

THE IMPACT OF FINANCIAL PERFORMANCE ON THE QUALITY OF PUBLIC SERVICES

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Abstract

In terms of the global economy financial performance is influenced by many operative and financial factors. Public enterprises also are influenced by many important factors such as successful corporate governance, the level of expenditure and the level of revenue collection. In order to offer qualitative public services for the clients, public enterprises have to achieve positive financial performance. This performance can be sufficient only on operational level. In an economy where prices are regulated by the regulatory offices, the collection of revenues is not adequately implemented, the level of expenditure is increasing, and financial performance is almost always negative. In these cases revenues generated from the activity of the public enterprises are not enough to cover the expenses which in most of the cases are very high compared to other similar private businesses.

In these environments, public services are at the lowest level or quality of services is generally at a low level. The next challenge for public enterprises in Kosovo is going to be the process of having positive financial performance and improvement of the quality of the public services. Almost all public enterprises in Kosovo are having difficulties with revenues which will ensure the development of their activity. Therefore, based on the current situation, public enterprises in Kosovo must prepare to face these challenges and have to find solutions that will help the managements of the public enterprises to meet the minimal requirements which will directly increase the level of services to citizens. Thus, the improvement of financial performance will be the target of the managements of public enterprises, board of directors, and shareholders.

Keywords: public enterprises, financial performance, quality of service, price, corporate governance.

1. INTRODUCTION

Development of public activity has special features which differ greatly in comparison with the development of a business in a market economy. Changing the organization of public enterprises from former socially and state owned enterprises, and application of corporate governance according to The Organization for Economic Co-operation and Development (OECD) principles represents one of the most difficult challenges not merely for public enterprises in Kosovo but also for all Western Balkan countries, especially for countries with developed economies. In all these countries, they are still continues efforts to reorganize and transform these enterprises into a more suitable for with the aim of increasing efficiency in the delivery of public services. In Kosovo, two former public enterprises have been transformed and now operate in other principles. So the former Public Enterprise Pristina International Airport "Adem Jashari" is governed by the consortium Limak & Lyon, so we had a process to award the concession and since 08 May 2013 a part of public enterprise Kosovo Energy Corporation (KEK) J.S.C (Joint Stock Company) - Distribution-sector distribution and supply power, functioning as a separate unit is sold, so it went through the process of privatization. Challenges for the transformation will continue but as for now some of the former socially owned enterprises are in stages of organization, reorganization, whereas some in the process of liquidation as previously passed bankruptcy process.

Public enterprises in Kosovo in the current form of organization were established in 2008 with the Law on public enterprises in Kosovo (Law No. 03 / L-087). However, all these public enterprises were established by the so-called former social enterprise. It is important that all these public enterprises have continued the same activity as they exercised when they were social enterprises. The difference in exercise (performance) activity is probably not as big as the difference in the form of governance. According to the aforementioned law these public enterprises should be governed according to the model "of corporate governance of enterprises in accordance with internationally recognized principles of corporate governance of public enterprises". So, there is a substantial difference in the form of their governance. From this form of

governance there are derived responsibilities and directions for managements and the Boards of Directors for positive results and performance. This is very clearly expressed by J.E. Stieglitz and C.E. Walsh in their book "Economics" where they claim that "The government influences the economy not only through taxes and expenditures but also through myriad regulations that affect every aspect of economic life", Chapter 17 The Public Sector, page number 375. On the other hand, most of these public enterprises are faced with problems of different nature, including here problems with low levels of liquidity. Thus, the qualitative of services provided to the clients are closely related to their financial performance. Therefore, the purpose of this research project is to explore and elaborate the importance proper governance and financial performance in the quality of services but also to further investigate causes and effects.

2. THE IMPACT OF FINANCIAL PERFORMANCE IN THE QUALITY OF PUBLIC SERVICES

2.1 The purpose and objectives of the research

The operation purpose of public enterprises is to provide quality services to the consumer. However, due to various difficulties, very often the quality of services provided is a challenge for the management of the public enterprises. These difficulties are encountered especially at public enterprises that deal with electricity supply, the water supply enterprises, and the most enterprises dealing with waste management collection.

One of the main objectives we intend to achieve by this research project is that by analyzing the factors that affect poor financial performance of public enterprises, to find solutions in order to increase the quality of public services. Another objective remains in identifying the challenges that arise from these factors which would be relevant in dealing with obstacles the influence public enterprise in public-service providence, revenue collection and financial performance.

We believe that through this study will help the managements of public enterprises by raising the awareness on all the stakeholders participating either as users or as providers of public services. Furthermore, we will come up with suggestions and possible solutions for all parties involved in these processes.

2.2 Methodology

We believe that the quality of public services is closely tied to financial performance. But there are a number of factors influencing the financial performance and positive result. Therefore, the basic research question of this paper is: What factors influence the achievement of financial performance and their impact? The central hypothesis of this paper is that financial performance affects the quality of public services. The method of this paper is based on a combination of primary and secondary data. It is based on the data presented in the audited financial statements during the past three years and followed by comparative analysis of secondary data. In this research paper we focused on three public enterprises: electricity supply, water supply and waste management and collection. We have estimated that one of the ways to contribute to this issue is the analytical approach of the indicators of financial statements because we believe that financial statements besides financial performance there are presented important elements related to expenditure and revenues.

3. THE IMPACT OF FINANCIAL PERFORMANCE IN THE QUALITY OF PUBLIC SERVICES

Even though public enterprises provide public services, based on the law that is applicable they are obliged to prepare a business plan and the plan should be approved by the Board of Directors. Through this plan there are planned revenues, expenses, operating profit, net profit after tax, cash flow, and many indicators of physical quantities. Then the plan is divided into monthly and quarterly, whereas Managements compare data by comparing actual with planned results. So, enterprises have an orientation associated with trends in their activity, but however some transactions such as accounts receivable, and the level of spending cannot be predicted accurately, which leads to the limitation in the performance of services. Restrictions on the amount of the supplied electric energy is manifested in the reduction of electricity supply to citizens, the so-called reduction regime is defined based on the set zones: zone A three hours of supply and one hour without electricity, area B, power two hours with the supply of electricity and two hours without electricity supply, and area C, three hours with electric supply and three hours without electricity supply. We also have the case of water supply, when there are restrictions on the amount supplied manifested by reductions on water delivery. Schedules from regional water enterprises and limitation in quality are manifested by low water quality which in many cases it is recommended not to be used. Such restriction from public enterprises that not have the opportunity to provide quality services directly affect the quality of life of citizens, in some cases event creating additional costs in an attempt to find alternatives for these services. Here we can

mention the generators and fuel costs or even buying drinking water but also other negative impacts such as noise and air pollution are almost inevitable. In analyzing the factors affecting financial performance, we are supporting data from the financial statements which directly provide information on income, expenditure levels, accounts receivable, bad debts, etc.

3.1. Regulatory offices and prices

The Energy Regulatory Office (ERO) was established upon the promulgation by the Kosovo Assembly of the Energy Laws on June 30th, 2004. Law 2004/9 "On the Energy Regulator" establishes the independent energy regulator in order to set the regulatory framework for a transparent and nondiscriminatory energy market that is based on free market principles and it promotes competition. ERO is responsible for regulating the Electricity, Natural Gas and District Heating sectors. To meet its responsibilities, ERO has the power to: modify, grant, suspend, transfer and withdraw licenses, supervise and control compliance with licenses, approve and fix tariffs and tariff methodologies for the purpose of regulating energy services, grant permits for the operation and construction of new generation capacities and gas pipeline systems including here direct pipelines and direct electricity lines, monitor the unbundling of the legal form, sets out the general conditions for energy supply and the necessary standards for the services to be met by the licensees, resolve disputes among energy enterprises and customers, energy enterprises and system operators, but also between two main energy enterprises, issue general acts and individual acts, and secondary legislation in accordance with the Law on Energy Regulator.

It also revises, approves and controls compliance with all the necessary codes, including distribution code and the grid, the electrical equipment code, the consumer protection code, electricity standards code, the trade code and the metering code, approve and control compliance with all technical rules including the rules of access and trade rules, enforce the provision of the Law on Energy Regulator and impose fines for different violations, performs other duties as assigned by the primary energy laws. Kosovo is a signatory party of the Energy Community Treaty and ERO it is responsible for establishing a regulatory framework that is in compliance with Acquis Communautaire provisions on Energy. So, as we can conclude regulatory office has an impact on setting energy price. Supply-demand approach is now applied in their case and therefore public enterprises have limitations in revenue collection in order to provide quality public services.

Water and Wastewater Regulatory Office (WWRO) was established in 2004 by Regulation 2004/49. This Regulation was amended by the Law on the Amendment of Regulation 2004/49 based on the Activities of Service Providers of Water and Wastewater (Nr. 03 / L-086), approved by the Assembly of Kosovo on June 13, 2008 in accordance with the Constitution of Kosovo. These two legal acts represent the legal framework for Water and Wastewater Regulatory Office (WWRO). Water and Wastewater Regulatory Office (WWRO) is an independent economic regulator of water and wastewater services in Kosovo. WWRO role is to ensure the provision of quality services, efficient, safe and non-discriminatory basis to all customers in Kosovo, taking into account environmental protection and public health. Competencies of Water and Wastewater Regulatory Office (WWRO) are licensing public enterprises that provide: (i) water and wastewater, (ii) bulk water supply for regional water suppliers, the determination of service fees for service providers licensed by Water and Wastewater Regulatory Office (WWRO), ensuring that fees are fair and reasonable, enabling financial viability of service providers, monitoring the implementation of service standards that provide licensed service providers, approval and supervision of the implementation of the Customer Charter that regulates the rights and obligations for both consumers and service providers licensed by Water and Wastewater Regulatory Office (WWRO), etc. As in the energy sector, also in the sector of water and wastewater, regulatory office sets service fees according to the methodology of regulatory office which is based on the idea of providing quality service and low prices for service users while securing financial sustainability for public enterprises. This model was designed to satisfy both providers and users, but it was almost always controversial and as an example we can mention the objections of civil society for increasing the price of electricity even though it was approved by the Energy Regulatory Office. Civil society organizations and other consumer protection organization have opposed recent increasing energy prices because according to the annual reports from the Energy Regulatory Office in 2013, 59.50% of energy consumption is by households. On the other hand the existence and action of regulatory offices can be justified by that fact that all these enterprises are the only operator in these activities. So, basically regulatory offices in these cases are mandatory as we have a monopoly because there is no competition which would lead to the regulation of price, and improvement of the quality of services.

3.2. Exemption from payment of certain social strata from the payment of public services

In order to increase the level of collection but also the creation of accurate records for the users of public services, public enterprises have accepted the decision for temporary release from the payments certain social strata that are in schemes of social assistance defined by the Ministry of Labour and Social Welfare. Another problem regarding the revenue collection is with poor revenue collection in the regions of minority communities, especially the Serbs in Northern Mitrovica. There was also a project with an aim of eliminating billing in abandoned settlements, the transfer of responsibilities to new users especially when settlements are used by the tenants, and the identification of the new consumer. Despite the government intervention with an effort of funding the lack of income collection, it only had poor impact on the cash flow but also on the financial performance of public enterprises.

3.3 Technical losses (power and water)

Due to the distributed and outdated network, public enterprises that provide water and power supply have a degree of technical loss from the generation processes to the consumers. Because of equipment obsolete distribution network public enterprises fail to provide all the water and power produced. This problem has been identified by the management of public enterprises and they treat as technical losses. These technical losses according to the annual report of ERO for 2013 were 16.4% for energy, whereas countries that have advanced networks these losses are 5-7%. In the water sector, these losses are even higher but also they have administrative losses. According to the Annual Report for 2013 Regional Water Company "Prishtina", J.S.C technical losses and administrative losses are up to 50%. These losses are very high and pose a challenge for management to reduce their impact on the financial performance of these enterprises.

Table1. Billing presented in percentage, for three years (2011-2013).

Billing							Public Enterprises	Billing in % from the total generation
Sector	2013	%	2012	%	2011	%		
Power supply of generated energy	79.00*	%	82.00	%	82.10	%	KEK	
Water supply	96.88	%	96.41	%	91.00	%	KRU "Prishtina"	
Waste management	100	%	100	%	100	%	KRM "Uniteti"	

*From January to April 2013 (I-IV).

Note: Table is created by the author for the purposes of this study; data were obtained from the financial statements of the aforementioned enterprises.

As we can see from the table above, billing is in lower level than generation of energy and water. Thus, this difference represents losses between billing and generation.

3.4 Low level of collection

One of the problems faced by the public enterprises in the energy and water sector that has the greatest impact on financial performance is revenue collection. Continuously for several years managements and boards of directors of public enterprises in Kosovo have an increasing priority regarding the level of revenue collection. Taking into account all the circumstances regarding their operation during last three years 2011-2013 there were some positive changes in terms of increasing the level of collection. In order to increase financial performance, improve the cash flow, provide capital investment funding from own resources and improving the quality of public services public enterprises should increase the level of revenue collection. We analyzed the data regarding the revenue collection of public enterprises in three sectors:

Table 2. Income collection presented in percentage for three years (2011-2013).

Income collection							Public Enterprises	Collection on % based on billing
	Sector	2013	%	2012	%	2011		
Power supply	89.00*	%	91.00	%	91.10	%	KEK RWC	
Water supply	74.93	%	73.00	%	72.08	%	"Prishtina"	
Waste management	70.00	%	70.00	%	74.36	%	RWC "Uniteti"	

*From January to April 2013 (I-IV).

Note: Table is created by the author for the purposes of this study; data were obtained from the financial statements of the aforementioned enterprises.

As we can see from the figure above, the collection is different in all sectors. Water and waste sectors are still far from the desired level of collection which would help on improving the financial performance and financial sustainability for providing quality services. As they are described by authors Stuart Slatter and David Lovett, in their book "Corporate Recovery-Managing Companies in Distress" by, page 14, "There are numerous symptoms indicating that a company may be entering decline. Depending on the observer's perspective, though, some are easier to see than others".

3.5 Corporate governance

Corporate governance in Kosovo has started to be applied in the public sector with the establishment of public enterprises. We can say that corporate governance does not enough experience in this sector. Selection of the people on board the directors, audit committees, other senior officials, who have implemented corporate governance, has not been selected based on professional criteria. In the development phases or so called transition phases like in countries such as Kosovo, it is not exempted even political interference. Probably the selection of professionals and responsible creating governing structures is among the problems faced by developing societies today. On regards to this topic expressed one of the representatives of liberal theory, Milton Friedman states in his book "Capitalism and Freedom", page 44-45, that: "The problem is how to build institutional structures that will give the responsibility to the government and at the same time, to limit the power given to the government and to prevent that this power may not be used to weaken, but instead, to strengthening free society".

Another important author such as Joseph E. Stieglitz has given his contribution to this topic in his book "The Price of Inequality", Chapter nine, page 264 where he claims that "Over the past quarter century macroeconomic and monetary policies and institutions have failed to produce stability; they failed to produce sustainable growth; and most importantly, they failed to produce growth that benefited most citizens in our society".

CONCLUSION

In this research paper, we introduced some of the factors, that does not mean that there is no other, that have an influence in the financial performance and quality of public services. The quality of public services is in one or another way constrained by financial performance. Financial performance serves for having clear objectives and comparison with the plan, but also as a basis for future planning, as a signal for management and information for decision makers, to establish accountability and transparency and as an incentive for management and employees.

As it is mentioned above despite of having worked in a market defined by regulatory offices, and having the help from government in form of subsidies for technical losses and capital investment but also finances in the form of loans, they have not made significant positive changes. A major issue that requires solution is the time it will take for these public enterprises to recover. This is going to be the main challenge for shareholder-government of Kosovo, and obviously they will have to make difficult but necessary decision. If the current

form of organization is having difficulties and possibilities of recovery are very small, there should be considered other forms of organization which may be more favorable. For the two cases mentioned above (Pristina International Airport - concession and Kosovo Energy Corporation Distribution-privatization) we have not yet a complete analysis of the functioning and quality of their services. But especially for some units of public enterprises such as revenue collection reorganization in the form of public-private partnerships, to grant a concession or partial privatization is of great importance for the financial performance, financial sustainability, and their further development and most importantly, increasing the quality of services offered to citizens.

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