UDK: 346.245:364.664(497.11)
UDK: 338.246(497.11)
DOI: 10.2478/jcbtp-2020-0003

Journal of Central Banking Theory and Practice, 2020, 1, pp. 45-59
Received: 29 September 2019; accepted: 14 November 2019

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Financial Borrowing by Local State-Owned Enterprises in Serbia: An Assessment of National Practice

Abstract: Serbian local state-owned enterprises (SOEs) owed in excess of EUR 220mn in late 2015, with estimates reaching a much higher figure. According to the national Fiscal Council, underinvestment by local governments amounted to some EUR 250mn annually. This paper looks at insufficient commercial borrowing by local SOEs trying to identify the causes of this financing gap by looking at two aspects: on one hand, we look at quantitative and qualitative inputs provided by local SOEs for credit analysis that may cause significant information asymmetries, and, on the other, we consider the possibility that bank credit analyses, even if done properly, could reveal that these firms are unable to borrow from banks.

The research has revealed that the length and efficiency of the bank credit approval process is dictated by: the need to properly organise qualitative and quantitative SOE information and ensure that it reflects the actual state of affairs; the poor quality of financial statements of SOEs and their pro forma annual business planning and reporting; a common lack of appropriate revaluation of future income; and an existent drawback related to ownership over fixed assets that are considered as a public property in Serbia (rather than as a property of the SOE that uses them).

On the other hand, banks do not distinguish sufficiently between private firms and SOEs. This does not allow banks to account for issues specific to SOEs such as the spillover of fiscal risk, corporate governance, relationships between the owner and its SOEs, economic and social objectives, and the like. The frequent inability of local SOEs to provide mortgages as collateral, coupled with the restriction on guarantees from local governments, nearly completely preclude lending for large-scale and long-term investment.

We conclude that local SOEs have a limited access to finance due to information asymmetries caused by unsuitable qualitative and quantitative inputs made by SOEs in the credit analysis process. Nevertheless, appropriate credit analyses reveal that these companies can be able to borrow commercially, especially in lower amounts and at shorter maturities which could mitigate underinvestment by local SOEs.

Key words: local SOEs, SOE credit analysis, entities connected with SOEs, collateralisation of lending to SOEs

JEL classification: H74, H81, L32

Introduction

According to the June 2017 analysis of the Fiscal Council of the Republic of Serbia, debts owed by local state-owned enterprises (SOEs) exceeded EUR 200mn, whilst aggregate debt of local governments (LGs) and their SOEs stood at nearly a billion euros (Fiskalni savet Republike Srbije, 2017). The Council felt that the current legislative and institutional framework was insufficiently transparent and did not permit a clear understanding or allocation of local SOEs' debts. As such, it could be claimed with certainty that some LG debt was, in fact, SOE debt. Local debt has also been growing rapidly, while borrowing is mainly used to meet current expenditure requirements. The Fiscal Council estimated the unmet need for investment at some EUR 250mn annually threatening to quantity and quality of basic communal services (Fiskalni savet Republike Srbije, 2017). On a long run, this will further enable deindustrialisation which is ongoing in the entire region (please see Tomljanović et al, 2019 for the case of the Republic of Croatia).

The practice of SOE financing in Serbia goes against findings and recommendations produced by the OECD following an assessment of how SOEs are financed in 22 countries (OECD, 2014). This study clearly suggests that best practice requires allowing public authorities to inject capital into these firms only if private investors in like circumstances would have acted similarly.

Serbian local SOEs (except those in four large cities, namely Belgrade, Niš, Novi Sad, and Kragujevac) have limited access to long-term finance. The market for municipal bonds is underdeveloped, and at any rate many local SOEs would not even meet the requirements for issuing these bonds. Cities and municipalities face their own financial difficulties and are therefore under substantial pressure to introduce hard budget ceilings and minimise subsidies. Finally, commercial banks are highly reluctant to lend to local SOEs. These difficulties are compounded by LGs setting pricing policies or insisting on unofficial debt relief for groups of socially vulnerable service users that jeopardise local SOEs' liquidity. To ad-

dress these issues, LGs often find more or less transparent means of subsidising SOEs, so becoming drawn ever more deeply into a vicious circle of opaque financial statements and reducing SOEs' chances of taking on commercial debt.

This paper attempts to shed light on the national practice in financing local SOEs through commercial loans. It endeavours to answer two research questions:

(1) Whether limited access to finance by local SOEs was the result of information asymmetries, in themselves caused by the insufficiently comprehensive and reliable inputs provided by SOEs in the credit analysis process, or

(2) Whether credit analysis, when appropriately performed, would find these businesses unable to borrow commercially.

The paper will first provide a review of the relevant literature, and then present the detailed methodological approach, analysis, and conclusions of the key considerations pertaining to credit analysis for local SOEs in Serbia. Finally, the paper will present conclusions in respect of the research questions.

Review of literature

In the following section, we will review the relevant literature in an attempt to shed light on the multitude of issues that affect SOE financing decisions, lessons learned by various types of lenders, credit analysis, and borrowing by SOEs. There is, however, a limited body of research dealing with these matters, in particular for commercial borrowing by SOEs.

As for **SOE financing decisions**, the 2014 OECD report referred to above provides an overview of best practices identified in 22 countries. According to the findings, in most countries the responsibility for identifying an optimal capital structure rests with SOE boards and managements, whilst the owners exercise various degrees of control over these decisions (from limited supervision to direct audit and approval of borrowing). Direct state support is not seen as negative in and of itself: it is justified when it covers the cost of meeting public service obligations required by the SOE's owner. Yet the report also highlights the challenge of appropriately calibrating this support, especially if commercial activities are not structurally separated from those that pertain to public policy and public interest (OECD, 2014).

SOEs are **most commonly financed** through loans from banks, international financial institutions, subsidies, grants, and, less frequently, by issuing securities.

This paper will focus on analysing conclusions and lessons learned with regard to SOE financing through loans extended by banks and IFIs.

Operating inefficiencies, accumulated debts, and excessive dependence on political factors and subsidies constrain access by SOEs to market finance. As a rule, **banks** avoid lending to SOEs at favourable terms (e.g. lower interest rates, grace periods, longer maturities, etc.) without first securing state guarantees, because banking regulations in most jurisdictions consider such loans highly risky (Prga, 2003).

International financial institutions (IFI) frequently lend to SOEs, especially in countries in transition and emerging markets, where their activities are twofold: (1) providing direct finance for infrastructure projects, and (2) financing structural reforms of SOEs that ought to facilitate these firms' access to market finance. The first approach entails financing large-scale infrastructure projects undertaken by SOEs. The European Bank for Reconstruction and Development (EBRD) is a typical example of an institution offering such financing. The second type of intervention is mostly intended to introduce structural reforms and corporatisation of governance and operations of SOEs that will allow access finance extended by commercial banks on substantially more favourable terms (World Bank, 1989). The World Bank (WB) is a typical example of an IFI most commonly focused on structural reforms.

Lessons learned from direct financing of infrastructure projects can contribute to answering our research questions. Here, the EBRD has gained considerable experience in SOE financing through its involvement from 2000 to 2013 in the reform and privatisation of SOEs in Eastern Europe, the Western Balkans, and the Commonwealth of Independent States. In a study of its experiences with 13 beneficiaries across nine different countries, the EBRD (2016) found that the creditor has to make loan approval conditional on altering how the SOE operates, for instance with regard to its corporate governance, and making certain that these changes cannot be rolled back later on. Experiences of other IFIs highlight the need to implement a phased and programmatic approach to support SOE reforms, the importance of enhanced governance and management practices, and an improved legal and regulatory environment that replicates as far as possible private sector commercial discipline in SOEs (ADB, 2017).

Some IFIs, such as the Inter-American Development Bank (IDB), believe in the importance of focusing on addressing **credit analysis issues**. The IDB notes the shortage of publicly available operating and financial performance data for SOEs (Ter-Minassian, 2017). In many cases, statutory disclosure requirements for fi-

nancial statements mean these businesses endeavour to meet the formal conditions without attempting to effectively improve the quality of the data they disclose. A review of statements published by Latin American SOEs found: (1) non-compliance with international standards for corporate accounts (IFRs); (2) limited degree of detail; (3) low or irregular frequency of publication; (4) lack of qualified external audit; and (5) lack of standardised, timely and reliable indicators of operational performance (KPIs), namely indicators of quality of the enterprises' outputs, coverage of their services, consumer satisfaction, as well as of efficiency of operations. (Ter-Minassian, 2017: 13).

International studies bear out the lack of transparency that affects the **quality of credit analysis** closer to Serbia, such as in Czechia, Slovakia, Hungary, and Poland. A study of 36 local SOEs across the four countries of the Visegrád Group found that transparency is high exclusively for information required to be disclosed by law (ownership structure, economic indicators, and public procurement information) (Kohoutková et al., 2017). Findings of regional studies that examined the operation and financing of (local) SOEs in the region and the former Yugoslavia do not differ greatly from the conclusions reached by IFIs. Papers by Bajo (2007) and Pendovska and Maksimovska-Veljanovski (2009), highlight the poor efficiency of local SOEs, political influence of local officials on the appointment of their managers, social pricing regulated at the level of general government (whereby these prices do not cover the actual cost incurred in providing services), and the limitations inherent in local SOEs' financial statements and operating reports, and, consequently, their opacity.

Studies have also revealed that the special relationship between SOEs and their owners directly impacts both credit analysis and borrowing by less creditworthy enterprises. For instance, Čulo (2011) examined a stratified sample of 20 Croatian SOEs of special public interest using standard creditworthiness assessment indicators and found 40 percent of them to be noncreditworthy, whilst 35 percent were overindebted: taken together, 75 percent of the firms examined faced indebtedness issues. Notwithstanding these problems, Croatian practice has found that overindebted SOEs have continued to borrow by drawing heavily on state guarantees as collateral.

This practice directly increases fiscal risk faced by the owners, which in most cases remains unmeasured, as creditors in practice view owners (either the central or the local government) as clients that pose no credit risk. The risk arising from the SOEs can contribute to the financial instability which depends on government's financial position or, more precisely, on market participants' perception of its prudency (Dumičić, 2018). Ter-Minassian (2017) concludes that, to minimise fiscal

risks, it is essential that the SOEs' access to financing be contained within limits consistent with their debt servicing capacity, in both the short and the long term.

This review of literature will also comment on the **specific features of the Serbian regulatory framework that affects lending to SOEs**. Under the Public Debt Law (Službeni glasnik Republike Srbije, br. 61/05, 107/09, 78/11, 68/15 i 95/18), SOEs cannot issue guarantees to any legal entities, including those they own. This piece of legislation stipulates that the state can issue a guarantee, in the form of a law, for debt incurred by local authorities and legal entities owned by the Republic of Serbia: as such, it follows that the law does not permit guarantees for borrowing by local SOEs. The law does not set out any conditions for borrowing by local SOEs or ways in which they may take on debt. Public Enterprises Law (Službeni glasnik Republike Srbije, br. 15/16) stipulates that the articles of association of an SOE must include conditions under which that enterprise can borrow. Consequently, the legal framework for borrowing by local SOEs is not strictly regulated, and the legislator has allowed the entity setting up an SOE to use its articles of association to set out how the SOE can take on debt.

Methodology and analysis

We sought to answer a two-fold research question: (1) whether limited access to finance by local SOEs was the result of information asymmetries, in themselves caused by the insufficiently comprehensive and reliable inputs provided by SOEs in the credit analysis process, and (2) whether credit analysis, when appropriately performed, would find these businesses unable to borrow commercially. As such, the assessment was carried out across two segments. Firstly, desk research and a series of interviews were conducted on a representative sample of five LGs in Serbia and their SOEs to analyse a set of financial and non-financial indicators available to banks in the course of credit analysis. Secondly, bankers were interviewed to identify aspects of the credit analysis process specifically applicable when lending to local SOEs.

No detailed or comparative data are available for borrowing by local SOEs in Serbia. The general database maintained by the Business Registers Agency shows neither the amounts nor purposes of individual loans, nor non-financial information needed for credit analysis (or for assessing information asymmetries in credit analysis). We therefore created a sample of five LGs (Sremska Mitrovica, Vranje, Paraćin, Knjaževac, and Osečina). These are two cities and three municipalities that constitute a representative sample also utilised for an official PEFA assessment

of the local level of governance in Serbia.[1] Detailed information for these LGs is given in Table 1 below. The research covered 19 local SOEs as per table below.

Table 1. LGs sample: Background

Local government	Type	No. of SOEs	Population	Region	Total expenditure planned in 2014 budget (RSD)	Per capita expenditure (RSD)
Sremska Mitrovica	City	4	85,902	Northern Serbia – Vojvodina	2,679,916,000	31,197
Vranje	City	6	85,802	Southern Serbia	2,181,130,000	25,421
Paraćin	Municipality	4	58,301	Central Serbia	1,502,977,256	25,780
Knjaževac	Municipality	4	37,172	Eastern Serbia	888,000,000	23,889
Osečina	Municipality	1	12,571	Western Serbia	338,479,000	26,925

Source: Public Financial Management Performance Measurement Report Serbia Municipalities, available online at *www.pefa.org*, supplemented by research findings

Desk research

The desk research involved a detailed review of articles of association of the sampled SOEs, their financial statements for the last three years, annual plans covering the same period, quarterly and annual reports required of SOEs by their parent LGs and reports required of LGs by the Ministry of Economy (MoE) under the Public Enterprises Law, as well as external auditors' opinions.

A detailed review found that most SOEs from our sample (18 of the 19) had **articles of incorporation** that formally complied with Article 6 of the Public Enterprises Law, which mandates that the articles should **regulate how the SOE can take on debt**. All SOEs had similarly worded provisions, which permitted the firms to raise finance from loans, grants and donations, budgets of their (local) owners and the central and provincial budget, and any other sources allowed by law; they also required local legislatures to approve any SOE borrowing. Four sets of articles of association included provisions whereby decisions on taking out credits or loans for liquidity purposes had to be made by the SOE's board and approved by the local legislature. In only one case the articles provided a detailed set of requirements and criteria for SOE borrowing: these stipulated that decision-making for borrowing of up to RSD 5mn was the responsibility of the board, whereas sums in excess of RSD 5mn required additional approval from the owner.

[1] Detailed information is available online at *pefa.org/country/serbia.*

The Rules on Quarterly Reporting of SOE Annual Plans, which entered into effect in April 2016, require reporting on 14 separate forms to allow the authorities to monitor the implementation of these firms' annual plans (see Article 2 of the Rules).[2] **A review of quarterly notifications produced by LGs** for the MoE, as well as of **quarterly SOE reports for their parent LGs**, revealed that eight of the 19 local SOEs currently had outstanding liabilities with banks and/or leasing firms. These were mostly loans intended to finance purchases of machinery, vehicles, and equipment, whereas only one company had borrowed to manage liquidity. Some firms reported having taken out leases mostly for equipment, machinery, and vehicles. Two businesses from the sample had also made significant investments, with neither of the two financed from traditional commercial sources but, rather, using a combined grant and loan from an IFI (in this case, the German KfW). Guarantees for these loans are, as a rule, issued by the state, with local SOEs most commonly posting bills of exchange as collateral. Commercial banks here serve as commission agents. The review also showed the quality of SOE reports was still poor, although the companies were making substantial efforts to enhance them. First and foremost, no satisfactory explanations are provided for deviations from annual plans agreed with owners. There is no discussion of either operational or financial indicators or a comparison of the evolution of these indicators over time. The operating analysis presented in the reports is not sufficient for an assessment of the company's strategy and its long-term plan.

We also **reviewed SOEs' financial statements**, which revealed an anomaly with regard to fixed assets. According to the Public Property Law (Službeni glasnik Republike Srbije, br. 72/11, 88/13, 105/14, 104/16 – dr. zakon, 108/16, 113/17 i 95/18), SOEs cannot own fixed assets that are public property. SOEs performing activities of public interest may only use real property that does not constitute a capital contribution if this use is allowed by a special law, articles of incorporation, or agreement entered into with its founder. Although the Public Enterprises Law requires SOEs to maintain records of publicly-owned real property they use, such property is not carried on their books. The issue is compounded by the chaotic state of public property registers: LGs are yet to inventory all their property and appraise it before they can recognise it on their books of account. These unresolved issues concerning public property affect SOEs in a number of ways. All ratios and indicators used in operating and credit analyses for SOEs that look at fixed assets or depreciation lead to unreliable conclusions. It is impossible to determine the exact cost of SOEs' products and services with any certainty. Cur-

[2] For a detailed review of the regulation and practice of SOE oversight in Serbia, see: Đulić, K., Jolović, A. (2018). Efikasnost nadzora nad lokalnim javim preduzećima u Republici Srbiji. Pravo i privreda, ISSN 0354-3501.

rent and major maintenance of assets cause problems, as SOEs ought to be tasked only with routine upkeep, since they do not formally own the assets in question. Moreover, when major maintenance is funded from credit lines such as those extended by KfW, this also begs the question of the economic logic of an SOE taking on and having to repay a loan for a fixed asset of which it is not permitted to take possession.

The SOEs annual and quarterly reports make it apparent that the quality of financial (and, in particular, non-financial) information is not satisfactory, as subsequently borne out in interviews with SOE managers. As we were unable to personally verify the accuracy of financial statements used for credit analysis, we reviewed the associated **audit reports**. In 2016 and 2017, no SOE included in the sample was audited by a reputable audit firm; auditors' opinions are qualified in one-half of all cases; and in one case the auditor stopped short of making a qualified opinion but did draw attention to a number of issues. Managers of SOEs we interviewed reported cases where auditors had refrained from making opinions, as well as that a number of auditors had sent 'letters to the management' but that there was usually no response in terms of improvements to areas identified by the auditors. Although some SOEs were endeavouring to enhance governance and control processes in their finance departments, this does little to change the overall guardedly positive impression of the quality of their financial information.

Interviews with representatives of SOEs and LGs

To gain some insight into lending practices and the type and extent of financial and non-financial data required by lenders from SOEs, we conducted one-on-one semi-structured interviews with officers of all 19 SOEs and staff tasked with SOE supervision at all five LGs. These interviews took place from January to July 2018.

The interviews began with a set of questions on banks' formal data requirements (both quantitative and qualitative) for SOEs. The answers revealed there was little difference between banks when it came to **quantitative data**. The standard set of information required comprised detailed information on: trade payables, trade receivables, outstanding loans, off-balance-sheet items, payment operations, detailed structure of balance sheet accounts, and the list of all connected entities and type of connection. We found differences in both how banks capture quantitative data and how they analyse the financial position of SOEs. Some banks require credit analysis to include the finances of the LGs, indirect budget beneficiaries, and other SOEs owned by the LG as they consider these to be 'connected entities'; other banks did not use this interpretation and did not require informa-

tion about the LG and other SOEs (guarantors excluded). Such a comprehensive analysis is justifiable only for long-term investment projects requiring large loan amounts.

There were similarities in the **qualitative information** required by banks. Lenders looked for detailed assessments of the competition (if any) and business development strategies. Competition assessments had to include an overview of market leaders and key competitors, and the estimated market share of the SOE and its competitors (current and future); strengths and weaknesses of the SOE relative to its competitors; key factors affecting the SOE's market (regulations, barriers to market entry for new participants, etc.); description of recent shifts in demand (how and why the market rose/fell, on average); current market conditions and future expectations; and an assessment of the size of the local market. We did not find a tailor-made approach in selecting key data; rather, the banks used a standard data set normally used to assess the solvency of their key target clients (large firms and corporate groups).

A second set of information concerned clients and suppliers. Banks required a detailed analysis of the top 10 clients and suppliers with the greatest turnover for the past two years). Here banks also insisted on aggregate balances of trade receivables/payables in foreign currency or indexed in foreign currency as of the last day of the preceding year. Further, the SOEs were asked to provide a detailed structure of trade receivables/payables by age as of the date of the latest gross balance sheet provided. No tailor-made approach was in evidence in this respect either, with the banks again using a standard data set suited to businesses. The appropriacy of this approach ought to be reconsidered. Since local SOEs' mainly serve citizens and most data described above are unavailable, it would be much more relevant to consider SOEs' collection rates, divide these figures into strata by length arrears (up to 30 days and over 90 days), and look at their trends or moving averages.

Lenders also sought information about SOEs' relationships with banks, including current indebtedness, guarantees, and off-balance-sheet items. Current indebtedness information comprised creditor name (bank or leasing firm), type of loan, intended use, approval date, final repayment date, approved amount, currency, outstanding amount as of application date, amount of instalment, repayment schedule, total amount of principal repayable in current year, loan calculation model, total amount of principal repayable next year, and collateral. Guarantee data usually included bank name, name of beneficiary, grounds for guarantee, amount, and maturity. Finally, off-balance-sheet information comprised creditor name, type of guarantee/letter of credit, grounds, approved amount, state of

guarantee, contract expiration date, and insurance (mortgage, lien, etc). Identical information was required for connected entities. Given banks' differing interpretations of what constitutes 'connected entities', there seems to be limited benefit in analysing all SOEs sharing the same owner for short-term loans or where lower amounts are sought.

We found little difference between banks' requirements for qualitative information. Some lenders explicitly asked for SOE managers to provide their details as early as the loan application stage (by asking for first and last name, position, years of service with the firm, and professional experience). Some banks also asked for detailed analyses of litigation, both of ongoing court cases and obligations arising from judgments rendered.

Interviews with representatives of commercial banks

To better understand lending by commercial banks, their assessment methods for quantitative and qualitative data received from local SOEs, and their experiences to date with local SOEs' ability to borrow on commercial terms, we also organised one-on-one semi-structured interviews with staff of commercial banks identified as the most common lenders in LG reports or interviews with SOE representatives. These interviews took place in July 2018 and involved six banks.

Bankers' responses can be summarised into five key aspects relevant for loan approval: quality of inputs received from local SOEs; credit analysis; key and/or specific risks posed by local SOEs; collateral and likely maturity of the approved loan; and type of loan.

Banks commonly see **inputs received from local SOEs** as questionable, as is also borne out by external auditors' opinions. The quality of inputs is directly influenced by the competence of the reporting SOE's head of finance. Collecting accurate and comprehensive information necessitates additional effort on the part of both the SOE and the bank and lengthens the approval process, so making it less efficient. This is due to the fact that SOEs usually do hold the necessary information, but this is not readily accessible or properly organised and may not reflect the actual state of affairs.

The procedure for **credit analysis** in the event of lending to local SOEs does not differ from analysis applicable to private businesses.

Risks posed by local (and other) SOEs are to some extent dissimilar from those encountered with private firms. According to banks, risks include incompetent managements, dependent on political actors and unable to make business decisions without first consulting the political bodies of the LGs in question; frequent changes to local SOEs' managements that may lead to complete reversals of these firms' strategies and business objectives; uneconomic cost management at the local SOE, including excess staffing; and the likely reputational risk faced by any bank attempting to collect non-performing debts from these firms, compounded by media reporting that seeks to mould public opinion by contrasting 'the common good' or 'public interest' with banks' allegedly 'private interests'. Sale of distressed and non-performing loans owed by local SOEs in the secondary market is difficult and would entail critically high discount rates (often as part of a package of loans). Banks claim that, before regulations were amended, additional risk had been posed by local authorities' practice of winding down distressed SOEs (and setting up new local SOEs to fill the same roles), leaving creditors unable to collect their debts. The bankers also said that risks borne by commercial lenders differed from those encountered by IFIs, since international creditors are better placed to negotiate with the public sector and the state (which underwrites any IFI loans).

As a rule, banks rely on the SOE borrower's bills of exchange as **collateral**. Another requirement in this regard is to provide a guarantor, most commonly another SOE or, in rare instances, a private firm. In view of the strictures of the Public Property Law, mortgages are not commonly used as collateral. This lack of mortgage security affects the effective interest rate, gross cost of any loan, maturity period, and extent of credit support. By way of a reminder, municipalities/cities are unable to guarantee their own SOEs' loans (Article 34, Public Property Law).

These loans most commonly have **maturities** ranging from one to three years, as dictated by the collateral available.

These loans are **intended** primarily for the purchase of means of transport, construction machinery, equipment, and spare parts, as well as to meet current liquidity requirements. Vehicles, machinery, and equipment are predominantly financed by bank-owned leasing firms.

Conclusion

Poor qualitative and quantitative inputs made by SOEs in the credit analysis process do limit their access to finance. The review of the associated audit re-

ports revealed overall guardedly positive impression of the quality of their financial information. The SOEs reports incorporate no satisfactory explanations for deviations from annual plans agreed with owners, while the annual plans are of the questionable quality as well. The length and efficiency of the credit approval process is dictated by the need to properly organise qualitative and quantitative information and ensure that it reflects the actual state of affairs, as well as to perform credit analysis for 'connected entities' (the LG, indirect budget beneficiaries, and other SOEs owned by the same local authority). Moreover, projections provided in local SOEs' plans most often lack appropriate revaluation of future income (both foreign currency and consumer price index revaluation). Local SOEs cannot set their prices independently, which means their projections lack objectivity, especially in terms of showing the structure and amounts of expenditures.

Due to *de jure* limitations of owning fixed assets that are public property and *de fact*o ownership of that property, combined with investment loans for that same property, financial statements of SOEs often are not in line with the key accounting and economic principles. One of the problems caused by that practice is that all ratios and indicators used in operating and credit analyses for SOEs that look at fixed assets or depreciation lead to unreliable conclusions.

Nevertheless, proper credit analyses reveal that these companies can be able to borrow commercially, especially in lower amounts and at shorter maturities. When collecting qualitative and quantitative information for credit analysis, banks do not distinguish sufficiently between private firms and SOEs; there is no tailor-made approach to data gathering that would allow banks to account for issues specific to SOEs such as the spillover of fiscal risk, corporate governance, relationship between owner and local SOE, economic and social objectives, and the like. The overwhelming impression is that banks treat SOEs like large corporations (their key clients) and that they have failed to come up with special tactics to deal with local SOEs. That having been said, this finding does not necessarily imply that a tailored approach would generate more revenue for banks nor that it would immediately increase investment required by SOEs.

The frequent inability of local SOEs to provide mortgages as collateral, coupled with the restriction on guarantees from LGs, nearly completely preclude lending for large-scale and long-term investment. It may also be difficult to sell these eventual distressed and non-performing loans in the secondary market. Yet, there is still room for local SOEs to borrow commercially in lower amounts and at shorter maturities.

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