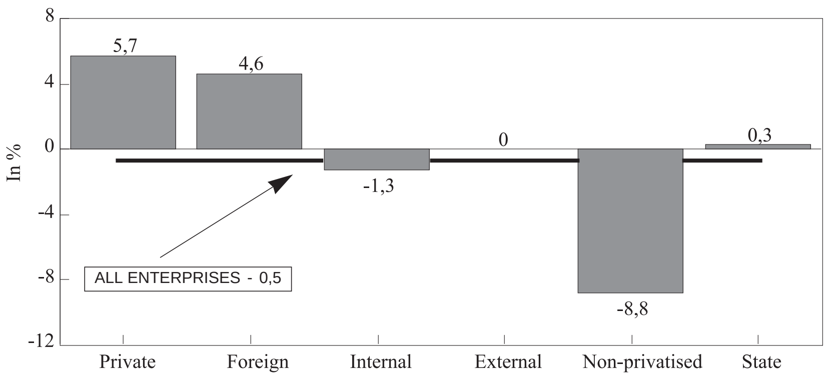
• The indicator of assets to equity ratio suggests that the above average profitability of private and foreign companies stems at least in part from the fact that these two ownership categories operate with above average assets to equity, or with relatively higher external sources of financing. On the other hand, a high assets to equity ratio in non-privatised companies is connected with considerable net loss. Apparently, companies with similar assets to equity ratio achieve entirely different results in profitability (see Figure 1). While private and foreign companies can easily carry a burden of high **indebtedness** (index of liabilities to equity is 315 compared to the average of all companies for private companies and 133 for foreign companies), this is not the case for non-privatised companies (index 208). Moreover, it is very likely that private and foreign companies take loans mainly for further development, whilst non-privatised companies are distressed borrowers requiring loans for current survival. The level of their indebtedness could be the result of failed investments in the past.

Table 2: Comparison of Selected Performance Indicators by Ownership Categories of Companies in 1995

	All com-panies	Private	Foreign	Internal	External	Non-privatised	State
Net return[1]/equity, %	-0.5	5.7	4.6	-1.3	-0.0	-8.8	0.3
Net profit[1]/sales, %	-0.4	1.3	1.5	-0.7	-0.0	-5.1	0.8
			Indices, All companies = 100				
Net sales/assets, %	76.7	174	210	146	108	91	36
Assets/equity, %	173	186	112	99	94	142	85
Value added[1]/employee, '000 SIT	1,834	106	131	92	107	74	118
Assets/company, mil SIT	2,258	23	74	56	141	119	676
Sales/company, mil SIT	1,731	41	156	82	153	108	244
No. of employees/company	188	30	72	108	146	125	261
Assets/employee, '000 SIT	12,009	77	103	52	97	95	259
Equipment in fixed assets, %	22.5	120	203	96	99	84	93
Equipment/employee, '000 SIT	1,864	56	168	43	89	72	311
Labor costs/employee, 000 SIT	1,830	92	110	93	106	93	113
Exports/net sales, in %	28.0	75	155	88	102	154	34
Liabilities/equity, in %	65.1	315	133	97	81	208	65

Source: Agency for Payments, calculations made by authors.
1. See notes to Table 1.

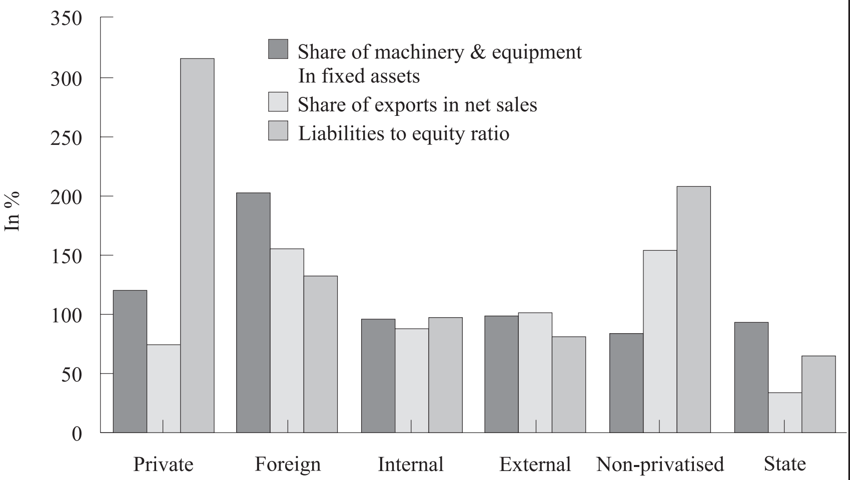
Figure 1: Return on equity in companies by ownership categories (1995)



Source of data: Financial statements 1995, AP, calculations IMAD

Figure 2: Selected operating indicators by ownership category (1995)

(indices, all companies = 100)



Source of data: Financial statements 1995, AP, calculations IMAD, BS

The high profitability of private and foreign companies is thus a result of above-average profit margin and total assets turnover as well as a favourable asset to equity ratio. Negative profitability in internal companies is to a great extent a consequence of poor profit margin (too high costs) and in non-privatised companies due to below-average total assets turnover and too high indebtedness. State companies (mostly public utilities) achieve above-average profitability mostly on account of high profit margin, while their total assets turnover and assets to equity ratio are below-average.

Differences between ownership categories are wide with regard to equipment per employee indicator (see Figure 2). Regarding this indicator, besides state companies, (index 311 compared to the average) foreign companies also stand out (168). All other categories have below-average value of equipment per employee, notably internal (43), private (56) and non-privatised companies (72). In private companies low value of equipment per employee is probably a result of their industrial structure with high share of trade and services, whilst in non-privatised and also in internal companies it is probably a result of the fact that they did not manage to sell off various non-productive assets.

This is also confirmed by the indicator of **share of equipment in fixed assets**, which is by far the highest in foreign companies (index 203) and private companies (120), whilst it is below-average in other ownership categories, notably in non-privatised companies (84). The fact that the most profitable ownership categories, i.e. foreign and private companies, have the highest share of equipment in fixed assets suggests that ahead of other ownership categories there lies a long-lasting process of rationalisation in terms of reducing the assets accumulated in non-productive capacities (land, buildings and various accompanying activities).

With regard to **export orientation**, the highest share of exports in sales is achieved by foreign (index 155) and non-privatised companies (154), followed by external companies (102). State (34), private (75) and internal companies (88) are doing the worst with regard to this indicator. High export orientation of foreign and non-privatised companies is to a great extent connected with their concentration in manufacturing (67.7% of all assets of foreign and 49.5% of all assets of non-privatised companies are in manufacturing), which is as a rule the main exporting activity. Similarly, low export orientation of state and private companies is an expected feature in view of activities in which they prevail (state companies in electricity, gas and water supply and various public services: private companies in trade, financial and business services), and in private and internal companies it is most likely linked to their relatively small size (measured by assets and sales per company) which is more ideally suited to the domestic market rather than the export market.

An interesting fact stemming from export orientation of selected ownership categories is that foreign companies achieve favourable business results (return on equity, etc.), whilst non-privatised companies, which are virtually the same regarding export orientation, are distressed exporters and achieve exceptionally poor business results. Apparently, exports of foreign companies are founded on certain comparative advantages, whilst non-privatised companies do not possess enough or any comparative advantages and export only because they are forced to do so because of low or non-existent demand for their products on the domestic market. Hence, high export orientation by itself does not also mean high export competitiveness.

Performance of Companies in the Period 1994-96

The basic issue of the analysis of the ownership structure and performance of companies is to find out what has been going on with the restructuring of companies, as reflected in decreasing losses and increasing operating profits and with the "exit" of loss-making companies. A relatively clear answer to these questions can be obtained from the comparison of data for the period from 1994 to 1996. Restructuring has been the fastest in externally owned, internally owned and foreign owned companies, whilst it has been too slow in non-privatised and state owned companies. Companies which generated the largest losses in 1995 were mostly bankrupt in 1996 (see next section).

Due to analytical reasons, it is sensible to distinguish in Slovenia between different categories of financial results and profits/losses of different segments of company performance.

For the *first category* there is a net overall profit/loss (point 1 in Table 4) which includes net profit/loss from regular activity (point 2 in Table 4) and net profit/loss from extraordinary revenues/expenses (point 5 in Table 4). However, the analytical value of this category is limited due to the enormous amounts of net profit/loss from extraordinary revenues/expenses, especially in internal, external and non-privatised companies which are a consequence of pre-privatisation accounting operations (such as the high valuation of assets, the gradual spending of accumulated provisions via extraordinary revenues,[2] and extraordinary expenses from write-offs resulting from privatisation audits).

The *second category* is net profit/loss from regular activity (point 2, Table 4), which incorporates net operating profit/loss (point 3, Table 4) and net profit/loss from financing (point 4, Table 4). The figures in the table suggest that net profit/loss from regular activity is to a major extent determined by a huge loss from financing, which accounted for more than 90% of total net loss from regular activity in 1995 and 1996. There are two reasons for such results:

- First is the effect of obligatory revaluation of equity which leads to (fictitious) expenses from financing in the companies in which equity exceeds the amount of those assets which are subject to revaluation. In fact this is only an accounting operation which is not backed by any actual flows but has an effect on the profit and loss figures. Revaluation has a considerable effect on the level of expenses from financing, which, however, cannot be calculated from the data available.[3]

- The second reason is high interest rates, which the enterprise sector pays to the inefficient and over-costly financial sector. It is probably not an overstatement to claim that the terms, or rather the costs, of financing contribute largely to companiesí highly negative results from regular activities.

It is quite normal that the corporate sector shows negative results in terms of financing, but Slovenian companies are, given the level of their net operating profits/losses, far too burdened by the costs of financing. This holds in particular for the internal, external and non-privatised companies. On the other hand, private, and especially foreign companies do not find it very difficult to cover net losses from financing by net operating profits, which is a normal picture of a sound corporate sector. Point 4 in Table 4 also indicates that, after an improvement in 1995, net losses from financing drastically increased in 1996 from SIT 36,446m in 1995 to SIT 58,965m in 1996, taking into account the comparable sample of 1,902 companies. The deterioration was the most severe in external and internal companies, followed by non-privatised and state companies. Although a large part of the deterioration in the financial result was due to revaluation, it could be concluded that higher costs of financing seriously hold back the process of restructuring in all companies that are financed domestically.

The net operating profit/loss is the *third category* that, given the normal financing situation, eventually reveals the real potential of companies' growth and development. The results of 1,902 companies which were active in the period from 1994 to 1996 indicate a constant deterioration in the net operating profit/loss: net operating profit of SIT 11,363m in 1994 turned into a net loss of SIT 1,381m in 1995, which further widened to SIT 3,848m in 1996. The deterioration in 1995 was exclusively due to external, internal and non-privatised companies. However, further deterioration in 1996 does not reveal the actual situation. The picture has been deformed entirely by the enormous deterioration in state enterprises whose net operating profit of SIT 2,799m in 1995 slumped to a net operating loss of a massive SIT 22,385m in 1996, also due to the full account of depreciation in the electricity supply sector. Had it not been for the state companies, the corporate sector would have generated a highly positive net operating profit of SIT 18,510m in 1996. The trend has been positive primarily in external and internal companies, whilst the net operating loss of the non-privatised companies remains critically high and indicates that the government-led rehabilitation programmes are not successful in improving the core business of enterprises.

Table 4: Net Profit/Loss of all Active Companies in Various Ownership Categories in the Period 1994-1996; in SIT million

	Total	Private	Foreign	Internal	External	Non-Privatised	State
1. Net overall profit(+)/loss (-)							
1994	-162	1,309	2,758	-1,057	6,843	-14,593	4,578
1995	-6,024	4,235	4,136	-804	7,320	-19,718	-1,193
1996	-43,039	1,578	5,842	356	8,125	-37,703	-21,237
2. Net profit (+)/loss (-) from regular activity							
1994	-20,545	-2,341	5,541	-7,309	1,429	-19,946	2,081
1995	-37,827	2,263	4,148	-13,589	-4,677	-26,202	230
1996	-62,813	-701	6,942	-12,022	-735	-27,758	-28,539
3. Net operating profit (+)/loss (-)							
1994	11,363	22	6,124	3,436	11,741	-10,897	937
1995	-1,381	6,442	6,119	-4,613	1,610	-13,738	2,799
1996	-3,848	4,590	9,940	1,178	13,589	-10,786	-22,359
4. Net profit (+)/loss (-) from financing							
1994	-31,908	-2,363	-583	-10,745	-10,312	-9,049	1,144
1995	-36,446	-4,179	-1,971	-8,976	-6,287	-12,464	-2,569
1996	-58,965	-5,291	-2,998	-13,200	-14,324	-16,971	-6,181
5. Net profit (+)/loss (-) from extraordinary revenues/expenses							
1994	20,383	3,650	-2,783	6,252	5,414	5,353	2,497
1995	31,803	1,971	-12	12,786	11,997	6,484	-1,423
1996	19,774	2,279	-1,100	12,378	8,860	-9,945	7,302

Source: Calculated using the Agency for Payments data.

1. All the companies which submitted their financial statements for 1995 and cumulatively fulfilled the following three criteria: (i) had at least 10 employees; (ii) had the value of assets at or above SIT 90m; (iii) had the value of net revenues from sales at or above SIT 180m. In 1995 there were 2.023 such companies.
2. In 1996, 121 companies out of the above 2,023 companies did not submit their financial statement, so that they were excluded from analysis.
3. 1,902 companies out of 2,023 companies submitted their financial statements in all three years from 1994 to 1996.

Throughout the period from 1994 to 1996 the situation seems, at first glance, to have constantly deteriorated with the net losses of the corporate sector incessantly and rapidly growing. Undoubtedly this holds for 1995, but a more detailed analysis of the developments in 1996 shows a somewhat different picture. The deterioration in 1996 was mostly caused by (i) aggravated situation in state companies which was again partly a consequence of the full account of depreciation in the electricity supply sector; (ii) a slump in net profit from extraordinary revenues/expenses (from SIT 31,803m to SIT 19,774m) due to accounting operations; and (iii) a further increase in net losses from financing (from SIT 36,446m to SIT 58,965m) also to a large extent due to accounting operations (revaluation). On the other hand, net operating profit - an indicator of true long-term development and growth potential of companies - increased strongly in 1996 in all ownership groups of companies, except non-privatised and state companies. The increase was most marked in external and internal companies which form the heart of the Slovenian corporate sector. This information is even more welcome since it indicates a positive turnaround in the performance of internal and external companies after a critically negative financial picture in 1995.

Table 5: Trends in Major Performance Indicators by Company Ownership Categories in 1994-96; for 1,902 Companies Active in the Entire Period

	Private	Foreign	Internal	External	Non-privatised	State
Return on equity[1]; %						
1994	0.4	5.1	0.7	1.7	-4.1	0.1
1995	7.0	4.6	-1.1	0.2	-5.6	0.2
1996	4.4	6.5	0.3	1.7	-4.1	-2.1
Profit margin[2]; %						
1994	0.1	1.8	0.3	1.4	-3.3	0.3
1995	1.8	1.5	-0.6	0.2	-3.7	0.7
1996	1.2	2.0	0.1	1.2	-2.8	-5.2
Total assets turnover[3]; %						
1994	136.1	150.2	107.4	78.8	61.3	30.7
1995	130.0	160.9	112.5	79.8	67.5	30.7
1996	130.7	169.5	114.8	88.7	68.5	31.0
Assets to equity ratio; %						
1994	264.0	190.2	163.6	152.8	198.9	129.5
1995	304.2	190.0	171.0	156.6	225.4	133.0
1996	312.5	187.9	176.2	158.7	213.7	133.5
Debt to equity ratio; %						
1994	153.1	84.2	56.1	43.8	105.3	26.2
1995	190.2	85.0	62.3	47.4	120.0	27.8
1996	201.0	83.9	67.2	49.7	121.2	28.7

Source: Agency for Payments; calculations made by authors.
1. Net operating profit (+)/loss (-) per equity.
2. Net operating profit (+)/loss (-) to sales ratio.
3. Sales to assets ratio.

Table 5, representing 1994-96 developments in major performance indicators for various ownership categories of 1,902 companies which were active in the entire period, sheds some additional light on the trends in enterprise restructuring and confirms the above findings. Measured by return (net operating profit) on equity and (net operating) profit margin there have not been many changes in 1994-96: foreign and private companies remain much better than companies from other ownership categories, followed by internal and external companies which saw record positive figures, whereas non-privatised and state companies bring up the rear. The positive development seems to be an improvement in return on equity and profit margin in internal and external companies in 1996 after a marked deterioration in 1995. Still, the 1996 improvement only brought them to the 1994 level (external) and not even that for internal companies. The situation in non-privatised companies has not improved in 1994-96, while in state companies it has deteriorated. There has been a general improvement in total assets turnover where all the ownership categories increased the amount of sales realised by given assets. On the other hand, increased debt to equity ratio of non-privatised companies combined with almost no improvements in performance indicators is worrying. With the exception of foreign companies, the increasing of debt to equity ratio is characteristic for all ownership categories.

“Exit” of Companies

Of 2,023 companies which were included in the 1995 analysis of financial results only 1,902 submitted financial statements in 1996. This means that 121 companies “exited” from our sample either due to their changed status or bankruptcy. Forty-nine of those companies went bankrupt, whilst other companies probably underwent some changes in status, either merging with another company or restructuring in some other way.[4] The comparison of the 1995 financial results of both groups of companies shows that the companies which departed accounted for a large part of the total loss of the enterprise sector. They generated 16.5% of overall losses and 13.8% of operating losses.

The analysis of net losses gives an even better picture. The companies which exited from the sample were responsible for 66% of total net overall losses and 88.1% of total net operating losses in 1995. It is the operating profit or loss which indicates whether a company, given its financial problems, is still able to carry out its primary activity in an economically viable way, and what are its growth and development prospects. Table 6 shows that there were non-privatised companies which got rid of the largest part of operating losses. The share of exiting companies in gross operating losses was 23.2% in the case of non-privatised companies, 16.6% for private companies, 13.9% for external companies and 8.7% for internal companies.

Undoubtedly, Slovenia has witnessed restructuring through the exit of loss-making companies, mostly companies with the highest operating losses. Restructuring through exit has been intense in private and external companies and, perhaps rather contrary to expectations, the most intense in non-privatised companies restructured through the Slovene Development Company. One could conclude that this governmental restructuring institution is more effective in promoting the exit of loss-makers in comparison to market forces in Slovenia which are mostly responsible for the exit of companies in other ownership categories. There is practically no exit in the group of foreign companies as they mostly operate with profit. Small private companies in Slovenia are profitable too, but they operate under great competitive pressure and therefore their relatively high percentage of exit is to be expected. On the other side, internally privatised companies generate more losses than externally privatised companies, but restructuring through exit is much more intense in companies that are not controlled by employees.[5]

Table 6: The Proportion of "Exit" Companies[2] in Total Companies[1] in 1995, in SIT million, in %

	Total	Private	Foreign	Internal	External	Non-privatised	State
1. Number of exit companies	121	21	1	30	41	22	6
As % of total companies	6.0	3.8	0.7	4.9	10.6	10.1	6.5
2. Assets of exit companies	335,312	7,638	137	28,623	60,255	57,956	180,703
As % of total companies	7.3	2.6	0.0	3.7	5.0	9.5	12.7
3. Employed in exit companies	26,037	1,775	22	4,377	8,701	7,022	4,140
As % of total companies	6.8	5.6	0.1	3.5	8.2	13.7	9.1
4. Gross overall loss of exit companies	14,977	1,841	9	1,889	3,073	8,043	122
As % of total companies	16.4	21.7	0.2	11.2	15.3	24.9	1.4
5. Gross operating loss of exit companies	12,438	1,400	8	1,691	3,219	5,997	123
As % of total companies	13.8	16.6	0.2	8.7	13.9	23.2	1.5

Source: Figures are computed using the Agency for Payments data.

1. All the companies which submitted their financial statements for 1995 and cumulatively fulfilled the following three criteria: (i) had at least 10 employees; (ii) had the value of assets at or above SIT 90m; (iii) had the value of net revenues from sales at or above SIT 180m. In 1995 there were 2.023 such companies.
2. In 1996, 121 companies out of the above 2,023 companies did not submit their financial statement and thus are excluded from the analysis.

Investments in the Enterprise Sector

New investment is the key ingredient to ensure the long-term competitiveness of Slovenian companies and their survival in the EU internal market. In recent years, the overall investment climate in Slovenia has been extremely negative. The period of disintegration of former Yugoslavia and macro-economic stabilisation in Slovenia was very uncertain and long-term decisions were avoided in most companies. In addition, there was only limited investment finance available from domestic and foreign sources and real interest rates were high. The main task of management teams was the very survival of their companies in these adverse circumstances and most of the restructuring activities were defensive: finding new markets for existing products and services, closing existing plants, selling assets, reducing the labour force and renegotiating old debts. In addition, strategic investment decisions were postponed until the new private ownership structure was defined in socially-owned enterprises. At this moment, privatisation is at least formally completed and macro-economic conditions are much better, but enterprise data indicates that investment activities are still only symbolic in some ownership categories.

With the analysis of the aggregate data we found that externally privatised companies invest much more in fixed assets than internally privatised companies (see Table 7). In 1995 and 1996 net investment in internal companies is even negative as they invest below depreciation costs. On the other side, external companies invest above the amount of depreciation and the stock of fixed assets is increasing. It seems that external companies are already in the phase of pro-active restructuring with positive net investments and both increasing sales and employment, while internal companies are still in the phase of defensive restructuring with decreasing sales and employment. Disinvestment and downsizing is often a necessary first step to generate funds for a long-term pro-active restructuring involving investment in new products and technologies. The key policy issue is whether internal companies are still in this phase because more restructuring was required, or is this a long-term characteristic implying that internally owned companies might not be capable, by themselves, of meeting the turn-around required by the EU integration process. Trends in aggregate data are not very clear. Net investments are negative, but the indebtedness of those companies is nevertheless increasing faster than in external companies. It seems that cash flow from disinvestment and additional borrowing in internal companies is partially used to finance losses of the companies and maintain employment and/or wages above the level that is sustainable in the long run.

Negative net investments are also a characteristic for the non-privatised companies that are restructured through the Slovene Development Company. On the other hand, foreign companies and especially private start up companies, with the clear ownership structure and strong profit motives, are the most active investors in fixed assets in 1995 and 1996 (see the ratio of net investments to sales and assets in Table 7). Nevertheless, it should be mentioned that the pro-active restructuring through new investments in the Slovenian commercial enterprise sector is still relatively weak. Most of the investments in 1995 and 1996 were realised in the public utility sector owned by the state. For example, 43% of gross investments and 79% of net investments in 1996 were realised in the public utility sector. Ratios of investment to assets show the same picture: state-owned public utilities are modernising their operation most intensively while the commercial enterprise sector is lagging behind.

Table 7: Investment and Ownership Categories in 1995 in 1996 (prices 1996)

	Gross investments in 000 SIT		Net investments in 000 SIT	
	1995	1996	1995	1996
Foreign	19.925.676	24.661.574	2.158.634	5.708.586
Internal	33.837.611	32.224.334	-2.594.648	-5.702.560
External	61.735.605	76.393.048	3.342.191	14.061.716
Private	25.894.258	19.689.577	14.202.729	6.930.145
Non-privatized	18.524.705	12.261.509	-1.307.654	-8.756.170
State	126.832.177	126.647.676	75.576.213	46.661.694
ALL COMPANIES	**286.750.032**	**291.877.718**	**91.377.465**	**58.903.411**

	Gross investments / Assets		Net Investments / Assets	
	1995	1996	1995	1996
Foreign	7,15%	8,57%	0,77%	1,98%
Internal	4,12%	3,94%	-0,32%	-0,70%
External	4,96%	6,11%	0,27%	1,12%
Private	8,41%	5,98%	4,61%	2,10%
Non-privatized	3,07%	2,21%	-0,22%	-1,58%
State	9,41%	9,12%	5,61%	3,36%

Source: Agency for Payments, calculations made by authors.

This lack of investment is one of the major problems for the long-term adjustment of the Slovenian enterprise sector to the competitive pressures of the EU internal market. The main reasons for not investing more intensively could be traced to the following: (i) absence of core owners with long-term prospective in most companies, (ii) lack of investment opportunities as many companies have not yet formed any strategic alliances with foreign partners that are required for successful operation in the EU internal market, and (iii) high cost and limited availability of investment finance due to restrictions on financing from abroad and structural characteristics of the domestic financial sector.

Major Problems Remain before Enterprise Sector Adjustment is Complete

As far as company restructuring is concerned, the end of privatisation witnessed the following categories of companies: (i) private and foreign with clear corporate governance and with no need for a major “transitional” restructuring; (ii) privatised (internal and external) which in most cases have neither clear corporate governance nor have they undergone the necessary restructuring; (iii) non-privatised which are mostly in a critical situation and (iv) state-owned companies in public utilities.

The above analysis seems to demonstrate that whilst the process of restructuring the Slovenian enterprise sector has not been at a standstill it has undoubtedly been too slow. Restructuring has been manifested by the bankruptcies of the largest loss-makers, by positive net investments in private, foreign and external companies and with a strong increase in net operating profits in 1996. The latter has been observed in virtually all ownership categories of companies, most of all in internal and external companies and the least in non-privatised companies. Hopefully this is a sign that the process of establishing corporate governance, which leads to further restructuring, has already been initiated in externally and internally privatised companies. On the other hand, non-privatised companies still record critically high operating losses which are being reduced at far too slow a pace and degree.

The ownership-performance overview of the Slovenian enterprise sector conveys the message that three issues will have to be dealt with in order to complete the transition process in the enterprise sector and, thus, to pave the way for a successful integration into the EU:

- the sustainable profitability of the externally and internally privatised companies which will form the core of the future economic structure of the country;
- the rapid reduction of the large loss making non-privatised sector in a way that is socially acceptable;
- the acceleration of new domestic entries and foreign entries through foreign direct investment.

The major post-privatisation issue in Slovenia is the establishment of corporate governance and overall restructuring of the privatised (internal and external) companies which represent by far the most important segment of the Slovenian manufacturing and service sectors. The ownership transformation process required by law does not necessarily mean real privatisation of the company in an economic sense which would lead to a major restructuring process. In particular, the process of recognising and responding to the full range of market incentives and building effective systems of corporate governance are, in many cases, just beginning. Ownership rights are currently dispersed among three different groups of owners with different interests and areas of expertise: a wide range of institutional investors, insiders and small investors. Even within each of these groups, interests are not homogenous. Production and employment are still dominated by companies where management practices have not changed. A large proportion of medium-sized firms are owned by the management and workers whose incentives to restructure, in particular through changes in working practices, are weak.

Regarding the companies which have not yet been privatised one should distinguish between those in the portfolio of the Slovenian Development Company and public utilities' companies. The first are a heavy burden on the budget and should undergo, as fast as possible, some basic restructuring including separation of viable from non-viable parts and subsequent privatisation of the former. It is important to keep in mind that the maintenance of the large non-privatised sector distorts competition mechanisms and ties up enormous human and financial resources which are not available for improving the performances of the privatised sector. Direct state intervention in individual companies is sometimes socially justified, but economically undesired in the long run as the state has not been successful in operational restructuring in Slovenia. For that reason, the basic starting point of enterprise sector reform should be that the long-term and extensive company restructuring based on new investments is in principle the responsibility of the new private owners.

Public utilities' companies are involved in enterprise sector reform mostly because their services represent inputs for other companies. There is definitely a major need for restructuring and regulating the utilities, for their de-monopolisation and, if feasible, privatisation to reduce their prices and increase the quality of their services. Data shows relatively strong investment activity in this sector but major improvements are not likely without comprehensive institutional and regulatory reforms.

Companies need to invest, especially in modern technology, to improve their efficiency so that they can both compete at home and take advantage of economies of scale which flow from access to the single European market. This capacity to adapt will be greater the more firms have access to investment finance, the better the quality of their workforce, and the more successful they are at innovation. FDI, meaning a transfer of a whole package of development ingredients, can play a particularly useful role in this regard. That is why the relatively modest amount of FDI is a problem in Slovenia.

The elimination of problems relating to the accomplishment of other major economic reforms, in particular (i) further stabilisation of the economy to eliminate indexation and the real appreciation of the Slovene Tolar, (ii) liberalisation and strengthening of the financial sector (which would require less state involvement) to decrease high real interest rates and improve access to finance, (iii) labour market reform to cope with wages, and finally (iv) fiscal and social security reform to reduce the wage wedge and fiscal pressures. These all form a necessary background for successful enterprise sector reform. The same holds for the appropriate regulatory framework and, even more so, for efficient law enforcement.

Besides creating a stable institutional framework for a private market economy, Slovenian economic policy related to the enterprise sector has until now been engaged predominantly in the defensive restructuring of some large industrial plants (e.g. steel mills, paper and pulp producers, automobile and related industries). The time has come to reorient enterprise sector economic policy into a pro-active policy which would support the development of growing and prospective companies and activities. The policy should focus on enterprise sector structural adjustments and competitiveness upgrading. Companies should be stimulated to make structural adjustments to the changing conditions of competitiveness with the introduction of new products and production procedures and with improvement to those already in existence. Industrial policy should not be focused mainly on the preservation of existing jobs but more closely connected with the policy of technological development, the promotion of an environmental approach to business, the stimulation of enterpreneurship and new entries, and finally to the improvement of the investment climate.

Analysis of trade specialisation shows that the competitive advantages of Slovenia seem to be situated more in terms of quality or product differentiation than in terms of price. Only continued openness to international markets and a good diffusion of technology and information can ensure the economic restructuring which is needed in Slovenia. Policies in support of such an orientation should be based on horizontal programmes available to all companies. On the other hand, industries relying merely on cost advantages are, in the medium and long-term, threatened by the potentially strong competition of neighbouring countries whose industries still have a substantial competitive edge in the context of rapidly increasing productivity. The cost based competitiveness model is not suitable for Slovenia due to its small economy, scarce local production factors, a relatively high-qualified labour force, the serious outflow of highly educated experts, and finally the downward rigidity of certain costs (wages, social security, state administration). Therefore, policies that would aim to restructure individual heavy loss-making companies in traditional industrial sectors would be in contradiction with the structural characteristics of the Slovenian economy and, in the end, could only impinge negatively on the overall restructuring process.

Notes

1. In 1995, 33,609 companies submitted their financial statements. For practical reasons the analysis took into account only "larger" companies which in 1995 fulfilled cumulatively the following three criteria: (i) had on average 10 or more employees; (ii) had the value of assets of SIT 90m or more, and (iii) had the value of net revenues from sales SIT 180m or more. There were 2,070 companies that met all three criteria. Within this group there were 47 companies in which ownership could not be identified and have therefore been excluded from the analysis. Thus, the analysis took into account 2,023 companies which accounted for 6.0% of total number of companies in Slovenia, but comprised as much as 83.5% of equity, 77.6% of assets and 78.5% of employed and realised 76.4% of sales (net revenues from sales), 87.5% of exports and 79.7% of net losses (profit-operating loss) of total non-financial corporate sector.
2. In 1996, net profit of the analysed companies from extraordinary revenues/expenses stood at SIT 19,774m, of that the revenues from the cancellation of provisions amounted to SIT 23,925m.
3. The picture is further distorted by the fact that in different ownership categories of companies the effect of revaluation is different. Higher is the share of equity in equity&liabilities, higher are the expenses from financing. The share of equity in equity&liabilities has been above average in state, external and internal companies. Hence, these companies record the above average expenses from financing due to revaluation.
4. It is interesting that the net overall losses (SIT 11,139m) and net operating losses (SIT 10,539m) of the 49 companies which went bankrupt almost match the data on the net overall losses (SIT 11,717m) of all 121 companies which exited the sample. Apparently, companies which merge with other companies are not loss-making.
5. It is interesting that in non-privatised and external "exiting" companies, the reduction in the number of employed (13.7% in non-privatised and 8.2% in external) was relatively larger than the reduction in assets (9.5% in non-privatised and 5.0% in external), whereas the situation has been the opposite in internal and, in particular, state enterprises. This indicates that among non-privatised and external companies, it was mostly above-average labour intensive companies which exited.

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