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TRANSFORMATION OF TOURISM AND HOSPITALITY INDUSTRY IN MACEDONIA

Abstract

In this paper, we address the problem of transformation of the tourism and hospitality industry in Macedonia. Despite the stable macroeconomic environment and the progress in the privatization process, the so called "transition recession" in the tourism and hospitality industry is still present. The post-privatization experience shows that the insider-oriented privatization has negative impact on the corporate governance and post-privatization financing and therefore, it seems to be the most important constraint in the restructuring of the privatized enterprises.

Keywords: Transition recession; Insider-privatization; Corporate governance; Post-privatization finance; Enterprise restructuring.

Introduction

Like all ex-communist countries, Macedonia saw a sharp decline in its economic activity during the transition to a market economy. The tourism and hospitality industry was also affected by the transformation recession although the output decline was slightly lesser compared to the economy as a whole. During 1991-95, the average annual growth rate of the real GDP in the tourism and hospitality was -7.3% while the whole economy was shrinking by an average annual rate of 8.6% (Statistical Office, 1997).

Yet, it is note-worthy that the negative tendencies in the tourism and hospitality industry were evident even before the transition process commenced. For example, between 1989 and 1992, the number of tourists and overnights dropped by 43% and 39% respectively. At the same time, the real GDP generated in the tourism and hospitality fell by 22% followed by a 18% decrease in the number of employees (Statistical Office, 1996). This may lead to a conclusion that the recession cannot be related exclusively to the transition process which is true, since the sharp decline during the pre-transition period is due to the turbulent events from the early 1990s (the disintegration of ex-Yugoslavia, external blockades, hyperinflation etc.).

Obviously, these shocks had a strong negative impact on the foreign as well as the domestic demand and therefore they appear to be a primary driving force behind the decline of the tourism and hospitality industry in the pre-transition period. But, despite this fact, it should be noted that the recession was prolonged beyond 1992 in contrast with the progress achieved in the macroeconomic stability and the near-completion of the privatization process.

Table 1
Basic development indicators of tourism and hospitality in Macedonia

	1992	1993	1994	1995	1996
GDP ¹	8.887	8.651	7.696	8.081	8.485
Turnover ²	-835.6%	189.4%	13.6%	-13.6%	-2.8%
Overnights ³	2.139.631	2.706.373	2.476.998	1.784.310	1.696.927
Tourists ³	585.699	647.728	615.134	503.837	476.205

Source: Statistical Office of the Republic of Macedonia (1996 and 1997); National Bank of the Republic of Macedonia (1998).

Notes:

1. In 1990 prices.
2. Annual real growth rates.
3. Total, foreign and domestic.

The statistical data presented above clearly indicate that there is something wrong with the reform process since there are no signs of strong recovering in the tourism and hospitality industry. In addition, we argue that the privatization model itself cannot lead to an effective restructuring of the enterprises, which in turn seems to be the main reason for the poor performance in this industry.

The privatization process in tourism and hospitality

Unlike most of the transition countries, which opted for mass privatization schemes, Macedonia has adopted the model of case-by-case privatization. The privatization process formally began in the middle of 1993 when the Parliament passed The Act on Transformation of Enterprises with Social Capital. The Act provides for several models of privatization: employee buy-out, management buy-out, sale of an ideal part of the company, privatization through additional share issue, debt-equity conversion, asset sell-off, leasing, liquidation etc. (Zakon za transformacija, 1993).

Methods of Privatization

However, in the practical implementation of the Law, the specific variants of EBOs and MBOs are by far predominant in terms of the number of enterprises and employees as well as the equity. In the first case, the employees are given the opportunity to buy out at least 51% of the appraised value of the enterprise under very favourable conditions (receiving large discounts and being able to pay the shares in five years, including a two-year grace period). In the second case, a group of natural persons (a management team) can obtain the right to control the enterprise by paying down only 10% or 20% of the appraised value, depending on the size of the enterprise. In addition, this privilege is balanced with the obligation to purchase at least 51% of the enterprise's shares in no more than five annual installments that are interest-free. The frequent use of this privatization method is especially favoured by the authorities who claim that it demonstrates a certain degree of ownership concentration with a positive impact on companies' efficiency (Agency of the Republic of Macedonia, 1996).

Privatization results

Initially, the privatization of tourism and hospitality enterprises represented only a small fraction of the entire privatization programme. Namely, at the beginning of the process, there were 70 enterprises to be privatized in this sector with 5.890 employees and DM 219 million-worth of equity. Obviously, the privatization of the tourism and hospitality enterprises was a marginal question regarding the total number of 1.216 enterprises to be privatized with 228.850 employees and worth some DM 3.3 billion. (Agencija na Republika Makedonija, 1997).

Although the actual implementation of privatization programme was prolonged to the beginning of 1995, the process progressed with an impressive pace, being almost completed by the end of 1997 when 1.132 enterprises (93% of the total) were formally privatized. In contrast with this progress, the privatization process in the tourism and hospitality has advanced rather slowly with only 56% of the total number of enterprises and 48% of the equity having been privatized.

Table 2
Privatization progress in the tourism and hospitality (end of December 1997)

	Privatized	In process	To be privatized
Number of enterprises	39	15	16
Number of employees	2.498	2.589	803
Equity (000 DM)	104.752	70.437	43.522

Source: Macedonian Privatization Agency (1997).

Some negative consequences

Since the passage of the Privatization Act in mid-1993, the Government officials have repeatedly praised the privatization process as successful and most suitable to the country's specific conditions. On the other hand, the Law has provoked a wide-spread criticism with regard to its negative impact on the pace of the reforms, corporate governance, capital market development, enterprise restructuring, business ethics and other areas of the country's economic and social development (see Slaveski, 1995). In this context, we also believe that the privatization model will adversely influence the further development of the tourism and hospitality industry in Macedonia.

We have already noted that the privatization process in the tourism and hospitality lags behind the progress achieved in the overall implementation of the privatization programme. It may suggest that the insider-based privatization methods (EBOs and MBOs) which are most frequently practiced are not suitable means of privatizing the enterprises in this industry. Namely, most of them are large measured by the capital base (since fixed investments account for the most of their assets) and therefore they are costly to buy-out. In addition, the small labour force employed in these enterprises implies that the number of potential buyers is quite limited while the modest financial capacity of the employees (due to the permanently declining personal income) is another limiting factor.

As the insider-oriented privatization methods obviously constrain the privatization process it will be necessary to supplement them with other techniques. In the absence of a mass-privatization programme, it seems that sales to strategic domestic and foreign investors could speed up the privatization of tourism and hospitality enterprises, especially those which are actually or potentially profitable. In this context, the other transition countries' experience shows that sales to strategic investors proved to be a successful way of privatizing the hotel industry (IBRD, 1997).

In addition, the experience shows that the insider-privatization encourages the emergence of internal interest groups, which struggle for control over enterprises. In some cases, a number of management teams compete to gain the control right which prolongs the privatization procedure with all the negative impact on the enterprise performance. This was the case with the privatization of HUNAP (a small enterprise with two hotels and 47 employees) where three management teams bid to buy-out the enterprise. The Privatization Agency signed a contract with one of the outside-teams and then, under the pressure of the insiders, it revoked the decision and signed a contract with the insider-team. In the meantime, the first management team initiated a lawsuit which temporarily suspended the privatization process (Dnevnik, 1998a).

At the same time, there are widespread conflicts between managers and employees in the enterprises privatized through MBOs. Even the privatization authorities admit that it is a common practice that employees are often brutally forced, under the threat of being degraded or even dismissed, to transfer their shares to top managers at large discounts. Recently, a group of shareholders in Makedonija-Turist (a company privatized through MBO) initiated a legal action against some of the top-managers, accused to have their shares illegally acquired (Dnevnik, 1998b).

The post-privatization restructuring

In contrast to the early days of transition, nowadays there is a consensus that the privatization process by itself, although being a necessary precondition, does not ensure a higher level of economic efficiency. In addition, it is commonly accepted that privatized enterprises have to be effectively restructured in order to improve their behavior and hence, performance.

With respect to enterprise restructuring, the first step is to impose financial discipline on the privatized firms by cutting direct government subsidies and opening markets to competition. It also requires removing two other sources of soft-budget constraints: bank credits on easy terms and interenterprise arrears (IBRD, 1996). Some of these conditions were met even in the pre-reform era when tourism and hospitality enterprises operated within relatively competitive environment and did not receive any direct budget subsidies.

In addition, the tight monetary policy and banking sector reform meant that non-viable enterprises had no longer access to cheap bank credits. Yet, with respect to the removal of inter-enterprise arrears, there is no significant improvement as both the lax legal regulations and inefficient courts enable many insolvent enterprises to avoid the bankruptcy procedure. This widespread financial non-discipline creates incentives for many non-viable enterprises not to undertake restructuring measures and at the same time, it has negative influence on the profitable ones.

Alongside with the macroeconomic stability and legal regulations, the choice of the method of privatization has a significant impact on the enterprise restructuring. This choice appears to influence both the depth and the pace of restructuring (EBRD, 1995). Indeed, the behavior of the enterprises privatized through management-employees buy-outs in Macedonia has undoubtedly proven the negative influence of the insider-privatization.

First of all, management-employees buy-outs did not improve the corporate governance in the privatized enterprises because it did not produce strong dominant shareholders who would be able to monitor the managers' behavior. Instead, they have resulted in a diluted ownership since even in MBOs, management teams consist of all company's employees (often, hundreds or even thousands of "managers"). In addition, insider-privatization methods have created another problem: they have put the employees in a conflict position because they appear both as shareholders and employees at the same time. In fact, this means a conservation of the old decision-making process inherited from the previous system (the so-called self-management) which proved to be extremely inefficient (For the criticism of the self-management, see Sirc, 1994).

Unsurprisingly, the weak corporate control mechanisms resulting from the insider-privatization led to accumulation of excessive power in the hands of incumbent managers who usually used it to "strip" the enterprise's assets. In addition, diluted ownership structures enable the old incumbent managers to preserve their jobs in spite of the companies' bad performance. In fact, the privatization process did not bring any improvement in companies' management since the old managers simply do not know the modern management techniques. Finally, the employees' dual position often leads to the famous "Ward paradox" since they prefer their personal short term goals (maximization of wages) to the firm's long term goals (maximization of profits). As a consequence, the privatized enterprises continued with the behaviour inherited from the previous system.

The post-privatization experience clearly showed that the bad financial condition of privatized enterprises seriously constrains their restructuring efforts. This means that the future restructuring results decisively depend on the mobilization of external finance. With respect to this, the experience shows that insider-privatization has extremely negative impact on the companies' ability to raise external funds in order to restructure. This negative impact comes from several reasons:

First, despite their bad financial condition and the urgent need for funds for restructuring, the privatized enterprises are not keen on new issues of shares as it could impose a danger of upsetting the ownership structure by allowing outside investors to obtain a significant stake of shares and thus, influence the management. This is the main reason why the privatized enterprises have not applied yet for listing on the Macedonian Stock Exchange nor have they issued shares in order to raise capital.

Second, enterprises which have chosen MBOs as a privatization method use the cash flows for repayment of the annual installments resulting from the privatization arrangements, thus being unable to pay dividends on the issued shares. This reduces the attractiveness of shares compared to the high-yielding bank deposits which seem to be a better investment alternative for small investors.

Third, both wealthy individuals and domestic and foreign companies are not interested in investing in the privatized enterprises strongly controlled by insiders in which they would only have a minor role.

Fourth, insider-dominated enterprises tend to oppose any public disclosure of information on their financial condition and business activity. This creates an information vacuum, which deters both individual and institutional investors from investing in these companies.

Although it is too early to assess the restructuring results of privatized enterprises, the available statistical data cannot indicate any significant improvement in the economic efficiency of these firms.

Table 3
Enterprise performance in tourism and hospitality

	1992	1993	1994	1995	1996
Pre-tax profit per employee ¹	1.647	7.469	24.004	20.604	16.910
Loss per employee ¹	2.215	14.318	21.570	33.446	46.517
Return on equity ²	1.1	1.4	3.4	2.6	2.1
Loss/fix assets ratio	n.a	n.a	3.0	4.2	5.7
Receivables/liabilities ratio	84.0	101.3	94.0	93.5	78.0
Revenues/expenses ratio	99.0	98.0	102.0	98.1	95.1
Debt/capital ratio	n.a	n.a	27.0	31.1	43.0

Source: Statistical Office of the Republic of Macedonia, Statistical Yearbook (Various issues).

Notes:

All figures are given in percentage points, except stated otherwise.

1. In denars, non-adjusted for the inflation.
2. Return means gross profit

In fact, the restructuring efforts of privatized enterprises are of very limited scope and usually take form of "reactive" restructuring (e.g. labor-shedding, real wage reductions etc.). For example, between 1992 and 1996, the number of employees in the tourism and hospitality enterprises fell by 21% (Statistical Office, 1996). At the same time, real wage cuts were not so sharp as they decreased only by 2.4% between 1994 and 1996 (Statistical Office, 1997). This indicate that insiders in the privatized enterprises may have already begun to behave in line with the "Ward paradox", aiming to maximize wages per employee.

With regard to the "strategic" restructuring, the privatized firms have not undertaken any significant measures. Experience shows that, due to the insider-privatization methods, most of the enterprises have preserved their old management teams, which have proved incapable to establish effective organizational structures, improve the product-mix and introduce new management techniques. Unsurprisingly, the privatized enterprises proved unable to compensate the loss of traditional markets (ex-Yugoslavia, Greece). On the contrary, the available statistical data suggest that the role of the western European market permanently diminishes.

Furthermore, it is clear that privatized enterprises, faced with capital constraints, cannot achieve any significant results in the field of the "deeper" restructuring. As a result, new capital investment in the privatized enterprises permanently decreases while depreciation largely exceeds gross investment, thus leading to disinvestment with its devastating impact on the restructuring of these companies.

Table 4
Investment in tourism and hospitality

	1993	1994	1995	1996
Net investment ¹	-79.827	-163.167	-178.366	n.a
Gross investment/GDP ratio	8%	3.8%	3%	n.a
Investment in fixed assets ²	189.4%	13.6%	-13.8%	-2.8%

Source: Statistical Office of the Republic of Macedonia (1997); Own calculations.

Notes:

1. In thousands of denars, non-adjusted for the inflation.
2. Annual real growth rates.

Conclusions

Although it is too early to assess the results of the privatization process which takes place in Macedonia, there is no evidence that the privatized enterprises have improved their performances. Undoubtedly, external shocks related to the conflicts and unstable political situation in the region have a great impact on the tourism and hospitality development in Macedonia. In addition, the domestic tourism demand has been seriously affected by the transformation recession as well as the restrictive macroeconomic policy pursued by the Government which have resulted in declining real personal income of the population.

At the same time, the privatization experience to-date has undoubtedly proven the negative impact of the insider-privatization methods on the restructuring of the tourism and hospitality industry. The insider-privatization hampers both the corporate governance of the privatized companies and their ability to attract external finance. As a result, the behavior of the privatized enterprises remained unchanged from the previous system and thus, their performances have not improved yet.

In order to facilitate the privatization and restructuring of tourism and hospitality enterprises, it will be necessary to revise the present privatization programme. First of all, the Privatization Agency should prefer, wherever it is possible, sales to outside investors versus management and employees buy-outs as a method of privatization. This should be accompanied with more active role in the sale of the so-called "residual shares" (the Agency's portfolio of shares in privatized companies) under more favourable terms. Finally, the authorities should encourage the transfer of ownership rights in order to enhance the ownership concentration.

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