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ECFIN Country Focus

ECONOMIC ANALYSIS FROM EUROPEAN COMMISSION'S DIRECTORATE-GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS

HIGHLIGHTS IN THIS ISSUE:

- *State ownership is still significant in Slovenia, with cross-ownership of corporates, insurance groups, banks and public funds, generating 1/6th of the value added of the economy and employing one out of eight people in the corporate sector.*
- *These inter-linkages create major fiscal risks, limit the adjustment capacity and distort resource allocation. Transfers to loss-making SOEs contributed 1.4 pps to the budget deficit of 6.4% of GDP in 2011, and the total debt of SOEs was at least 30% of GDP.*

Slovenia: State-Owned and State-Controlled Enterprises

By Svetoslava Georgieva and David Marco Riquelme***

Summary

This Country Focus describes the role of State-Owned and State-Controlled Enterprises (SOEs) in the Slovenian economy by analysing over 40 key SOEs in terms of their financial performance and their impact on public finances, growth and adjustment capacity.

SOEs generated one sixth of the value added of the Slovenian economy and employed one out of eight people in the corporate sector in 2011.The most recent financial data available for all companies (2011) show that several SOEs have been accumulating losses and losing equity value, partially due to the current downturn, but also due to inefficient capital structures.

The losses and high debt levels increase recapitalisation needs and solvency risks of these companies in the trough of the economic cycle, with direct implications for Slovenia's public finances. Cross-ownership and inter-linkages among some of the financially-troubled SOEs and state-owned banks with increasing non-performing loans (NPLs) amplify these risks. Capital transfers to loss-making SOEs contributed 1.4 pps to the budget deficit of 6.4% of GDP in 2011. The total debt of non-bank SOEs was at least 30% of GDP, with 5.4 pps attributable to companies consolidated with general government accounts. In addition, SOEs are the main beneficiaries of state guarantees worth 25% of GDP, which constitute a contingent liability for the general government.

Part of the current situation can be traced back to the privatisation model chosen during the transition period. Still today, the dominant role of company-internal and public owners is seen as obstacle for strategic investors and foreign direct investment (FDI), while this distorts the allocative function of capital and labour markets and limits the adjustment capacity of the economy. In the coming period, there will be a need to address major fiscal risks related to SOEs and to implement a coherent strategy to improve corporate governance, restructure indebted companies, and reduce the state's participation, particularly in the financial sector and in other sectors, where ownership is typically private in market economies.

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The views expressed in the ECFIN Country Focus are those of the authors only and do not necessarily correspond to those of the Directorate-General for Economic and Financial Affairs or the European Commission. The Country Focus benefited from comments from the Slovenian country team at Unit H.1.

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Introduction

This Country Focus explores the importance of SOEs in the Slovenian economy...

This Country Focus analyses the role of State-Owned and State-Controlled Enterprises[1] (SOEs) in the Slovenian economy and their inter-linkages with the financial sector. It draws on publicly available information to provide a fresh analysis of the state-owned segment of the Slovenian economy in terms of financial performance, impact on public finances and, ultimately, macroeconomic and fiscal risks.

The Republic of Slovenia (RS) owns - directly or indirectly - stakes in at least 80 companies. Its direct ownership (76 companies, 10 of which are in bankruptcy) was, until recently, centralised under the umbrella of the Capital Assets Management Agency (AUKN). AUKN was established in the context of Slovenia's OECD accession in 2010 (OECD, 2011b). The RS also has indirect ownership in a number of companies (mostly overlapping with direct ownership) through public funds, state-owned banks, insurance groups and other directly owned SOEs. Many of these stakes are consolidated in the fully state-owned funds KAD (pension fund), SOD (restitution fund), DSU (former Development Corporation) and PDP (a fund to manage distressed assets). According to legislation adopted in December 2012, AUKN was to be replaced by the Slovenian Sovereign Holding (SSH), with the aim of consolidating and managing all state assets (directly- and indirectly-owned) under one structure, and allowing for the privatisation of some of these assets. However, the political context since the beginning of the year has delayed the process of setting up SSH, and AUKN as a management structure was temporarily replaced by the state fund SOD. The current government has signalled that there will be changes to the existing legal framework and has committed to producing a comprehensive strategy by Q3 2013. In the meantime, the government has approved a list of 15 companies for privatisation, which includes the second largest bank (NKBM), the largest telecom operator (Telekom Slovenije), and other smaller assets. Nevertheless, strategic questions remain open and implementation of the adopted SSH Act has been postponed.

...by analysing over 40 key SOEs in terms of their financial performance and impact on public finances, growth and adjustment capacity.

The assessment in this Country Focus is based on the review of 46 SOEs,[2] four of which are consolidated in the General Government Accounts (GGA), while the remaining 42 companies are outside the GGA. Financial data are sourced from annual reports, the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), and Finance Top 101 (local newspaper). All data are for 2011, since full year data for 2012 were not available for many of the companies. The cut-off date is May 1st 2013.

The Role of SOEs in the Economy

SOEs represent one sixth of total value added...

The total book value of the directly-owned state portfolio is, according to the AUKN 2011 annual report, EUR 8.8 bn, or just over 24% of GDP in 2011 (Graph 1). SOEs represent one sixth of total value added in the economy and are dominant in sectors that in other developed economies are typically privately owned, e.g. the financial sector and telecommunications (OECD, 2011b). Moreover, all the companies included in the Ljubljana Stock Exchange's benchmark SBI TOP index are either state owned or state controlled (e.g. Telekom Slovenije, Triglav, NKBM).

...and employ one out of eight people in the corporate sector.

With 11% of total employment, SOEs also have sizeable effect on labour productivity and the competitiveness of the Slovenian economy. At least one out of eight employees in the corporate sector is employed by one of the largest 46 SOEs or state-owned banks considered in this paper.[3]

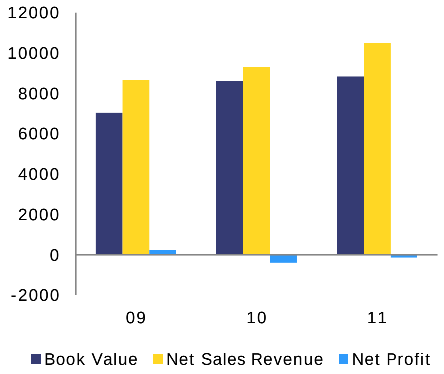
[1] A company is here defined as an SOE, i.e. state-owned or state-controlled, if the Republic of Slovenia owns directly or indirectly at least 25% plus one vote of the total capital, thus having an effective blocking minority over most strategic corporate transactions. The computation of state ownership may not be fully exhaustive due to the complexity of shareholding structures and the lack of publicly available data. The following methodology was used: (i) given cross-ownership and circular references, in such cases, ownership is calculated first without the overlapping share to obtain a provisional stake, which is then used to calculate the total ownership; (ii) the resulting share is adjusted proportionately if the state holds below 50% but unadjusted if above 50%; (iii) only the top 10 shareholders are taken into account; and (iv) the state ownership indicated is always that of the parent company and not of the group (i.e. excludes subsidiaries).

[2] The review sample is selected mostly according to availability of data and the overall macroeconomic significance of the companies. Banks and insurance companies are excluded from the financial performance analysis (but not from impact on public finances) due to the differences in their business model and key financial ratios.

[3] These employment numbers are derived from the almost 90,000 employees in the 46 SOEs reviewed plus those employed by state-owned banks. The number would increase if all SOEs were included. Please note that employment numbers include only employees based in Slovenia (number estimated by approximation where granular data are not available). Public sector employment includes employees in the government administration, health and education sector. Private sector employees are calculated as a residual.

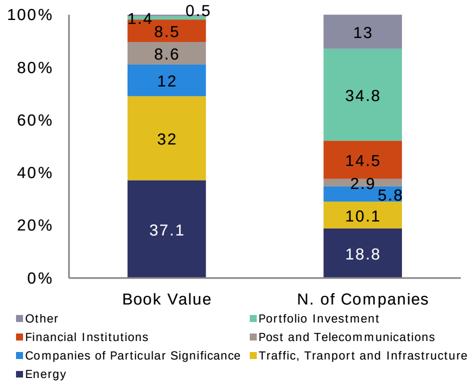
Several SOEs are accumulating losses and losing equity value, partially due to the current downturn...

Graph 1: Book value and net sales revenue of the total RS portfolio, 2011 (EUR m)



Source: AUKN Report 2011
Note:The RS portfolio includes only direct ownership and approximately 76 companies.

Graph 2: Book value and number of SOEs by sector, 2011 (% of total)



Source: AUKN Report 2011
Note: The RS portfolio includes only direct ownership and approximately 76 companies.

The Financial Performance of SOEs

Table 1: SOEs consolidated with GGA (FY 2011, in EUR m)

Company	Sector	State ownership	Total Assets	Total Equity	Turnover	EBITDA	EBITDA margin	Net profit after tax	ROE	Gross Debt	Net Debt (less cash)	Net Debt Leverage (x EBITDA)	Equity/ (Equity +Debt)	Employees	Score
KAD	Pension fund	100%	1320	523	127	-124	-98%	-129	-23%	528	498	na	51%	58	1
DSU	State fund	100%	141	59	6	3	54%	0	1%	65	64	20.8x	48%	23	2
Railway Holding	TRAN	100%	650	171	396	43	11%	-15	-6%	394	385	9.0x	31%	8797	1
SOD	Restitution fund	100%	1265	128	218	na	na	na	na	962	955	na	12%	54	2

Table 2: SOEs outside GGA (FY 2011, in EUR m)

Company	Sector	State ownership	Total Assets	Total Equity	Turnover	EBITDA	EBITDA margin	Net profit after tax	ROE	Gross Debt	Net Debt (less cash)	Net Debt Leverage (x EBITDA)	Equity/ (Equity +Debt)	Employees	Score
Elektro Ljubljana Group	ENER	82%	515	269	449	39	9%	7	2%	123	114	2.9x	70%	964	5
Elektro Gorenjska Group	ENER	85%	202	136	83	14	16%	2	1%	37	34	2.5x	80%	333	4
HSE Group	ENER	100%	2276	1409	1320	190	14%	70	5%	493	426	2.2x	77%	3815	5
Elektro Primorska Group	ENER	82%	214	135	125	15	12%	1	1%	32	31	2.0x	82%	489	4
Elektro Maribor Group	ENER	83%	344	234	175	26	15%	5	2%	43	35	1.4x	87%	817	5
ELES Group	ENER	100%	699	457	392	40	10%	-3	-1%	110	78	2.0x	85%	533	3
Elektro Celje Group	ENER	81%	268	181	139	26	18%	7	4%	37	36	1.4x	83%	683	5
Geoplin Group	ENER	54%	432	288	401	44	11%	19	7%	50	44	1.0x	87%	187	5
GEN-I Group	ENER	69%	219	49	1012	20	2%	14	43%	15	-6	0.0x	113%	109	5
NEK	ENER	50%	513	440	198	73	37%	0	0%	32	32	0.4x	93%	623	4
GEN Energija Group	ENER	100%	720	529	559	75	13%	21	4%	23	13	0.2x	98%	282	5
SODO	ENER	100%	88	4	341	3	1%	2	32%	0	0	0.0x	103%	26	4
Adria Airways	TRAN	96%	96	22	150	-7	-4%	-12	-54%	45	44	na	34%	450	1
Adria Airways Tehnika	TRAN	100%	17	5	23	-1	-3%	-4	-86%	5	5	na	52%	229	1
DARS	TRAN	100%	5529	2427	311	261	84%	25	1%	2954	2952	11.3x	45%	1249	2
Luka Koper Group	TRAN	72%	478	241	144	50	35%	0	0%	206	205	4.1x	54%	1020	2
Aerodrom Ljubljana	TRAN	72%	129	123	33	14	43%	5	4%	0	0	0.0x	100%	410	5
DRI	TRAN	100%	24	19	19	2	12%	2	9%	0	-1	0.0x	103%	289	5
PDP	CF	100%	37	27	0	-1	na	-17	-62%	10	10	na	74%	7	1
Javni Holding Ljubljana	CF	100%	532	378	238	30	13%	8	2%	34	27	0.9x	93%	2516	5
Telekom Slovenije Group	COMM	75%	1575	815	815	263	32%	34	4%	488	427	1.6x	66%	3597	5
Posta Slovenije	COMM	100%	301	250	238	38	16%	9	4%	0	-2	0.0x	101%	6534	5
Nafta Lendava Group	PI	100%	46	10	49	-1	-2%	-5	-45%	33	31	na	25%	396	1
Sava Group	PI	31%	611	166	194	20	10%	-157	-49%	371	361	18.2x	31%	2135	1
Pivovarna Lasko Group	PI	40%	570	125	323	29	9%	-28	-5%	389	367	12.5x	25%	1820	1
Unior Group	PI	58%	376	147	226	23	10%	0	0%	161	157	7.0x	48%	3018	2
Mercator Group	PI	31%	2648	789	2928	177	6%	24	3%	1185	1157	6.5x	41%	12034	2
Petrol Group	PI	38%	1537	442	3270	116	4%	52	12%	612	551	4.8x	44%	3761	2
Talum Group	PI	87%	206	108	261	1	0%	-7	-7%	44	40	37.2x	73%	997	1
Paloma Group	PI	71%	52	8	87	5	6%	-1	-6%	20	20	3.8x	30%	820	3
Elan Group	PI	100%	124	49	90	9	9%	-1	-3%	40	35	4.2x	58%	586	1
Cimos Group	PI	34%	749	139	456	67	15%	3	3%	409	401	6.0x	26%	3515	2
Hit Group	PI	60%	305	105	190	32	17%	-6	-5%	160	139	4.4x	43%	2015	1
Helios Group	PI	34%	367	200	338	22	6%	1	1%	119	97	4.5x	67%	1319	2
Intereuropa Group	PI	51%	407	141	212	23	11%	-5	-5%	203	185	8.2x	43%	908	1
Krka Group	PI	28%	1534	1140	1076	301	28%	163	15%	70	49	0.2x	96%	4603	5
Iskra Avtoelektrika Group	PI	43%	175	43	245	20	8%	6	15%	68	66	3.3x	39%	1555	5
Istrabenz Group	PI	32%	377	13	145	15	11%	-25	na	335	323	21.2x	4%	1108	1
Loterija Slovenije	PI	40%	49	29	104	6	6%	5	16%	2	-8	0.0x	137%	62	5

Flagging score (from worst to less worrying)
1. Negative territory (high leverage over 4x + negative EBITDA and/ or Net profit)
2. High leverage (over 4x)
3. Negative Net profit and ROE
4. Low earnings and ROE below 1%
5. No major issues identified.

Sectors:
(i) ENER - Energy
(ii) TRAN - Traffic, Transport and Infrastructure
(iii) CF - Capital Funds, Business Special Significance
(iv) COMM - Post and Telecommunications
(v) FIG - Financial and Insurance Groups
(vi) PI - Portfolio Investments

Notes: (i) Flagging scores are used to allow for a simple overview of the financial performance of SOEs and to identify potential risks. Scores range from 1 (worst performers) to 5 (no issues identified) according to net debt leverage and profitability. Companies with a score of 1 report net losses and high levels of debt when compared against cash flows. Some of these not only have a negative net profit but also a negative operating profit (EBITDA), indicating potential difficulties in covering debt obligations.
(ii) Note that only EUR 50 m of KAD's financial obligations are classified as bank debt, while most of the remaining debt is classified as other long-term financial obligations related to pension transfers. Net profits reported are from continuing operations. Employment numbers include employees in Slovenia only, where data are available.
(iii) Eight of the SOEs in the above table are on the list of 15 companies adopted by the government for privatisation in April 2013: Adria Airways, Adria Tehnika, Aerodrom Ljubljana, Elan, Helios, Paloma, Telekom Slovenije, Unior.
Source: AUKN Report 2011, Annual company reports for 2011, AJPES, Finance Top 101, own calculations.

The most recent aggregated financial report by AUKN (2011) shows a sluggish improvement in financial performance (Graph 1). However, many of the SOEs reviewed, including the state-owned funds consolidated with the GGA, are still accumulating losses and losing equity value, thereby posing fiscal and macroeconomic risks. In 2011, EUR 415.4 m (1.1% of GDP) of total net losses were generated (Table 3), one third of which was by companies consolidated with the GGA. This amount increases to EUR 924.8 m (2.5% of GDP) if the three largest state-owned banking groups (NLB, NKBM and Abanka) are also included.

...but also due to their debt-burdened capital structures and sub-optimal corporate governance...

Table 3: Summary of SOEs' financial performance, (FY 2011, in EUR m)

	Total Losses	Total Profits	Gross Debt	Employees
TOTAL (Table 1, 2 & Insurance)	**-415.4**	**545.2**	**10905.1**	**81079**
as % of GDP (Total Empl)	*1.1%*	*1.5%*	*30.1%*	*10.0%*
TOTAL INSIDE GG (Table 1)	-144.7	0.3	1948.9	8952
as % of GDP (Total Empl)	*0.4%*	*0.0%*	*5.4%*	*1.1%*
TOTAL OUTSIDE GG (Table 2 & Insurance)	-270.7	544.9	8956.1	72127
as % of GDP (Total Empl)	*0.7%*	*1.5%*	*24.7%*	*8.8%*
Companies with score 1 & 2	**-411.7**	**106.2**	**9228.8**	**44789**
as % of GDP (Total Empl)	***1.1%***	***0.3%***	***25.5%***	***5.5%***

Notes: (i) Debt of banks and insurance companies is not included in the summary table due to differences in business models. Total net losses (net profits) is the sum of losses (profits) of all loss (profit) making SOEs. Employment numbers include employees in Slovenia only from the 46 SOEs reviewed, where data are available, excluding those employed by state-owned banks.
(ii) See notes of Table 2 for more information on flagging scores and methodology used.
Source: AUKN Report 2011, Annual company reports for 2011, AJPES, Finance Top 101, own calculations.

Half of the SOEs reviewed, both inside and outside the GGA, have net debt leverage of at least four times their operating earnings (EBITDA). About a quarter report net debt over 1% of GDP each (Tables 1 and 2). The companies reporting low or negative EBITDA together with leverage of more than four times represent the highest credit risk. They remain the most vulnerable in terms of cash flow and working capital stability, solvency and capital adequacy, in the context of a prolonged adverse economic scenario. In addition, most of the SOEs report negative or low net profit and return on equity, which could be the result of a squeeze in profit margins in the relevant industry due to the economic crisis, inefficient management of the underlying businesses, or debt-burdened capital structures (i.e. high interest expenses). Although, companies in the private sector may face similar issues, their impact on public finances would not be as direct as in the case of SOEs.

...which increase recapitalisation needs and solvency risks in the trough of the economic cycle.

Some of the companies in the energy, pharmaceutical and entertainment (e.g. lottery) sectors report better financial performances, although this may reflect profits from higher rents due to market structure (e.g. natural monopoly or regulated industry) rather than good economic performance per se. The profitability of the restitution fund SOD (EUR 115 m net profit) was mainly due to EUR 180 m of one-off items.[4]

Impact on Public Finances

Direct recapitalisations, called-in state guarantees and other public capital transfers to loss-making SOEs contributed 1.4 pps to a general government deficit of 6.4% of GDP in 2011 (Table 4 and Graph 3). Half of this amount is attributable to the recapitalisation of NLB, the largest, state-owned banking group in Slovenia. The remainder was distributed to other loss-making SOEs. Some of the recapitalisations were carried out through KAD and SOD, which were in turn recapitalised by the state.

Capital transfers to SOEs contributed 1.4 pps of GDP to the budget deficit in 2011...

Deficit-increasing recapitalisation needs were lower in 2012 but might increase once again in 2013 (Table 4 and Graph 3). In 2012, the government reported one direct capital injection for the second NLB recapitalisation and additional called-in state guarantees, while NKBM's recapitalisation was not recognised as a capital transfer (see Box 1). Most of the expected deficit-increasing transfers in 2013 are related to NLB and its EUR 320 m contingent convertible (CoCo) bond subscribed by the government, which was triggered in

[4] SOD explained the profit in 2011 by c. EUR 180 m one-off reimbursement by the state following changes in the legislation reported as revenue. The one-off reimbursement included parts of the restitution compensations that SOD was paying to the government annually in the past decade (2001-2010).

February 2013.[5] In addition, NKBM's EUR 100m hybrid instrument, subscribed by the government in the absence of immediate private interest, was also triggered in early 2013.

...with a lower contribution to the deficit in 2012...

Table 4: SOE recapitalisations and other capital transfers, 2011-2013

Company name	Transfers (EUR mn) 2011	2012	2013*	Type of Transfer (2011/ 2012/ 2013)
NLB	243	63	*320*	State Recap/ State Recap/ NLB CoCo
NKBM	104	65	*100*	Recap/ Sale of Subsidiary/ NKBM Hybrid Loan
Adria Airways	49	-	-	State Recap
Slovenian Railway holding	119	-	-	Recognition of Slovenian Railways claims to RS
KAD	90	-	-	State Recap (not deficit-increasing)
SOD	60	-	*20*	State Recap (not deficit-increasing)
Other	79	24	*28*	Called state guarantees
Total	**693**	**152**	***468***	
Total as a % of GDP	**1.9%**	**0.4%**	***1.3%***	
Total deficit increasing	**490**	**87**	***448***	
Total deficit increasing as a % of GDP	**1.4%**	**0.2%**	***1.3%***	

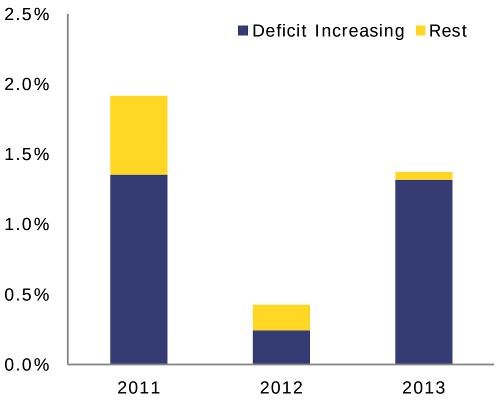
Source: Oct 2012 EDP tables and Ministry of Finance.
** Final decision on fiscal treatment subject to Eurostat decision. Please see end-note 10 for more details.*

...but with further risks in 2013 and beyond to come from continuing losses of SOEs and recapitalisation needs, especially of the banking sector.

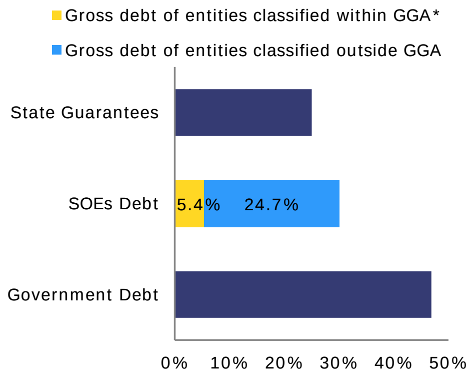
Box 1: Indirect public recapitalisations of banks and impact of cross-ownership

In 2011, NKBM, the second largest banking group in Slovenia, raised EUR 104.3 m by means of a public offering. The state participated indirectly by transferring its pre-emptive rights to acquire new share in the bank to three fully state-owned SOEs. In their capacity of pre-emptive right holders, those three SOEs acquired new shares in NKBM in proportion to the state's participation at the time, i.e. just enough to avoid diluting the overall state ownership below the initial 51%. In 2012, one of those companies, Posta Slovenije, which as of end 2012 held a 6.6% stake in NKBM as a result of the above transaction, is expected to incur EUR 5 m in impairments due to the devaluation of NKBM shares. This compounds the financial pressure for the main universal service provider in the postal sector. In 2012, as described in Box 3 of European Commission (2013), NKBM succeeded in improving its capital basis by EUR 65 m through the sale of its insurance subsidiary to an SOE. Together with the 2013 hybrid loan of EUR 100 m, this brings state involvement for the past three years to around EUR 218 m[6].

Graph 3: SOE recapitalisations and other capital transfers, 2011-2013, as % of GDP



Graph 4: Total debt of all 46 SOEs reviewed, 2011, as % of GDP



Total debt of SOEs is at least 30% of GDP, with 5.4 pps attributable to SOEs consolidated with the General Government Accounts...

Source: October 2012 EDP tables, Government Accounts, Ministry of Finance, news releases (Table 4); AUKN Report 2011, Annual company reports for 2011, ECFIN Winter Forecast 2013, own calculations (Tables 1, 2 and 3).

...and contingent liabilities of 25% of GDP...

Further risks for the public deficit may come from continuing losses in vulnerable SOEs and banks, which, in the absence of an improved economic outlook and necessary restructuring, would reduce further their equity and might require fresh injections from the

[5] The NLB CoCo was purchased by the state in 2012 in the absence of immediate private interest and it was triggered in February 2013.

[6] The EUR 218 m state involvement is the sum of the hybrid loan conversion (EUR 100 m), the proceeds from the sale of the insurance subsidiaries (EUR 65 m) and 51% of the capital raised in the public offering (i.e. EUR 53 m), as the remainder was purchased by private investors.

state.[7] The Stability of Banks Act foresees up to EUR 1bn for direct bank recapitalisations following impaired assets transfers from banks' balance sheets to the Bank Asset Management Company (BAMC).[8]

...with the planned BAMC bonds related to the transfer of non-performing loans from bank balance sheets posing further risks to the state budget.

The total debt of SOEs is at least 30% of GDP, with a majority of this (25.5 pps) concentrated in companies with over four times debt leverage, which are also making losses or turning very low profits (Scores 1 and 2, Table 3). SOEs consolidated with the GGA have debt equivalent to 5.4% of GDP compared with the total government debt of 46.9% in 2011 (Graph 4). The debt of SOEs outside the GGA is 24.7% of GDP, with infrastructure company DARS (8.1%), Mercator (3.3%) and Petrol (1.7%) being the three largest contributors. The BAMC is expected to increase government debt further by up to 11% of GDP (EUR 4 bn)[9].

In addition, SOEs are the main recipients of state guarantees. The corresponding contingent liabilities are equivalent to 25% of GDP and are among the highest in the EU.[10] Some of the main beneficiaries are DARS (8.1% of GDP), SID bank (3.6%) and SOD (1.3%).

Cross-Ownership of SOEs and the Financial Sector

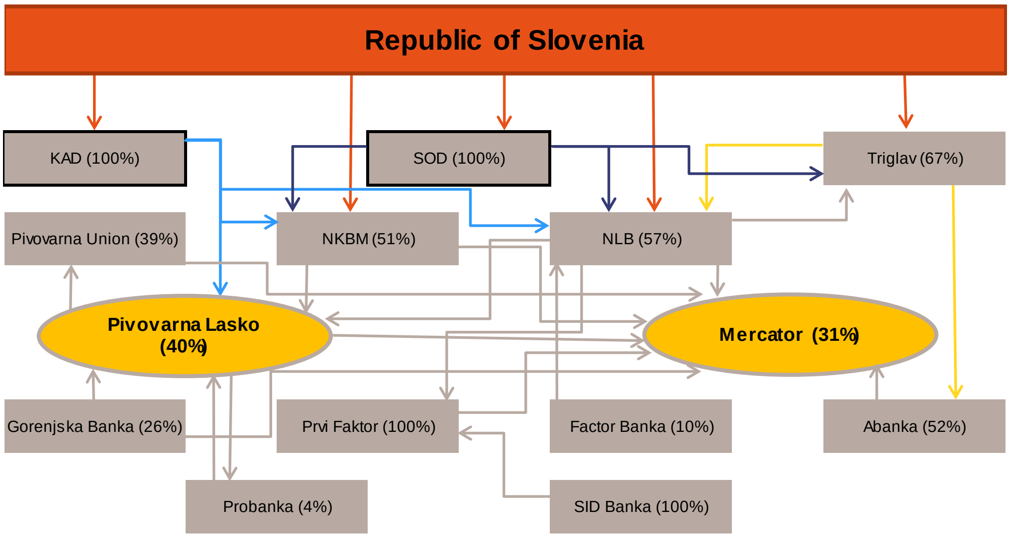
Inter-linkages of financially troubled SOEs and debt-burdened state banks amplify risks...

The cross-ownership of SOEs in the non-financial sectors and state-owned financial institutions amplifies the fiscal risks and hinders economic adjustment. State ownership encompasses a complex matrix of banks, insurance groups and non-financial corporations, which own each other (see Graph 5). Some of these face financial difficulties and ultimately rely for capital on the government or the state-owned funds.

...and this can be traced back to privatisation during the transition period...

The origin of these inter-linkages can be traced back to Slovenia´s transition from planned to market economy. Privatisation was gradual and allowed for both paid and non-equivalent (i.e. voucher-based) privatisation (Simoneti, 2001). Each citizen was granted vouchers that could be exchanged for shares in companies or in authorised investment funds according to the envisaged final split stipulated in the Ownership Transformation Act[11] (Table 5). However, the overall bias in favour of insider control, which could be explained by the business culture existing at the time, left ownership in the hands of fragmented but collectively powerful insiders or under state dominance, with few incentives to improve profitability and restructure companies.

Graph 5: SOEs ownership structure (%) –Pivovarna Lasko and Mercator



Source: AUKN Report 2011, Annual company reports for 2011, own calculations.
See Graph 30 in European Commission (2013) for a similar chart for Intereuropa.

[7] Additional expected recaps of SOEs and banks were not included in the table and the graph. These are normally deficit-increasing one-off capital transfers, with the final decision thereon being taken by Eurostat twice a year (March and October).

[8] As stipulated in the adopted Act on Bank Stability, the BAMC could receive impaired assets from banks of up to EUR 4 bn (to be replaced by government guaranteed bonds), which implies recognising capital losses in banks upfront and recaps by the state of up to EUR 1 bn.

[9] The BAMC is expected to be classified as part of the GGA, in the absence of interest from private investors. However, treatment is subject to Eurostat's final decision.

[10] See Eurostat (2011). Data refer to the guarantees given by the central government only and do not include guaranteed interests.

[11] The Act stipulating the regulation and rules according to which the privatisation was implemented during the transition in the 1990s.

...,which resulted in the dominance of highly fragmented but collectively-powerful internal owners with no incentives to restructure financially-troubled companies...

Table 5: Split of privatisation shares in Slovenia according to the Ownership Transformation Act

Entity entitled to receive shares	Share to be received (% of total)	Way of transfer	Reasoning
KAD	10%	Free transfer	KAD and SOD were initially envisaged as portfolio investors which would use profits on investments to fund pensions and other state liabilities in relation to the restitution process under the Denationalisation Act.
SOD	10%		
Privately managed privatisation funds	20%	In exchange for vouchers purchased from citizens	Created with the intention to offset influence of insiders and to monitor management performance as an external shareholder.
Internal owners	20%	In exchange for vouchers	To give priority to employees and management to acquire shares in the company they work for at favourable conditions.
Optional	40%	Sell/ in exchange for vouchers	The use of the remaining 40% was optional: for buy-outs by internal owners, in exchange for vouchers by the public or the private investment funds, or for sell to strategic investors.

Source: Simoneti, 2001

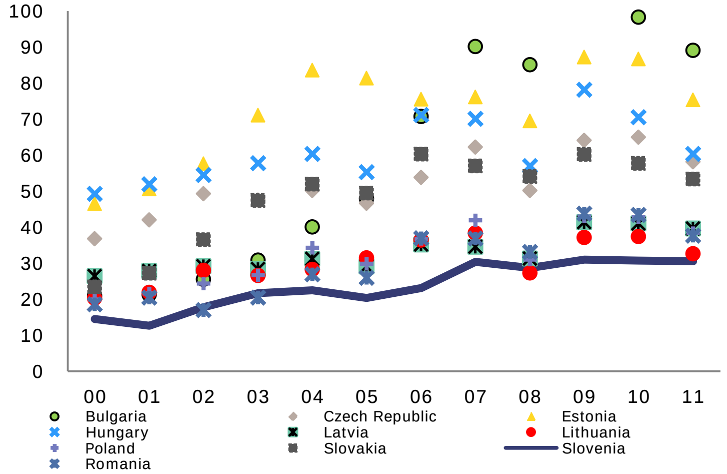
A second privatisation wave was initiated to consolidate ownership interest and increase the share of strategic investors. However, given the dominance of internal owners and the state, the emphasis was on management buy-outs, supported by a high level of debt provided by state-owned banks, and on distributing the remaining shares to state-owned funds. KAD and SOD, initially envisaged as portfolio investors, have consolidated their ownership stakes in large companies. Thus, neither the first nor the second wave of privatisation attracted enough strategic investors or foreign participation to allow for the restructuring of financially-troubled companies during the transition (Simoneti, 2001).

...,who later on consolidated their shares using debt or sold them to state and quasi-state funds...

Consequently, Slovenia is among those transition economies that have received less FDI than might be expected based on economic fundamentals.[12] Inward FDI stock remains by far the lowest among all EU10 Member States (Graph 6). Slovenia is considerably behind its peers in large-scale privatisations, corporate governance and privatisation of the banking sector (EBRD, 2012).[13] Extensive state ownership also hindered the development of an effective corporate governance regime, which in turn led to low profitability and financial vulnerability during the crisis. The European Commission pre-accession reports on Slovenia already highlighted the role of these features in hindering development, competition and FDI inflows (European Commission, 2000).[14] These issues remain valid and continue to keep private investment and FDI at a low level in the Slovenian economy (see Box 3 in European Commission, 2013).

...keeping participation of strategic investors and FDI at a low level in the Slovenian economy...

Graph 6: Net FDI stock in EU10 countries (% of GDP)



Source: United Nations (2012)

...and distorting the normal allocative function of capital markets.

Some of these companies emerged weaker from the economic crisis and became a burden for the banking sector. Debt-to-equity swaps of SOEs' defaulted obligations strengthen the negative fiscal feedback loops between the banking sector and the sovereign further, and amplify the risk of contagion through the state-bank-corporate nexus. Furthermore, cross-

[12] Comparing the FDI Attraction Index with the FDI Potential Index, Slovenia scores "below expectations", UNCTAD 2012.

[13] Comparative analysis with peers has been carried out on the basis of EBRD transition and structural indicators. Comparisons are based on Slovenia's average position during the transition period and its position according to latest data (2012). Slovenia was compared against the average of three groups of CEE countries: (i) Eight EU Member States from the CEE region and Croatia, (ii) Six EU Member States which entered the EU in 2004 and (iii) the two euro-area members from the region.

[14] See European Commission (2000), pps. 58 and 81, European Commission (2003), pps. 5-9 and 59, and Lindstrom and Piroska (2004), p. 6.

ownership, cross-subsidies and cross-recapitalisation of SOEs and state-owned banks, together with state influence and sub-optimal corporate governance soften budget constraints and distort the normal allocative function of capital and labour markets.

Conclusions

- *Complex cross-ownership amplifies fiscal risks linked to SOEs.*

Complex cross-ownership of financial institutions and corporates amplifies fiscal risks. Several SOEs, both inside and outside the general government, have been accumulating losses and losing equity value, and could face solvency risks if the economic downturn continues, but also as a result of their debt burdened capital structures, cash constraints and low profitability. Their total debt amounts to almost a third of Slovenian GDP, with approximately 5 pps of this concentrated in SOEs consolidated with the GGA. Recapitalisations and other liabilities of SOEs in 2011 added close to 1.4% of GDP (c. EUR 0.5 bn) to the government budget.

- *Successful implementation of a privatisation strategy, restructuring of non-performing companies, and improvement in corporate governance and profitability are crucial for the Slovenian economy.*

Major fiscal risks linked to further state recapitalisations and government guaranteed debt of SOEs need to be addressed and minimised, given subdued economic performance and delayed restructuring. At the same time, improving corporate governance and profitability, restructuring indebted companies, and reducing the state's participation, particularly in the financial sector, are essential for restoring growth potential and underpinning Slovenia's credibility in financial markets. The government has already committed to producing a comprehensive and long-term strategy for the management of state-owned assets by Q3 2013, and implementation of this would be crucial.

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