

RESTRUCTURING OF SERBIAN RAILWAYS JSC¹

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Abstract

The restructuring process of "Serbian Railways" JSC (Serbian Railways) was launched in 1991 and due to various reasons has not been implemented until 2015. After 25 years of "preparation" restructuring process was carried out in a way that only formally satisfy the government, World Bank, IMF and the EU and essentially will lead the Company to even greater uncertainty and struggle for survival. During the last 25 years, the railways has been neglected and forgotten by the State. In the last two years significant investments are going on, however the Company is not prepared to enrich the capital and valorizes it on the transport market.

Keywords – „Serbian Railways“ JSC; Serbian Government; IMF; World Bank; European Union; Restructuring

INTRODUCTION

Railways represent a unique organizational and technical- technological system. Failure to adapt to market conditions, the expansion of road transport, insufficient quality and incompleteness of transport services, high operating costs, high losses, inadequate organization of system, etc., influenced the initiation processes of transformation of the railway.

In the year 1991 the EU directives set out the foundation and guidelines for the restructuring of the railway system and railway companies (Directive 91/440 / EEC on the development of railways in the future).

REB „Belgrade" has started preparatory activities for the restructuring process already in 1991, but because of international sanctions imposed by the international community and because of wars on the territory of former Yugoslavia, these activities were frozen. The continuation of the

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restructuring process was re-launched in 2002, but due to the unwillingness of railways and several governments of the Republic of Serbia, no significant progress has been achieved. By signing of the Memorandum between the World Bank and the Government of the Republic of Serbia in 2014., model of the organization, as well as the planned deadlines for the establishment and independent work of newly established railway companies has been defined. By hiring the consulting firm "Planet" from London, documents that have elaborated the process of restructuring has been worked out.

By decision of Government of the Republic of Serbia disintegrative changes were made and consequently, on 10.08.2015. three new companies were created, which have to deal with core business (Infrastructure, Passangers, Freight).

Existing Enterprise „Serbian Railways“ JSC should be dealing with:

- Solving historical debts.
- Restructuring of workforce.
- Restructuring of subsidiaries.
- Institutional development of the railway sector.

SUMMARY OF THE CURRENT STATE OF “SERBIAN RAILWAYS“ JSC

„Serbian Railways“ JSC have started the process of restructuring unprepared, although during the period 2002-2014 several consultants were working on various segments of the restructuring program. Most of these programs were conditioned by obtaining EBRD or EIB loans. SR management as a rule, were adopting these documents as recommendations, avoiding their obligatory implementation. On the other hand, even at the level of the Government of the Republic of Serbia in that period, there was no critical mass for changes in the railway sector.

PREVIOUS WORK OF CONSULTANTS ENGAGED BY “SERBIAN RAILWAYS“ JSC, THE MINISTRY OF TRANSPORT AND SERBIAN GOVERNMENT

In developig of restructuring program of Public enterprise „Serbian Railways“ during the period 2002 - 2014, several consulting companies were engaged in six projects:

- The project of reconstruction of Serbian Railways - Institutional study - Consultant Booz Allen & Hamilton.

- The project "Creating a regime of access to infrastructure and catalog data on the network for the railway sector in Serbia" - Consultant Booz Allen & Hamilton
- The project "Assistance in restructuring" - BCEOM Consultant.
- The project "Development of a 5-year Business Plan for “Serbian Railways” and the Contract Agreement between the State and Infrastructure manager on the level of rail infrastructure services for the provision of the use of railway infrastructure in Serbia" - Consultant ROLAND BERGER and SPECHT.
- The project "Technical Assistance to Serbian Railways in the restructuring of selected areas" - Consultant AT Kearney & TRADEMCO.
- The project "Assistance in restructuring" - Consultant Pricewaterhouse, Coopers Consulting Ltd. (PWC).

TERMS OF REFERENCE BETWEEN THE WORLD BANK AND GOVERNMENT OF THE REPUBLIC OF SERBIA²

The Government of the Republic of Serbia has concluded Stand-by arrangement for the financial support of the International Monetary Fund (IMF) in order to support growth and job creation, in which it has been agreed a comprehensive reform of the railway sector, which is currently in progress. The reform that is being applied is based on the Action Plan for the railway reform, which was jointly prepared by the Ministry of Construction, Transport and Infrastructure of the Republic of Serbia (MgSi) and the World Bank.

The aim of railway reform is to improve operational and financial performance of the railway sector in Serbia. The intentions of the reforms are to achieve the goal by creating a sustainable market-oriented railway companies whose roles and functions, relations with the Government of the Republic of Serbia, and the interrelationships between them, are in full compliance with the EU directives on rail sector and relevant Serbian legislation.

In accordance with the program defined by the Government of the Republic of Serbia and the World Bank in 2014. in the framework of the

² Full text at this point is taken from the ANNEX II: Terms of Reference - Technical assistance to the Ministry of Construction, Transport and Infrastructure (MgSi) and railway companies in state ownership in Serbia – Comprehensive reform of railways.

Action Plan for the railways reform, after the accelerated project financed by the EU in 2015., are completed, railways reform plans envisage existence of four separated societies: the former vertically integrated state-owned railway company "Serbian Railways" JSC, and three new companies created by separation of the activities and by creation of new State owned companies (corporate separation).

- "Serbia Railways" JSC.
- "Serbian Railways Infrastructure" JSC.
- "Serbia Train" JSC - Passenger Railway Transport".
- "Serbia Cargo" JSC.

After the creation of IM, this Company has taken the responsibility to ensure that the railway network is "available" for users. Infrastructure access charge based on the "offer of the infrastructure services" as described in the Network Statement of IM is a way of doing this properly.

IEWS OF MANAGEMENT OF "SERBIAN RAILWAYS" JSC RELATING TO THE RESTRUCTURING PROCES

The Board of Directors of „Serbian Rilwas“ JSC in February 2015 adopted a document called ACTIVITY PLAN IN THE RESTRUCTURING PROCESS OF „SERBIAN RAILWAYS“ JSC, with the following attitudes:

- The restructuring of "Serbian Railways" JSC needs to be performed within the deadlines defined in the Reform Action plan, prepared by the World Bank (WB), together with the Ministry of Construction, Transport and Infrastructure.
- The restructuring of "Serbian Railways" JSC needs to be performed in compliance with the EU Directives, Memorandum of Understanding on the development of the South East Europe core regional transport network, and on the basis of the projects and studies prepared within the EU assistance (in particular General Master Plan for transport in Serbia, the strategy of railway, road, inland water way, air and intermodal transport development in the Republic of Serbia 2008-2015).
- The aim of the restructuring of "Serbian Railways" JSC is to make the railway companies in Serbia profitable, economically responsible, efficient and competitive in the long run, under the conditions of liberalized railway transport market in Serbia.
- State financing of the railway sector should be focused on the basis of contractual relationship (development and maintenance of the railway infrastructure and the organization of railway transport, the obligation of

public rail transport of passengers and the development of intermodal freight transport).

The restructuring of “Serbian Railways” JSC needs to be carried out in phases, based on defined plans for corporate and financial restructuring, taking into account the particularities of the railway market and railway heritage in Serbia. The restructuring of SR implies the following complex processes:

- a) Technical-technological modernization.
- b) Organizational structure modernization.
- c) Modernization of human resources and expert skills - development of managerial and expert knowledge.
- d) Business management model modernization.
- e) Introduction of IMS (integration: QMS, EMS, SMS, EnMS, ISMS).
- f) The introduction of information systems class: ERP, DMS, MIS, DSS.
- g) Financial consolidation.
- h) Social program.

Corporate Restructuring of “Serbian Railways” JSC, implies preparation of organizational structure, which consists of four business companies, including a variety of technological and business units:

- a) Freight transport company
 - b) Passenger transport company
 - c) Rail infrastructure management company
 - d) Holding Company
- In the later stages, in accordance with results of feasibility studies, the introduction of outsourcing companies for the following activities: railway rolling stock maintenance, maintenance of Overhead Contact line (OCL), Signaling-Safety and Telecommunication systems, for the development of intermodal centers, for asset management and commercialization of railway stations, for legal support, etc.
 - New companies should start with a healthy balance sheet and without liabilities and historical debts which should be taken over by the State.
 - New companies should start without the surplus of labor and property. Defining of the labor surplus should be based on the Labor Study, and defining of the property surplus on the basis of separation Balance Sheet.
 - Property surplus and labor surplus has to be taken over by the Holding Company. The Holding Company, together with the State, needs to solve the issue of the labor surplus through a social program, and the property

surplus needs to be commercialized and used for repayment of historical debts and financing of the Holding Company.

- Holding Company should have both, coordinating and controlling function, compared to the profit companies, and it can, in the long run, take over corporative functions (strategy and development, consolidated planning, implementation and controlling of the model of project management – PPM, running of the business books, preparation of the financial reports and expert opinions, integrated purchase, legal representation, harmonization of the interrelations and arbitrations, etc.), if it is shown that their existence in the profit companies is more expensive and of lesser efficiency. Function of the Holding and its duration term should be studied carefully, in order to avoid the mistakes of some railway companies in the region).
- Complete process of restructuring of SR should be carried out in close cooperation with Ministry of Construction, Transport and Infrastructure, as well as with Ministry of Economy, Ministry of Finance, Ministry of Justice, Ministry of Labor, Employment, Veterans and Social Affairs and the Property Directorate of the Republic of Serbia.

ACTIVITIES OF INTER-MINISTERIAL GOVERNMENT COMMISSION

In order to manage the process of reforming the “Serbian Railways” JSC, Serbian government has formed an interministerial Commission composed of representatives of the Ministry of Construction, Transport and Infrastructure, Ministry of Economy, Ministry of Finance, Ministry of Labor, Employment, Veteran and Social Affairs, Railways Directorate and “Serbian Railways” JSC.

The Commission has worked mainly on the formal requirements for the implementation of obligations under the Terms of Reference that are related to creation of normative acts. “Serbian Railways” JSC professional services have developed all the necessary documents for the initiation of a status changes of the Company.

ACTIVITIES OF THE CONSULTING COMPANY "PLANET" WHICH HAS DEVELOPED RESTRUCTURING PLAN

In May 2015. Government of the Republic of Serbia, engaged the consulting company "PLANET" from London to develop a Program of Restructuring. The final report from 09.10.2015 has been adopted by the Government of the Republic of Serbia as a framework program of

restructuring railway sector in Serbia. Institutional improvements have been designed in such a way to harmonize the railway sector in Serbia with EU laws include the following:

- Limiting the possibilities of the Government of the Republic of Serbia to intervene in the daily operations of the railways on the basis of the planned introduction of the PSO (Public Service Obligation/Obligation of public transportation), MAIC (Multi Annual Infrastructure Contract) and IAC (Infrastructure Access Contract/Contract on use of infrastructure) the contract of 01.01.2016.
- The release of “historical” debt based on the fact that the Government of the Republic of Serbia should take responsibility for its repayment.

In addition to the fact that the total cost recovery in the rail is 55% (income of RSD 12.3 billion, the total cost of RSD 22.4 billion in 2014), it is necessary, in the coming period to achieve financial and business improvements through key strategies:

- Rationalization of the railway network on the basis of its contribution to the Income Statement. This also includes the elimination of transportation that generates a loss, if it is not specifically financed by the Government of the Republic of Serbia.
- Reorganization of activities based on the need for structural changes, focus on customers, better defined responsibility of business management and decentralization of levels of the authority and responsibility.
- The newly formed companies should be rid of non-core activities and non-functional properties, which through the sale or commercialization should provide funds for repayment of historical debts which state did not take over.
- “Serbian Railways” JSC should take the labor surplus, in order not to burden the operating result of the newly formed companies.
- Strategy of maintenance that should compensate lack of investment in maintenance over the past decade.
- The investment strategy that focuses on priority areas and strictly comply with the restructuring plans.
- Human resources strategy, as a key element for the execution of other strategies.

Business strategies that will improve business performance such as:

- Increase the effectiveness and efficiency of operations.
- Seek for opportunities to develop additional sources of revenue indirectly related to accessory services in the transport of passengers and goods.
- Modernization of business processes and improvement of sales.

- Increase productivity by increasing labor and reducing the number of employees by 6,151 to 2020. Where by the State is to provide 39 million EUR for social program.
- State is to take over all liabilities for international loans for which guarantees were issued in the amount of RSD 81.4 billion and liabilities to the state-owned enterprises in the amount of 5,36 million RSD.
- To realize investment plan during the next five years in the amount of:
 - 274 million € for "Serbia Train" JSC, whereby investment will focus on rolling stock (90%), the new ticketing system (5%) and information systems (5%).
 - 458 million € for "Serbian Cargo" JSC, whereby investment will focus on rolling stock (98 %) and information systems (2%).
 - 3.95 billion € for "Serbia Railways Infrastructure" JSC, whereby the investment will be focused on reconstruction (69%), modernization (29%), stations and information systems (2%).
- Establish a professional management in all companies.

BASIC PROBLEMS IN THE IMPLEMENTATION PROCESS OF RESTRUCTURING

By disintegration of the railway sector in Serbia the process of restructuring is only initiated. Unfortunately, the Ministry of Construction, Transport and Infrastructure believes that the process of restructuring of railways is successfully completed, which is presented to the public and to representatives of the IMF and the WB. Except for the establishment of new enterprises, serious progress has not been achieved.

- By separation balance sheet of property and liabilities newly established companies have not started without non-core activities, non-functional properties and historical debts.
- Labor surplus has not been transferred to the "Serbian Railways" JSC because the State has not provided funds for social program, so that redundant workers is still a burden on new companies.
- State has provide only about 50% of the funds for the Public service obligations, in accordance with methodology adopted by the Government of Republic of Serbia, with the obligation of "Serbia Train" JSC to organize transport on the whole network. "Serbia Train" JSC is not allowed to create the price of transport in accordance with market conditions although they are 2-3 times lower than prices for bus transport for the same or better quality of service. All this will directly affect the quality of

maintenance of vehicles, their reliability - or directly on the quality of service.

- The liberalization of the market that was made 8.2.2016. Already in the year 2017. Will directly jeopardize survival of "Serbia Cargo" JSC, because this Company is not ready for market competition (in the sense of technique, technology, organization, personnel and information system). Around 70% of "Serbia Cargo" JSC revenue derives from international transport by foreign operators driveways at the entrance of our country and taking over the goods at the exit from Serbia.
- The State has not developed a five-year national program of development and maintenance of rail infrastructure, therefore it is not known how much funding is provided for this purpose.
- For the year 2016 State has provided insufficient funds for infrastructure maintenance and traffic regulation. The resources that are at the disposal of "Serbian Railways Infrastructure" JSC are sufficient only to regulate traffic and maintain an emergency. All this will lead to a further decline in the parameters of non-overhauled lines, which will have a direct impact on decline in the quality of transport services of goods and passengers, substantial disturbances of security and a significant increase of costs per gross ton km or passenger km.

CONCLUSION

Restructuring of railways is to be understood as a dynamic and continuous process. Based on experience of the EU member states, we can conclude that the application of so-called "*learning from mistakes*" approach is being implemented. Due to the complexity of railways, creating of economic organism that is capable of adopting to the market conditions and to remain firm and stable when it comes to safety, reliability and quality of service - is very difficult. First of all, it is necessary to create a critical mass for management of changes, to raise knowledge and responsibility of every employee at a significantly higher level.

Restructuring activities should not be seen only as a defensive process (staff reductions, cost reductions, etc.), but as a potential for the development of human resources and new technologies, which for the company can secure stable economic conditions and market competition with the upcoming competition. This is a permanent activity which t is adjusted according to specific changes in the environment.

From the experience of EU countries we can notice that holding prevails as an organizational model. Disintegrated model of organization is mainly

applied in candidate countries for EU membership, with the imposed obligations:

- Increasing the quality of infrastructure by foreign loans whereby, as a rule, the execution of works and equipment are entrusted to the companies from highly developed EU countries. Construction of infrastructure by the EU standards is a direct consequence of the excessive indebtedness of all candidate countries.
- Payments of the minimum cost of leasing of infrastructure by the operators (the latest EU regulations), so that biggest part of the costs of maintaining the infrastructure are borne by the State.
- The liberalization of market, with special emphasis on the commodity transport, where foreign operators are in a much better position, thus retaining the only profitable segment of the railways for themselves.

Rapid liberalization of the market (before entering the EU) is direct consequence of bringing national operators to disadvantage position compared to private operators, and indirectly, to decrease in the activity of the economy that works for the railway.

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