

The background of the cover is a dramatic photograph of a volcanic eruption. A bright, glowing plume of orange and yellow lava or ash rises from a dark, jagged volcanic landscape. The scene is illuminated by the intense light of the eruption, creating a stark contrast between the dark rocks and the fiery sky.

HRVATSKI  
RACUNO  
VOĐA

*Journal of  
Accounting  
and  
Management*

UDC 65.012/657.1/657.6/657.63/658.14

ISSN 2459-5888

Vol. 7 No. 1  
pages: 1 - 68

Croatian Accountant

June  
2017





# **Journal of Accounting and Management**

**Volume 7, No. 1, 2017**  
Pages: 1 - 68

*Zagreb, June 2017*

# **Journal of Accounting and Management**

## **Founder**

Croatian Accountant – Independent Association of Accountants,  
Tax Advisors and Finance Professionals

## **Published by**

Croatian Accountant © Copyright 2017  
UDC 65.012/657.1/657.6/657.63/658.14  
ISSN 2459-5888

## **Editor-in-Chief**

Đurđica Jurić, PhD (CRO)

## **Editorial Board**

Tamara Cirkveni, PhD, Senior Lecturer (CRO)  
Tatjana Dolinšek, MsC (SLO)  
Martina Herceg Rendeli, MA (CRO)  
Ljerka Markota, PhD, College Professor (CRO)  
Urszula Michalik, PhD (POL)  
Miroslawa Michalska-Suchanek, PhD (POL)  
Dubravka Paris, MA, Lecturer (CRO)  
Dolores Pušar Banović, PhD, Senior Lecturer (CRO)

## **Address of the Editorial Office**

Hrvatski računovodja, HR – 10000 Zagreb, Vlaška 68  
Phone: + 385 1 4699 700, Fax: + 385 1 4699 703  
e-mail: [info@hrvatski-racunovodja.hr](mailto:info@hrvatski-racunovodja.hr)  
[www.hrvatski-racunovodja.hr](http://www.hrvatski-racunovodja.hr)

**Journal of Accounting and Management** is published in two issues a year.

**Journal of Accounting and Management** is a free periodical of the Croatian Accountant – Independent Association of Accountants, Tax Advisors and Finance Professionals.

**Journal of Accounting and Management** is indexed in:

- HRČAK (Portal of scientific and technical journals of the Republic of Croatia),
- European Reference Index for the Humanities and Social Sciences - ERIHPLUS

All rights reserved. Authors are responsible for the linguistic  
and technical accuracy of their contributions.  
Electronic version only.

## **FOREWORD**

Dear readers,

as for previous six years it is our great pleasure to present the seventh Volume of our **Journal of Accounting and Management**. This issue comes with one novelty, the indexation of our Journal in *European Reference Index for the Humanities and Social Sciences - ERIHPLUS*. This indexation represents the completion of one of our goals that we have set in the existence of our Journal.

In the following period we are going to continue to be a platform for researchers and professionals to share results of new research and practice in a wide variety of topics in the field of accounting and management. We are also going to continue with our efforts to include our Journal in specific and professional databases.

The Journal contains the selected papers presented at the *International Scientific and Professional Conference Accounting and Management* organized by the Association „Croatian Accountant“ and the RRiF College of Financial Management, Zagreb , as well as the original papers submitted directly to the Journal.

All the papers have been blindly peer-reviewed, requiring the acceptance by two independent reviewers to be published in this Journal.

The Journal is on a completely open-access basis and is available for use to scholars, professionals and students.

We thank all the authors, co-authors and reviewers for their effort and willingness to share their knowledge and especially the readers and users of our Journal and we invite and welcome new submissions of articles

**Editor-in-Chief**

Đurđica Jurić, PhD, College Professor



## CONTENTS

Dubravka Krivačić, Ph.D.

Original Scientific Paper

**SUSTAINABILITY REPORTING QUALITY:  
THE ANALYSIS OF COMPANIES IN CROATIA**

1 - 14

Mercy T Magombeyi,

Prof. Nicholas M. Odhiambo

Original Scientific Paper

**FOREIGN DIRECT INVESTMENT IN BOTSWANA:  
TRENDS, REFORMS AND CHALLENGES**

15 - 32

Tankiso Moloi, Ph.D.

Preliminary paper

**APTITUDE AND POSITIONING OF CHIEF RISK OFFICERS  
IN SOUTH AFRICA'S PUBLIC INSTITUTIONS**

33 - 44

Ivana Perica, M.A.

Original Scientific Paper

**COMPARATION OF PRODUCTION AND SERVICE COSTS  
IN CROATIA AND COST REDUCTION MEASURES**

45 - 56

mr. Alenka Poljičak, B.Sc.

Professional paper

**THE SYNERGY OF PUBLIC PROCUREMENT AND MANAGMENT  
FOR PROJECTS FINANCED FROM THE EUROPEAN STRUCTURAL  
AND INVESTMENT FUNDS**

57 - 68

**INSTRUCTIONS FOR AUTHORS**

69

**PUBLICATION ETHICS AND PUBLICATION MALPRACTICE**

**STATEMENT FOR JOURNAL OF ACCOUNTING AND MANAGEMENT**

70





Original Scientific Paper

UDC: 657.1/657.63

*Paper received: 06/04/2016*

*Paper accepted: 12/04/2016*

# **SUSTAINABILITY REPORTING QUALITY: THE ANALYSIS OF COMPANIES IN CROATIA**

*Dubravka Krivačić, Ph.D.*

*Karlovac University of Applied Sciences, Karlovac, Croatia*

*E-mail: dubravka.krivacic@vuka.hr*

## **ABSTRACT**

Movement of companies towards sustainable development resulted in increased demand from their stakeholders to disclose sustainability reports. Sustainability reports are considered as an evidence of responsible business practice that provides the necessary non-financial information to external and internal stakeholders. Sustainability reports enable companies to consider their efficiency in addressing the sustainability issues, and at the same time easier to assess the opportunities, but also the challenges they face. In their preparation is advisable to use reporting criteria established by independent international organizations and initiatives, ensuring the quantity but also the quality of reported information. The purpose of this paper is to determine the level of sustainability reporting quality of companies in Croatia, which will allow drawing conclusions about the usefulness of the sustainability information to stakeholders. The paper will at the same time provide space for further research of importance of non-financial reporting standardization.

**Keywords:** *sustainability reporting; quality; analysis*

## **1. INTRODUCTION**

Today we are witnessing the transformation of traditional accounting reporting models, mostly focused on financial and historical data, towards new forms of reporting: non-financial reporting, i.e. sustainability reporting. That is the result of increased pressure of internal and external stakeholders on the

company to report not only the financial but also the social and environmental performances of their businesses. Sustainability reporting is the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organizational performance towards the goal of sustainable development (GRI, 2006, p. 3). It serves as a tool to change external perceptions, to instigate dialogue with stakeholders and to play an important role in communication and relationship building between the organisations and stakeholders (Bonson and Bednarova, 2015, p. 183). Sustainable development reports are public reports by companies to provide internal and external stakeholders with a picture of corporate position and activities on economic, environmental and social dimensions, i.e. attempt to describe the company's contribution toward sustainable development (WBCSD, 2002, p. 7). The reasons why companies disclose sustainability reports are different. Research has found that companies report to respond to stakeholders' expectations and contribute to the welfare of society (Morsing and Shultz, 2006), in order to manage their own legitimacy (Reverte, 2009), in order to preserve their reputation (Reynolds and Yuthas, 2008), and to achieve profitability in the long run by reducing information asymmetry (Merkl-Davies and Brennan, 2007, Du, Bhattacharya and Sen, 2010). Sustainability reporting instils discipline and helps a company think about and define its long term vision and raises awareness of sustainable practices in the whole organisation (ACCA, 2013, p. 6). Over the last decade, a growing number of reporting initiatives, principles and guidelines have been developed to provide companies, as well as other types of organizations, an appropriate reporting framework (e.g. UNGC Principles, OECD Guidelines for Multinational Enterprises, Global Reporting Initiative Reporting Framework, ISO 26000, AA1000). However, many different reporting frameworks, as well as the complexity of the reporting process, may be confusing for companies and their decision on what and how to report, so in recent years there is growing debate about the need to harmonize the structure of sustainability reports globally. Therefore, welcome are the efforts by the Global Reporting Initiative to try to bring some harmonization into the broad variety of reporting formats that are emerging (WBCSD, 2002, p. 3). With the same effort, the International Integrated Reporting Committee (IIRC) was founded, which published the International Integrated Reporting Framework in 2013. The framework implies incorporating the environmental and social aspects of business operations into companies' annual reports. The purpose of the Framework is to establish guiding principles and content elements that govern the overall content of an integrated report, and to explain the fundamental concepts that underpin them (IIRC, 2013, p. 4). Including corporate responsibility data in annual financial reports is now a firmly established global trend, making it easier for investors to access non-financial information (KPMG, 2015, p. 36). However, given

that in most countries sustainability reporting is still voluntary, the companies decide independently what information, when, how and in what context will report. Even when it is mandatory, for example according to the EU Directive 2014/95 which requires companies to describe their business model, and outcomes and risks of adopted mandatory policy issues, it is aimed at aligning with some of the known reporting frameworks, about which companies decide independently. It is to be expected that the future pressures of different users of sustainability reports will affect the content of the reports, as was the case with financial reporting. Yet, there will be a challenge to balance between what is realistic to expect companies to report on and what stakeholders want to see reported (WBCSD, 2002, p. 3). One is, however, certain, the quality of sustainability reports will have to be provided for stakeholders because the information that companies provide has to be a reliable foundation for decision making. The level of sustainability reporting quality is just beginning to attract attention of scientists and accounting experts. So far only a small number of papers have been published in this area. By addressing the issue of the quality of sustainability reporting, and determining the level of reporting quality in companies in Croatia the goal of this paper will be accomplished, and the paper will contribute to making conclusions about the usefulness of reported information and possible criteria for standardizing nonfinancial reporting.

## **2. PREVIOUS RESEARCH**

The number of companies publishing sustainability information increases year by year. KPMG's research on corporate responsibility reporting (which is a synonym for sustainability reporting) in 2015 found that reporting on corporate responsibility is a standard practice of 92% of the largest 250 companies (G250) worldwide, and that reports from European companies have the highest quality (KPMG, 2015). The growth trend of the number of companies publishing sustainability reports is unquestionable, but the stakeholders' interest is increasingly concerned with the quality of reported information and the models of its measurement. Quality should reside in the manner in which the disclosed information transforms stakeholders' knowledge of the firm's corporate strategy (Brammer and Pavelin, 2008, p. 126). However, designing and implementing a sustainability reports that fits the needs of these different stakeholder groups is a difficult task (Freundlieb and Teuteberg, 2012, p. 1177). Despite the different background of sustainability reporting contained in the standards and guidelines, the quality criteria are quite similar (Freundlieb and Teuteberg, 2012, p. 1179), so it is difficult for companies which publish reports to find a framework that would best provide stakeholders with the quality of information. The quality of information enables stakeholders to make sound

and reasonable assessments of performance, and take appropriate action (GRI, 2006, p. 13), so the reports should reflect positive and negative aspects of the organization’s performance; issues and information should be selected, compiled, and reported consistently; the reported information should be sufficiently accurate and detailed; information should be made available in a manner that is understandable and accessible to stakeholders; information should be gathered, recorded, and reports compiled, analysed, and disclosed in a way that could be subject to examination (GRI, 2006). Information is relevant when it helps to evaluate a company’s activities, reliable when it is free from material error and bias, i.e. faithfully reflects activities and processes, and when it is comparable over time, but also with information of different companies (WBCSD, 2002).

**Table 1.** Review of the quality of sustainability reporting criteria

GRI	WBCSD	IIRC
balance	relevance	materiality
comparability	materiality	conciseness
accuracy	reliability	reliability
timeliness	comparability	completeness
clarity		consistency
reliability		comparability

*Source: The author according to: GRI Sustainability reporting guidelines 3.0, 2006; WBCSD, Sustainable development reporting: Striking the balance, 2002; and IIRC, The International IR Framework, 2013*

The quality of the decisions made by users of information depends on the quality of the sustainability report, so any inaccurate and unreliable information can mean loss of reputation and business partners, and ultimately affects the sustainability of the company that publishes it. By analysing the quality of sustainability reporting in six highly developed European countries (Poland, Sweden, Denmark, United Kingdom, France and the Netherlands) Habek and Wolniak determined that the level of quality of the analysed reports is generally low and that in all analysed countries there is room for improvement (Habek and Wolniak, 2016, p. 415).

**Table 2.** Sustainability report quality indicators

RELEVANCE OF INFORMATION INDICATOR	CREDIBILITY OF INFORMATION INDICATOR
sustainability strategy	readability
key stakeholders	basic reporting principles
targets	quality of data
trends over time	stakeholders dialogue outcomes
performance indicators: market place	feedback
performance indicators: workplace	independent verification
performance indicators: environment	
performance indicators: community	
improvement actions	
integration with business processes	
executive summary	

*Source: Habek, P., Wolniak, R., Assessing the quality of corporate social responsibility reports: the case of reporting practices in selected European Union member states, Qual Quant, No. 50, 2016, p. 410*

The study analysed the quality of the reports through, for this opportunity defined, the indicators of importance and credibility (Table 2). It was found that the importance of disclosed information in the observed reports was higher than their credibility. The highest level of quality indicators has been determined in the reports from companies in France and the Netherlands, which may be related to the fact that France in 2001 has made an obligation to companies to include sustainability information in their annual reports, while the Netherlands was one of the few countries that developed a separate accounting standard for independent verification of sustainability reports. Regarding existing standards and guidelines for sustainability reporting, Freundlieb and Teuteberg (2012) have found that they are too focused on the content of the report and that they, from the position of stakeholders, ignore the acceptance of existing information system criteria that are proven valid in other problem areas. In response to these shortcomings, they presented a multi-metric framework that directly involves different stakeholder groups in defining the quality criteria and its proper evaluation. Baviera-Puig et al. argue that organizations must overcome the challenges of publishing sustainability reports that will successfully meet the demands of different stakeholders, and they propose a method for assessing the communication and features of sustainability reporting that includes multi-stakeholders approach (Baviera-Puig et al., 2015). By identifying the factors influencing the quality of corporate reporting on the environment, as very important sustainability dimension, Brammer and Pavelin (2008) have determined that high-quality reporting is present in larger

companies and those in sectors that have a great impact on the environment. The research related to the establishment of the framework for improving the quality and comparability of the nonfinancial information reporting system, carried out on the sample of Croatian companies, came to the conclusion that there are certain preconditions for successful implementation on nonfinancial reporting by domestic companies and suggest an innovative approach that emphasizes the harmonization of segment reporting and external reporting system (Peršić, Bakija and Vlašić, 2015).

### **3. METHODOLOGY AND THESIS OF THE RESEARCH**

Research that deals with the quantity of corporate reporting often analyse companies quoting on stock exchanges, "since they are most exposed to the public and are expected to provide most information for decision making on the capital market" (Ienciu, Muller and Matis, 2011, p. 124). This approach was applied in Croatia when investigating the level of corporate responsibility reporting on the sample of companies listed on the Zagreb Stock Exchange in 2012. The survey found that 22% of companies report information on environmental responsibility, but only 3% of them prepare reports on social responsibility (Krivačić, 2012). Analysing the current state of sustainability reporting of companies listed on the Zagreb Stock Exchange, it was found that a relative number of those publishing sustainability reports increased to 8%. However, in the survey of sustainability reporting quality, it was decided to use reports available through the Croatian Business Council for Sustainable Development (CBCSD) web site, where 20 reports are available, which is the larger number of reports than those that can be collected from the database of companies listed on Stock Exchange. The analysis was included sustainability reports (social responsibility reports, sustainable development reports) available at web address <http://www.hrpsor.hr/popis-nefinancijskih-izvjestaja-1-101.html> (retrieved March 19<sup>th</sup> 2016). The quality of the sustainability reports is defined as a subject of the research. Due to the lack of a generally accepted model for measuring the quality of reporting, it is possible to take the quantity of reporting as a measure for the quality of reporting, because it has been shown that the quantity and the quality are positively correlated (Hail, 2001, p. 14). Given that the Reporting Guidelines of the Global Reporting Initiative are the most popular reporting framework, and are applied in the preparation of more than 60% of all sustainability reports in 45 countries of the world (KPMG, 2015, p. 45), and taking into account the fact that they are also applied by companies in Croatia, a model of assessment of sustainability reports quality, based on these Guidelines, was used in this study, especially in the part related to environmental and social performance indicators. The paper is based on the assumption

that compliance with GRI Guidelines is an appropriate indicator of reporting quality, i.e. a firm evidence of corporate responsibility towards stakeholders and their commitment to addressing sustainability issues. By content analysis of the sustainability reports, key environmental and social indicators for each individual company are identified. Environmental indicators include: a) material used, b) energy consumption, c) water consumption, d) impact on biodiversity, e) greenhouse gas emissions and emissions of harmful substances, f) waste and waste water production, and g) initiatives to mitigate environmental impacts. Social indicators were analysed as follows: a) employees, b) occupational health and safety, c) employee education and training programs, d) diversity and equal opportunities of employees, e) respect of human rights, f) participation in the local community, and g) concern about health and safety of customers. In order to verify correlation between certain characteristics of an enterprise and the quality of the sustainability report, the following research hypotheses have been defined:

*H1: There is a positive and significant correlation between the quality of sustainability reports and size of the company.*

*H2: There is a positive and significant correlation between the quality of sustainability reports and industry of the company.*

*H3: There is a positive and significant correlation between the quality of sustainability report and quotation of the company on the stock exchange.*

#### **4. RESEARCH RESULTS**

The reports covered by the analysis related to the year for which the companies published them on the CBCSD website, which in most cases were reports for business year 2014 (74%) and 2013 (11%), and two previous years (2012 and 2011, 10%), as well as for the latest year 2015 (5%). It was determined that analysed companies have continuity in publishing sustainability reports over the past few years, however, less than half (47%) have reporting continuity for more than five years. Companies mostly use the usual report names such as a "sustainability report", "sustainable development report" or "corporate social responsibility report", while only one of the observed companies integrates sustainability information into an annual report. In the reporting, 47% of the companies are aligning to the GRI Reporting Guidelines, which is consistent with Habek and Wolniak's research (2016, p. 415). Apart compatibility with the GRI Guidelines, some of them (44%) point out compliance with the UNGC Principles, while compatibility with the UNGC Principles but not with the GRI Guidelines is visible in 26% of other reports. Some companies (27%) explicitly do not state compliance with any internationally rec-

ognized reporting framework. Variations in reports of companies that make them according to the GRI Guidelines are noticeable depending on what version of the Guidelines (G3.1 or G4) they apply, and depending on the level of compliance with these Guidelines (either core or extensive). For companies which make reports in accordance with UNGC Principles, variations are less noticeable, and a possible reason for this is that companies are describing their compliance with UNGC Principles, which does not mean the publication of concrete quantitative indicators. The quantity of analysed reports ranges from only 10 to over 200 pages, and the average number of reports pages is 75. Of the company's environmental indicators, the companies primarily publish information on water consumption (75%) and energy consumption (70%), waste and wastewater production (70%), and greenhouse gas emissions and emissions of harmful substances (65%). Of the social indicators companies publish mostly information about the activities within the local community (90%), and then information about the employees (85%) and information about the occupational health and safety (85%). Given the number of indicators published by companies and their coverage in the reports, it is recognized that most of the analysed companies provide relatively good quality of information on sustainability, although reports should be subject to independent audits.

**Table 3.** Distribution of sustainability reporting quality indicators (environmental and social dimensions) of companies in Croatia

DIMENSION	INDICATOR	NUMBER OF COMPANIES WHICH REPORT INDICATOR
ENVIRONMENTAL DIMENSION	a) materials used	10
	b) energy consumption	14
	c) water consumption	15
	d) impact on biodiversity	9
	e) emissions of greenhouse gasses and harmful substances	13
	f) waste and wastewaters production	14
	g) initiatives to mitigate environmental issues	7



DIMENSION	INDICATOR	NUMBER OF COMPANIES WHICH REPORT INDICATOR
SOCIAL DIMENSION	a) work force	17
	b) occupational health and safety	17
	c) education and employee training programs	14
	d) diversity and equal opportunities of employees	12
	e) respect for human rights	8
	f) participation in local community	18
	g) health care and customer safety	13

Source: The author according to GRI G4 Guidelines for sustainability reporting: Reporting principles and standard disclosures, 2013, available at <https://www.globalreporting.org/resource-library/Croatian-G4-Part-One.pdf> (retrieved March 16<sup>th</sup> 2016) and sustainability reports available at web page of CBCSD, <http://www.hrpsor.hr/popis-nefinancijskih-izvjestaja-1-101.html> (retrieved March 19<sup>th</sup> 2016)

In order to determine the existence of a statistically significant correlation between certain characteristics of a company and the quality of the sustainability report, Pearson correlation coefficients were calculated, and it was determined whether there was a statistically significant correlation between the quality of sustainability reporting and the size, industry and quotation of the company on the stock exchange. As a measure of reporting quality for each company, a number of published environmental and social indicators were defined, with a maximum of 14 indicators. The size of the company was measured by the number of employees. According to the activities of the companies, they are grouped into two groups: environmentally sensitive (manufacturing) and environmentally less sensitive (service) companies. The system of grouping companies was also applied to the last variable, where companies are viewed as those which have and those which do not have quotation on the Zagreb Stock Exchange. Calculated coefficients and determined levels of significance are shown in Table 4. The results showed that there is a positive correlation between variable QUAL (quality of sustainability report) and variable SIZE (size of the company measured by total number of employees), and that it is statistically significant ( $r = 0.03$ ), thus confirming the first hypothesis (H1). However, there are no statistically significant correlation ( $r = 0.5$ ;  $r = 0.6$ ) between variable QUAL and variable IND (basic industry of the company), as well as variable QUAL and variable LIST (listing on the stock exchange), and therefore the remaining two hypotheses of research (H2 and H3) were not confirmed.

**Table 4.** Correlation matrix

		QUAL	SIZE	IND	LIST
<b>QUAL</b>	Pearson Correlation	1	.478*	-.149	.122
	Sig. (2-tailed)		.033	.530	.609
	N	20	20	20	20
<b>SIZE</b>	Pearson Correlation	.478*	1	-.187	.027
	Sig. (2-tailed)	.033		.431	.909
	N	20	20	20	20
<b>IND</b>	Pearson Correlation	-.149	-.187	1	.378
	Sig. (2-tailed)	.530	.431		.100
	N	20	20	20	20
<b>LIST</b>	Pearson Correlation	.122	.027	.378	1
	Sig. (2-tailed)	.609	.909	.100	
	N	20	20	20	20

\*. Correlation is significant at the 0.05 level (2-tailed).

Source: Author's processing in statistical computing program SPSS

In previous research the size of the company has shown as a factor that has a statistically significant impact on sustainability reporting (Branco and Rodrigues, 2008, Haniffa and Cooke, 2009), which can be related to the assumption that large companies are exposed more to the public. The reason why size of the company in this research has shown as significant impact factor on the quality of sustainability reporting can also be that in the sample were mostly companies with recognized brands of products and services that use their own social responsibility and disclosure of information on the achieved sustainability effects as a means of differentiating from competitors and attracting customers. Same as the size of the company, in some previous research the industry has shown a significant impact factor, especially in companies operating in environmentally sensitive sectors (Branco and Rodrigues, 2008). In this research, the industry of the company has not been identified as a significant factor influencing the quality of reporting, which may be due to the fact that there were only a few companies in the sample belonging to environmentally sensitive industry (e.g. oil production, cement production, etc.). In the research of Bonson and Bednarova (2015) listing on the stock exchange has proven to be a significant factor, while in this research this wasn't confirmed. This may be due to the relatively poor development of the capital market in Croatia, compared to highly developed countries, as well as not recognizing sustainability information as significant indicator of the effectiveness and efficiency of businesses from the standpoint of domestic investors.

## 5. CONCLUSION

Through sustainability reports companies present their environmental responsibility, focus on the protection of labour and human rights and improvement of employee satisfaction, social inclusion and support to development of local community, communication with stakeholders and involvement of their demands in decision-making processes. Sustainability reporting becomes a regular business practise of companies worldwide. Slowly, but certainly enters into business practice of companies in Croatia, as well. Given the number of indicators that the companies analysed in this survey are reporting in accordance with the GRI Guidelines, there is a discovery of a relatively good quality of sustainability information, although confirmation of this should be the opinion of an external audit. Of the observed factors influencing the quality of reporting, only the size of the company proved statistically significant. Sustainability reporting is a challenge, as it requires certain organizational changes to implement it, and invest time and resources into monitoring environmental and social aspects of business, measuring efficiency in these aspects, data analysis, and producing reports. Therefore, a large number of companies, especially those smaller ones, do not yet decided on the implementation of such business practice.

## REFERENCES

1. ACCA, The Business Benefits of Sustainability Reporting in Singapore, Association of Chartered Certified Accountants, 2013, <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/other-PDFs/sustainability-roundtable.pdf> (retrieved 01/12/2014)
2. Baviera-Puig, A. Gómez-Navarro, T., García-Melón, M., García-Martínez, G., Assessing the Communication Quality of CSR Reports: A Case Study on Four Spanish Food Companies, *Sustainability* No. 7, 2015, p. 11010-11031, doi:10.3390/su70811010
3. Bonson, E., Bednarova, M., CSR reporting practise of Eurozone companies, *Revisita de Contabilidad – Spanish Accounting Review*, Vol. 18, No. 2, 2015, p. 182-193
4. Brammer, S., Pavelin, S., Factors influencing the quality of corporate environmental disclosure, *Business Strategy and the Environment*, No. 17, 2008, p. 120-136
5. Branco, M. C., Rodrigues, L. L., Factors Influencing Social Responsibility Disclosure by Portuguese Companies, *Journal of Business Ethics*, No. 83, 2008, p. 685-701
6. Directive 2014/95/EU, *Official Journal of the EU*, 11/15/2014
7. Du, S., Bhattacharya, C., Sen, S., Maximizing business returns to corporate social responsibilities: the role of CSR communication, *International Journal of Management Reviews*, Vol. 12, No. 1, 2010, p. 8-19
8. Freundlieb, M., Teuteberg, F., Evaluating the quality of web based sustainability reports: a multi-method framework, 45th Hawaii International conference on System Sciences, 2012, <http://www.computer.org/csdl/proceedings/hicss/2012/4525/00/4525b177.pdf> (retrieved 03/19/2016)

9. Global Reporting Initiative (GRI), G4 Sustainability reporting guidelines: Reporting principles and standard disclosures, 2013, <https://www.globalreporting.org/resourcelibrary/Croatian-G4-Part-One.pdf> (retrieved 03/16/2016)
10. Global Reporting Initiative (GRI), Guidelines for sustainability reporting 3.0, 2006., <https://www.globalreporting.org/resourcelibrary/GRI-G3-Croatian-Reporting-Guidelines.pdf> (retrieved 03/21/2015)
11. Habek, P., Wolniak, R., Assessing the quality of corporate social responsibility reports: the case of reporting practices in selected European Union member states, *Qual. Quant.*, No. 50, 2016, p. 399-420
12. Hail, L., The Impact of Voluntary Corporate Disclosures on the Ex ante Cost of Capital for Swiss Firms, 2002, SSRN: <http://ssrn.com/abstract=279276> or <http://dx.doi.org/10.2139/ssrn.279276> (retrieved 03/26/2012)
13. Haniffa, R. M., Cooke, T. E., The impact of culture and governance on corporate social reporting, *Journal of Accounting and Public Policy*, Vol. 24, No. 5, 2005, p. 391-430
14. Croatian Business Council for Sustainable Development (CBCSD), <http://www.hrp-sor.hr/popis-nefinansijjskih-izvjestaja-1-101.html> (retrieved 03/19/2016)
15. Ienciu, A., Muller, V., Matis, D., Environmental reporting within the Romanian companies, *International Journal of Energy and Environment*, Vol. 5, No. 1, 2011, p. 123-131
16. International Integrated Reporting Council (IIRC), The International Integrated Reporting Framework, 2013, [www.theiirc.org](http://www.theiirc.org) (retrieved 03/15/2016)
17. KPMG, Currents of change: The KPMG Survey of Corporate Responsibility Reporting 2015, [www.kpmg.com/crreporting](http://www.kpmg.com/crreporting) (retrieved 12/05/2015)
18. Krivačić, D., Corporate environmental reporting – analysis of companies listed on the Zagreb Stock Exchange, *Accounting and Management*, 13<sup>th</sup> International Scientific and Professional Conference, Zagreb, 2012, Proceedings, Vol. 1 – Scientific Papers, p. 57-67
19. Merkel-Davies, D., Brennan, N., Discretionary disclosure strategies in corporate narratives: Incremental information or impression management? *Journal of Accounting Literature*, No. 26, 2007, p. 116-196
20. Morsing, M., Schultz, M., Corporate Social Responsibility Communication: Stakeholder information, response and involvement strategies, *Business Ethics: A European Review*, Vol. 15, No. 4, 2006, p. 323-338
21. Peršić, M., Bakija, K., Vlašić, D., Framework for improving quality and comparability of non-financial reporting system. *Copernican Journal of Finance & Accounting*, Vol. 4, Iss. 2, 2015, p. 109-127
22. Reverte, C., The impact of better corporate social responsibility disclosure on the cost of equity capital, *Corporate Social Responsibility and Environmental Management*, No. 19, 2012, p. 253-272
23. Reynolds, M., Yuthas, K., Moral discourse and corporate social responsibility reporting, *Journal of Business Ethics*, Vol. 78, No. 1-2, 2008, p. 47-64
24. World Business Council for Sustainable Development (WBCSD), Sustainable development reporting: Striking the balance, 2002, [http://wbcstdservers.org/wbcstdpublications/cd\\_files/datas/financial\\_capital/reporting\\_investment/pdf/SustainableDevReporting-Striking-the-balance.pdf](http://wbcstdservers.org/wbcstdpublications/cd_files/datas/financial_capital/reporting_investment/pdf/SustainableDevReporting-Striking-the-balance.pdf) (retrieved 01/16/2016)

## **KVALITETA IZVJEŠTAVANJA O ODRŽIVOSTI: ANALIZA PODUZEĆA U HRVATSKOJ**

### **SAŽETAK RADA:**

Usmjerenost poduzeća održivom razvoju rezultirala je povećanjem potražnje njihovih dionika za objavljivanjem izvještaja o održivosti. Izvještaje o održivosti smatra se dokazom odgovorne poslovne prakse koji eksternim i internim dionicima osigurava potrebne financijske i nefinancijske informacije. Izvještaji o održivosti omogućavaju poduzećima sagledati njihovu učinkovitost u rješavanju problema održivosti, a ujedno i lakše procijeniti koristi, ali i izazove s kojima se suočavaju. U njihovu sastavljaju uputno je koristiti kriterije za izvještavanje nezavisnih međunarodnih organizacija i inicijativa, čime se osigurava kvantiteta, ali i kvaliteta objavljenih informacija. Svrha ovoga rada je utvrditi razinu kvalitete izvještavanja o održivosti poduzeća u Hrvatskoj, što će omogućiti donošenje zaključaka o korisnosti objavljenih informacija dionicima. Rad će ujedno otvoriti prostor za daljnja istraživanja potrebe standardizacije nefinancijskog izvještavanja.

*Ključne riječi: izvještavanje o održivosti; kvaliteta; analiza*



Original Scientific Paper

UDC: 65.012/657.6

*Paper received: 03/03/2017*

*Paper accepted: 16/06/2017*

## **FOREIGN DIRECT INVESTMENT IN BOTSWANA: TRENDS, REFORMS AND CHALLENGES**

***Mercy T Magombeyi***<sup>1</sup>

*Department of Economics; University of South Africa, Pretoria, South Africa*

*E-mail: tsile.musa@gmail.com*

***Prof. Nicholas M. Odhiambo***

*Department of Economics; University of South Africa, Pretoria, South Africa*

*Email: odhianm@unisa.ac.za / nmbaya99@yahoo.com*

### **ABSTRACT**

This paper gives an overview of foreign direct investment (FDI) in Botswana from 1980 to 2013. The trends in FDI inflows, reforms that have been implemented, and challenges that need to be addressed in order to increase FDI inflows into the country are also highlighted. Reforms on FDI have been two-pronged. Firstly, there are policies that are aimed at creating a vibrant industry important for investment. Some of the policies pursued are: supportive industrial policies, regional integration and bilateral and multilateral trade agreements. Secondly, there are policies that directly target FDI. Among such policies are investment incentives, regulatory reforms, exchange control relaxation, Bilateral Investment Treaties (BITs) and the creation of Special Economic Zones. The overall analysis of the study shows FDI inflows in Botswana have been highly volatile and depressed since 1980, although a gradual increase has been recorded since the mid-90s.

***Key words:*** *Foreign Direct Investment (FDI); trends; reforms; challenges; policies*

---

<sup>1</sup> Corresponding Author [Dcom Student, Economics Department, University of South Africa, Pretoria].

## 1. INTRODUCTION

Low investment levels in developing countries have been associated with low economic development and a number of challenges, such as widespread poverty and generally low living standards. In an effort to increase investment capital, most governments in developing countries opened up their economies to FDI. The investment gap in most developing countries is a result of low savings – not sufficient to support investment needs. Besides closing the investment gap, FDI is associated with other positive direct effects, such as the creation of job opportunities that benefit the locals. FDI also brings technology which is important in improving production, management and marketing efficiency, competitiveness of the host economy, also speeding up the integration of the host country into the global world. It is these positive effects that make FDI attractive to developing countries, including Botswana.

There is a vast amount of literature supporting the positive effects of FDI on economic growth and poverty reduction. Among empirical studies in support of a positive effect of FDI on economic growth is Esso (2010), which, in a study on the relationship between FDI and economic growth between 1970 and 2007 in Sub-Saharan Africa, confirmed a long-run relationship. Adam (2009), in a study on 42 Sub-Saharan Africa, between 1990 and 2003 found FDI to have growth effects. Feeny (2014), in a study on the Pacific Island countries from 1971 to 2010, found FDI to be associated with high economic growth. Almfraji *et al.* (2014) found FDI to positively affect economic growth in Qatar between 1990 and 2010. Other studies explored the importance of FDI on poverty reduction. Gohou and Soumare (2012), for example, in a study on 52 African countries between 1990 and 2007, found FDI to reduce poverty. Jalilian and Weiss (2002), in a study on the ASEAN countries, found FDI to reduce poverty. The positive contribution of FDI to economic growth and poverty reduction, among other benefits, makes it important to developing countries.

The neoclassical and endogenous growth theories also support a positive relationship between FDI and economic growth and poverty reduction. In the neoclassical growth theories, technology and labour growth are exogenous (Solow, 1956). FDI in the neo-classical theories, augments domestic capital, although diminishing returns in the long run makes FDI to have the same effect as domestic capital (Solow, 1956). However, in the endogenous growth theories, technological progress is endogenously determined, making FDI to have a long-term effect on growth by offsetting diminishing returns (Lucas, 1988; Romer, 1990). It is this short- or long-run relationship that makes FDI important in economic development and poverty reduction in host countries.

FDI in Botswana plays an important role in closing domestic investment gap. FDI increases the stock of capital for investment, helps in the creation



of jobs and increases competitiveness of the host country industries through technological transfer (Blomstrom and Kokko, 1996; Klein *et al.*, 2001). The government also get revenue from taxes levied – which is important in the provision of public services and supporting developmental programmes. High growth levels lead to an increase in job opportunities, general improvement in living standards and advancement in technology (Klein *et al.*, 2001). Although FDI plays a pivotal role in economic growth, there is need for a review of its importance in Botswana within a rapidly changing regional, global and economic environment. It is this gap that this study aims to fill by having a fresh look at FDI dynamics in Botswana.

The rest of the paper is divided as follows: Section 2 gives an overview of FDI in Botswana. Section 3 outlines the reforms that have been implemented to harness FDI inflows. Section 4 gives trends in FDI inflows and Section 5 highlights the challenges that have been faced in increasing FDI inflows. Section 6 concludes the paper.

## **2. FOREIGN DIRECT INVESTMENT IN BOTSWANA: AN OVERVIEW**

The Transitional Plan for Social and Economic Development of 1965 marked the Botswana regime of implementing socio-economic policies through the National Development Plans (NDP). The government policies on FDI are enshrined in Pillar 2 in the NDP 10 that strives to build a prosperous, productive and innovative nation. The economy of Botswana in the 1980s was centred on mining following the discovery of diamonds in 1967. The main focus was building capacity in the mining sector to exploit and negotiate foreign direct investment deals with Multinational Companies (Crisuolo, 2008).

Government policies aimed at attracting FDI included: exchange control reforms, building a stable and sound macroeconomic environment, formation of investment support policies, regulatory reforms, trade agreements, regional integration, investment incentives, building Special Economic Zones among other policy initiatives aimed at supporting investment from both domestic and foreign investment. The government also made concerted effort to channel diamond proceeds to build and stimulate economic development – important for investment.

Despite the reforms implemented, FDI inflows remained depressed between 1980 and 2013. The average percentage of FDI inflows to GDP from 1981 to 1990 was 3.8%. From 1991 to 1994 Botswana recorded negative FDI inflows with the highest percentage registered in 1993 of 6.9% (World Bank, 2014). The percentage of FDI to GDP started increasing from 1994 to 2000, recording

an average percentage of 1.4% (World Bank, 2014). From 2002 to 2013 positive inflows were received. FDI inflows as a percentage of Gross Fixed Capital Formation (GFCF) were sluggish between 1990 and 1994 (UNCTAD, 2015b). The percentage of FDI to GFCF increased from 1995. The average percentage between 1995 and 2013 was 11.2 % (UNCTAD, 2015b). While greenfield inflows were characterised by sharp increases and deep falls, a general upward trend was recorded from 2003. From 2003 to 2013 the average inflows were \$515 million. The highest inflows were recorded in 2008, with \$1.9 billion; while the lowest was registered in 2013 with \$1.3 million (UNCTAD, 2015b). Greenfield inflows as a percentage of Africa greenfield inflows remained depressed between 2003 and 2013 with an average percentage of 0.58% (UNCTAD, 2015b).

Although FDI inflows improved from the 90s, the levels were low as measured by FDI as a percentage of GDP, GFCF and greenfield inflows. Botswana faces a number of challenges that are hampering high and consistent FDI inflows. These challenges include, among others, shortage of skilled labour; restrictive investment-related policies; restrictive access to land for industry development; lack of a single comprehensive document easily accessible to investors; and a localisation policy which affects recruitment of foreign employees.

### **3. FOREIGN DIRECT INVESTMENT REFORMS IN BOTSWANA**

The economy of Botswana relied on mining in the early 1980s and it formed the major source of government revenue (UNCTAD, 2003). The foreign investment was concentrated in the extraction sector of the economy (OECD, 2014). A number of reforms have been implemented to increase FDI inflows directly or indirectly in Botswana that include exchange control relaxation, industrial development, regulatory reforms, trade and regional integration among other reforms that will be discussed in detail in this section.

As part of the regional integration initiative, Botswana is a member of Southern Africa Customs Union (SACU) that has consisted of South Africa, Swaziland, Botswana, Namibia and Lesotho since 1910 and was part of the renewed agreement in 1969 (SACU, 2015). Another agreement was signed in 2002 to further trade relations among the member states and establish new revenue sharing formula, facilitate coordination in competition, trade and protection of infant industries (SACU, 2015). SACU allows goods from member countries to be tariff-free, while a common external excise tariff is charged on non-members (SACU, 2015).

Botswana was a founding member of Southern Africa Development Co-ordination Conference (SADCC) in 1980 which transformed to Southern Africa Development Community (SADC) in line with political and economic devel-

opments in 1992 (SADC, 2015b). SADC recognises the importance of foreign direct investment in national economic development. Initiatives related to investment have been advanced through the formation of the Protocol on Finance and Investment, the launch of a free trade area and the Industrial Policy Framework.

In 1982 the government introduced the Financial Assistance Policy (FAP) with the objective to expand export market, create employment and develop skills (UNCTAD, 2003). The FAP offered grants to both foreign and local companies who wanted to start businesses in Botswana. The policy was abolished in 2001, due to the high failure rate of projects. FAP was replaced by the Citizen Entrepreneurial Development Agency (CEDA), which focuses on companies owned by Botswana citizens (UNCTAD, 2003). The discontinuation of the programme implied a reduction in incentives for foreign investors as they have no access to CEDA investment support programmes.

In 1997 Botswana came up with the long-term economic plan called Vision 2016. The vision encompasses seven pillars, with pillar 2 focusing on investment support – building a prosperous, productive and innovative nation (Vision 2016, 2015). The Vision 2016 constitute the main goals government target to achieve by 2016, while the National Development Plans (NDP) including the NDP 10 – spanning from 2009 to 2016 – are used as instruments to achieve the Vision 2016 targets.

In 1997 the Botswana Export Development and Investment Authority (BEDIA) was formed to offer investment promotion including overseeing the promotion of investment and exports (OECD, 2014). BEDIA had the National Committee on Trade Policy and Negotiations Forum that discussed broad investment and trade issues. BEDIA had a role to advocate for changes in laws that negatively affect establishment of business in Botswana (OECD, 2014:94). A dialogue was established between investors and the agency through the Botswana Investment Guide and the Aftercare Questionnaire (OECD, 2014).

Botswana signed Bilateral Investment Treaties (BITs) between 1997 and 2006 (UNCTAD, 2015a). Out of the BITs that Botswana signed, only two BITs with Germany and Switzerland are currently in force (UNCTAD, 2015a). The BIT with Germany was signed in 2000 and came into force only seven years later in 2007 while the BIT with Switzerland was signed in 1998 and came into force two years later (UNCTAD, 2015a). BITs help to boost investment protection on outward and inward FDI investments (UNCTAD, 2007). They set out policy guidelines on protection, expropriation and dispute resolution for foreign investments (UNCTAD, 2007). The extent to which Botswana utilises BITs to foster FDI is more limited than envisaged by the number of agreements signed as compared with those that have been put into force (UNCTAD, 2015a).

Botswana embarked on exchange control reforms in the 1990s and by the 1999 all exchange controls were removed (OECD, 2013). Foreign currency is available to all investors from domestic and foreign sources. Access is free without any consideration to export volumes of investor business (OECD, 2014). Foreign owned companies can access funds from financing houses like the Botswana Development Cooperation, although a certain percentage of the project costs are required from the investor (OECD, 2014).

The IFSC, which focused on off shore financial investment promotion, was established in 2003 and later merged with BEDIA in 2012. The IFSC promoted investment in financial services to foreign investors (IFSC, 2015). Any company that qualified for IFSC status enjoyed a number of incentives. The selection criteria was based on a sound business proposal, sustainability of the business and the capacity of the business to hire and train its staff. The incentives which were offered in turn included: low tax, access to an expanding taxation avoidance treaty network, facilitation of work permits and tax administration benefits (IFSC, 2015).

A company that registered with the IFSC benefited from a discounted corporate tax of 15% from 25% normal corporate tax rate (IFSC, 2015). They also had access to Botswana 200% tax trading rebate as well as exempt from value added tax, capital gains and disposal of shares (IFSC, 2015). For companies that released 49% or more of their equity for trading on the Stock Exchange, a capital gains exemption was granted on disposal of shares (IFSC, 2015). In addition, the IFSC also assisted foreign companies in the processing of work and resident permit.

Botswana pursue an increase in market access through multilateral and regional trade agreements. The programmes related to trade are under the Department of International Trade, created in 2003. The main responsibilities of the department are to implement, monitor and negotiate trade policy and negotiate trade agreements. The core departments on trade issues include the Multilateral Trade Division, Regional and Bilateral Trade and Trade Policy and Research Division. Grouping of trade issues ensures effective and sufficient attention is given to trade issues with the view of maximising benefits for economic diversification and development.

Botswana has passed and amended a number of acts to support investment registration, regulation and operation. The revised Companies Act of 2004 requires registration of companies and removal of the need for Memorandum of Association, providing simple registration forms (OECD, 2014). Foreign companies have three options open for registration of companies. These include: i) a company limited by shares; ii) a close company; and iii) a company limited by guarantee (Ministry of Trade and Industry (MTI), 2015a).

Besides registration of a company, companies are expected to have a licence when venturing into manufacturing. Eligibility for an industrial licence for companies that venture into manufacturing requires fulfilment of the Industrial Development Act 2006 and its Regulations of 2008 (MTI, 2015b). The licences are issued by the Industrial Licensing Authority and Regional Licensing Committee (MTI, 2015a). Import permits are required for imports outside SACU, Malawi and Zimbabwe (MTI, 2015a). The import permit issuance has been decentralised for ease of access to importers (MTI, 2015a).

The Industrial Development Act of 2006 decentralised licensing to local authorities through the District Licensing Committees (MTI, 2015b). A company can obtain a licence from the council in its location. The decentralisation process speeds up the licensing process.

The Protocol on Finance and Investment was signed by SADC member states in 2006. The Protocol highlights the importance of foreign investment and encourages nations to support and provide incentives to attract FDI (SADC, 2006). The main objectives of the Protocol are to achieve cooperation and convergence in policy related to FDI, macroeconomic stability, legal framework, harmonisation of FDI policies and financial market development (SADC, 2006). The Protocol covers the need for nations to support entrepreneurship in industries that support FDI. The importance of FDI is covered in Article 4 of Annex 3 of the Protocol (SADC, 2015a). The SADC Regional Indicative Strategic Development Plan (RISDP) provides factors that investors consider when choosing to settle in a country and act as a guideline on the areas that member countries can develop in order to be competitive in attracting FDI (SADC, 2015a). Under the Protocol, SADC provide template for Bilateral Investment Treaties as a way of harmonising investment policies and laws (SADC, 2012).

The government also signed a number of bilateral and multilateral trade agreements (AFDB and OECD, 2008). In 2006, the Southern African Customs Union (SACU) signed the SACU- European Free Trade Area (EFTA) to facilitate free movement of trade between SACU members and the EFTA members (BITC, 2015c). Botswana is also part of the African Growth and Opportunity Act, World Trade Organisation SACU-United States of America Trade, Investment and Development Cooperation Agreement (SACU US TIDCA) and SACU-European Free Trade Association Free Trade Agreement (SACU EFTA FTA), among other agreements (BITC, 2015c). These agreements help in the expansion of market for Botswana exports.

The SADC free trade area was launched in 2008 to facilitate free movement of goods within SADC while each member maintains external tariff on non-members (AFDB and OECD, 2008). Botswana trade relations with SADC are governed by the Protocol on Trade of 2005. The Protocol enhances economic

development and encourages the creation of a climate that support foreign investment (MTI, 2015d). The Protocol outlines the deepening of integration from a Free Trade Area by 2008 to a Customs Union by 2010, Common Market by 2015, and Monetary Union by 2016 (MTI, 2015d).

In 2008, Botswana passed the Trade Act S.I. 21, which provide for regulation of trade activities, licensing, monitoring and compliance to the law. The Act provides an avenue for government to build legitimate and competitive industry which can compete on the global world.

The Competition Act of 2009 established a Competition Authority and Competition Commission responsible for unfair business competition and resolution of competition matters (Competition Authority, 2015). The Competition Commission provides dispute resolution on matters related to competition. The Act is in line with the national Competition Policy for Botswana passed in 2005 (Competition Authority, 2015).

In 2010 government of Botswana came up with the Special Economic Zones Policy. The Special Economic Zone (SEZ) is a geographical economic area with its own administrative SEZ Authority (MTI, 2010:2). SEZ provides an investor-friendly environment and the main objective is to diversify the economy for sustainable development after diamond resources. They also act as incubators for competitive enterprises in Botswana (MTI, 2010). The government created six specialised zones, namely: Agriculture Hub, Innovation hub; Diamond hub; Education hub; Health hub; and Transport hub (MTI, 2010). The SEZs provide a competitive and attractive investment environment for business; diversification; private sector-led business clustering; efficiency, provision of incentives, equal treatment of domestic and foreign businesses (MTI, 2010). The incentive framework includes corporate tax reductions or exemptions, and duty-free importation of raw material and capital goods for businesses under the SEZs (MTI, 2010).

A merger of the IFSC and the BEDIA was formed in 2012. This resulted in the formation of the Botswana Investment and Trade Centre (BITC), created through the BITC Act of 2011, which led to the repeal of the BEDIA Act and dissolving the IFSC. The BITC is mandated to promote investment; develop strategy and competitiveness, export development and promotion, brand management and shared services; and promote special economic zones (BITC, 2015a). The creation of BITC led to harmonisation and coordination of investment promotion.

Investment sectors supported by BITC are: education, agriculture, energy, services, health, ICT, manufacturing, mining and transport, and logistics (BITC, 2015a). The BITC, through the Business Facilitation Plan, provides information related to the establishment of business ranging from company registra-

tion, work and resident permit application process and tax registration (BITC, 2015b).

Bilateral Investment Treaties (BITs), together with the constitution, make provisions for the protection of investors and compensation (OECD, 2014). The Companies and Intellectual Property Authority Act, number 14 of 2011, provides for the creation of the Companies and Business Name Office, Industrial Property Office and Copyright office. The Copyright and Neighbouring Rights Act and Industrial Property Act provide protection of investors in Botswana (OECD, 2014). Botswana is also part of international organisations on intellectual property like the Agreement on Trade Related Aspects of intellectual Property Rights and African Regional Intellectual Property Organisation.

The Industrial Development Policy of 2014, first launched in 1984 and reviewed in 1998 to align the policy with economic developments, focus on; modernisation, diversification, industry facilitation and support and development of infrastructure for industrial development (Republic of Botswana, 2014). The policy also supports development of skills necessary to support industrial development, and facilitates building a strong industry base which is important in attracting investment.

The SADC Industrial Development Policy Framework of 2014 recognises the importance of industry development in economic diversification (SADC, 2014). The main objective of the policy is to provide areas of cooperation at regional level. The policy framework acknowledges the role that member countries have to play in facilitating industrial development as a way of stimulating transition of respective economies to high-income countries and building a vibrant industrial base (SADC, 2014). The regional collaboration among SADC member states assists in solving problems such as market access, competitive bottlenecks, under-development of infrastructure and a narrow manufacturing base (SADC, 2014).

The MTI offers incentive programmes to investors like the drawback provision, Economic Diversification Drive and Rebate 470.03 (MTI, 2015c). The Drawback Provision allows exporters to claim back duty paid for imports in the manufacturing industry (MTI, 2015c). The Rebate 470.03 applies to manufacturers, importers and exporters (MTI, 2015c). The incentive programme provides rebate on all components and material covered in the permit for manufacturing goods exclusively for export outside the SACU (MTI, 2015c).

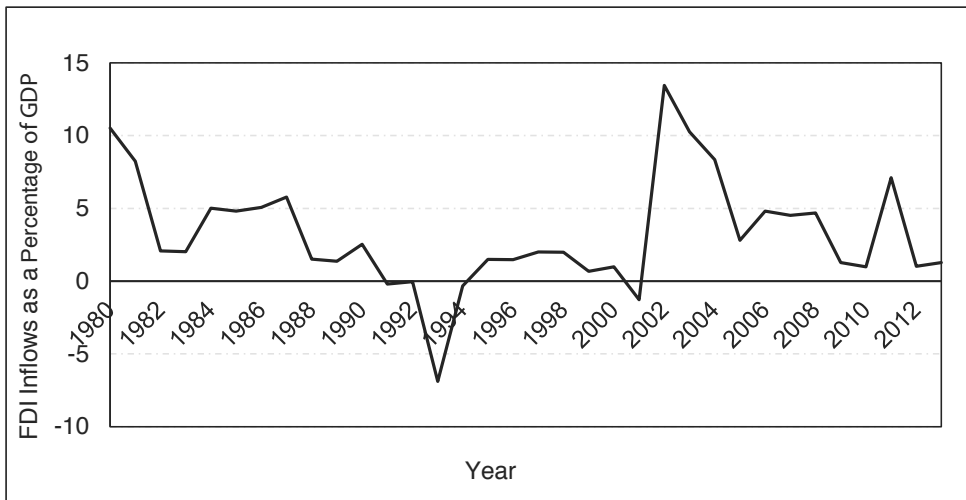
Foreign access to some sectors where public interest is regarded as priority is limited. These sectors are reserved for Botswana citizens (OECD, 2014). The restriction are pursued through the Localisation Policy, Reservation Policy and Economic Diversification Drive, especially the short-term strategy (OECD, 2014). The Industrial Development Amendment Regulation of 2008 reserves

small and medium manufacturing to citizens. The same reservation is provided in the Trade Act of 2008; Liquor Act of 2003; Public Procurement and Asset Disposal Board; Citizen Economic Empowerment Policy; Petroleum (Production and exploration) Act; and the Mines and Mineral Act of 1999 (OECD, 2014). Government also retains 15% of shares in the mining business for any mining licence issued (OECD, 2014).

#### 4. FOREIGN DIRECT INVESTMENT TRENDS IN BOTSWANA

FDI inflows as a percentage of GDP were modest from 1980 to 2000 before taking a gradual upward trend to 2013 (World Bank, 2014). Figure 1 shows trends in FDI inflows as a percentage of GDP from 1980 and 2013.

**Figure 1:** FDI inflows as a Percentage of Gross Domestic Product 1980-2013



Source: World Bank, 2014

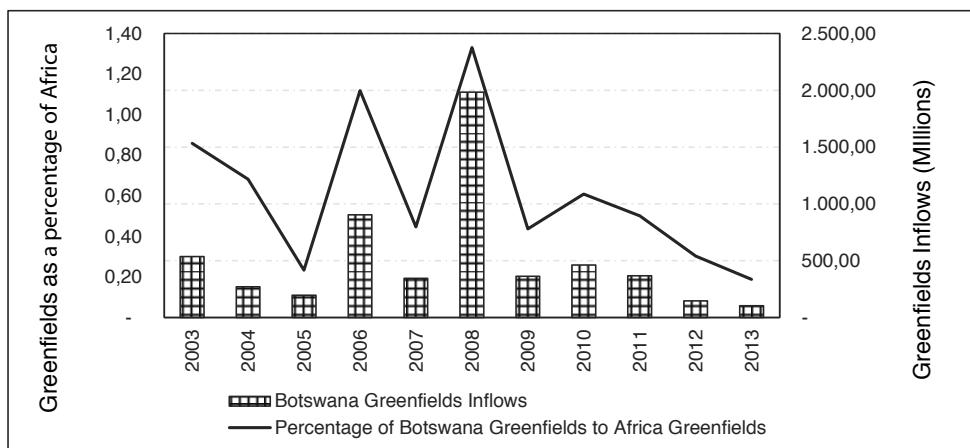
Figure 1 shows that FDI inflows as a percentage of GDP in 1980 were at a peak with 10.5%, before a decline of 21.6% in 1981 (World Bank, 2014). The FDI inflows continued on a downward trend from 8.2% to 2.1%, with another decline to 2% in 1983 (World Bank, 2014). The inflows improved by 146.7% in 1984 to register 5% before declining to 4.8% in 1985. In 1986 the percentage of FDI inflows increased to 5% and another increase of 14% was recorded in 1987 (World Bank, 2014). A downward trend was registered from 1988 to 1989 with 1.5% and 1.3% respectively. In 1990 the percentage increased by 84% to give 2.5%. From 1991 there was a decline, recording a negative 6.9% in 1993. The inflows remained negative in 1994 at 0.3% before improving to 1.48% in 1995



(World Bank, 2014). The period between 1995 and 2013 was characterised by large fluctuations, although the percentage of FDI inflows to GDP remained positive, with the exception of 2001 that recorded a negative 1.2% (World Bank, 2014). The average percentage over the period was 3.4%. Years with exceptionally high percentage of inflows to GDP were 2002, 2003 and 2004, with 13.4%, 10.2% and 8.3% respectively. FDI inflows as a percentage of GDP fluctuated much from 1980 to 2013 with major improvement recorded after 1994.

Greenfield FDI is new investment where a new firm is established forming a foreign affiliated company (UNCTAD, 2000:2). Greenfield leads to improvement in the productive capacity of a country with new linkages brought into the industry network. Figure 2 shows trends in greenfield FDI inflows in Botswana and greenfield as a percentage of greenfield in Africa.

**Figure 2:** Trends in Greenfield FDI Inflows and Greenfield as a percentage of Africa Greenfield FDI Inflows 2003-2013.



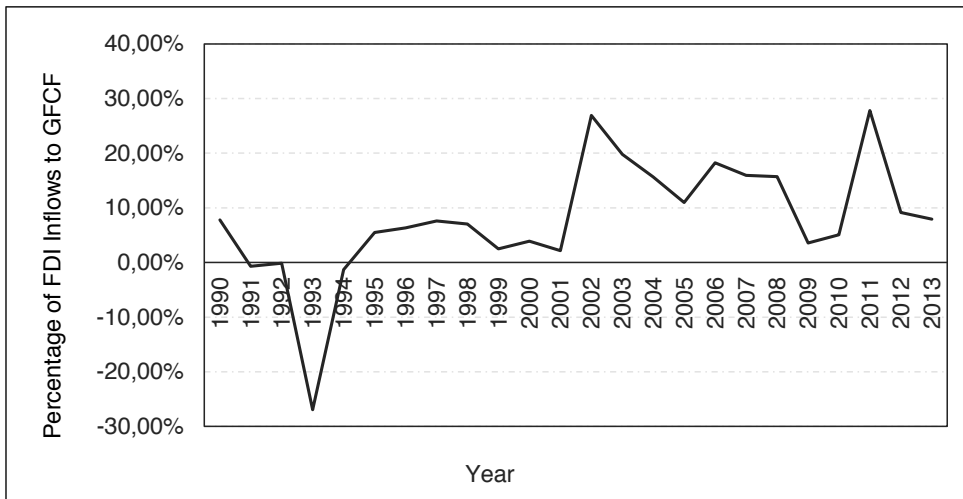
Source: UNCTAD: 2015b

Greenfield inflows in Botswana were at \$536 in 2003 before declining by 50% in 2004 to register \$270 million (UNCTAD, 2015b). In 2005 another decline of 28% was recorded before a sharp increase to \$903 in 2006 (UNCTAD, 2015b). In 2007 a decline of 62% was recorded to give an inflow of \$345 million. A sharp increase to \$1.9 billion was recorded in 2008 which also marked the highest inflow of greenfield FDI in Botswana between 2003 and 2013 (UNCTAD, 2015b). The peak was followed by a decline of 82% in 2009. From 2009 greenfield FDI inflows took a downward trend from \$460.9 million in 2010 to \$103.5 million in 2013. The average inflow of \$287 million was registered between 2009 and 2013 (UNCTAD, 2015b).

Greenfield FDI inflows in Botswana as a percentage of greenfield FDI inflows in Africa were low, averaging 0.58% from 2003 to 2013 (UNCTAD, 2015b). The percentage of greenfield inflows was at 0.86% in 2003 before declining to 0.23% in 2005 (UNCTAD, 2015b). In 2006 an increase of 0.9% was recorded, giving 1.12%, which is also the second highest percentage in Botswana greenfield inflows as a percentage of inflows received in Africa during the period (UNCTAD, 2015b). This was followed by a decline 0.67% in 2007 before an increase of 1.33%, was registered in 2008, giving the highest percentage of inflows from 2003 to 2013. A gradual decline was registered from 2009 from 0.44% to 0.19% in 2013 (UNCTAD, 2015b). The share of Botswana greenfields in Africa remained depressed over the period characterised by high fluctuations.

FDI inflows are important as a source of investment funds. FDI augment domestic investment capital to enable a high capital base difficult to achieve with domestic savings alone. Figure 3 shows trends in FDI inflows as a percentage of Gross Fixed Capital Formation from 1990 to 2013.

**Figure 3:** Trends in FDI inflows as a Percentage of Gross Fixed Capital Formation 1990 -2013



Source: UNCTAD: 2015b

In 1990, FDI inflows as a percentage of GFCF was at 7.8% before registering a decline in 1991 to give a negative 0.69% (UNCTAD, 2015b). The FDI inflows remained depressed in the negative, with the highest figure of -26.9% recorded in 1993 (UNCTAD, 2015b). In 1995 a 5.5% was recorded and a further increase of 0.82% was recorded in 1996 (UNCTAD, 2015b). In 1997, another increase

of 1.28% was registered before a downward trend from 1988 to 1999 (UNCTAD, 2015b). Major fluctuations were registered from 2000 and 2013, although the percentage of FDI to GFCF remained positive (UNCTAD, 2015b). The years which recorded high inflows were 2011, 2002, 2003 and 2006, with 27.8%, 26.9%, 19.8% and 18.3% respectively, while lowest inflows were recorded in 2001 with 2.15% and 2009 with 3.6% (UNCTAD, 2015b). The average percentage of inflows between 2000 and 2013 was 13% (UNCTAD, 2015b). An upward trend in FDI inflows as a percentage of GFCF was realised from 2000 (UNCTAD, 2015b).

## **5. CHALLENGES IN INCREASING FOREIGN DIRECT INVESTMENT IN BOTSWANA**

Botswana has an acute shortage of skilled labour (Ministry of Finance and Development Planning, 2013:9). In response to the challenge, government has put in place policies that aim to address quality of education and increasing skills in the labour force. Among such initiatives are the Revised National Policy on Education of 1994 and National Policy on Vocational Education and Training of 1997. In 2009 the National Human Resource Development Strategy was also launched. The overarching objective of the policies is to provide education and skills oriented to the market needs.

Although Botswana has made strides in formulating laws and investment policies that protect investors, those laws are fragmented and not easily accessible to investors (OECD, 2014). The Botswana Constitution 1966 provides for protection of investors. In the case of expropriation for development for community benefits the aggrieved can seek recourse to Botswana courts and government is also obliged to pay compensation. In addition, the Acquisition of Property Act and the Tribal Land Act also make provisions related to expropriation. The laws are under different policy documents and there is no single document easily accessible to investors (OECD, 2014). This makes the information less accessible, resulting in some investors not being aware of the rights afforded to them under Botswana law (OECD, 2014).

According to OECD (2014:74), the Botswana framework for commercial dispute resolution is weak and outdated. The country ranked 74th out of 189 in 2015, a fall from 66th position in 2014 in the World Bank Doing Business ranking (World Bank, 2015b). The Trade and Dispute Act of 2004 provides for the establishment of an industrial court, but this has been dealing with labour-related disputes. Botswana lacks commercial courts dedicated to expeditious commercial dispute resolution. The Arbitration Act of 1966 does not make provisions for commercial courts in Botswana, but recognises the role of the High

Court of Botswana (OECD, 2014). The alternative dispute resolution platform is the Botswana Institute of Arbitrators, which is a voluntary informal dispute resolution and concentrates largely on the construction sector (OECD, 2014).

Botswana faces challenges in infrastructure development, which is important in regional and international accessibility (AFDB, 2009; OECD, 2013). The most critical infrastructure challenge is electricity generation, which has persisted from 2006 and is compounded by the reduced capacity of South Africa to export power to Botswana (AFDB, 2009). The financing gap across infrastructure sectors which cannot be closed by public funds has resulted in government considering Public-Private Partnership in infrastructure provision (OECD, 2013).

## **6. CONCLUSION**

This paper has provided an overview of FDI in Botswana; highlighted policy reforms to boost FDI inflows; tracked the trends in FDI inflows and outlined the challenges that have been faced by government in its effort to increase FDI inflows. The government has implemented a number of policies aimed at increasing FDI inflows directly or indirectly which include: exchange control reforms in the area of dividend and repatriation of profits; regulatory reforms, for example, the Companies Act, Industrial Development Act and Amended Regulations to strengthen industrial base; development of Special Economic Zones; the formation of the Botswana Trade and Investment Centre to advance trade and investment promotion; and multilateral trade agreements, among other policy initiatives. In response to the policy reforms, FDI inflow increased gradually in the mid-90s, but the levels remained low. FDI inflows as a percentage of GDP were depressed from 1980 to 1994 with some years registering negative inflows. High percentages of FDI inflows to GDP were recorded from 2001 to 2013 with an average of 5%, while FDI inflows as a percentage of GFCF decreased from 1990 to 1994, before taking a gradual upward trend from 1995. Although a marginal fall was registered in 1999, FDI inflows continued the upward trend to 2013. Despite a gradual increase in FDI inflows, Botswana still faces a number of challenges. These challenges include, among others: shortage of skilled labour, restrictive investment-related policy, restrictive access to land for industry development, insufficient infrastructure, and lack of a single comprehensive and easily accessible information access on investment.

## REFERENCES

1. Adam, S. 2009. Foreign direct investment, domestic investment and economic growth in Sub-Saharan Africa. *Journal of Policy Modelling* 31. 939-949.
2. AFDB and OECD, 2008, Africa Economic Outlook. [Online]. Available from <<http://www.oecd-ilibrary.org>>. [Accessed 1 June 2015].
3. AFDB, 2009, Botswana Country Strategy Paper 2009-2013. [Online]. Available from <<http://www.afdb.org>>. [Accessed 19 July 2015].
4. AFDB, OECD and UNDP, 2014. Africa Economic Outlook: Botswana. [Online]. Available from <<http://www.africaeconomicoutlook.org>>. [Accessed 28 June 2015]
5. Almfraji, MA., Almsafir, M. K. and Yao, L. 2014. Economic growth and foreign direct investment inflows: The case for Qatar. *Social and Behavioural Science*, 109, 1040-1045.
6. BITC, 2015a. Investment Sectors. [Online]. Available from <<http://www.bitc.co.bw>>. [Accessed 1 July 2015].
7. BITC, 2015b. Incentives for Investors. [Online]. Available from <<http://www.bitc.co.bw>>. [Accessed 1 July 2015].
8. BITC, 2015c. Botswana Investor's Handbook. [Online]. Available from <<http://www.gobotswana.com>>. [Accessed 1 July 2015].
9. Blomstrom, M and Kokko, A. 1996. The Impact of Foreign Investment on Host Countries: A Review of the Empirical Evidence. Stockholm School of Economics, NBER and CEPR.
10. Competition Authority, 2015. About Competition Authority. [Online]. Available from <<http://www.competitionauthority.co.bw>>. [Accessed 29 June 2015].
11. Criscuolo, A. 2008. Briefing Note: Botswana. [Online]. Available from <<http://www.sitesources.worldbank.org>>. [Accessed 15 June 2015].
12. Esso, LJ. 2010. Long run relationship and causality between foreign direct investment and growth: Evidence from ten African countries. *International Journal of Economics and Finance* 2. 168-177.
13. Feeny, S., Iamsiraroj, S and McGillivray, M. 2014. Growth and foreign direct investment in the Pacific Island countries. *Economic Modelling* 37. 337-339.
14. Gohou, G and Soumare, I. 2012. Does foreign direct investment reduce poverty in Africa and are there regional differences. *World Development* 40(1). 75-95.
15. Government of Botswana. 2008. Botswana Excellence-A Strategy for Economic Diversification and Sustainable. [Online]. Available from <<http://www.gov.bw>>. [Accessed 19 July 2015].
16. IFSC, 2015, Why Botswana IFSC. [Online]. Available from <<http://www.botswanaifsc.com>>. [Accessed 25 May 2015].
17. Jalilian, H and Weiss, J. 2002. Foreign direct investment and poverty in the ASEAN region. *ASEAN Economic Bulletin* 19(3). 231-253.
18. Klein, M., Aaron, C and Hadjimichael, B. 2001. Foreign Direct Investment and Poverty Reduction, Research Working Paper No 2613, World Bank. Washington, DC.
19. Lucas, EJ Jr. 1988. On mechanics of economic development. *Journal of Monetary Economics* 22. 3-43.
20. Ministry of Finance and Development Planning, 2013. Mid Term Review of NDP 10. [Online]. Available from <<http://www.finance.gov.bw>>. [Accessed 20 July 2015].
21. MTI, 2010. Special Economic Zones Policy for Botswana. [Online]. Available from <<http://www.mti.gov.bw>>. [Accessed 30 June 2015].
22. MTI, 2011. Economic Diversification Drive: Medium to Long Term Strategy. [Online]. Available from <<http://www.mti.gov.bw>> [Accessed 2 July 2015].
23. MTI, 2015a. Business Registration. [Online]. Available from <<http://www.mti.gov.bw>>. [Accessed 30 June 2015].

24. MTI, 2015b. Botswana Trade and Industry Legislation. [Online]. Available from <<http://www.mti.gov.bw>>. [Accessed 30 June 2015].
25. MTI, 2015c. Investor Programmes. [Online]. Available from <<http://www.mti.gov.bw>>. [Accessed 30 June 2015].
26. MTI, 2015d. Botswana's Bilateral, Regional and Multilateral trade Agreements. [Online]. Available from <<http://www.mti.gov.bw>>. [Accessed 30 June 2015].
27. OECD, 2013. Investment Policy Reviews: Botswana. [Online]. Available from <<http://www.oecd.org>>. [Accessed 1 July 2015].
28. OECD, 2014. Investment Policy Reviews: Botswana. [Online]. Available from <<http://www.oecd.org>>. [Accessed 1 July 2015].
29. Republic of Botswana, 2012. Citizen Economic Empowerment Policy. [Online]. Available from <<http://www.mti.gov.bw>>. [Accessed 6 July 2015].
30. Republic of Botswana, 2014. Industrial Development Policy for Botswana. Paper Number 3. [Online]. Available from <<http://www.mti.gov.bw>>. [Accessed 1 July 2015].
31. Romer, PM. 1990. Endogenous technology change. *Journal of Political Economy* 98 (5). S71-S5102.
32. SACU, 2015. History of SACU. [Online]. Available from <<http://www.sacu.int>>. [Accessed 20 July 2015].
33. SADC 2015a. Foreign Direct Investment. [Online]. Available <<http://www.sadc.int>>. [Accessed 30 June 2015].
34. SADC 2015b. History and Treaty. [Online]. Available <<http://www.sadc.int>>. [Accessed 18 July 2015].
35. SADC, 2012. SADC Model Bilateral Investment Treaty Template. [Online] Available from <<http://www.investmentpolicyhub.unctad.org>>. [Accessed 30 June 2015].
36. SADC, 2014. SADC Industrial Development Policy Framework. [Online]. Available from <[sadc.int](http://www.sadc.int)>. [Accessed 30 June 2015].
37. SADC. 2006. Protocol on Finance and Investment. [Online]. Available from <<http://www.sadc.int>>. [Accessed 30 June 2015].
38. Solow, RM. 1956. A contribution to the theory of economic growth. *The Quarterly Journal of Economics* 70 (4). 65-94.
39. UNCTAD, 2000. Impact of Cross Border Mergers and Acquisitions on Development and Policy Issues for Consideration: Note by UNCTAD Secretariat. [Online]. Available from <<http://www.unctad.org>>. [Accessed 18 July 2015].
40. UNCTAD, 2003. Investment Policy Review: Botswana. [Online]. Available from <<http://www.unctad.org>>. [Accessed 10 July 2015].
41. UNCTAD, 2007. Bilateral Investment Treaties 1995-2006: Trends in Investment Rule Making. [Online]. Available from <<http://www.unctad.org>>. [Accessed 30 June 2015].
42. UNCTAD, 2015a. Bilateral Investment Treaties. [Online]. Available from <<http://www.investmentpolicyhub.unctad.org>>. [Accessed 30 June 2015].
43. UNCTAD. 2015b. World Investment Report: Annex Tables. [Online]. Available from <<http://www.unctad.org>>. [Accessed 14 July 2015].
44. UNDP, 2005. Poverty Status Report for Botswana: Incidence, Trends and Dynamics. International Poverty Centre. [Online]. Available from <<http://www.ipc-undp.org>>. [Accessed 29 May 2015].
45. Vision 2016. 2015. Status at a Glance across All Pillars by Key Result Areas. [Online]. Available from <<http://www.vision2016.co.bw>>. [Accessed 11 July 2015].
46. World Bank, 2014. World Bank Development Indicators. [Online]. Available from <[www.data.worldbank.org](http://www.data.worldbank.org)>. [Accessed 18 December 2014].
47. World Bank, 2015a. Doing Business. [Online]. Available from <[www.doingbusiness.org](http://www.doingbusiness.org)>. [Accessed 18 July 2015].

## **IZRAVNA INOZEMNA ULAGANJA U BOCVANI: TRENDovi, REFORME I IZAZOVI**

### **SAŽETAK RADA:**

Ovaj rad daje pregled izravnih inozemnih ulaganja (FDI) u Bocvani u periodu od 1980. do 2013. godine. Proučavani su trendovi priljeva izravnih inozemnih ulaganja, provedene reforme i reforme koje je još potrebno provesti kako bi se povećala izravna inozemna ulaganja u zemlju. Reforme su dvosmjerne. Prvo, postoje politike čiji je cilj stvoriti dinamičnu industriju pogodnu za ulaganja. Neke od politika koje se provode su: politike potpore industriji, regionalna integracija te bilateralni i multilateralni trgovinski sporazumi. Također, postoje politike koje izravno utječu na izravna inozemna ulaganja. Među takve politike spadaju inicijative za ulaganja, regulatorne reforme, popuštanje kontrole tečaja, bilateralni sporazumi o ulaganjima te stvaranje posebnih gospodarskih zona. Sveukupna analiza studije pokazuje da su izravna inozemna ulaganja u Bocvani bila iznimno nestabilna i slaba od 1980-godine iako sa blagim porastom od sredine 1990-ih godina.

*Ključne riječi: izravna inozemna ulaganja;; trendovi; reforme; izazovi; politike.*





Preliminary paper

UDC: 65.012/657.6

*Paper received: 10/05/2017*

*Paper accepted: 26/06/2017*

## **APTITUDE AND POSITIONING OF CHIEF RISK OFFICERS IN SOUTH AFRICA'S PUBLIC INSTITUTIONS**

*Tankiso Moloj, Ph.D.*

*Department of Accountancy, University of Johannesburg, South Africa*

*E-mail: smoloi@uj.ac.za, tankisomoloi@webmail.co.za*

### **ABSTRACT**

This paper places the CROs proficiencies and positioning in a wider debate surrounding the weaknesses in internal controls in South Africa's public institutions. It uses and pays particular attention to the qualifications and professional membership as measures of proficiency as well as the remuneration scale, and the reporting lines as measures of positioning.

With regard to the proficiency, it was noted that the majority of CROs had the post High School Qualifications. However, with regard to the positioning of CROs, the paper found that there was huge variation in the remuneration scale and confusions regarding the line of reporting. For instance, some CROs had the functional lines of reporting to their executives, whereas other CROs had the functional lines of reporting to their overseeing bodies (Audit Committee, Risk Management Committee, Audit and Risk Management Committee etc.)

**Keywords:** *Chief Risk Officers (CROs); Enterprise Risk Management (ERM); Human Capital (HC); Public Sector (PS)*

## I. INTRODUCTION

The Auditor General of South Africa continues to be concerned that despite efforts made by the South African Local Government Association, National Treasury and the Department of Cooperative Governance and Traditional Affairs in addressing challenges relating to the causes of audit disclaimers, change continues to be very slow.

In this regard, South Africa's public officials have been unable to reign on irregular expenditure, fruitless and wasteful expenditure as well as the unauthorised expenditure. For instance, of the R1.2 trillion budget for the 169 national and provincial government departments as well as 315 public entities, in the 2015/16 fiscal year, R46.4 billion was classified as irregular expenditure (this was R25.7 billion in 2014/15 and R62.7 billion in 2013/14 fiscal years), about R1.4 billion was classified as fruitless and wasteful expenditure (this was R1 billion in 2014/15 and R1.2 billion in 2013/2014) and R925 million was classified as unauthorised expenditure (this was R1.6 billion in 2014/15 and R2.6 billion in 2013/14) (Auditor General South Africa (AGSA), 2016, AGSA, 2015 & AGSA, 2014).

In municipalities, of the R347 billion expenditure budget for the 272 municipalities in 2014/15, R14.8 billion was classified as irregular expenditure (this basket was R11.5 billion in 2013/14 and R12.2 billion in 2012/13), R1.34 billion was classified as fruitless and wasteful expenditure (this was R687 million in 2013/14 and R860 million in 2012/13), and R15.32 billion was classified as unauthorised expenditure (this was R11.4 billion in 2013/14 and R8.5 billion in 2012/13) (AGSA, 2015, AGSA, 2014 & AGSA, 2013,).

According to the National Treasury's Public Sector Risk Management Framework, the enterprise risk management unit is tasked with coordinating and supporting the overall institutional risk management process (National Treasury, 2010). In this regard, this paper argues that individuals providing support referred herein, should themselves be highly proficient in the subject. These individuals are referred to as Chief Risk Officers (CROs).

It is expected that most public institutions will have in place the enterprise risk management unit headed by the respective CRO. This expectation centres on the requirements of the Public Finance Management Act (PFMA) and the Municipal Finance Management Act (MFMA), where sections 38(1)(a) (i) and 51(1)(a)(i) of the PFMA requires that the Accounting Officers/Authorities ensure that their institutions have and maintain effective, efficient and transparent systems of risk management (RSA, 1999); and sections 62(1)(c)(i) and 95(c)(i) of the MFMA, requires the Accounting Officers to ensure that their municipalities and municipal entities have and maintain effective, efficient and transparent systems of risk management (RSA, 2003).

If risk management units have been set up and the CROs are proficient in the subject matter that they providing support on, then how can risks such as irregular expenditures, fruitless and wasteful expenditures etc. continue to materialise? The continuous materialisation of these events points to the fact that some parts of the control environment are vulnerable (have weaknesses). The purpose of this paper is to examine specific proficiencies and the positioning of CROs overseeing South Africa's public institutions.

The introduction provided the overview on the state of risk management in South Africa's public service institutions in order to give context. The following section will review the related literature. This section will be followed by a section that outlines the research process. Further, the analysis and interpretation of findings will be conducted and finally the conclusion.

## **II. RELATED LITERATURE**

Academic literature on the subject of risk management in general, and literature in the public sector, specifically is a growing body (see Moloi 2016a and Moloi 2016b). However, it is recognised here that literature on Chief Risk Officers is generally scarce. More so, academic literature on CROs in the public space is almost next to non-existent.

Having indicated this, practitioner literature on the CROs appear to be a growing body. The growth of practitioner literature on the CROs is attributable to the need by industry to have a fully integrated risk management programme. Brown (2010) appears to support where it is pointed out that the business failures of the past were 'attributed to ineffective Governance, Risk and Compliance (GRC) systems. And further, accountabilities of senior executives were rapidly increasing, it was thus difficult for Chief Executive Officers and Chief Financial Officers to dedicate sufficient time to the finer points of risk management.

In looking at the evolving role of the CRO, the Economist Intelligence Unit (The Economist, 2005), came to the conclusion that it has been the pressure and the need to respond to 'increased regulatory pressures and a growing array of business risks', which is actually the main cause of the CRO position emerging as one of the most important positions in the management team.

In 2016, Ernst and Young (2016), conducted the Bermuda Insurance CRO Survey. Their finding was that the risk function has clearly established itself in the organizational structure. Further, they observed that the establishment of the risk function in the organisation structures was accompanied with CROs playing a role across all key processes within the organization.

In the paper entitled 'the Triumph of the Humble Chief Risk Officer', Mikes (2014) seek to revisit the role of the CRO. Following the assessment of the

evolving role of the CRO, Mikes (2014) concludes that the role of the CRO 'may be less about the packaging and marketing of risk management ideas to business managers, but instead, the facilitation of the creation and internalization of a specific type of "risk talk" as a legitimate, cross-functional language of business'.

### **III. RESEARCH PROCESS**

As indicated in the introductory, the continuous leaks in the public resources through fruitless and wasteful expenditure, irregular expenditure etc. points to some form of weaknesses in the public institutions system of control. Since both the PFMA and the MFMA requires that institutions have and maintain effective, efficient and transparent systems of risk management and the Public Sector Risk Management Framework requires that the enterprise risk management unit, with its head as the CRO, coordinates and support the overall institutional risk management process, this paper aims at examining specific proficiencies and positioning of CROs overseeing South Africa's public institutions in order to draw out and analyse this for the purpose of determining whether this is part of contributors to the weaknesses in internal controls.

However, firstly it is useful to explain how this research was carried out. This work was supported by the University of Johannesburg's Department of Accountancy and the Office of Accountant General (OAG) in the National Treasury of South Africa through a memorandum of understanding.

The author, with the assistance of the Risk Management Support Unit in the OAG carried out five months of fieldwork during 2016. The material was gathered primarily through the questionnaire that was administered to the key interest groups involved with risk management policymaking and the implementation of this in South Africa. The administered questionnaire contained questions on the academic qualifications of the CROs, professional membership bodies which CROs are members, the scale of the CROs remunerations as well as functional and administrative lines of reporting of these CROs.

Respondent were identified according to their expertise and role in the public institutions risk management process. This identification process involved the examination of the CROs register which is the register kept by the Office of Accountant General. Thus, the questionnaire was sent to all CROs in the register. To supplement this process, the questionnaire was also distributed in the National Treasury's CROs forum. The questionnaire contained both the closed and the open ended questions. Marcus (1999) and Valentine (1997) favours this approach as they believe that it allows the researcher to examine topics under review in greater depth. One hundred questionnaires (100) were received back from responded. All the questionnaires received were deemed valid for processing as all questions had been answered by respondents.

Duffy (2008) views the approach followed here as compatible with the one used in international politics. In this regard, Duffy (2008) is of the view that this approach is 'the most useful and productive method of carrying out research on the international politics of a particular issue'. Further, the idea of engaging the CROs who are senior executive in the risk space is consistent with what Duffy (2008) refers to as the engagement of the elite as which accordingly is 'a standard technique in political research'. Accordingly, this technique, is particularly useful in terms of 'uncovering the complex and sensitive power dynamics of policymaking that are so often excluded from and 'scripted out' of public policy reports and quantitative datasets'.

#### IV. RESEARCH FINDINGS AND INTERPRETATION

**TABLE 1** – FINDINGS – ACADEMIC QUALIFICATIONS OF CROs

Qualification type	National government departments	Public entities	Provincial departments	Municipalities	Total
No qualification	1	0	0	0	1
Grade 12/ Matric	1	1	2	4	8
Diploma	0	1	1	2	4
National diploma	1	3	6	5	15
Bachelor's degree / B Tech	6	12	21	8	47
Honours degree	4	19	14	2	39
Master's degree/ MBA	4	16	3	0	23
Doctoral degree/ PhD	0	0	1	0	1

Majority of qualifications held by Public Sector CROs are between the Bachelor's degree / B Tech degree and Honours degrees. There was one (1) CRO with no qualification and this CRO was in the NGD. One (1) CRO in the PGD had a PhD.

**TABLE 2** – FINDINGS – PROFESSIONAL MEMBERSHIPS OF CROs

Institute	National government departments	Public entities	Provincial departments	Municipalities	Total
No membership	3	1	5	5	14
Institute of Internal Auditors	3	14	11	3	31
Association of Certified Fraud Examiners	1	7	8	5	21
Institute of Business Continuity Management	0	5	1	0	6

<b>Institute</b>	<b>National government departments</b>	<b>Public entities</b>	<b>Provincial departments</b>	<b>Municipalities</b>	<b>Total</b>
Institute of Risk Management South Africa	5	28	14	5	<b>52</b>
South African Institute of Government Auditors	0	1	0	0	<b>1</b>
South African Institute of Professional Accountants	1	3	0	0	<b>4</b>
South African Institute of Chartered Accountants	1	11	1	0	<b>13</b>

Fourteen (14) CROs had no professional membership i.e. three (3) in NGDs, one (1) in a Public Entity, five (5) in PGDs and municipalities respectively. The Institute of Risk Management South Africa (IRMSA), had the largest slice of membership subscriptions by CROs, followed by the Institute of Internal Auditors South Africa (IISA) and then the Association of Certified Fraud Examiners (ACFE). Other institutes reported include IMFO, ISACA, Ethics SA, IODSA and CISA.

**TABLE 3 – FINDINGS – CROS REMUNERATION**

<b>Package category</b>	<b>National government departments</b>	<b>Public entities</b>	<b>Provincial departments</b>	<b>Municipalities</b>	<b>Total</b>
Director General/City Manager/ Municipal Manager	0	2	0	0	<b>2</b>
Deputy Director General/ Deputy Municipal Managers/ Executive Director	1	9	2	0	<b>12</b>
Chief Director/ Divisional Heads/ General Manager	3	9	2	0	<b>14</b>
Director/ Senior Manager	7	10	12	1	<b>30</b>
Deputy Director/ Manager	0	7	13	3	<b>23</b>
Assistant Director/ Assistant Manager	1	1	1	8	<b>11</b>

Majority of CROs are remunerated at the levels of Director/ Senior Manager, followed by Deputy Director/ Manager. The highest paid CROs are in the Public Entities (two CROs) and they are at the level of Director General/City Manager/ Municipal Manager. The second highest paid CROs are at the level of Deputy Director General/ Deputy Municipal Managers/ Executive Director, one (1) is in the NGD, nine (9) are in Public Entities and two (2) are in PGDs. Municipalities reported the lowest paid CROs as the majority of them were at the Assistant Director/ Assistant Manager level.

**TABLE 4 – FINDINGS – FUNCTIONAL LINE OF REPORTING**

<b>Line of reporting</b>	<b>National government departments</b>	<b>Public entities</b>	<b>Provincial departments</b>	<b>Municipalities</b>	<b>Total</b>
Audit Committee	5	22	5	4	<b>36</b>
Risk Management Committee	5	19	19	12	<b>55</b>
Director General/City Manager/ Municipal Manager	3	3	7	5	<b>18</b>
Deputy Director General/ Deputy Municipal Managers/ Executive Director	0	4	4	3	<b>11</b>
Chief Director/.Divisional Heads/ General Manager	4	3	1	0	<b>8</b>
Director/ Senior Manager	0	1	0	0	<b>1</b>

In general, the functional line of reporting appears to be both the Audit Committee (five NGDs, twenty two Public Entities, five PGDs and four municipalities) and the Risk Management Committee (five NGDs, nineteen Public Entities and PGDs respectively and four municipalities). In some cases, CROs indicated that their functional line of reporting was the Executive i.e. Director General/City Manager/ Municipal Manager (three NGDs, three Public Entities, seven PGDs and five municipalities), Deputy Director General/ Deputy Municipal Managers/ Executive Director (four Public Entities, four PGDs and three municipalities), Chief Director/.Divisional Heads/ General Manager (four NGDs, three Public Entities and one PGD), Director/ Senior Manager (one Public Entity).

**TABLE 5 – FINDINGS – ADMINISTRATIVE LINE OF REPORTING**

<b>Line of reporting</b>	<b>National government departments</b>	<b>Public entities</b>	<b>Provincial departments</b>	<b>Municipalities</b>	<b>Total</b>
Audit Committee	0	3	0	3	<b>6</b>
Risk Management Committee	2	5	4	3	<b>14</b>
Director General/City Manager/ Municipal Manager	5	12	11	10	<b>38</b>
Deputy Director General/ Deputy Municipal Managers/ Executive Director	1	8	4	4	<b>17</b>

<b>Line of reporting</b>	<b>National government departments</b>	<b>Public entities</b>	<b>Provincial departments</b>	<b>Municipalities</b>	<b>Total</b>
Chief Director/ Divisional Heads/ General Manager	3	5	5	0	<b>13</b>
Director/ Senior Manager	0	2	1	1	<b>4</b>

In general, the administrative line of reporting appears to be both the Director General/City Manager/ Municipal Manager (five NGDs, twelve Public Entities, eleven PGDs and ten municipalities) and the Deputy Director General/ Deputy Municipal Managers/ Executive Director (one NGDs, eight Public Entities four PGDs and municipalities respectively). In some cases, CROs indicated that their functional line of reporting was a level lower i.e. Chief Director/ Divisional Heads/ General Manager (three NGDs, five Public Entities and PGDs respectively) as well as Director/ Senior Manager (two Public Entities, one PGD and one municipality).

## **V. CONCLUSION**

This paper aimed at examining specific proficiencies and positioning of CROs overseeing South Africa's public institutions in order to draw out and analyse this for the purpose of determining whether this is part of contributors to the weaknesses in internal controls.

The proficiencies were deemed as a function of qualifications as well as membership of professional body, whereas the positioning was deemed as a function of remuneration scale where the CRO has been positioned as well as the reporting line. As such, the administered questionnaire contained questions on the academic qualifications of the CROs, professional membership bodies which CROs are members, the scale of the CROs remunerations as well as functional and administrative lines of reporting of these CROs.

The findings are that the public institutions CROs have post school qualification, with the majority of them holding a Bachelor's/ B Tech degree. There was one instance where the CRO did not hold any qualification. The disadvantage of the measuring instrument is that it did not request the information on the nature of qualification, so that it could be determined whether the qualification is in line with the requirement of the risk management position. Further studies on this area could determine this.

Of concern though is that there were some CROs that were not part of any professional body. Majority of CROs indicated that they were members of IRMSA, which is a relevant body when it comes to risk management. The downside though is that some professional bodies, in the past, awarded mem-



bership on the basis of the recognition of prior learning without assessing the competence of the member.

Public institutions CROs are remunerated differently, with the majority of them being remunerated at a Director level. This could cause a loss of skills and corporate memory as those that are remunerated at levels that are lower could seek opportunities for advancement in areas where the remuneration is higher. A unitary scale could be considered per sector i.e. similar scale at national government level, similar scale in municipalities etc.

There seem to be confusion between the functional line and the administrative line of reporting. Ideally, with these types of positions, the functional line of reporting should be the overseeing body (risk management committee, audit committee, audit and risk committee etc). The administrative line of reporting could be the Accounting Officer.

In conclusion, on paper, there does not seem to be an issue on the proficiency side as measured by qualifications and professional membership, except the fact that qualifications held by the CRO could be incompatible with the position and that the professional membership body may not have assessed the competencies during the members' admission. To ensure compatibility and proper support, National Treasury could standardise and promote certain proficiencies as key requirements for the CRO position.

In a similar manner, because of a huge variation in the remuneration scale and confusions regarding the line of reporting, National Treasury could standardise this. This could be helpful, particularly in instances where CROs have implied that the position of the CRO is too junior to attend strategic meeting or even engage with the executive members.

## REFERENCES

1. Auditor General South Africa (AGSA). (2016) *'National and provincial audit outcomes, PFMA 2015/16'*, Republic of South Africa, Pretoria.
2. Auditor General South Africa (AGSA). (2015) *'National and provincial audit outcomes, PFMA 2014/15'*, Republic of South Africa, Pretoria.
3. Auditor General South Africa (AGSA). (2015) *'Local government audit outcomes, MFMA 2014/15'*, Republic of South Africa, Pretoria.
4. Auditor General South Africa (AGSA). (2014) *'National and provincial audit outcomes, PFMA 2013/14'*, Republic of South Africa, Pretoria.
5. Auditor General South Africa (AGSA). (2014) *'Local government audit outcomes, MFMA 2013/14'*, Republic of South Africa, Pretoria.
6. Auditor General South Africa (AGSA). (2013) *'Local government audit outcomes, MFMA 2012/13'*, Republic of South Africa, Pretoria.
7. Brown, L. (2010) *'The Chief Risk Officer: your business ally'*, Enterprise Risk Services, Deloitte: Middle East

8. Duffy, R. (2008) 'Neoliberalising Nature: Global Networks and Ecotourism Development in Madagascar', *Journal of Sustainable Tourism*, 16:3, pp. 327-344.
9. Ernst and Young. (2016), 'Charting the evolving role and authority of the Chief Risk Officer', 2016 Bermuda Insurance CRO Survey.
10. Marcus, G.E. (1999) *Ethnography through thick and thin*, Princeton, NJ: Princeton University Press.
11. Mikes, A. (2014) *The Triumph of the Humble Chief Risk Officer*, Working Paper, 14-114, Harvard Business School.
12. Moloi, T. (2016a) 'Key mechanisms of risk management in South Africa's National Government Departments: the Public Sector Risk Management Framework and the King III benchmark', *International Public Administration Review*, 14: 2-3, pp. 37-52.
13. Moloi, T. (2016b) 'Risk management practices in the South African public service', *African Journal of Business and Economic Research*, 11: 1, pp. 17-43.
14. National Treasury. (2010) *The Public Sector Risk Management Framework*, Republic of South Africa, Pretoria.
15. National Treasury, Office of Accountant General (OAG). (2015) *Updated Guidelines on Irregular Expenditure*, Republic of South Africa, Pretoria.
16. National Treasury, Office of Accountant General (OAG). (2014) *Guidelines on Fruitless and Wasteful Expenditure*, Republic of South Africa, Pretoria.
17. National Treasury, Office of Accountant General (OAG). (2014) *Guidelines on Unauthorised Expenditure*, Republic of South Africa, Pretoria.
18. Republic of South Africa (RSA). (1999) *The Public Finance Management Act, No. 1 of 1999*, Republic of South Africa, Cape Town.
19. Republic of South Africa (RSA). (2003) *The Municipal Finance Management Act, No. 56 of 2003*, Republic of South Africa, Cape Town.
20. The Economist. (2005), *The evolving role of the CRO*, The Economist Intelligence Unit.
21. Valentine, G. (1997) 'Tell me about. . . Using interviews as a research methodology', In R. Flowerdew and D. Martin (eds) *Methods in Human Geography* (pp. 110-126). London: Longman.

---

Tankiso Moloi, PhD is a professor in the Department of Accountancy at the University of Johannesburg. He has written and reviewed several articles on corporate governance and risk management in South Africa.

## DEFINITIONS

- The PFMA defines the irregular expenditure as 'the expenditure other than authorised expenditure' (RSA, 1999). This expenditure, the PFMA states that it would have been incurred in contravention of or that is not in accordance with the requirements of the applicable legislation such as the Act itself, the State Tender Board Act or any provincial legislation providing for procurement procedures in that particular provincial department (National Treasury, 2015).
- Fruitless and wasteful expenditure is defined as 'expenditure made in vain and would have been avoided had reasonable care been exercised (RSA,

1999). In the guidelines for fruitless and wasteful expenditure, the Office of Accountant General add that the 'in vain' would refer to a transaction, event or condition which was taken without anything being derived from it or substance which did not yield any desired result or outcome' (National Treasury, 2014).

- Unauthorised expenditure refers to 'an overspending on a vote or a main division within a vote. It can also be defined as 'an expenditure that is made not in accordance with the purpose of a vote or in the case of a main division, not in accordance with the purpose of that main division' (National Treasury, 2014).

## **STAVOVI I POZICIONIRANJE GLAVNIH UPRAVITELJA RIZIKOM U JAVNIM INSTITUCIJAMA JUŽNE AFRIKE**

### **SAŽETAK RADA:**

Ovaj rad proučava vještine i poziciju glavnih upravitelja rizikom u okviru nedostataka i slabosti internih kontrola u južnoafričkim javnim institucijama. Posebnu pažnju posvećuje kvalifikacijama i članstvu u profesionalnim udruženjima kao mjerilo vještina te skalu nagrađivanja i linije izvještavanja kao mjerilo pozicioniranja.

Uz poštivanje stečenih vještina zamijećeno je da većina glavnih upravitelja rizikom ima srednjoškolsko obrazovanje. Međutim, uzimajući u obzir pozicioniranje glavnih upravitelja rizikom ovaj rad pokazuje velike varijacije u skalama nagrađivanja te zbrku u načinu izvješćivanja. Na primjer, dio upravitelja rizikom redovita izvješća daje rukovoditeljima dok drugi izvještavaju izravno nadzornim tijelima (revizorski odbor, odbor za upravljanje rizicima, odbor za reviziju i upravljenje rizicima i dr.).

*Ključne riječi: glavni upravitelj rizikom, upravljanje rizicima poduzeća, ljudski kapital, javni sektor*

Original Scientific Paper  
UDC: 657.1/658.14  
*Paper received: 30/ 03/ 2016*  
*Paper accepted: 18/ 04/ 2016*

# **COMPARATION OF PRODUCTION AND SERVICE COSTS IN CROATIA AND COST REDUCTION MEASURES**

*Ivana Perica, MA*

*University of Split, Faculty of Economics, Split, Croatia*

*E-mail: iperica@efst.hr*

## **ABSTRACT**

Creating a product or service is carried out by the joint efforts of materials, labour and property and equipment. These elements are consumed in the business process, and therefore recognized in accounting system and financial statement as cost items. In order to achieve optimal balance between cost and revenues and consequently the best financial results it is necessary to manage cost. The knowledge of costs structure should constitute the starting point for any cost management activities. The aim of this paper is to identify and analyze the cost structure of production and service industry examples in Croatia. The study was conducted on a sample of 8,913 active companies operating in the sector of food and drinks production and intellectual services in Croatia. The results point to differences in the cost structure that have served as a base for proposed cost reduction measures for each of the analyzed industries.

**Keywords:** *costs reduction; production industry; service industry*

## **1. INTRODUCTION**

Companies currently operate in very unsure and risky environments but strive to cover all costs to remain profitable, regardless of their branch of work. Although, it needs to be pointed out that in modern business environments

cost cutting should be achieved without drops in quality or functionality of products or services. That means that cost cutting should be done by eliminating or cutting down cost which is irrelevant to the core business. (Škrtić, 2005:104). Rationalization of costs is the only way to stay afloat in a global market flooded with strong competitors. Reports from the field clearly show that the number of companies that earn enough to recklessly spend is marginal in comparison to the number of companies that need to take care of their expenses (Belak, 2005:61).

In order for the process of cost rationalization to yield any positive result, it is necessary to know the cost structure of an enterprise, and the approach to cost rationalization itself should be consistent and work with the specificity of the business activity. Based on all the above, this paper has the following objectives: to identify and analyze the cost structure on the example of manufacturing and service activities and to propose measures to reduce costs for each of the activities.

## **2. THEORETICAL BACKGROUND**

Processes within a company that creates products or services are carried out with the mutual interaction of materials, labor and work resources. Each of these elements are consumed in the business process. Cost represents the value of resources sacrificed or spent in order to achieve specific goals such as creation of goods or services (Drury, 2008: 27). In order to achieve the optimum ratio between value and cost, it is necessary to maintain a quality cost management strategy. Cost management strategy does not only mean cost cutting. The term also encompasses a special way of managing an enterprise and doing business that is focused on cost rationalization. According to Ramljak (2013), cost rationalization is the activity of a business entity that seeks to structure and adequately manage the volume of costs that fits a particular enterprise. Rationalization represents the process of balancing costs of all resources in the business process and rejection of everything irrational. This means that it is necessary to provide transparency and insight wherever there is cost of any kind, determining why the costs occurred and finding any way for them to be lower. It is only then that you can introduce relevant rationalization measures (Peršić, 2005: 13).

Cost rationalization, cost behavior and cost structure were research topics of many relevant authors.

Zhu (2000) analyzed the expenses of the production industry in Singapore that occurred within changes in the local economy. The production sector of Singapore transformed from labor intensive manufacturing to an indus-

try which is dominated by capital and technology. This transformation led to changes in cost structure which are especially obvious in labor costs increase. Changes within cost structures in the Japanese production industry were the topic of a research done by Tetsuhiro (2009). That research showed that companies that reduced sales revenue due to global competition changed their cost structure. Companies that would usually never think about cutting down on labor changed their cost structure and managed to cut down on labor costs. Traditional Japanese managing policies entail a great amount of social responsibility but they still reduced the number of employees and made a cut in salaries. That is a big change since the Japanese always considered labor costs as a fixed whereas now they treat it as variable expense. Cost structure within the context of fixed and variable expenses was the topic of research of Oberholzer and Ziemerink (2004). The goal of their research was to determine cost structures in big companies and they determined that there is a significant negative link between fixed costs and the level of technological development. They also determined that labor intensive companies have a large proportion of fixed costs and that most of those costs are labor costs compared to technologically advanced companies.

Novak and Popesko (2014) see cost structure within the context of direct and indirect costs and in their research they paid attention to the structure and cost behavior based on a random sample of companies that belong to the manufacturing sector in the Czech Republic. They figured that efficient cost cutting can be done by increasing the share of indirect costs in total costs due to use of cheaper raw materials, increase of distribution and communication costs that could benefit from market research costs, increased mechanization, automation and so on.

This topic was also researched in Croatia. The Belak and Vukušić (2001) research was conducted on 53 companies from areas of manufacturing, services, trade and finances. The sample included 54% of large companies, 40% of small businesses and 6% of medium-sized businesses. The research was done as a questionnaire survey and, among other things, showed the way of monitoring and managing costs in the sampled companies. It determined that a very high percentage (24%) of the sampled companies did not have a cost rationalization strategy and if they did, they rarely enforced cost-cutting measures in their entirety, while 4% of the sampled companies did not even control the process. Perčević (2006) researched the structure of production costs on a sample of 35 companies whose core business is manufacturing products and identified the most commonly used cost accounting methods. The results of the research show what is the most significant share in the structure of production costs in manufacturing companies in Croatia. The costs of direct material accounted

for 50% - 80% of total costs in all Croatian sampled subjects. The research also found that the Croatian manufacturing sector mostly uses traditional accounting methods that are characteristic for manufacturing sectors with a relatively low level of automation of production processes. Mihić (2009) research dealt with cost management in small and medium-sized manufacturing companies in Croatia. That research concluded that most small and medium-sized companies do not implement strategic cost management but instead opt for the traditional cost management model. Belak and Bulić (2011) have developed a model for cost management in times of crisis and in their research they managed to propose a cost reduction strategy in the following order: costs that have the least impact on revenue, costs that are easiest to cut and costs that have the biggest share in total spending. Ramljak and Rogošić (2012) investigated the implementation of strategic cost management methods for large Croatian companies in the context of cost reduction and control. The research has shown that 66% of the sampled companies used at least one of the strategic cost management methods. Dražić Lutilsky et al. (2014) researched which cost management models are used by companies in Croatia to support and maintain competitiveness. The research was done in 2012. and it sampled 70 Croatian companies and the result of this empirical research confirmed that Croatian companies do not apply adequate cost management models which then hinders their efficiency and competitiveness.

Based on a review of current research and available data, there was no research that considered cost structure analysis and cost cutting measures by comparing the costs of companies between different industries which has been established as the subject of this paper and its main scientific contribution. An additional contribution to science is the scope of empirical research, given that all active sampled companies were in business in 2014.

### **3. DEFINING SAMPLES AND RESEARCH METHODOLOGY**

This research sampled and compared companies that are doing business within the sector of production and companies that stem from the services sector. Companies that were chosen to represent the production industry were food and drinks producers. Companies that were chosen from the intellectual services industry did bookkeeping, marketing, engineering, consulting or law.

The sample was selected from the Bureau Van DijkAmadeus database based on the following criteria:

1. The company was active in 2014.
2. The company published their financial statements for 2014.
3. The company is based in Croatia



4. According to the National Classification of Activities NKD-2007 (Narodne novine, 58/2007), the main activity of the company belongs in field C – processing industry, section 10 – food products production and field M – professional, scientific and technical activities, sections 69 – legal and accounting activities, 70 – management activities (management consulting), 71 – architectural activities and engineering, 72 – scientific research and development, 73 – marketing and market research and 74 – other scientific, professional and technical activities.

In this way, a representative sample of a total of 8,913 companies was formed. Subsequent deep analysis of the sampled data found that 430 enterprises made most of their revenue by doing business activities that were not registered as their main business, which is why they were excluded from the sample. Therefore, a final sample of 8,483 companies was obtained. A smaller amount of sampled companies, 891 of them, were in the manufacturing industry while the rest were a part of the service sector. After downloading all of the finances, all data was transferred to Microsoft Excel. Using function and formula, cost structure was determined for sampled companies. For the purposes of statistical testing, SPSS software package was used. Given the theoretical postulates related to cost management and the wide range of companies in Croatia as well as various activities they deal with, different approaches to cost cutting can be expected. The goal of this paper is to identify and analyze the cost structure on examples of manufacturing and service industries in Croatia to better determine and compare cost structures for any differences. Based on the final goal of the research, the following hypothesis was defined for the purposes of statistical testing:

*H: There is a significant statistic difference in cost structure between companies that do business in different industries.*

Since manufacturing companies use more material and work resources while creating products and since there are more automated business processes within their companies than in service companies that rely mostly on human capital, it is expected that companies from the manufacturing sector will have a higher share of material costs in the structure of total costs.

It is also expected that they will have a lower share of labor costs in the structure of total costs than those of service-related businesses.

After the subject and the objectives of the research have been determined and with the research hypotheses set, the following variables were defined: the share of material costs in total costs, the share of labor costs in total costs, the share of amortization costs in total costs, the share of financial costs in total costs, the share of extraordinary costs in total costs and the business activity of a business enterprise. These costs are relativized for maximum possible

comparability among the companies. This way, each company received a share of the individual cost within the total cost. The variable business activity of a business entity is determined on the basis of the NKD code according to which the Central Bureau of Statistics classifies businesses according to the activities performed in accordance with the regulations and appears in two modalities: production enterprises (NKD 10) and service companies (NKD 69 through 74)

#### 4. RESEARCH RESULTS

Cost structure analysis is based on cost records analytics divided into sub-species and according to the reaction to the branch of industry the companies are involved with. The goal of this cost structure analysis is to determine the order of priorities of cost cutting measures. Cost structure according to the main categories depending on the branch of industry the analyzed companies are involved with is shown in Table 1.

**Table 1:** Cost structure by types of cost within different industries

	PRODUCTION INDUSTRY	SERVICE INDUSTRY
% financial costs	2%	2%
% extraordinary costs	1%	0%
% material costs	65%	43%
% labor costs	25%	46%
% amortization costs	7%	9%

*Source: Authors' calculation (2016)*

From the data available in Table 1 it is clearly visible that there is a significant difference between cost structures of production and service industries. Further analysis of production companies cost structure defined a characteristic cost structure within the production sector in Croatia. Production sector cost structure is dominated by material costs with a share of 65%, while labor costs sit at 25%. Cost structure analysis showed that the share of other expenses is mostly less than 10%, where 7% go to amortization costs, 2% to financial costs while extraordinary costs sit at 1%.

Cost structure within the service sector is dominated by labor costs with a share of 46% while material costs sit at 43%. Further analysis showed that amortization costs sit at 9%, financial costs at 2%, while extraordinary costs went down to 0%. A comparison of cost structures show that in the service industry a majority of the expenses are due to human resources, while in the production industry a majority of the expenses are due to material costs. The statistics show that companies that deal in production spend much more on

material in order to make their products, while companies from the service industry tend to spend more on engaging human capital.

Comparing the amortization costs with companies from the production industry and companies from the service industry it is clear that amortization costs have a higher share in total costs of the service industry than in the production industry. The service industry is more technically equipped in the sense that the industry is based in IT and other fine technical equipment. The specific characteristic of amortization costs is the fact that it's per-determined by prescribed rates. Compared to other types of cost, this item also differs from other costs because within the work cycle process it is impossible to talk about rationalisation, usual savings and cost cutting. Instead the process of transformation goes as scheduled by predetermined and proclaimed procedures and norms. (Kovačević, Vojnović, 2000: 336).

#### 4.1. HYPOTHESIS TESTING AND DISCUSSION

With the data gained from results, the second part of the research consisted of a t-test with a goal to test the statistic significance of the difference of arithmetic middles to precisely determine cost structure variables in companies from the production and service industries.

The results of these tests are shown in Table 2:

**Table 2:** Results of the t-test

	t	df	Sig. (2-tailed)	Mean Difference	Standard error difference
% financial costs	1,218	1374,072	0,224	0,002057	0,001689
% extraordinary costs	1,617	1018,687	0,106	0,002131	0,001318
% material costs	33,532	1183,784	≈ 0,000	0,214297	0,006391
% labor costs	-36,73	1357,904	≈ 0,000	-0,20263	0,005517
% amortization costs	-4,658	1145,524	≈ 0,000	-0,01586	0,003404

*Source: Authors' calculation (2016)*

These results show that the t-test is statistically significant in the values of the variables of the share of material costs in total costs, the share of labor costs in total costs and the share of amortization costs in total costs in relation to the type of industry. Examining the statistically significant differences in the values of the variables of the financial costs share in total costs in relation to the type of industry, the results show that there are no statistically significant differences for those variables.

## 4.2. COST REDUCTION MEASURES SUGGESTION

According to the previously explained research results a priority sequence was constructed for optimal cost cutting for Croatian companies, both in the service and production industries. As seen in Table 3 and Table 4, while proposing cost cutting measures in manufacturing the priorities are material costs since they have the greatest share within the total cost. Given that labor costs have the biggest share within the cost structure of the researched sample of companies that deal with service activities it is only logical that cost cutting should be focused in labor costs.

**Table 3:** Cost reduction measures u proizvodnim poduzećima u Hrvatskoj

PRIORITY	TYPE OF COST	COST REDUCTION MEASURE
1.	material costs	<ul style="list-style-type: none"> <li>• Cutting down on supplies cost (choosing more affordable suppliers)</li> <li>• Cutting down on shipping costs</li> <li>• Reducing extra waste and damaged goods</li> <li>• Optimizing the flow of materials, detecting bottlenecks</li> <li>• Cost control during the stage of product development (replacing expensive raw materials with cheaper ones if possible)</li> <li>• Changing the method of cost accounting</li> </ul>
2.	labor costs	<ul style="list-style-type: none"> <li>• Decreasing salaries while maintaining the same number of working hours</li> <li>• Cutting down on the number of working hours within a week</li> <li>• Cost cutting on Christmas and Easter bonuses</li> <li>• Cutting down on prolonging contracts for workers</li> <li>• Reducing the number of workers</li> <li>• Stimulative bonuses</li> </ul>
3.	amortization costs	<ul style="list-style-type: none"> <li>• Renting machinery and leasing property</li> <li>• Changing methods of amortization</li> <li>• Increasing the estimated lifetime of use</li> <li>• Calculating amortization at a lower rate in the case of equipment depreciation, physical wear and tear or reduced capacity</li> <li>• Letting go of useless property</li> </ul>
4.	financial costs	<ul style="list-style-type: none"> <li>• Shortening the delayed payment period for mandatory payments</li> <li>• Having better relationships with banks</li> <li>• Revising of short-term and long-term financing</li> </ul>
5.	extraordinary costs	<ul style="list-style-type: none"> <li>• Rationalization in managing company property</li> </ul>

Source: Author of the paper (2016)

**Table 4:** Cost reduction measures within the Croatian service industry

PRIORITY	TYPE OF COST	COST REDUCTION MEASURE
1.	labor costs	<ul style="list-style-type: none"> <li>Improving work efficiency by eliminating redundant steps in the process</li> <li>Simplifying work processes, linking similar tasks</li> <li>Improving work efficiency thru staff education and training</li> <li>Introducing stimulative bonuses or performance payments</li> <li>Increasing use of technology (computers, software)</li> <li>Reducing the fluctuation of employees (invisible low quality costs)</li> <li>Applying non-cash prize programs for employees</li> </ul>
2.	material costs	<ul style="list-style-type: none"> <li>Using technologies to simplify work processes</li> <li>Rationalization of suppliers (higher discounts, long-term contracts)</li> <li>Selling off unnecessary equipment and leasing property that isn't being used but demands maintenance costs</li> <li>Cutting down on unplanned expenses by enforcing internal rules</li> </ul>
3.	amortization costs	<ul style="list-style-type: none"> <li>Acquisition of technologically advanced long-term property and equipment by operational leasing</li> </ul>
4.	financial costs	<ul style="list-style-type: none"> <li>Improvement in managing finances</li> <li>Look for alternative means of financing</li> </ul>
5.	extraordinary costs	<ul style="list-style-type: none"> <li>Rationalization in managing company property</li> </ul>

Source: Author of the paper (2016)

## 5. CONCLUSION

Cost rationalization was so prevalent during the recession so it seems that it will remain a priority for some time in the future. It is for this reason that the aim of this paper is to analyze the types of costs in Croatian production and service industries and suggest cost cutting measures. The research has shown that the hypothesis has been confirmed. The results indicate to differences within the cost structure which is the basis for creating an order of priorities for their reduction.

Since the majority of costs within the manufacturing industry are material costs, cost-cutting measures should definitely be applied there. Table 3 shows cost-cutting measures suggestions while also showing a proposal for amortization calculations and amortization methods. However, their application is governed by accounting standards and companies do not have the freedom to pick any methodology. According to MRS2 and HSF110, the cost of inventory calculation methodology of choice could be the weighted average cost method or the FIFO method. In the context of short-term cost reduction, the FIFO method gives better results because the value of material is calculated with older prices that are usually lower. According to MRS 16, MRS 38, HSF1 5

and HSFI 6 amortization methods that can be used are: the linear method in which costs stay the same for a lifetime of use, the degressive method in which costs are reduced during a lifetime of use and the functional method where the costs are based on the expected use. By applying these methods the cost-cutting is not effective in the long run.

The service industry is dominated by labor costs and that should be the focal point of cost-cutting.

Future research on this topic should be expanded to other industries like trade and tourism since tourism is one of the most important industries in Croatia. Research can be also more accurate if the size of the companies is taken into consideration where cost-cutting measures are applied. The contribution of this paper is cost structure analysis and cost cutting measures development by comparing costs of companies that stem from different industries.

## REFERENCES

1. Belak, V.(2005):Računovodstvene podloge za upravljanje troškovima, uZbornik radova:Upravljanje troškovima,Zadar,Hrvatski računovođa,59-81.
2. Belak, V.iBulić, A.(2011): Costmanagement model underconditionsof global economiccrisis, Int. J. ofEconomicsandBusinessResearch, 3(2), 131 – 146.
3. Belak, V. iVukšić,N.M.(2001): Croatianenterpriseintransition: analysisoftheCroatiancost-management model, u Zbornik radova: 4th InternationalConference, on Enterprise inTransition,Split-Hvar, Ekonomski fakultet Split, 189-191.
4. Dražić Lutilsky, I.,Žmuk, B., Dragija, M., Ivanko, S.(2014):Moderncostmanagementmodels: Are theyusedinCroatiancompanies?, u Zbornik radova:Proceedingsofthe 3rd InternationalScientificSymposiumEconomyofEastern Croatia – VisionandGrowth, Sveučilište Josipa Jurja Strossmayera u Osijeku, Ekonomski fakultet u Osijeku,245-254.
5. Drury, C. (2008): Management andcostaccounting, London (UK), South-Western.
6. Kovačević, B. i Vojnović, S. (2000): Upravljanje amortizacijom - specifičnim oblikom troškova poslovanja, Ekonomski pregled, 51(3-4), 334-358.
7. Mihić, M.(2009): Upravljanje troškovima u malim i srednjim proizvodnim poduzećima, u Zbornik Ekonomskog fakulteta u Zagrebu, 161-176.
8. Novak, P. i Popesko, B.(2014): CostVariabilityandCostBehaviourinManufacturing Enterprises, EconomicsandSociology, 7(4),89-103.
9. Oberholzer, M. i Ziemerink, J.(2004):Costbehaviourclassificationandcostbehaviourstructures ofmanufacturingcompanies, MeditariAccountancyResearch,12(1),179-193.
10. Perčević, H.(2006):Metode obračuna troškova u proizvodnom sektoru Republike Hrvatske, Ekonomski pregled, 57(9-10), 647-667.
11. Peršić, M. (2005):Upravljanje troškovima u globalizacijskim procesima, u Zbornik radova:Upravljanje troškovima, Zadar, Hrvatski računovođa, 7-57.
12. Ramljak, B.(2013):Racionalizacija troškova u funkciji ostvarenja poslovnog rezultata, u Zbornik radova: Računovodstvo, financije i porezi u praksi - XLVIII. savjetovanje Računovodstvo, financije i porezi u praksi, Brela, Udruga računovođa i financijskih djelatnika Split, 1-12.
13. Ramljak, B. i Rogošić, A.(2012):Strategic Management AccountingPracticesin Croatia, Journalofinternationalmanagementstudies,7(2), 93-100.

14. Škrtić, M.(2005): Upravljanje troškovima ciljem povećanja konkurentnosti, u Zbornik radova:Upravljanje troškovima, Zadar, Hrvatski računovođa, 103-121.
15. Tetsuhiro, K.(2009): CoststructurechangesofJapanesemanufacturersamidst global competition, *Asiapacificjournalofeconomics&business*,12(2), 75-87.
16. Zhu, J.(2000): Industrialpropertyandstructural change ofmanufacturing: a relative-costanalysis, *RURDS*, 12(1),2-16.

## USPOREDBA TROŠKOVA PROIZVODNIH I USLUŽNIH DJELATNOSTI U HRVATSKOJ I MJERE ZA SMANJENJE

### SAŽETAK RADA:

Stvaranje proizvoda ili usluge odvija se uz zajednički angažman materijala, rada i imovine. Svojim angažmanom u poslovnom procesu ovi elementi se troše, a vrijednosni iskaz njihovog utroška za poduzeće predstavlja trošak. Kako bi se postigao optimalan odnos između troškova i ostvarenih rezultata nužno je kvalitetno upravljanje troškovima. Ono što mora predstavljati polazište u svakom upravljanju troškova je poznavanje strukture troškova. Cilj ovog rada je identificirati i analizirati strukturu troškova na primjerima proizvodnih i uslužnih djelatnosti u Hrvatskoj. Istraživanje je provedeno na uzorku od 8.913 aktivnih poduzeća koji posluju u djelatnosti proizvodnje hrane i pića, te djelatnosti intelektualnih usluga u Hrvatskoj. Dobiveni rezultati ukazuju na razlike u strukturi troškova na temelju kojih su predložene mjere za smanjenje troškova za svaku od analiziranih djelatnosti.

*Ključne riječi: smanjenje troškova; proizvodna djelatnost; uslužna djelatnost*



Professional paper  
UDC: 65.012

*Paper received: 11/04/2016*

*Papaer accepted: 25/04/2016*

## **THE SYNERGY OF PUBLIC PROCUREMENT AND MANAGMENT FOR PROJECTS FINANCED FROM THE EUROPEAN STRUCTURAL AND INVESTMENT FUNDS**

*mr. Alenka Poljičak, B.Sc.*

*Agency APPA d.o.o., Šibenik, Croatia*

*E-mail: alenka.poljicak@si.t-com.hr*

### **ABSTRACT**

Under the Partnership Agreement with the European Commission, the Republic of Croatia has available 10,675 billion euros for use from the European Structural and Investment Funds in the period up to the year 2020.

Most of the EU funds will be „spent“ on the basis of public works, public supply and public service procurement contracts and according to experience, it is assumed for it to be the 48% of the total received funds. The implementation of public procurement procedures while respecting the strict legally prescribed procedures precedes the conclusion of the contract, just as the allocation of funds is a matter to complex criteria for choosing the best projects to be co-financed out of EU funds.

Past experience in the implementation of projects funded by European Structural and Investment Funds has shown that frequent errors occur in the area of public procurement due to the non-compliance of officials implementing public procurement and officials implementing projects co-financed out of EU funds. Since it is in the interest of the project submitter to coordinate the usage of funds received under given terms and conditions, it is necessary to include a public procurement specialist in the initial phase in order to avoid unnecessary errors in later phases of the project.

*Key words: EU funds, public procurement; project management; public procurement contract; planning and implementation of the projects*

## **1. EUROPEAN STRUCTURAL FUNDS AND EUROPEAN UNION DEVELOPMENT STRATEGY**

The European Union, as an unique economic and political partnership between 28 European countries<sup>1</sup> aims to economically foster the whole Union by strengthening each of its member country.

European development strategy guidelines are presented in the document Europe 2020 – A strategy for smart, sustainable and inclusive growth<sup>2</sup>. Europe 2020 is a ten-year strategy for the period from the 2010 to the year 2020 that joints and organises economic, social and development policies into two levels – the EU level and the national level of each individual member country in order to achieve the general progress of all.

“The Commission is proposing five measurable EU targets for 2020 that will steer the development process and be translated into national targets: for employment; for research and innovation; for climate change and energy; for education; and for combating poverty.”<sup>3</sup>

In order to achieve the goals, the European funds have been established to be sources for financing various investment projects throughout Europe.

The main financing sources for EU’s development policy are five structural and investment funds:

1. European regional development fund (ERDF)
2. European social fund (ESF)
3. Cohesion fund (CF)
4. European agricultural fund for rural development (EAFRD) and
5. European maritime and fisheries fund (EMFF).

European regional development fund (ERDF) aims to strengthen the economic and social cohesion by correcting imbalances between its regions. It mainly focuses on infrastructure investment projects, investments in production for job creation, local development and development of small and medium businesses.

The European social fund (ESF) focuses on human capital investments, promotes investments in the quality of manpower and aims to facilitate employment or education for the unemployed and those who are at risk of poverty.

The cohesion fund (CF) is a financial mechanism for financing the large

---

<sup>1</sup> The Republic of Croatia became the 28th EU member country on 1 July 2013

<sup>2</sup> EUROPE 2020 – A strategy for smart, sustainable and inclusive growth. (2010, March 3). Retrieved from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF>

<sup>3</sup> EUROPA 2020. – *Europska strategija za pametan, održiv i uključiv rast*. (2010, March 3). Retrieved from: [http://www.safu.hr/datastore/filestore/10/Strategija\\_Europa\\_2020.pdf](http://www.safu.hr/datastore/filestore/10/Strategija_Europa_2020.pdf)

infrastructure projects in the EU related to transport and environmental protection in countries with a GDP per capita of less than 90% of the EU average, including the Republic of Croatia.

European agricultural fund for rural development (EAFRD) sets six common priorities that aim to strengthen the competitiveness of all types of agriculture on the basis of knowledge transfer and innovations, as well as restoring and preserving the ecosystem.

European maritime and fisheries fund (EMFF) is intended for financing sustainable fishing, supports coastal communities in diversifying their economies and finances projects that create new jobs and improve quality of life along European coasts.

These five funds are known as the European Structural and Investment Funds (ESIF) that in the period from 2014 to 2020 reach the total of 454 billion euros<sup>4</sup> while the amount provided for the Republic of Croatia totals 10.675 billion euros<sup>5</sup>.

Fund management is subject to strict rules that ensure firm control over the spending of funds. One of the control mechanisms includes the implementation of public procurement procedures in accordance with European directives for all EU members.

## 2. PUBLIC PROCUREMENT IN THE EUROPEAN UNION AND THE REPUBLIC OF CROATIA

In accordance with the legally prescribed procedures, public procurement is one of the primary tools for control of the efficiency of public spending, while to the beneficiaries of EU funds it also represents a very important business function for the implementation of the *Europe 2020 strategy*.

The Public Procurement Act of the Republic of Croatia and related subordinate regulations are mandatory for contracting authorities<sup>6</sup>, contracting

---

<sup>4</sup> *Evropska komisija, Europski strukturni i investicijski fondovi*. (n.d.). Retrieved from: [http://ec.europa.eu/contracts\\_grants/funds\\_hr.htm](http://ec.europa.eu/contracts_grants/funds_hr.htm)

<sup>5</sup> *ESI fondovi 2014.-2020.*. (n.d.). Retrieved from: <http://www.strukturnifondovi.hr/esi-fondovi-2014-2020>

<sup>6</sup> According to the Article 5 in the Public Procurement Act of the Republic of Croatia, contracting authorities who are bound by the Act are the following:  
Contracting authorities are the following:

1. the state bodies of the Republic of Croatia,
2. local and regional self-government units,
3. legal persons established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character and which meet one of the following conditions:
  - they are financed from the State Budget or the budget of local or the budget of regional self-government unit or other such legal persons in more than 50%, or

entities<sup>7</sup> and for all subjects concluding contracts which contracting authorities subsidize or co-finance with more than 50%.<sup>8</sup>

The public procurement is regulated by European directives, namely by:

1. Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement

2. Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors; and

**3. Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts.**

Since it is mandatory for all EU member countries to apply these directives to their national legislation, the legal framework for the implementation of public procurement is almost identical to all the member countries.

The basic principles of public procurement are prescribed by the directives, such are the principle of competition, the principle of fairness, the principle of the prohibition of discrimination, the principle of mutual recognition, the principle of proportionality, the principle of transparency, and the application of these principles ensures effective public procurement and the economical use of public funds.

This general principles represent the basic framework for the implementation of public procurement procedures, defined by the Public Procurement Act<sup>9</sup>. It is basic framework for public purchaser but also for all other users of

- they are subject to management supervision by state bodies, local and regional selfgovernment units or other such legal persons, or
- they have a supervisory board, an administrative or managerial board, more than half of whose members are appointed by the state bodies, local and regional self-government units or other such legal persons,

4. associations formed by the bodies referred to in points 1 and 2 of this paragraph or legal persons referred to in point 3 of this paragraph.

<sup>7</sup> According to the Article 6 in the Public Procurement Act of the Republic of Croatia, contracting entities are the following:

1. contracting authorities which pursue one or more activities referred to in Articles 107 to 112 of this Act when procuring supplies, works or services for the purpose of performing those activities,
2. an undertaking over which one or more contracting authorities exercise or may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein or the rules which govern it, and which pursue one or more of the activities referred to in Articles 107 to 112 of this Act when procuring supplies, works or services for the purpose of performing those activities,
3. entities which have as one of their activities any of the activities referred to in Articles 107 to 112 of this Act or a combination thereof and operate by virtue of a special or exclusive right granted by a competent authority when procuring supplies, works or services for the purpose of performing those activities, and which are not contracting authorities or undertakings within the meaning of points 1 and 2 of this paragraph.

<sup>8</sup> *Službeni list Europske Unije L94 od 28. ožujka 2014..* (2014, March 28). Retrieved from: <http://eur-lex.europa.eu/legal-content/HR/TXT/PDF/?uri=OJ:L:2014:094:FULL&from=HR>

<sup>9</sup> Public Procurement Act of the Republic of Croatia (NN 90711, 83/13, 143/13, 13/14)

EU funds (like private profit organization according to this Act – the so-called NPO (Non-Purchasing Organizations). Special rules for NPO are prescribed by the Annex 01 Public Procurement Procedures for Legal Persons Not Obligated by the PPA<sup>10</sup>.

### **3. PUBLIC PROCUREMENT MANAGEMENT IN PROJECTS FINANCED FROM THE ESI FUNDS**

The general principle of the public procurement is “best value for money” which means finding the best way to get in time, get what is necessary for the contracting authorities and for end-users who will, in the end, get the proper quality for their money.

In the process of gaining permissions for the use of the ESI funds<sup>11</sup>, the applicant is preparing the project documentation that includes the investment plan, the business plan or the feasibility study. Within this documentation the applicant presents the technical structure of the investment, the list of investments in the property, facilities etc., according to which a procurement plan shall be designed. The design of a procurement plan implies that the elements of procurement are known, ie whether the subject of public procurement are goods, services or construction works. At that point, it is right to ask whether the applicant is well-versed in the market so that he can define the procurement that will meet the needs of the project and its users. The public purchaser procurement plan is the basic document defining the procurement item<sup>12</sup>, the procedure of the public procurement<sup>13</sup>, the time the procedure process will start and whether to conclude a contract or a framework agreement and how long will it last. At the very beginning, in the process of preparing the documentation for applying for a grant from ESI funds, it is recommended for the applicant to include a specialist in public procurement. In that way significant risks arising out of wrong access to public procurement can be avoided. Moreover because projects financed by the ESI<sup>27</sup> funds will always be realised through public procurement contracts, one or more, smaller or larger extent and complexity. Therefore, it is certain that a public procurement specialist will be hired within the project, where he may be the project manager or project employee or external associate.

---

<sup>10</sup> Structural funds. Retrieved from: <http://www.strukturnifondovi.hr/vazni-dokumenti>

<sup>11</sup> European Structural and Investment (ESI) funds

<sup>12</sup> Goods, services and/or construction works

<sup>13</sup> There are seven types of public procurement procedure: 1. open procedure, 2. restricted procedure, 3. negotiated procedure, 4. competition, 5. competitive dialogue, 6. I.B procedure and 7. National prequalification system

Over the period from 2007 to 2013, *ex-ante* control of the processes of using EU funds in member countries has found a number of errors made in the public procurement procedures. Public procurement is one of the general *ex-ante* requirements in legal acts, it prescribes that appropriate mechanisms are needed for effective implementation of the public procurement rules of the EU, in order to achieve the transparency of the contract awarding procedures and to include staff trained and informed about relevant information<sup>14</sup>.

### 3.1. KEY RISKS IN THE AREA OF PUBLIC PROCUREMENT FOR EU PROJECTS

The fact that 48% of the received EU funds<sup>15</sup> are “spent” through public procurement contracts is a starting point for an argument that the risks of implementing public procurement procedures are the key risks for the success of the placement of public EU funds. Risks occur when defining the needs of the contracting authority and the procurement planning, in the area of defining technical specifications of the subject of procurement, in the selection of the best process for the planned procurement, in the area of preparation of the Tenderer’s Guidelines and tender calls, in the area of defining the selection criteria as well as in the negotiation phase if assumed to be included in the process ultimately there are the risks of delays in the realization of the contract or the risk of non-fulfillment of the contract. Regardless of which of the above mentioned risks is considered, they all ultimately reflect on the quality of the contract realisation or framework agreement, and the success of the entire project.

For example, incorrectly defined **technical specifications** or inadequately defined cost estimate will certainly result in additional costs caused by downtimes, additional purchases, or even inefficient procurement that no longer has any purpose. Various oversights in the making of the cost estimate may be done due to the inability to overview the structure of the subject of procurement because all the relevant stakeholders did not participate in the creation of the cost estimate. For example, if performing construction works at sites near which there are archaeological finds, it is necessary to consult experts or even change the location of the building, because possible archeological discovery during the construction works would certainly cause downtime and possibly unsuccessful realization of the project itself.

---

<sup>14</sup> *Pogreške u rashodima za ruralni razvoj – što ih uzrokuje i kako ih se nastoji otkloniti.* (2014). Retrieved from: [http://www.eca.europa.eu/Lists/ECADocuments/SR14\\_23/SR14\\_23\\_HR.pdf](http://www.eca.europa.eu/Lists/ECADocuments/SR14_23/SR14_23_HR.pdf)

<sup>15</sup> *Javna nabava - Smjernice za praktičare o izbjegavanju najčešćih pogrešaka u postupcima javne nabave u okviru projekata financiranih iz europskih strukturalnih i investicijskih fondova.* (2015). Retrieved from: [http://ec.europa.eu/regional\\_policy/sources/docgener/informat/2014/guidance\\_public\\_proc\\_hr.pdf](http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/guidance_public_proc_hr.pdf) (p. 7)

**The selection of the procurement procedure** depends on the subject of procurement, its complexity, as well as on the number and strength of economic entities – potential tenderers. In the case of complex subjects of procurement, additional time is required to explore markets, new products and technologies as possible solutions for the project requirements. There are several types of procedures, among with the open procedure is the most commonly used in the Republic of Croatia – in 85.06%<sup>16</sup> of the total conducted procedures, respectively 12.695 procedures. Compared to the period from 2006 to 2010 in the European Union, the open procedure was used in 73%<sup>17</sup> of the total number of procedures conducted. The most significant increase in the same period was in the use of the competitive dialogue which increased from 0.7% (2006) to 8.6% (2010) in the total number of EU procedures. This is due to conclusions of extremely valuable public procurement contracts, especially for infrastructure projects. Assuming that the allocated sum of 10.675 billion euros will be “spent” during the next ten years, which meand around 1.0 billion euros a year, an increase in the existing value of public procurement contracts will be made for around 7.5 billion kunas or around 50 billion kunas a year, so the number of procedures, so that the number of comples procedures will also increase for a significant share.

The open procedure is mostly used in cases where it is possible to precisely define the cost estimate and technical specifications of the procurement item, while the use of negotiating procedures and competitive dialogue is predominant in cases when the contracting authority purchases very complex procurement items and uses the experience and knowledge of potential tenderers in order to be able to define the best solution for the realization of the project during the negotiation. For example, the construction of an airport, a motorway, a wastewater treatment plant, etc.

The selection of the procedure determines the time dynamics from the announcement to the conclusion of the contract. More complex procurement cases require more complex procedures, so it is necessary to harmonize the dynamics of the project’s activities with procurement dynamics. In regard to this, it is desirable that the applicants plan the dynamics of the implementation of the project with great caution and realistically in relation to the size of the investment they wish to implement. The question is whether it is possible to plan the implementation of the project within a year if it is about the construction of facilities for which a public tender is needed to be made before. The

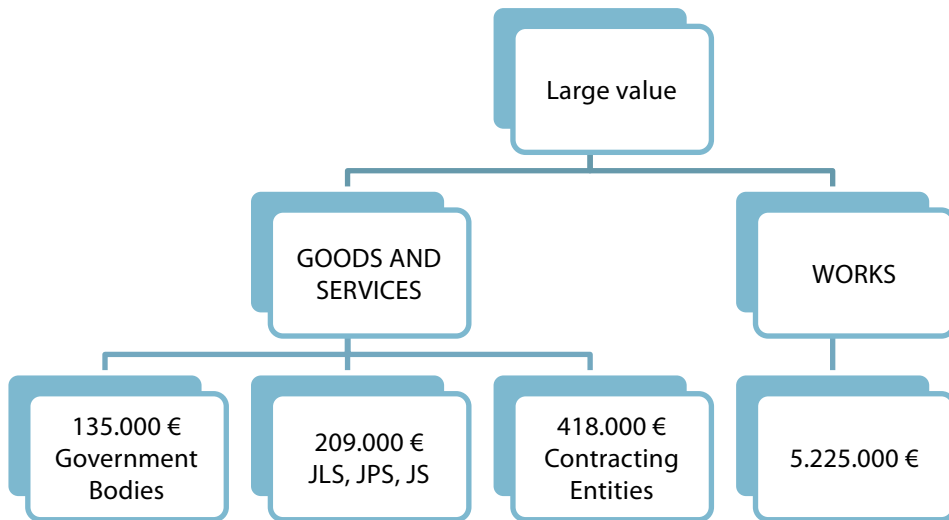
---

<sup>16</sup> *Statističko izvješće o javnoj nabavi u RH za 2014. godinu.* (2015, June). Retrieved from: ([http://www.javna-nabava.hr/userdocsimages/userfiles/file/Statisti%C4%8Dka%20izvje%C5%A1%C4%87a/Godi%C5%A1nja/Statisti%C4%8Dko\\_izvjesce\\_JN-2014.pdf](http://www.javna-nabava.hr/userdocsimages/userfiles/file/Statisti%C4%8Dka%20izvje%C5%A1%C4%87a/Godi%C5%A1nja/Statisti%C4%8Dko_izvjesce_JN-2014.pdf)) (p. 29)

<sup>17</sup> *Public procurement in Europe, Study of procurement regulation.* (2011). Retrieved from: [http://ec.europa.eu/internal\\_market/publicprocurement/docs/modernising\\_rules/cost-effectiveness\\_en.pdf](http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/cost-effectiveness_en.pdf)

question is also whether it is possible to prepare the tender documentation for the EU project within three to six months when it is required that a realistic cost estimate and a procurement plan for the realization of the project are included. Is it possible that such short deadlines provoke the opposite effect, a quick and unrealistic overview of the project that will have a negative impact on the project implementation stage, as well as on the realization of the public procurement contract. For example, for the implementation of an open procedure, it is necessary for it to be planned for at least three to six months before, depending on whether large or small value is being procured, while for the planning of each of the two-phase procedures it takes few months more.

Procurements of small values range from 200,000.00 kunas (for goods and services), and from 500,000.00 kunas (for works) up to the european level values (values in the following table).



Source: Uredba komisije EU 2015/2340, 2015/2341 and 2015/2342 od 15.prosinca 2015.. (2016, January 1). Retrieved from: <http://www.javnabava.hr/default.aspx?id=4079>



	TYPE OF THE PROCEDURE	DEADLINE FOR SUBMISSION			
		APPLICATION FOR PARTICIPATION		TENDERS	
		Low	High	Low	High
1.	OPEN PROCEDURE			<b>20</b>	<b>40</b> (PIO <sup>18</sup> up to 36, but not less than 22 days.)
2.	RESTRICTED PROCEDURE	<b>20</b>	<b>30</b> (In urgent cases not less than 15 days.)	<b>20</b> (-5 days in cases when complete TD <sup>19</sup> is published on the EOJN <sup>20</sup> .)	<b>40</b> (-5 days in cases when complete TD <sup>34</sup> is published on the EOJN <sup>35</sup> , in urgent cases not less than 15 days.)
3.	NEGOTIATED PROCEDURE	<b>20</b>	<b>30</b> (In urgent cases not less than 15 days.)	Determined by the contracting authority – <b>reasonable deadline</b>	Determined by the contracting authority – <b>reasonable deadline</b>
4.	NEGOTIATED PROCEDURE WITHOUT PUBLICATION	<b>Reasonable deadline</b> for initial tender, but if necessary, after the initial review of the tender – the contracting authority may invite the tenderer to modify and / or supplement the tender or to deliver the final tender within a <b>reasonable deadline</b> .			
5.	COMPETITIVE DIALOGUE	<b>20</b>	<b>30</b>	Determined by the contracting authority – <b>reasonable deadline</b>	Determined by the contracting authority – <b>reasonable deadline</b>

Source: Public Procurement Act of the Republic of Croatia (NN 90/11, 83/13, 143/13 i 14/13) – modified <sup>18 19 20</sup>

Therefore, in the phase of preparation of the project documentation for the application for the ESI funds, the deadlines for implementation of pub-

<sup>18</sup> If the public contracting authority has published a PIO - prior (information / indicative) notice provided that the PIO contains all the information that should be in the invitation to tender from Annex V.A (B) of the Act, that the PIO has been notified of a minimum of 52 days and a maximum of 12 Months prior to the day of the call for tenders

<sup>19</sup> Tender Documents

<sup>20</sup> EOJN –The Electronic Public Procurement Classifieds portal

lic procurement procedures should be set as well as the time needed for the preparation of the procedure and for market research.

#### 4. CONCLUSION

A long-term period is coming when domestic infrastructure projects, larger and smaller, will be funded through ESI funds. The disharmony between the planning phase, ie the preparation of the project for allocation of funds and the project implementation phase, with particular emphasis on the implementation of public procurement within the project, leads to smaller or greater risks, whether financial, technical, social and / or ecological. It is certainly a recommendation not to avoid public procurement procedures that are in accordance with European directives and the national legal framework, in order to avoid unacceptable costs.

When considering the aspect of public procurement, in order to minimize the risks it is necessary to harmonize the applicant's organisation in the planning phase and in the project realization phase in a way that at the very beginning of the project planning and designing, the applicant engages the person who will later be involved in the implementation of public procurement procedures, resulting in more efficient spending of funds and successful completion of a concrete project. It ensures correct handling of goods, works and services, ie the correct definition of procurement, selection of the best public procurement procedure for goods, services and / or construction works, optimum timing of the implementation of certain activities, reduction of the risk of complaint, and ultimately the successful funding through grants from EU funds.

#### REFERENCES

1. *EUROPA 2020. - Europska strategija za pametan, održiv i uključiv rast. (2010, March 3). Retrieved from: [http://www.safu.hr/datastore/filestore/10/Strategija\\_Europa\\_2020.pdf](http://www.safu.hr/datastore/filestore/10/Strategija_Europa_2020.pdf)*
2. *Sporazum o partnerstvu – između Republike Hrvatske i Europske Unije za korištenje EU strukturnih i investicijskih fondova za rast i radna mjesta u razdoblju od 2014. – 2020.. (2014). Retrieved from: [http://www.safu.hr/datastore/filestore/10/ESI\\_fondovi\\_-\\_Sporazum\\_o\\_partnerstvu\\_RH\\_i\\_EK.pdf](http://www.safu.hr/datastore/filestore/10/ESI_fondovi_-_Sporazum_o_partnerstvu_RH_i_EK.pdf)*
3. *European Commission: the budget explained. Retrieved from: [http://ec.europa.eu/budget/explained/index\\_en.cfm](http://ec.europa.eu/budget/explained/index_en.cfm)*
4. *Odluka Europske Komisije o odobrenju zaključivanja operativnih programa - Smjernice za zaključivanje 2007. – 2013.. (2015, April 30). Retrieved from: [http://ec.europa.eu/regional\\_policy/sources/docoffic/official/guidelines/closure\\_2007\\_2013/annexe\\_guidelines\\_closure\\_20072013\\_hr.pdf](http://ec.europa.eu/regional_policy/sources/docoffic/official/guidelines/closure_2007_2013/annexe_guidelines_closure_20072013_hr.pdf)*
5. *EUROPA: EU funding. Retrieved from: <http://europa.eu/about-eu/funding-grants/>*
6. *Uvjeti za pripremu i provedbu projekata. Structural funds. Retrieved from: <http://www.strukturnifondovi.hr/vazni-dokumenti>*
7. *Aneks 01\_Postupci javne nabave za pravne osobe koji nisu obveznici ZJN. Structural funds. Retrieved from: <http://www.strukturnifondovi.hr/vazni-dokumenti>*

8. *Kako koristiti strukturne fondove za politiku MSP-ova i poduzetničku klimu.* (2013). Retrieved from: <http://ec.europa.eu/enterprise/policies/sme/regional-sme-policies>
9. *Tehnička pomoć – koji je njen doprinos poljoprivredi i ruralnom razvoju* (2015.) Tematsko izvješće. Europski revizorski sud. Ured za publikacije Europske unije.
10. *Vodič za korisnike europskih strukturnih i investicijskih fondova i povezanih instrumenata EU-a.* (2014). Ured za publikacije Europske unije.
11. *Pogreške u rashodima za ruralni razvoj – što ih uzrokuje i kako ih se nastoji otkloniti.* (2014). Tematsko izvješće. Europski revizorski sud. Ured za publikacije Europske unije
12. *Uvjeti za pripremu i provedbu projekata* (2014, July). Ministarstvo regionalnog razvoja i fondova EU. Version 4.1.
13. *Javna nabava - Smjernice za praktičare o izbjegavanju najčešćih pogrešaka u postupcima javne nabave u okviru projekata financiranih iz europskih strukturnih i investicijskih fondova.* (2015). Retrieved from: [http://ec.europa.eu/regional\\_policy/sources/docgener/informat/2014/guidance\\_public\\_proc\\_hr.pdf](http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/guidance_public_proc_hr.pdf) (p. 7)

## SINERGIJA JAVNE NABAVE I UPRAVLJANJA PROJEKTIMA FINANCIRANIH IZ EUROPSKIH STRUKTURNIH I INVESTICIJSKIH FONDOVA

### SAŽETAK RADA:

Na temelju Sporazuma o partnerstvu sa Europskom komisijom, Republika Hrvatska ima na raspolaganju 10,675 milijardi EUR-a za korištenje iz europskih strukturnih i investicijskih fondova u razdoblju do 2020. godine.

Najveći dio dodijeljenih sredstava iz EU fondova za odobrene projekte „trošiti“ će se na temelju sklopljenih ugovora o javnoj nabavi roba, usluga i radova, a prema dosadašnjem iskustvu pretpostavlja se da je riječ od oko 48% ukupno dodijeljenih sredstava. Sklapanju ugovora prethodi provođenje postupaka javne nabave uz poštivanje strogih zakonski propisanih procedura, upravo kao što i dodjeljivanje sredstava iz EU fondova podliježe složenim kriterijima odabira najboljih projekata koji će se sufinancirati iz bespovratnih sredstava.

Dosadašnje iskustvo u provedbi projekata, financiranih iz europskih strukturnih i investicijskih fondova, pokazalo je da se učestale greške javljaju u području javne nabave, i to uslijed neusklađenog djelovanja službenika koji provode javnu nabavu i službenika koji provode projekte sufinancirane iz EU fondova. S obzirom da je u interesu prijavitelja projekta da uskladi korištenje dobivenih sredstava zadanim uvjetima, to je potrebno već u početnoj fazi izrade projekta uključiti specijalistu javne nabave, a radi izbjegavanja nepotrebnih grešaka u kasnijim fazama.

*Ključne riječi: EU fondovi, javna nabava, upravljanje projektima, ugovor o javnoj nabavi, planiranje i provedba projekta*

## INSTRUCTIONS FOR AUTHORS

All the papers dealing with the topics of accounting and management are welcome. All the submitted papers are considered for publication and have been blindly peer-reviewed by two independent reviewers.

The papers are categorized in the scientific, professional and other papers:

- **Original scientific paper** contains previously unpublished original results of scientific research;
- **Preliminary paper** presents the primary findings of research in progress, which requires urgent publication, but without the level of deep and thorough study required for the original scientific paper;
- **Review article** contains a detailed and comprehensive critical review of a certain problem area, but with no significant originality of the obtained results;
- **Professional paper** contains the information and experience relevant for a certain profession, but without scientific characteristics.
- **Case study** contains a description and detailed information about the particular subject or small group.

The Editorial Board determines the category of the paper, based on the reviewers' proposals.

The Journal of Accounting and Management is published in two issues a year.

All the papers should be submitted by mail or email to the address of the Editorial Office. The authors are obliged to follow these instructions:

1. The manuscripts should be written in English.
2. The manuscript should be submitted in a MS Word format.
3. A cover page should be supplied, containing the title of the paper, name(s) and address(es) of the author(s), including the telephone number, e-mail address and the name and postal address of the author(s) home institution.
4. The full paper should not exceed 10 single-spaced pages of text (font: Times New Roman, size 12) including graphs, tables, endnotes and references.
5. The paper should begin with an abstract of not more than 900 characters and maximum 5 key words
6. The Editors reserve the right to make editorial changes in order to adjust the style of the paper to the Journal.
7. The manuscripts are not returned.
8. No payment is made to the authors for publication of the paper.

# **PUBLICATION ETHICS AND PUBLICATION MALPRACTICE STATEMENT FOR JOURNAL OF ACCOUNTING AND MANAGEMENT**

Our ethic statements are based on the Committee on Publication Ethics Best Practice Guidelines for Journal Editors developed by the Committee on Publication Ethics (COPE).

## **Duties of Editors**

---

### **Publication decisions**

The editorial board is responsible for deciding which of the articles submitted to the journal should be published.

The editorial board will be guided by the policies of the journal and constrained by legal requirements related to libel, copyright infringement and plagiarism. Members of the editorial board will confer and refer to reviewers recommendations in making this decision.

### **Equality**

An editor, member of the editorial board or reviewer must evaluate manuscripts for their intellectual content without regard to race, gender, political philosophy, sexual orientation, ethnic origin, citizenship, or religious belief of the authors.

### **Confidentiality**

The review process takes place in two stages. In the first stage the editor must not disclose any information about a submitted manuscript to anyone other than the corresponding author, reviewers, potential reviewers, and other editorial advisers. This stage concludes with an agreement between the author and reviewers about the continuation of their cooperation in the open reviewing forum in which issues of confidentiality do not arise.

### **Disclosure and conflicts of interest**

Unpublished materials disclosed in a submitted manuscript must not be used in an editor's, reviewer's or any other reader's own research without the express written consent of the author.

## **Duties of Reviewers**

---

### **Contribution to Editorial Decisions**

Reviewers assist the editorial board in making editorial decisions and through the editorial communications during the open review process with the author may also assist the author in improving the paper.

### **Qualification of Reviewers**

Any selected referee who feels unqualified to review the research reported in a manuscript or knows that its prompt review will be impossible should notify the editor and excuse himself from the review process. The editorial board is responsible for ensuring the competence of the reviewers

### **Promptness**

Authors will normally receive feedback about the acceptance of his/her paper for the reviewing process within three weeks and in another three weeks s(he) will normally receive the first response from the reviewers.

The editorial board is responsible for ensuring the promptness of responses in the open review process.

### **Confidentiality**

Any manuscripts received for review in the open review process are subjected to the criteria of enhancing their rationality through the mutual rational controls of critical discussion.

### **Establishing Standards of Objectivity through Critical Discussion**

Reviews should be conducted objectively. Authors are encouraged to make explicit the internal criteria they use to evaluate the validity of their contributions to knowledge. Personal criticism of the author is inappropriate. Referees should express their views clearly with supporting arguments in the spirit of enhancing the quality of the paper through the mutual rational controls of critical discussion.

### **Acknowledgement of Sources**

Reviewers should identify relevant published work that has not been cited by the authors. References to the ideas of others should be accompanied by the relevant citation. A reviewer should also call to the editor's attention any substantial similarity or overlap between the manuscript under consideration and any other published paper of which they have personal knowledge.

### **Disclosure and Conflict of Interest**

Information or ideas obtained through peer review must only be used with the explicit agreement of the participants in the peer review. Reviewers

should not consider manuscripts in which they have conflicts of interest resulting from competitive, collaborative, or other relationships or connections with any of the authors, companies, or institutions connected to the papers.

## **Duties of Authors**

---

### **Reporting standards**

Authors of reports of original research should present an accurate account of the work performed as well as an objective discussion of its significance. Underlying data should be represented accurately in the paper. A paper should contain sufficient detail and references to permit others to judge the validity of the contributions to knowledge. Authors are asked to provide the raw data in connection with a paper for editorial review, and should be prepared to provide public access to such data and should in any event be prepared to retain such data for at least two years after publication.

Fraudulent or knowingly inaccurate statements constitute unethical behavior and are unacceptable.

We believe it is important to emphasise that the editorial board is not responsible for copyrights and for any ethical consequences of the publication of any particular contribution (written or in the form of multimedia). However, we expect that all people providing sources of data for published accounts have been given informed consent and that no one in any way involved in the processes of the research has been coerced into co-operation or is unknowingly being co-opted. Authors should have written permission of parents to include photos or videos of children and juveniles into research accounts.

### **Originality and Plagiarism**

The Editorial Board of JAM recognise different cultural beliefs about the acceptability of quoting the ideas of others as if they were one's own. The documents concerning the submission of papers for JAM review recognise these different cultural beliefs and emphasise the statement that 'authors should ensure that they have written entirely original works, and if the authors have used the work and/or words of others that this has been appropriately cited or quoted.'

### **Concurrent Publication**

Submitting the same manuscript to more than one journal concurrently, constitutes unethical publishing behaviour and is unacceptable.



### **Authorship of the Paper**

Authorship should be limited to those who have made a significant contribution to the conception, design, execution, or interpretation of the reported study. All those who have made significant contributions should be listed as co-authors. Where there are others who have participated in certain substantive aspects of the research project, they should be acknowledged or listed as contributors.

The corresponding author should ensure that all appropriate co-authors and no inappropriate co-authors are included on the paper, and that all co-authors have seen and approved the final version of the paper and have agreed to its submission for publication.

### **Disclosure and Conflicts of Interest**

All authors should disclose in their manuscript any financial or other substantive conflict of interest that might be construed to influence the results or interpretation of their manuscript. All sources of financial support for the project should be disclosed.

### **Fundamental errors in published works**

When an author or reader discovers a significant error or inaccuracy in the published work, it is the author's obligation to promptly notify the journal editor and work with the editor to retract or correct the paper.





