

Article by the Principal Deputy High Representative, Donald Hays

Mindset Transition

Transition to a prosperous market economy involves more than changing regulations and laws – it requires a change of mindset. And the indignant reaction from some quarters to the Special Auditor's reports on public utilities companies shows that certain people haven't yet made this mindset transition.

The free market works on a very simple principle – successful companies deliver high-quality goods to customers at a price that customers want to pay.

To do that, they apply modern management techniques. They maintain strict internal controls to make sure their managers perform effectively and don't misuse corporate resources; they draw up and implement detailed business plans that allow the company to forecast and exploit new market opportunities; and they pay their workers on time.

The audits of the Elektroprivredas, the Vodoprivredas, the employment bureaux and the telecom companies have revealed that a modern management culture – one that can compete in the global economy — hasn't taken root among BiH public companies. That's why they are not delivering high-quality products to customers at competitive prices. They are still part of an outdated management culture where tenders are conducted in a way that favours insiders instead of customers, where senior managers operate without adequate controls, where bookkeeping is opaque and administration is bloated and inefficient.

There are clear indications that parties have drained off resources to finance government activities that have no bearing on their core operations. For example, telecom earnings have been expropriated in order to pay pensions, without proper approval. This style of government accounting is incompatible with a modern market economy. It is the government's job to pay pensions, not the phone company's job. As it is, citizens are paying twice for their pensions – once to the pension fund and once through a mark-up on their telephone calls. That makes telephone calls more expensive, which is a drag on the economy. Furthermore, average salaries at these public utilities are dissociated from wages and prices. The average salary at BH Telecom, for example, is more than twice the Federation average (is it a surprise, then, that international rates are so expensive?)

The Special Auditor's findings show – in documented detail — a management culture where the governing board meets rarely, where the auditor doesn't audit, where loans are taken out and never repaid.

"All truth passes through three stages," according to the German philosopher Arthur Schopenhauer, "First, it is ridiculed. Second, it is vigorously opposed. Third, it is accepted as being self-evident."

We have passed the ridicule stage with regard to reforming BiH's public enterprises, and we are rapidly passing through the vigorous opposition phase (there have been noisy complaints about the Special Auditor's work, but no one has rebutted her findings). We are about to enter the self-evident phase — the citizens of this country want their public utilities run properly; no one really believes the status quo is in the interest of the citizens of BiH.

Companies in BiH need to be subject to modern and efficient codes of corporate governance. The serious issue – which should be at the forefront of public discussion now — is *how* we are going to bring that about.

The Prime Ministers have committed themselves to an all-out campaign to tackle corruption and inefficiency at the public utilities. These measures are targeted and effective. They have publicly stated their commitment to adopt a new Law on Public Enterprises, which will establish a detailed code of ethics for all public-company employees, from the chairman down. For example, in future no board member or company employee will be allowed to conclude contracts with other companies under their own or their family members' control.

I can't imagine anyone objecting, in public at least, to these proposals. They are in the interest of citizens and in the interest of clients of these companies.

The proposed law will also require the setting up of independent internal controls and strict approval processes for procurement, and distribution of profits and adherence to business plans. Companies will be obliged to compile

financial statements to international bookkeeping standards — that means every last KM accounted for. The new rules will also make it clear that board members must *understand* their legal obligations. When managers are held accountable in the future they won't be able to plead ignorance. And if they break the rules they will be liable to a fine, or imprisonment in serious cases.

I would expect journalists, commentators, politicians, economists — and, indeed, managers of public companies — to come out enthusiastically in support of these sensible proposals. After all, they are going to save the people of this country a great deal of money.

Modern standards of corporate governance are the only way that BiH is going to make the transition to a successful market economy. This country needs competitive and growing companies because it needs tens of thousands of new jobs — and the only way those jobs are going to be created is if honest, creative, competent managers are allowed to get on with the business of running efficient and competitive companies. They can only do that in a culture that rewards talent not connections.

The culture of corporate cronyism has had its day. The old style of treating public companies as political fiefdoms won't work. Those who haven't absorbed this haven't yet made the mental transition to the free market.