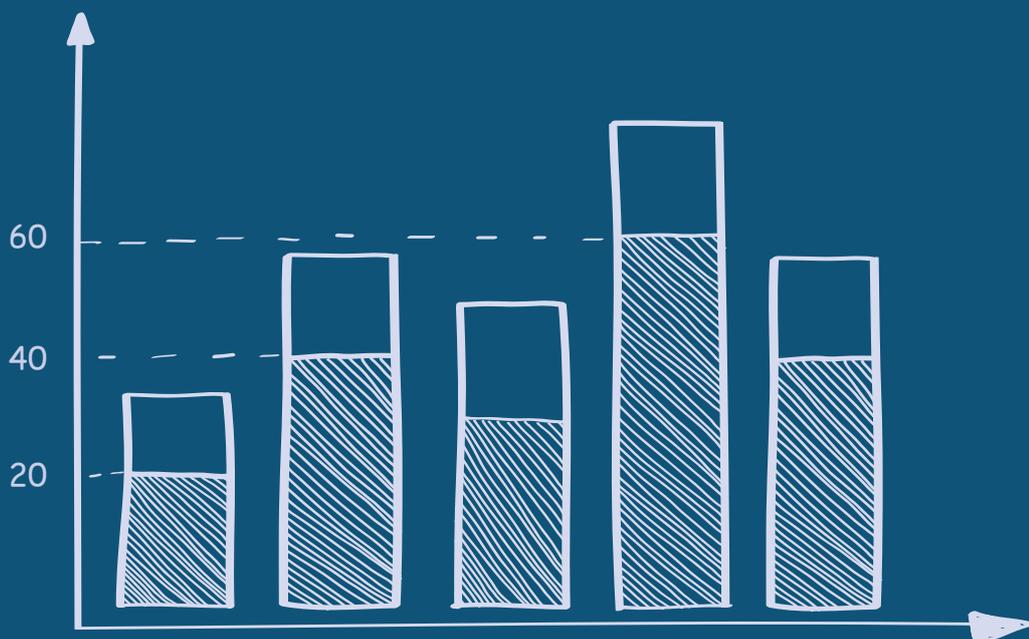




# Financial sustainability of public undertakings in Moldova: findings and trends

*Mihail MANOLI*

*Economist, PhD in Economics*



**INEKO**

Institute for Economic and Social Reforms



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The report is a product of the initiative "Supporting democracy, independence and transparency of key public institutions in Moldova" The initiative is implemented by the Institute for Development and Social Initiatives (IDIS) "Viitorul", in partnership with the Institute for Economic and Social Reforms in Slovakia (INEKO) and is financially supported by the Official Development Assistance Program of the Slovak Republic (SlovakAid). The initiative aims to inform the public about the development of democracy and the independence of key state institutions, as well as to improve the transparency and financial stability of local public authorities and state-owned enterprises in the Republic of Moldova.

The opinions expressed in this report are those of the authors and do not necessarily reflect the official policy or position of INEKO and SlovakAid.



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# Summary

The Institute for Development and Social Initiatives (IDIS) “Viitorul”, with the aid provided by the Institute for Economic and Social Reforms (INEKO), has assessed the financial sustainability of Moldovan public undertakings under the initiative “Supporting democracy, independence and transparency of key public institutions in Moldova”. IDIS “Viitorul”, in partnership with INEKO, implemented this initiative supported financially by the Official Development Assistance Programme (SlovakAid) of the Slovak Republic. The initiative pursues the goal to raise public awareness about the development of democracy and independence of key state institutions, as well as about improved transparency and financial sustainability of Local Public Authorities and public undertakings in Moldova. The ranking of public undertakings with the highest level of transparency is available at: [www.companies.viitorul.org](http://www.companies.viitorul.org).

The initiative “Supporting democracy, independence and transparency of key public institutions in Moldova” aims also to develop instruments for assessing the financial sustainability of state-owned enterprises, as well as their transparency. Once the decision-making processes and financial data are made public, the scope for defective actions may shrink.

Public undertakings have a significant impact on the country economy, as well as on population’s welfare. As per the data comprised by the State Register of Legal Entities of the Republic of Moldova, as of 1 January 2019, there were 1 552 active state- and municipal-owned enterprises and 4 416 joint stock companies. In addition to their social impact, as public undertakings tend to employ a large number of people, they render important public services. As per the National Bureau of Statistics data for 2009-2017, the significant influence of public undertakings on the country GDP formation varied in the range of 23.22% – 17.30%.

According to the ranking posted on [www.companies.viitorul.org](http://www.companies.viitorul.org), there are several companies, including “Centrul de Telecomunicatii Speciale” (44 points), SoE “MoldATSA” (44 points), SoE “Moldpres” (43 points), SoE “Casa Presei” (43 points) and SoE “Posta Moldovei” (40 points), which are the most transparent Moldovan state-owned enterprises in 2018. At the same time, Moldova Railroad Company in the area of construction “Confercai”, Division for Real Estate Operation and Editorial-Printing Company “Tipografia Centrala” are positioned at the opposite pole.

In order to calculate the transparency ranking for the previous year, the activity of 68 Moldovan state- and municipal-owned enterprises, as well as of publicly owned or controlled commercial companies, with the size of assets exceeding MDL 1 million, was monitored during 2017. The public undertakings were assessed on the basis of six transparency criteria, namely economic indicators, transparency and access to information, public procurement and property, human resources, ethics and conflict of interests, grants and sponsorships. The maximum score for an enterprise amounted to 100 points.

Having reviewed the financial sustainability indicators of public undertakings for the period of 2015-2018 we find that only JSC “Metalferos” and SoE “Centrul Național pentru Frecvente Radio” are positioned amongst the most transparent undertakings by the size of assets, sales and profits. Moreover, JSC “Metalferos” (third place) is one of the top leaders in terms of collected profits and financial sustainability. The company achievements stem from its legal advantages rather than from its internal management. In other words, the company efficiency is based mostly on competition restrictions.

The assessment of public undertakings’ financial sustainability was the subject-matter of several research studies conducted in the Republic of Moldova, including the present Study. All these researches stated that the **financial health of public undertakings failed to show an upward trend during 2015-2018**. The research results ascertained the lack of development in terms of undertakings’ financial health. In fact, all of them are positioned at the end of the developed ranking, which justified the failure to fulfil the provisions referred to in Article 3 of the Law on the administration of public property and its transfer into private property (No. 121-XVI dated 04.05.2007).

Relying on experience, one can say that the state is not the most efficient economic operator, nor is it the best manager of assets. Hence, there are no substantial grounds to hold certain assets with high economic potential in the state ownership. If we do not count on privatisation to redress the situation, then it would be necessary to review the content of the national legislation, primarily the Law on Joint-Stock Companies, and bring it in compliance with the international practice.

The matter of public undertakings efficient administration has been addressed and treated differently. Some international bodies, such as the International Monetary Fund (IMF) and the World Bank (WB), consider privatisation of those undertakings to be the best solution. At the same time, the OECD and many international experts argue that public undertakings have the same potential to become as efficient as the private ones, should they be based on **appropriate principles of corporate governance**, which include sound incentives for the people involved in administration/management.

Therefore, it is **necessary to promote the new vision on corporate governance in the internal regulatory acts**. Corporate governance is a system of rules, practices and processes through which a company is managed and controlled to attain future sustainable development. In fact, this system means the management of an organisation by pooling all internal components and implementing successfully the risk management, financial management and internal control systems.

# Legal framework

The Ministry of Economy and the Public Property Agency boost the legal framework on public property management and the state policy on public undertakings' administration. The Ministry of Finance plays an important role in the administration process. The state policy is promoted through the following key regulatory acts:

1. Law on the administration of public property and its transfer into private property (No. 121-XVI dated 04.05.2007);
2. Law on state and municipal-owned enterprises (No. 246 dated 22.11.2017);
3. Law on joint-stock companies (No. 1134-XIII dated 02.04.97);
4. Accounting and financial reporting Law (No. 287 dated 15.12.2017);
5. Government Decision on certain matters relating to the apportionment of the yearly net profit of joint stock companies, which have government stakes, and of state-owned enterprises (No. 110 dated 23.02.2011);
6. Government Decision approving the Regulation for state representation in commercial companies (No. 1053 dated 11.11.2010).

According to Article 19 3 (b) of the Law on state and municipal-owned enterprises, within 24 months after the enactment of this law, the Government must initiate the reorganisation of public undertakings in other legal types of organisation referred to in the legislation. The aforementioned deadline expired in November 2019. Other legal types of organisation include joint stock companies (JSCs) and limited liability companies (LLCs).

Out of the said regulatory acts, both the Law on joint-stock companies (No. 1134-XIII dated 02.04.97) and the Law on State- and Municipal-owned Enterprises (No. 246 dated 22.11.2017) include similar weaknesses and obsolete provisions, namely the need to establish censor committees, although they were enacted in 1997 and, accordingly, in 2017. (JSCs shall establish censor committees as per the provisions of Article 71; the state- and municipal-owned enterprises shall establish censor committees in compliance with the provisions of Article 10).

# Public companies in Moldova: their importance for the economy

According to the data comprised by the State Register of Legal Entities of the Republic of Moldova, as of 1 January 2019, there were 1 552 active state- and municipal-owned enterprises and 4 416 joint stock companies. The distribution of population by the types of ownership shows that 75.0% of all employed people work in the private sector, while circa 24.4% work in the public sector, of which more than 84.0% (20.5%) are employed by budget entities, and approximately 16.0% (3.90%) – by state- and municipal-owned enterprises.

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total	1 143	1 173	1 147	1 173	1 185	1 204	1 220	1 208	1 252
<i>of which:</i>									
Public	324	324	321	316	308	319	296	310	298
Private	819	850	825	856	877	884	924	898	954
<b>In % to the total</b>									
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
<i>of which:</i>									
Public	28,4	27,6	28,0	27,0	26,0	26,5	24,2	25,6	23,4
Private	71,6	72,4	72,0	73,0	74,0	73,5	75,8	74,4	76,6

**Table 1:** Employed population by types of ownership; thousands of persons. Source: the National Bureau of Statistics.

Throughout 2009-2017, the public sector share in the country GDP varied in the range of 23.22% - 17.30%, amounting to 20.13% on the average. Public undertakings have a significant impact on the country economy, as well as on population's welfare. In addition to their social impact, as public undertakings tend to employ a large number of people, they render important public services such as sanitation, manufacturing of essential goods, power supply, infrastructure maintenance and development services, etc. As per the data of the National Bureau of Statistics, the significant inputs brought to the formation of the country GDP by public undertakings are displayed in Table 2.

	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>GDP</b>	<b>60 430</b>	<b>71 885</b>	<b>82 349</b>	<b>88 228</b>	<b>100 510</b>	<b>112 050</b>	<b>122 563</b>	<b>135 397</b>	<b>178 881</b>
<i>of which:</i>									
Public	14 032	15 754	15 636	18 159	20 721	22 133	24 212	25 756	30 970
Private	33 868	37 731	49 207	49 835	58 301	65 018	66 724	73 805	106 190
Mixed (public and private) with no foreign contribution	1 569	3 065	2 107	1 851	1 733	1 295	2 479	2 415	2 145
Mixed and foreign entities	10 961	15 335	15 399	18 382	19 755	23 603	29 148	33 420	39 576
Public sector share in GDP, %	23,22	21,92	18,99	20,58	20,62	19,75	19,76	19,02	17,3

**Table 2:** *Gross Domestic Product by types of ownership, millions of MDL. Source: the National Bureau of Statistics.*

# Public undertakings lack transparency and efficient management

The initiative “Supporting democracy, independence and transparency of key public institutions in Moldova” aims to develop instruments for assessing the financial sustainability of state-owned enterprises, as well as their transparency. Once the decision-making processes and financial data are made public, the scope for defective actions may shrink.

According to the ranking posted on [www.companies.viitorul.org](http://www.companies.viitorul.org), there are several companies, including “Centrul de Telecomunicatii Speciale” (44 points), SoE “MoldATSA” (44 points), SoE “Moldpres” (43 points), SoE “Casa Presei” (43 points) and SoE “Posta Moldovei” (40 points), which are amongst the most transparent state-owned enterprises in Moldova in 2018. At the same time, Moldova Railroad Company in the area of construction “Confercai”, the Division for Real Estate Operation and Editorial-Printing Company “Tipografia Centrala” find themselves at the opposite pole.

In order to calculate the transparency ranking for the previous year, the activity of 68 state- and municipal-owned enterprises was monitored, as well as publicly owned or controlled commercial companies of the Republic of Moldova, with the size of assets exceeding MDL 1 million, was monitored during 2017. The public undertakings were assessed on the basis of six transparency criteria, namely economic indicators, transparency and access to information, public procurement and property, human resources, ethics and conflict of interests, grants and sponsorships. The maximum score for an enterprise amounted to 100. According to [The 2019 Monitoring Report of public undertakings’ transparency](#), the general average of transparency attained by Moldovan public/municipal undertakings and publicly/municipally owned or controlled commercial companies reached 17.4 percentage points. The SoEs registered an average of 17.7%, while the MoEs – an average of 12.7%. Such outcomes may be justified by the fact that public undertakings, as a rule, are larger, have more employees and financial resources.

At the same time, according to the same ranking from 2018, public undertakings were subject to review depending on the size of assets, sales and profits. Hence, the largest companies in terms of assets’ size were as follows:

- JSC “Moldovagaz” – MDL 12 billion;
- SoE “Administratia de stat a drumurilor” – MDL 9 billion;
- JSC “Termoelectrica” – MDL 5 billion;
- SoE “Calea Ferata din Moldova” – MDL 3 billion;
- SoE “Moldelectrica” – MDL 1.5 billion.

In addition to their real value, the assets managed by those companies have a strategic value, such as the infrastructure, without which the country economy could not operate. Even if those undertakings have a major importance for the country economy, they lack transparency and efficient management, falling under political influence.

The ranking listed also the enterprises with the *largest sales*, namely:

- JSC “Moldovagaz” – MDL 5.7 billion;
- JSC “Energocom” – MDL 3.4 billion;
- SoE Air Company “Air Moldova” – MDL 2.5 billion;
- JSC “Termoelectrica” – MDL 2.4 billion; and
- JSC “Metalferos” – MDL 1 billion.

As for the *size of gained profits*, the top was represented by:

- JSC “Moldovagaz” – MDL 262 million lei;
- JSC “Moldtelecom” – MDL 103 million;
- JSC “Metalferos” – MDL 41.3 million;
- SoE “Centrul National pentru Frecvente Radio” – MDL 27 million;
- JSC “Energocom” – MDL 20 million in 2017.

Enterprise	Ranking as per transparency indicators, %							
	Position	TT, out of 100 points	EI 19 points	TAI 24 points	PPP 23 points	HR 14 points	ECI 13 points	GS 7 points
JSC “Moldovagaz”	58	5	0	17	0	7	0	0
SoE “Administratia de stat a drumurilor”	12	34	84	44	22	18	0	0
JSC “Termoelectrica”	6	38	95	63	17	7	0	0
SoE “Calea Ferata din Moldova”	18	24	55	42	9	7	0	0
SoE “Moldelectrica”	8	36	95	54	13	14	0	0

**Table 3:** Information on the ranking of top five undertakings by size of their assets, as per the 2019 transparency indicators. Source: IDIS “Viitorul” and INEKO.

The data displayed in Table 3 show that JSC “Moldovagaz” scored 0 points for four transparency assessment indicators out of six. Thus, out of 19 points for *Economic indicators* it scored 0 points; out of 23 points for *Public procurement and property* – 0 points; out of 13 points for *Ethics and conflict of interests* – 0 points; and out of 6 points for *Grants and sponsorships* – 0 points. The company is positioned on the 58<sup>th</sup> place as it scored 5 points out of 100.

The particularly complicated situation within JSC “Moldovagaz” has been confirmed also by the Public Property Agency. Despite the fact that the company gained net profits during 2017 (MDL 1 926 080 470) and 2018 (MDL 191 492 290) attributable to its operations, the net assets (represented as equity) amounted to MDL minus 1 032 715 240 at the end of 2017, and MDL minus 841 281 380 at the end of 2018.

One of the key goals of public property management is to gain profit for the benefit of the public. However, we have the largest deficiencies here. In terms of the gained profit and return on equity, one is able to acknowledge the maladministration of public undertakings. Out of those 50 public entities subject to review, only 38 were profitable in 2018. Concurrently the losses recorded by the remaining 12 public undertakings amounted to MDL 423 million, of which MDL 414 422 317 or 97.87% were incurred by the following undertakings: “Calea Ferata din Moldova” – 12.57%, JSC “RED Nord-Vest” – 14.73%, JSC “Termoelectrica” – 17.02 %, and SoE “Air Moldova” – 53.64%. The profits recorded in 2018 amounted to MDL 535 361 681, of which MDL 262 366 383 lei or 49% was earned by JSC “Moldovagaz”. The undertakings positioned in the ranking on the 2-9 places covered 45.71% of the overall profit earned by the entities subject to review. Besides, all five undertakings scored 0 points for two indicators, namely *Ethics and conflict of interests* and *Grants and sponsorships*.

The review of financial sustainability indicators of public undertakings for 2015-2018 shows that according to the size of assets, sales and profits, two entities out of the top five, namely JSC “Metalferos” and SoE “Centrul National pentru Frecvente Radio”, find themselves at the forefront.

JSC “Metalferos” is one of the top leaders in terms of collected profits and financial sustainability during 2015 – 2018. The company achievements stem from its legal advantages rather than from its internal management. In other words, the company efficiency is based mostly on competition restrictions and distribution of private undertakings’ profits towards JSC “Metalferos”, having infringed the provisions referred to in the Law on the administration of public property and its transfer into private property (No. 121-XVI dated 04.05.2007), Article 3 (c) “Main goals and principles of public property administration and its transfer into private property”, namely the development of competition within the national economy.

Enterprise	Position in the ranking			
	2015	2016	2017	2018
SoE “Centrul pentru Standardizarea si Experimentarea Calitatii Productiei de Conserve”	1	5	3	2
SoE “Centrul de Stat pentru Atestarea si Omologarea Produselor de Uz Fitosanitar si a Fertilizantilor”	2	1	2	3
JSC “Metalferos”	3	2	1	1
SoE “Fintehinform”	4	3	-	-
SoE “Centrul National pentru Frecvente Radio”	5	4	4	4
SoE “Pulbere”	-	-	5	-
JSC “Furnizarea energiei electrice NORD»	-	-	-	5

**Table 4:** Financial sustainability of public undertakings during 2015 –2018. Source: IDIS “Viitorul” and INEKO. Data processed by the author.

In terms of financial sustainability, depending on the owner of public undertakings, several research studies were conducted in the Republic of Moldova, including the present study. All these researches stated that the financial health of public undertakings failed to show an upward trend during 2015-2018. The research results ascertained the lack of development in terms of undertakings' financial health. This fact is proved also by the outcomes of the financial sustainability ranking, developed on the basis of four years of operation of five largest public entities by the size of their assets. The ranking results regarding those five undertakings are displayed in the Table below.

Enterprise	Enterprise position in the ranking of financial sustainability			
	2015	2016	2017	2018
JSC "Moldovagaz"	50	50	54	51
SoE "Administrația de stat a drumurilor"	46	44	50	53
JSC "Termoelectrica"	49	47	49	48
SoE "Calea Ferata din Moldova"	43	42	53	47
SoE "Moldelectrica"	47	41	43	40
Number of entities subject to review	50	50	57	57

**Table 5:** *The position of five forefront undertakings by the size of assets and financial sustainability ranking. Source: IDIS "Viitorul" and INEKO. Data processed by the author.*

The 2015–2018 research results ascertained the lack of development in terms of undertakings' financial health. In fact, all of them are positioned at the end of the ranking.

The data showed in Table 4 justified the failure to fulfil the provisions referred to in the Law on the administration of public property and its transfer into private property (No. 121-XVI dated 04.05.2007), Article 3 "Main goals and principles of public property administration and its transfer into private property". By this law, the state defines three core goals for the administration of public property, namely harmonisation of the size and structure of public property, as well as the manner of their administration with the state's and administrative-territorial units' functions; attracting investments into the country public sector and ensuring efficient management; boosting competition in the national economy.

There is no subsidiary body to the public interest, which would secure the oversight of public property management. We can say that the state failed to fulfil all three goals mentioned above. There is a strong need to change and rethink the administration system of state-owned enterprises.

# Conclusions and recommendations

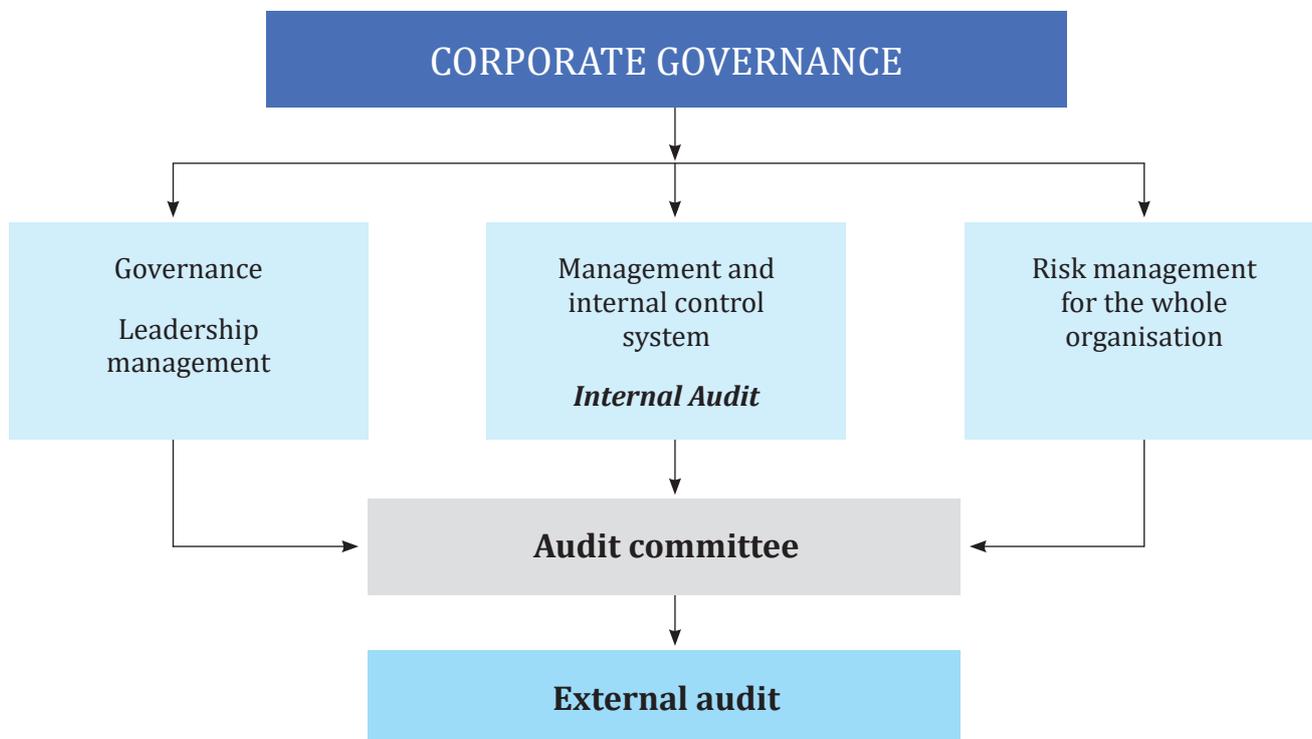
**The main shortcomings in the management of public undertakings** have been ascertained in many cases by the Court of Accounts and by the Financial Inspection. They have become evident in many areas, such as:

1. The issue of inefficient procurement. Among the procurement-related infringements committed most often one can mention the following:
  - a. carrying out procurement procedures at unjustified prices;
  - b. carrying out procurement procedures through intermediates;
  - c. carrying out large procurement volumes without the consent of the board/founder;
  - d. carrying out procurement procedures in the breach of the legislation, procedures, and in-house regulations.
2. The issue of poor management of assets, which reveals itself by the failure to use such as intended; failure to employ the purchased equipment and its malfunctioning due to inappropriate conditions for its storage. Poor management of liabilities also pertains to this category, which leads to the shortage of financial means; thus, the undertaking is forced to attract foreign sources of funding.
3. Unjustified remuneration of personnel. The infringements relating to the remuneration of personnel committed most often are the following:
  - a. calculation and payment of salaries exceeding the ceiling defined and approved by the wage bill;
  - b. unjustified inclusion of salary increases in the cost of services/products;
  - c. granting premiums/bonuses when lacking performance indicators;
  - d. remuneration of employees in the breach of current legislation and in-house regulations.
4. Unreasonable regulation of proceeds. Some undertakings are not perceived as entities, which pursue the goal to gain profits, even if they operate with the highest possible degree of economic efficiency, but rather as entities through which the relevant central institutions try to solve, discretionally, some social issues.

Relying on experience, one can say that the state is not the most efficient economic operator, nor is it the best manager of assets. Hence, there are no substantial grounds to hold certain assets with high economic potential in the state ownership. If we do not count on privatisation to redress the situation, then it would be necessary to review the content of the national legislation, primarily the Law on joint-stock companies, and bring it in compliance with the international practice.

The matter of public undertakings efficient administration, which have been established and managed by the state, has been addressed and treated differently. Some international bodies, such as the International Monetary Fund and the World Bank, consider **privatisation of those undertakings to be the best solution**. At the same time, the OECD and many international experts argue that public undertakings have the same potential to become as efficient as the private ones, should they be based on **appropriate principles of corporate governance, which include sound incentives for the people involved in management**.

Therefore, it is **necessary to promote the new vision on corporate governance in the internal regulatory acts. Corporate governance is a system of rules, practices and processes through which a company is managed and controlled to attain future sustainable development.** In fact, this system means the management of an organisation by pooling all internal components and implementing successfully the risk management, financial management and internal control systems, as it is showed in the Figure below.



Source: Marcel Ghita, Corporate Governance, Economica publishing house, 2008, p.14.

*Figure 1. Corporate governance operating principles*

Corporate Governance operates on the basis of several principles, which are considered as pillars of good governance, namely **integrity; transparency; accountability and competence**. Integrity is a key concept and includes an adequate and ethical behaviour, respectively, the due care about the interests of other people and social accountability. This concept is implicit for the activities carried out in the public sector, while for the private sector it is a principle meant to derive profits. Transparency is necessary because the irregularities and/or poor performance take place usually behind closed doors. When the facts are visible, they are open to public opinion, subject to justified findings of professionals, and there are greater chances for improvements. The exposure of actions and decisions to public review contributes to improved behaviours and performances. As a rule, transparency is a fundamental principle for those organisations that are willing to learn. There is no developments and good performance without openness; it is not possible to become more efficient. Certainly, one could hide non-professional behaviour and poor performance in the short term, but he/she would never succeed in the long-run.

Accountability is the most important principle of governance, but it is less understood and complied with by organisations. Indeed, in the majority of organisations, accountability is not sufficiently defined, nor is it clear for organisation employees and its managing body.

