

BUREAUCRATS IN BUSINESS: AN ATTEMPT TO MEASURE STATE ENTERPRISE DECISION MAKING AND MANAGERS' ATTITUDES

Institute for Market Economics

Introduction

We define "bureaucracy" in business as an agent with two features: first, an agent who applies management approaches against market principles in resource allocation; second, the bureaucrats tend to change the rules of the game established by themselves. The bureaucratic approach to the business affairs is closely associated with inefficient resource allocation and unclear rules.

We measured the bureaucracy in business by means of a standardized questionnaire, filled by face-to-face interviews with managers or executive directors of 117 state owned enterprises (SOEs), public (joint stock companies) and private companies of the questionnaire. The companies in the sample are all state and formerly state companies which during the survey were found as follows: SOEs — 34.4%, in process of privatisation (47.9%) or recently privatised (17.7%).

The research was conducted on a representative cluster in 17 regional towns and Sofia. Companies were selected by random procedures from the BULSTAT register. The survey took place in May 1997.

The questionnaire was designed by IME and the Agency for Socio-economic Analysis, owned by Docho Michailov and was consulted by law attorneys, and experts in econometrics, management and statistics. It consists of 45 precoded and open questions, comprising 201 variables.

Measurement of bureaucracy

The distribution of time of the managers' is the principle measure (indicator) of bureaucracy applied in this research. The managers' time consists of time for consultations with superiors, time for work with institutions, operational management time, deal-digestion time. Besides time, level of managers independence and factors of decision making were also taken into account.

All bureaucracy measures were structured in the contexts of Corporate governance and Operational management. Corporate governance management focuses on manager's relationship with superior institutions and other integral activities of the company. Operational management treats managers' relationship with inferiors and current management activities. Nevertheless this division is conventional and was made only as attempt to structure results.

Potential factors which may initiate bureaucracy's intervention in time and resource allocation were selected as follows:

- 1) Legal and privatization factors, including ownership, privatization phase, type of superior structures and others.
- 2) Size, structure and competitiveness, including organisational factors, industry sector, level of competitiveness, technological level, type of preferred partners and others.
- 3) Management values, practices, and attitudes, including job values, accessibility values, power values, intention to avoid rule, and others.

All bureaucracy indicators were taken as dependent variables (time, remuneration, salaries, frequency of consultations with superiors and others) , while all bureaucracy factors as independent ones. The analyses revealed how bureaucracy factors affect bureaucracy indicators. Efficiency indicators were treated as dependent (variables) on the bureaucracy measures.

The first step of analyses was to process all variables by descriptive statistics providing row distribution of values. Where appropriate, and particularly for time variables scales

were constructed integrating all time values of a particular bureaucracy indicator. These scales were tested for alpha consistency and were consequently structured as new *level* variables to compute low, middle and high levels of a particular indicator. These procedures enabled application of variation (Anova) analyses which tested all potential relationships among bureaucracy indicators, factors and company efficiency. Because of the cumulative nature of time scales, mean values of time appearing in Anova analyses may not be interpreted as real time indicators and have a statistical meaning only. All interrelations with a level of significance below 0.05 were treated significant. Only these effects are discussed in this report.

The report

This report summarises the first attempt in Bulgaria to measure costs of decision making and managers attitude in SOEs, enterprises being privatised and recently enterprises. The results are representative and valid for the Bulgarian SOEs. Consistency analyses revealed that results do not change with further increase of sample size. However, broader conclusions would require a sequence of surveys. Data on private (recently privatised) companies (17.9%) has a control and comparative value only. It may not be interpreted for any conclusions about bureaucracy or time management in the private sector.

Background

Bulgaria is one of the transitional countries which will repeat macroeconomic stabilisation reform again. The introduction of the currency board set up a new rules for both real and financial sectors. SOEs and private enterprises should operate under hard budget constraint.

It is generally accepted that bureaucratic approach has been one of the major institutional barriers to the market reforms in Bulgaria. Most analysts admit that here, as elsewhere, bureaucrats allocate resources according to unclear criteria and in an inefficient way; that both management and privatisation of the SOE is a duty of government officials who maximise their utility, i.e. impede structural reforms; that huge state owned sector is the main source of bureaucracy's economic power, and so on. At the same time nobody in Bulgaria bothered to initiate a survey into this conventional wisdom, and measure structural reform blocking procedures.

During last years, state owned enterprises worked under unfavourable and unstable economic conditions. A real economic growth was registered in 1995 — GDP; the payment balance was positive, inflation was curbed and reached its lowest level for the entire transitional period. However, the recovery was a conjuncture, and based on debt and quasi-fiscal financing. In 1996, Bulgarian economy entered a deep crises: high inflation rates, avalanching government debt, insolvent banks and shattered finance system.

The deep crisis in 1996 was rather unexpected by the government given the good economic performance in 1995. High inflation expectations induced a mass withdrawal of deposits from the commercial banks and a currency substitution. Banking sector crisis was of a systemic nature, deeper than a mere liquidity crisis. The inability of the government to tackle the crisis necessitated an introduction of a Currency Board regime.

Government debt and monetary policy

Total debt increased three times within 1996. The soft budget constraints were the most important factor for debt growth. In 1994 state-owned enterprises wrote-off their balance sheets BGL 26.4 bln. and USD 1.8 bln. liabilities to the banking system. The government undertook these liabilities by issuing 25-year bonds. The economic policy aimed at transferring liabilities from both financial and non-financial sector to the

budget rather than introducing hard budget constraints and reducing deficits in the economy.

The growth of net foreign assets in 1995 was the most important factor increasing money supply. The high interest differential attracted a lot of short term capital in the first half of 1995. Net foreign assets growth had not been offset by domestic assets reduction and reserve money grew faster than inflation rate and was an important factor for the high inflation rate in 1996 (336%). In 1996, growth of domestic assets was effectively sterilised by foreign assets decrease.

The short term capital inflow in 1995 resulted in a positive overall BOP. Interest rates differential in the first half of 1996 had an opposite impact on short term capital inflow. Meanwhile, Bulgaria's long term liabilities to the rest of the world have a different dynamic.

Legal framework of SOEs

Most SOEs have been transformed into commercial companies under the legal form of one-person owned joint stock companies (where the sole shareholder is the government/line ministries) and one-person owned limited liability companies (established by SOEs or the government/line ministries). This procedure is regulated by the Law on SOEs Transformation into Commercial Partnerships (1991) This gave them an opportunity to act as real commercial entities due the fact they were set in same legal regime (re.: capital provisions, management structure, etc.) as private companies, in conformity with the Commercial Act of 1991. The difference stemmed from the execution of the property rights in SOEs. A number of Council of Ministers decrees (N265/1992, amended in 1993 and N7/1994 on the enforcement of the property rights on SOEs, amended three times in 1995 and 1996) attempt to put some order in the governments role of the principal. The latter decree stipulates that in both types of SOEs Council of Ministers or the line ministries exercise the owner's rights (Article 9), appointing the majority of the Board Members. From a legal point of view, there is no difference between private companies and SOEs; in SOEs the government plays the role of the shareholders' general meeting. However, government representative in the boards found a way to maximise their utility through transferring liabilities from the enterprises to the budget.

Financial incentive are seen at the level of five minimal wages a month for Boards of Directors member, or at 350 per cent of the average salary for the managers. Any other way of financial encouragement for economic results to be achieved in favour of the company is not allowed as well. Taking into consideration all these relevant facts it can be concluded that the relationship between the members of the executive bodies of state owned joint-stock and limited liability companies from one hand and the State as a sole shareholder, from the other, are administrative rather than contractual for there is almost no space for a consent between the parties.

Management contracts with executive directors and Board and Supervisory Board members are negotiated between each member of the Board on one side and the appointed Minister as an owner's representative on the other. They are concluded on the basis of a special order issued by the Minister for the appointment of those persons as members of the Board. Such appointment substitutes the election of the members by the General Meeting of Shareholders. The contracts are concluded in accordance with the general principles of Bulgarian Civil Code. They can not be employment contracts. The parties' rights and obligations including the remuneration due to the members of the executive bodies and the limits imposed on the grant of powers in connection with their functions are in fact not subject to prior negotiation. They should be in conformity with the legal rules in force and the unilateral will manifested by the representative of the State in the contract — the Minister appointed by the Government. As it was said above the powers of the Executive bodies of state owned companies are quite limited. Although such issues as the adoption of the inner structure of the company and its market policy are within the competence of its executive bodies, as a whole they have less powers in the decision-making process under such management contracts than those granted to the same bodies of the companies in the private sector. In the case of the two-tier system the management

contract is negotiated actually between the Chairman of the Supervisory Board as its representative, and the members of the Board of Managers.

There is a second type of management contracts in SOEs: those concluded with the Executive Directors of the Board of Directors and the executive members of the Board of Managers. The contracts are negotiated between the Board of Directors (the Board of Managers) represented by its Chairman on one side and the appointed Executive Director (executive member) on the other. They also shall be in conformity with the general principles of Bulgarian Civil Code and cannot have the form of employment contracts though they contain some provisions concerning working conditions, salaries, etc., and though that person is an "in-house" and a kind of employee of the company. In that position he or she deals as a Manager of the company and Head of its inside administrative staff. Nevertheless, there are the same contractual restrictions like those applied to the Management contract concluded with the appointed Minister as an "ordinary" member of the Board. There can not be real negotiation on the terms and conditions of the contract concerning parties' rights and obligations, claims for damages, dissolution of the contract, etc. if there is an offer which differs from that proposed by the State. Nevertheless a good manager is quite free to carry a reasonable and successful economic policy in conformity with the company's interests. The third type of Management contracts are those concluded with all other members of the "in-house" administrative personnel of the company, including the Industrial Director, the Marketing Director, etc. Those contracts are always employment contracts as these persons are employees of the companies. These contracts are concluded between the single Executive Directors, or the executive members of the Board of Directors (Board of Managers) of SOEs from one hand, and each member of the administration, from the other. In that case the Executive Director and the other party are free to negotiate the terms and conditions of the contract in accordance with the provisions of the current Bulgarian legislation.

However, the main problem is that the members of the executive bodies are not motivated to deal like real managers because of the existence of numerous restrictions to their activity including an absolute lack of financial encouragement.

On the other hand almost all of the members of those bodies are members of public administration as well. They in fact have been elected as members of the executive bodies as a result of their occupation as governmental employees, not because of their managing experience. That fact proves that to some extent the business activity of the state owned companies is determined by political rather than economic reasons, and is directly connected with the will of the ruling party and its government to reform the existing economic system in Bulgaria.

Corporate Governance Issues

We used consultation time on different economic issue (with superiors) to outline SOEs decision making costs.

Companies managed by a board of directors need more time on consultations than the others. Working with Board of directors requires weekly consultations, while managers under other superior structures consult them once or twice per month. Companies where owners are represented by the Manager need less time for consultations with superiors (twice a month). Alternatively, in the recently privatised companies or companies under privatisation where owner representatives are physical persons or private companies report higher time spent on consultations (once a week). Respondents who state that Ministry departments are responsible for the final risk of the companies show higher consultation time.

SOEs with a government share of more than 50% also need 4.67 more consultations than the average time spent of consultations. At companies owned by local governments this estimate is 2.47 times average value.

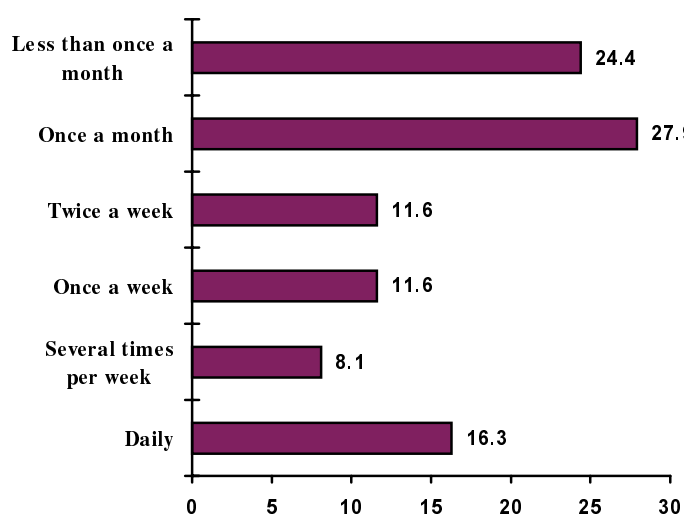
Most of the consultations are devoted to financial management (57.3%) and investments (45.8%). Less consultations is necessary for personnel selection and salaries. Sales and new clients are more "disputable" than the suppliers.

Organization structure is an important transaction costs factor. So the state owned enterprises are much more bureaucratic than private ones and transaction costs are higher. Physical persons and private companies representing the government-owner or privatisation funds-owner manifest the same feature.

The general answer to that question looks as follows:

Single answer	Valid percent	State
Q12. <i>How often do you consult representatives of the company owners</i>	Daily	16.3
	Several times per week	8.1
	Once a week	11.6
	Twice a week	11.6
	Once a month	27.9
	Less than once a month	24.4
	N/A	(10.4)

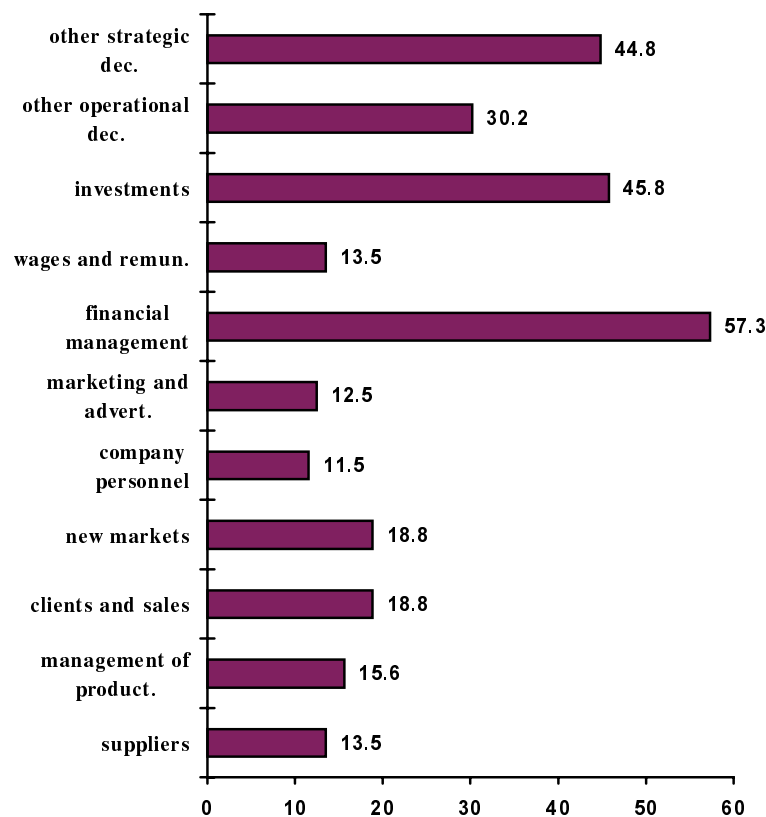
[Valid percent: Frequency of relationships with superiors]



Here is the distribution of time by issues:

Multiple answer	Yes Percent	State
Q13. <i>What kind of decisions do you have to consult with the owners of the company</i>	About suppliers	13.5
	About management of production	15.6
	About clients and sales	18.8
	About new markets	18.8
	About company personnel	11.5
	About marketing and advertising	12.5
	About financial management, loans and profit allocation	57.3
	About wages and remuneration	13.5
	About investments and long-term assets	45.8
	About other operational decisions	30.2
	About other strategic decisions	44.8

[Yes Percent: Subject of consultations]

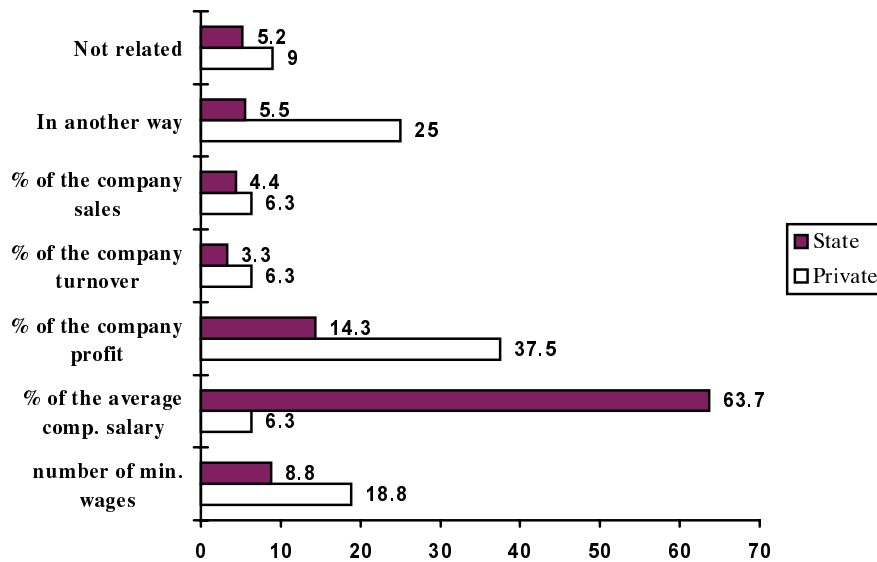


Remuneration of managers

The results suggest that company profits does not correlates with the additional remuneration. The research results suggests that managers' remuneration in the most companies is not bound to the profit. The state-owned companies did not use system of stimulus on the base of market principles.

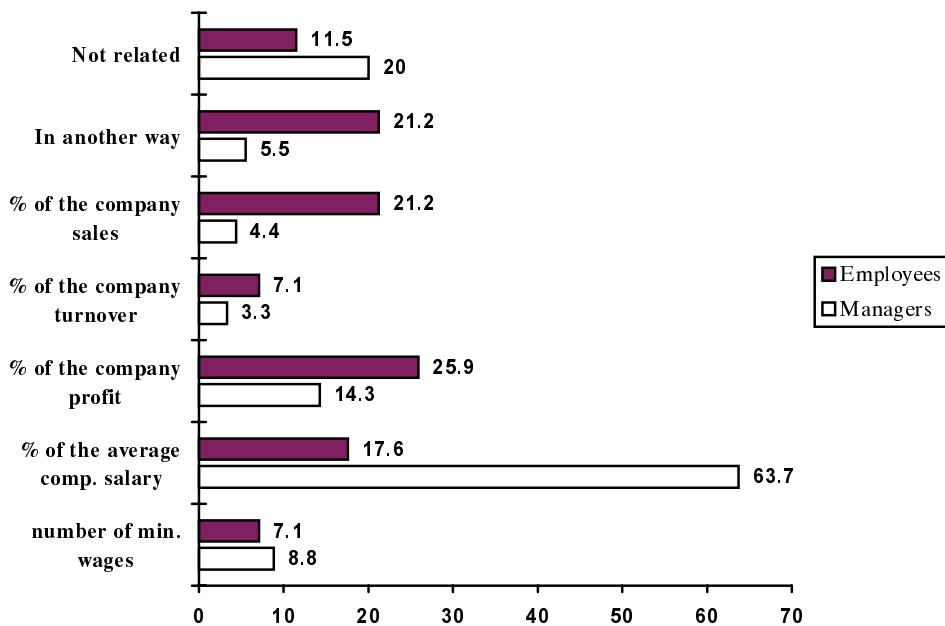
Multiple answer	Valid percent	State	Private
Q14. Is your personal remuneration related to the efficiency of the company	Related to a number of minimal salaries	8.8	18.8
	Related to a % of the average company salary	63.7	6.3
remuneration related to the efficiency of the company	Related to a % of the company profit	14.3	37.5
	Related to a % of the company turnover	3.3	6.3
	Related to a % of the company sales	4.4	6.3
	In another way	5.5	25.0
	Not related : Missing values	(5.2)	(9)

[Valid percent: Managers' incentives]



Only 5.2% of managers do not receive remuneration's related to any index of company efficiency. The most frequent incentive is to link remuneration to a per cent of the average for the company salary (63.7%). Another commonly used formula is to connect remuneration to the company profit (14.3%). Most infrequently remuneration is attached to company sales and turnover.

The graph below provides comparisons between managers and employees' incentives:
 [Valid percent: Employees' incentives / Managers' incentives]



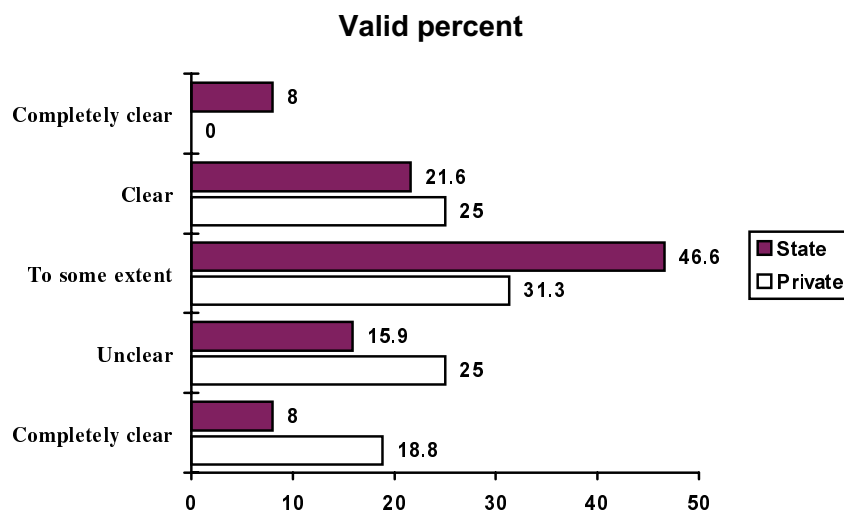
The results show that employees' incentives are different. While only 5.2% of managers lack additional remuneration, more than 11% of their employees do not have such motivation. Employees receive their additional remuneration more often on the basis of company profits and company sales, while managers are stimulated on the basis of the average company salary.

Rules of the Game

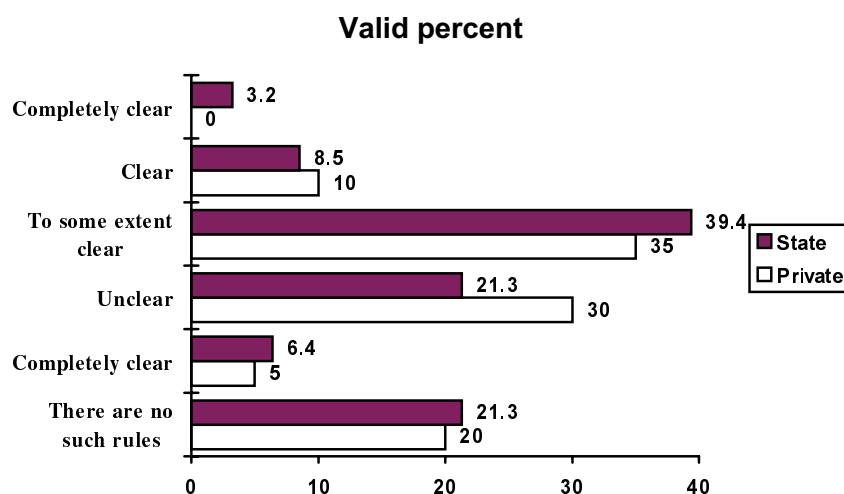
21,6% of the SOE and 25% of the private companies managers shared the opinion that the state clearly defines the rules of the game (Q30). This sharply contrasts with the small percentage of managers, who answer positively to the question 31 "Are there

clear rules of the game” in Bulgaria (only 8,5% of the SOE and 10% of the private companies).

Single answers	Valid percent	State	Private
Q30. How the state defines the administrative rules for the companies	Completely unclear	8.0	18.8
	Unclear	15.9	25.0
	To some extent clear	46.6	31.3
	Clear	21.6	25.0
	Completely clear	8.0	0



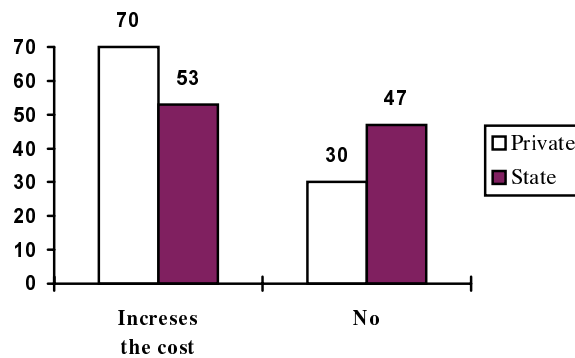
Single answers	Valid percent	State	Private
Q31 Are there clear “rules of the game” in Bulgaria	There are no such rules	21.3	20
	Completely unclear	6.4	5
	Unclear	21.3	30
	Clear to some extent	39.4	35
	Clear	8.5	10
	Completely clear	3.2	0



The answers suggest that the real problem is not lack of the regulations but the lack of effective enforcement and economic incentives mechanism. The inability of the bureaucrats to work within the rules established by themselves pre-determines low respect to the law. The inefficient law enforcement induces higher transaction costs (Q32).

Single answers	Valid percent	State	Private
Q32. How much observing legal rules of the game increase the cost of the deals	Does not increase the costs	47	30
	Increase the costs with 15%	20.5	20
	Increase the costs with 30%	12	15
	Increase the costs with 50%	13.3	35
	Increase the costs with 70%	3.6	0
	Increase the costs with 100%	3.6	0
	Increase the costs with 200%	0	0
	Increase the costs with 200%	0	0

[Valid percent]

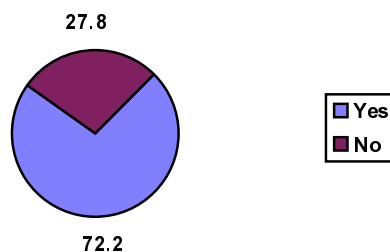


Illegal Practices

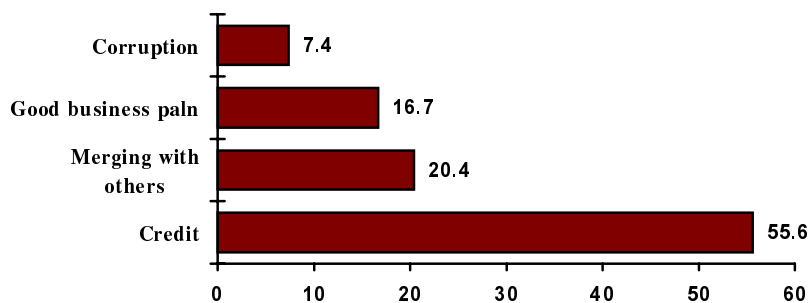
Majority of the managers declared that they will try to win a auction by raising money or by drafting a good business plan. (Q37 *If you want to win a public sale, but you do not have money, what would you do?*). Only 7,4% declared they are going to win the auction at the price of avoiding rules of the game.

Q37. *If you want to win a public sale but you do not have enough money, what would you do?*

I will participate anyway



I will win it through
Valid percent

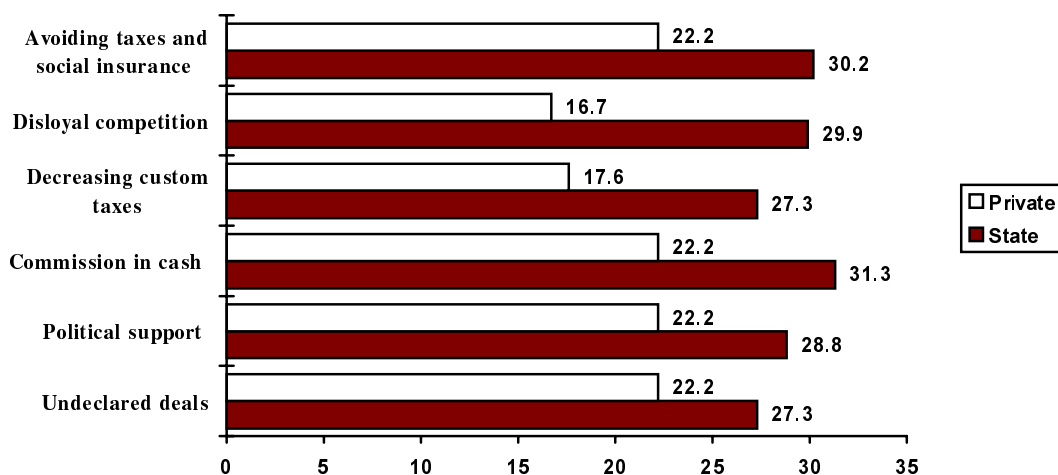


Managers who believe that illegal practices are commonly used for decreasing transactions costs (Q33) spend more time on institutions. This is particularly valid for illegal practices such as *political support, commission in cash, and avoiding taxes*.

Q33. How often according to you are the following methods used for decreasing the deal costs:

Single answers	State/Private	Means State	Never State	Means Private	Never Private
Use the scale: 0 - never 1- very seldom 2- seldom 3- sometimes 4 - often 5- very often	Undeclared deals	1.36	27.3	1.55	22.2
	Political support	1.19	28.8	1.11	22.2
	Commission in cash	1.45	31.3	1.33	22.2
	Decreasing custom taxes	1.56	27.3	1.82	17.6
	Disloyal competition	1.97	29.9	2.33	16.7
	Avoiding taxes and social insurance	1.46	30.2	1.22	22.2
	Other	0.77	66.7	0	0

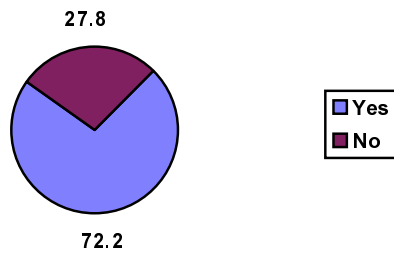
Valid Percent Never



Managers claiming they *will (attempt to) win an auction, even if they have no money* (Q37) again incur high institutional time. So the illegal practice increases time cost not only for consultations with superiors but for contacts with other institutions as well.

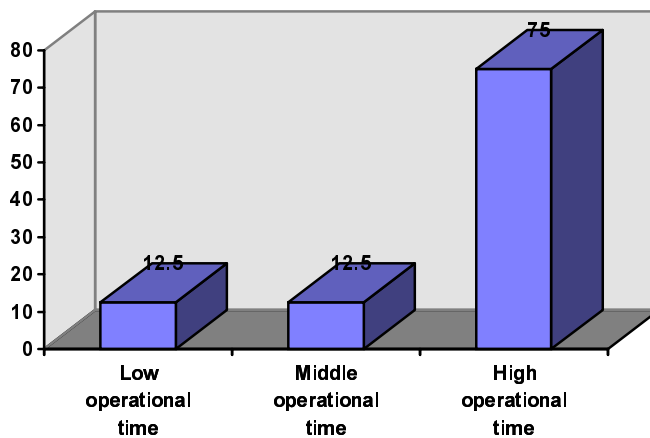
Q37. If you want to win a public sale but you do not have enough money, what would you do?

I will participate anyway



Operational Time and "Efficiency"

As stated in the introduction, we measure bureaucracy through the time allocation. However, there is no standard pattern of efficiently allocated time. For this reason we used a pure empirical division "low", "middle" and "high" amount of time spent. The crosstabulation shows that



75 % of managers consulting owner's representatives on a daily basis are spending comparatively high time on operational management. Results prove that operational time is more dependent on bureaucratic influence than corporate governance management time.

It is interesting to check what institutions consume managers time.

1. The three group that attract most of the managers' time are: privatisation funds are engaged most often in the changes of personnel and remuneration. Compared with other institutions they take as much time for this work as tax administrations and other "external"¹ shareholders.
2. "external" shareholders also a significant share of the management time. They are interested most often in new partners and personnel remuneration.
3. physical persons and private companies are among the most time consuming institutions; they take on average 5 days as potential clients and expend more time on current management than any other institution;

Politicians do not take much of the managers time. If mentioned they are in the context of financial management and new partners. Similarly Trade unions are not among the institutions expending much of the management time.

Central and local government are comparatively low time consuming institutions. Tax administration takes time for checking personnel remuneration.² Director boards are also low time consuming. If engaged with the management they spend time working on

¹ External shareholders are those "outsiders" who oppose "the insiders"; according to the Privatisation Act the latter have the right to acquire up to 20% of the shares paid at their face value under the conventional privatization scheme, and 10% if an enterprise is privatised through a voucher scheme.

² The issue is that SOEs are restricted in their wage policies, they pay tax on wage bill increase.

new clients and sales. Work with other company managers is related to current management, new partners and sales.

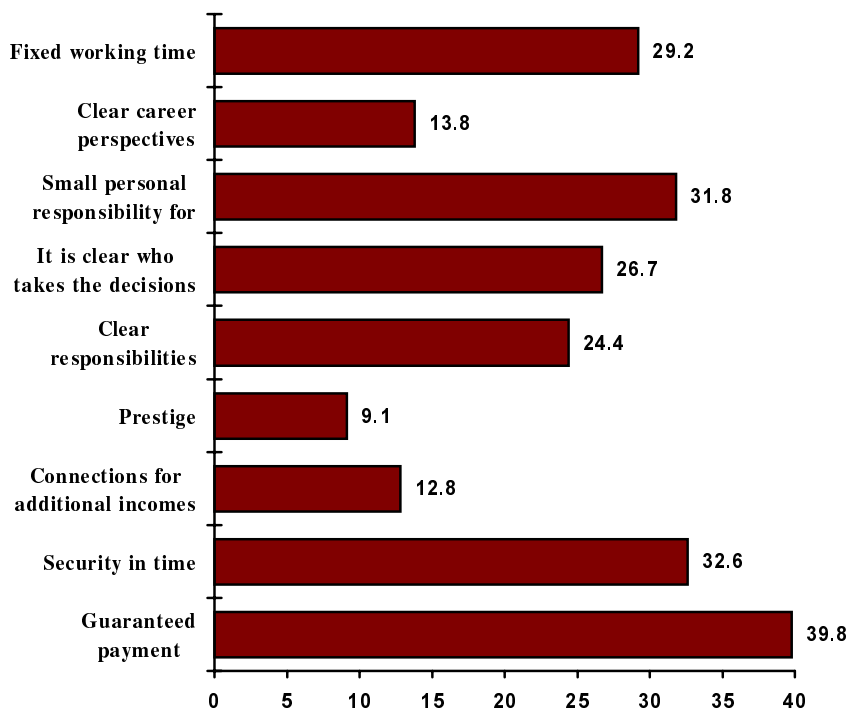
What influence time on operational management

Other managerial values that affect institutional time are *prestige* and *clear responsibilities for decisions*. Managers selecting these values for job motivating factors (Q35) spend much time with institutions. These relationships show that time spending could be dependent on completely psychological factors too. Obviously working with institutions may bring not only time costs but also *prestige* or *certainty in decision making* for the managers.

Q35. How can the following factors , according to you, motivate the majority of the people working in state companies:

Single answers	Means	State
Use the scale: 1-Strongly disagree 2-Disagree 3-Neutral 4-Agree 5 -Strongly agree	Guaranteed payment	4.16
	Security in time	4.09
	Connections for additional incomes and remuneration	3.05
	Prestige	3.04
	Clear responsibilities	3.83
	It is clear who takes the decisions	3.96
	Small personal responsibility for the things which are beyond one's control	3.89
	Clear career perspectives	3.43
	Fixed office time	3.89

[Valid percent: Strongly agree]



Managers believing that illegal practices are commonly used for decreasing transaction costs (Q33) are again using more management time. Such practices include are *undeclared deals*, *political support*, *cash commissions* and *avoiding taxes*. Similarly to consultation time such attitudes increase bureaucracy time in operational management. The question *If you want to win a public sale but you do not have enough money, what would you do?* (Q37) again provides interesting predictions of time management: Managers who *will try to acquire credits and will work on business*

programme spent more operational time than those who *will merge with advantageous partners* or will simply *corrupt the auction*. The question was asked to identify pro-corruption intention of managers. Answers given show relatively low number of those who would attempt to avoid auction rules of the game. Only 7.4% of the managers would employ corruption to win the auction. 73.3% of the managers would win the auction in a legal way: credit or a good business plan.

Some general conclusions

The survey needs additional assessment of the results and a comparison with the financial reports of the individual enterprises interviewed. For the time being it is possible to identify the following general findings.

The establish owner-representation pattern in Bulgarian public sector (respectively — the execution of government's right of an owner) fails not only on the general regulatory level by not creating proper incentive but also initiates management practices that require time consuming decision making on the micro-level of the enterprise operation.

Recently privatise enterprises or those in a privatisation procedure, where the owner represented by physical person or private companies, or physical person representing privatization funds manifest signs SOE-like behavior.

We have found that among SOEs managers the initial (or original) pro-corruption attitude is relatively low. At the same time, almost half of them think that rigid observation of the enacted regulations increase transaction costs with at least 15%. Also, they claim that the most frequent way of increasing the transaction costs in providing "commissions in hand". It seems that the system creates incentives to avoid strict observation of the rules while personal attitudes would rather reject the corruption as such.