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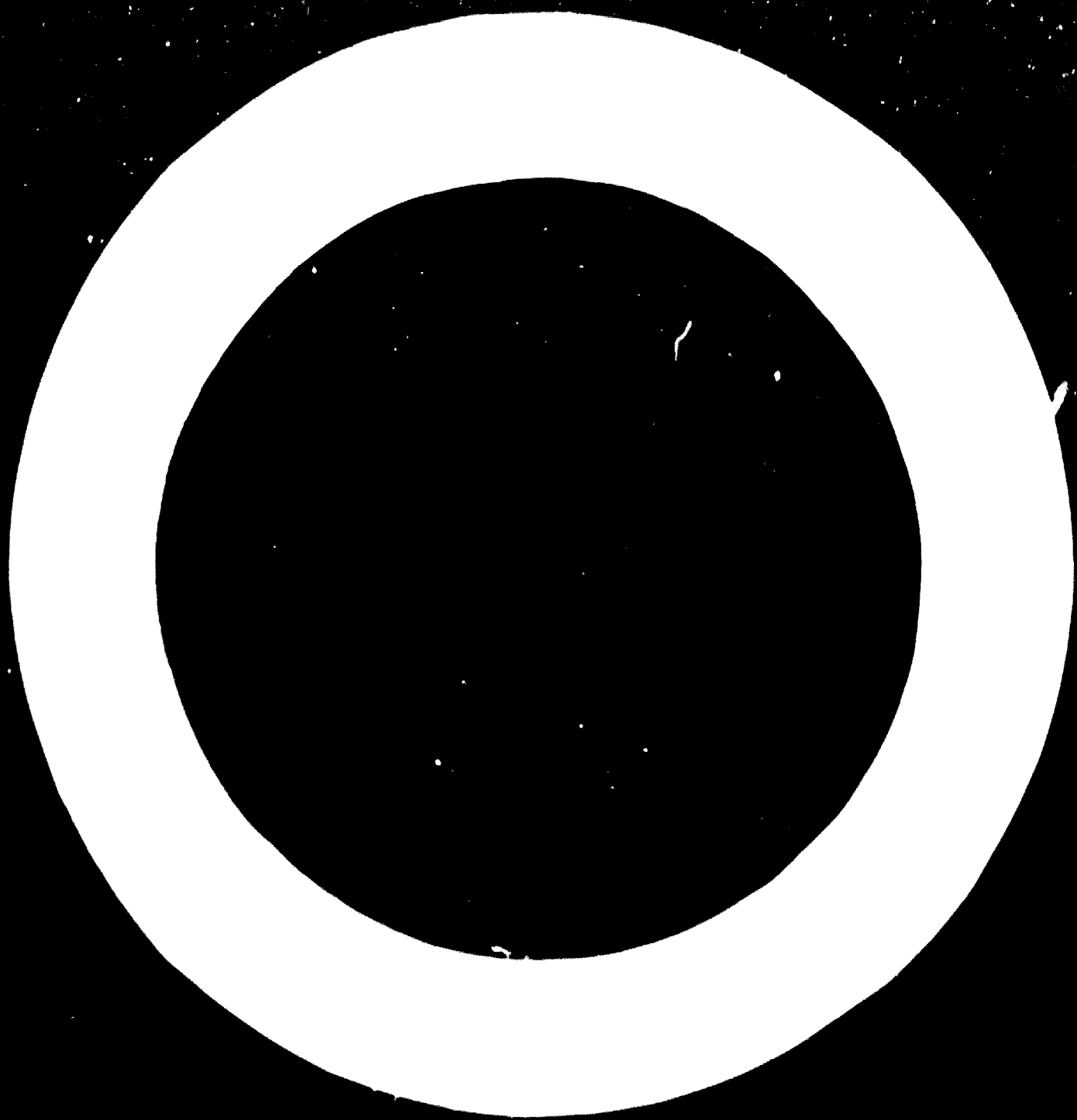
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FINANCING OF PUBLIC ENTERPRISES
ENTERPRISES IN POLAND

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FINANCING OF POLISH INDUSTRIAL ENTERPRISES

INTRODUCTION

The overwhelming part of Poland's industrial production comes from public enterprises. The share of public enterprises in Polish industrial production rose to 90% in 1967, when the share of manufacturing co-operatives fell to 10%. Only about 1% of industrial production was produced in small private enterprises and smaller workshops.

State-owned enterprises in Poland, like in economic systems of other socialist countries, are separate units in organizational and economic sense. They independently dispose of a fixed and working capital assigned to them, independently undertake and regulate their obligations.

General principles of the financial organization of state enterprises are regulated by the government. These regulations are gradually improved, by experience, whose is gathered in course of time and also by changes in the character and structure of the economy. Some general requirements are laid generally at the beginning of each five-year plan, so that in the course of fulfillment of the plan the principles of financial organization of state enterprises are relatively steady. Polish economy enters the new five-year plan in 1971. This gives an opportunity to discuss new ideas, experience, draw conclusions and prepare new proposals concerning proposals, improvements of and principles governing finances of state enterprises. The discussion is just under way. This paper is devoted to a study of requirements to this paper set by the government and to a description of actual principles of financing of state industrial enterprises in Poland, but it also will consider some of proposals leading to further improvements. The changes in financing of state industrial enterprises, and new organization, were introduced in 1970. According to the newly formed state industrial enterprises are equipped with a fixed statutory fund, which covers the requirements of their investments, including inventories. Investments for the state are financed directly from the state budget. The state-owned enterprises can thereby accumulate surplus funds to be used for their own new budget. Since the state-owned enterprises are not subject to profit allocations, the state-owned enterprises have secured investments resulting in the growth of production are considered therefore as profitable.

[Concise Statistical Yearbook of Poland 1968, p. 65]

State industrial enterprises are grouped in Poland branch-wise forming the so-called "corporations (trusts) of industrial enterprises". The head office of the "corporation" supervises its subsidiaries or enterprises within the corporation, acts as a "decision maker" in some special economic fields (allocation of production of individual goods to separate enterprises, medium-term investments in fixed assets, technical progress policy, export policy), and administers funds for the promotion of growth of the whole branch of industry. The head office determines as well the main planned targets (global production, production of some, most important goods, exports, profitability coefficient) and puts ceilings on the means used to reach these targets such as global fund of wages, quantity of employment, import of raw materials - according to planned targets and ceilings fixed for the entire "corporation" by the relevant ministries including such industry ministries as Ministry for Arm. Industry, Ministry for Machine Industry, Ministry for Food Industry.

1. Division of profits and formation of funds.

State industrial enterprises sell their products at "industrial selling prices", fixed by state authorities called Special Committee for Prices generally at the level of equilibrium between supply and demand. The gross profit seen as a difference between the industrial selling price and the prime costs of production, is very different in various goods and branches of industry, generally it is higher in consumer goods than in investment goods. There are established special "factory prices" to diminish these differences. The factory price of a commodity contains its planned average prime costs and a rate of the net profit. The rate of the net profit is to calculate separate factory prices needs not to be the same for each commodity. The rate can be taken as an instrument of the state economic policy, for example if the governmental economic authorities want to promote the output of given goods, they can calculate higher rate of net profit when fixing the factory prices. The difference between the industrial selling price and factory price to be paid to the budget as turnover tax. The difference between the factory price and prime costs of production forms the net profit.

The principles of forming the prices are now criticized and proposals to make some changes in this field put forward. The reason for this criticism is the fact, that the proportions between the factory prices of various goods are quite different from the proportions between the industrial selling prices of these goods. Consequently the producer, interested in net profit, is not informed of the preferences of the buyer which are reflected in the level of industrial selling prices and the buyer is not informed of the costs of production which are reflected in the level of factory prices.

As a result of these criticisms proposals are now put forward to abandon the establishment of factory prices and, to collect the turnover tax as a percentage to the global turnover of an enterprise, rate of the turnover tax being established at the same level for branches of industry or for great groups of goods. This system of turnover tax can be introduced only very gradually and carefully because it affects as well prices which are very strictly related to industrial selling prices and which must themselves change in the course of the system of unified rates of turnover tax as introduced.

The net profit of a state industrial enterprise is divided into four parts:

- interest on fixed assets paid to the state budget
- enterprise fund which is the share of the employees in the profit
- transfer to the head office of the "corporation" and
- development fund of the enterprise.

Interest on fixed assets: This is a kind of property tax. It was introduced in 1956 to encourage state industrial enterprises to use more effectively their fixed assets and to calculate more carefully the investment projects. The rate of interest is fixed generally at 5% of the net value of amortization deducted of fixed assets. In some branches of industry, profitability, of which is rather low, the rate of interest is lower as well and totals 2.5%.

Enterprise fund: The planned amount of enterprise fund is fixed in the annual plan of each enterprise as a percentage of the planned yearly payroll. This percentage varies in different branches of industry from 3,5% to 5,5% of an enterprise will reach the profitability coefficient, i.e. the relation between the net profit after paying the interests on fixed assets and the prime costs of production, according to the plan, then such an enterprise forms enterprise fund in the planned amount. If the actual profitability coefficient is higher than it was planned, then the enterprise forms the enterprise fund correspondingly higher than it was fixed in the plan. In the opposite case, that is if the actual profitability coefficient is lower than it was planned, the enterprise fund is as well lower than it was fixed in the plan; and if the actual profitability coefficient falls below 80% of the planned coefficient, the enterprise forms no enterprise funds at all.

The enterprise fund is a source of rewards paid to the employees of an enterprise and for financing social investments such as construction of dwelling houses. In 1967 the expenditure of the enterprise funds in industry totalled 5.932 million zlotys, i.e. 11% of the net profit of state industrial enterprises after paying the interest on fixed assets and 1% of the yearly payroll in these enterprises.

After formation of the enterprise fund the rest of the net profit is divided, according to the normative fixed for each enterprise by the head office of the relevant corporation, into transfer to the head office and development fund.

The development fund:- This is used to finance part of the increase of working assets in the form of investments and small-scale investments or the so-called centralized investments. First of all the enterprise has to finance from the development fund 60% of increase of so-called "current" inventories and 100% of increase of irregular inventories. The inventories of an industrial enterprise are classified as follows:

- regular inventories divided into
 - current and irregular inventories; and
- irregular inventories.

Current inventories are those which are necessary to carry on the normal economic activity of an enterprise.

Seasonal inventories are connected with the seasonal character of purchases or raw materials (e.g. food industry), or with seasonal character of production of finished goods.

Irregular inventories are those goods completely useless for a given enterprise, or new goods purchased for production of goods, which are not yet produced by the enterprise, or inventories gathered in exchange with other enterprises.

A state industrial enterprise is obliged to cover 50% of current inventories and 100% of irregular inventories with its own capital. If the investment in a new enterprise by the enterprise has to increase its own capital, it will be financed from the development fund. The rest of the investment of the enterprise is to be financed decentralized from state budget resources.

2 Hoczniak *Statystyka* 1967, pp. 142, 379 and 574

In 1967 the total development funds of state industrial enterprise amounted to 17,009 million zlotys, i.e. 18% of the net profit of these enterprises after payment of interest on fixed assets. From this sum 10,007 million zlotys were provided to increase own working capital of these enterprises and 5,001 million zlotys were spent to finance investment outlays. The rest covered other outlays, such as repayment of loans granted previously by the head office of the corporation from its reserve fund.

The reason to regulate in such a way the direction of using the development fund was an intention to encourage the effective use of working assets, i.e. inventories. All or almost all Polish state industrial enterprises need investments in fixed assets and there is a very great interest in all modernization schemes. The regulations concerning the use of the development fund should enable every enterprise to increase investments in fixed assets, if the increase of inventories could be lowered. On the opposite case, i.e. if the increase of inventories is relatively high, the part of development fund remaining for financing of investment outlays is very small. Thus the enterprise has a choice between increasing its inventories or increasing investments in fixed assets.

The experience in this field is, however, rather poor and new proposals to change the way of financing the increase in working assets and decentralized investments in fixed assets are being considered.

First of all the demand for investment goods in Poland is generally very high. This is connected with the big investment projects financed as centralized investments and this can no longer be increased without a very serious effect on the investment market. In the past few years many industrial enterprises have disposed of rather large sums from their development funds provided to finance the investment outlays; and the only way to control the use of these funds at disposal of the industrial enterprises was to open their deposit accounts with the banks. These term deposits, practically obligatory, pay interest at the rate of 3.4% when the term is one year and, 4.3% when the term is longer than one year.

In many instances it was not possible to give up the centralized investments especially if the increase of inventories was so high that it absorbed the whole development fund. The great part of the decentralized investments consists of purchase of machines necessary to replace the used ones which cannot work any longer. An enterprise is obliged to put out a part of the normal amount of profits to the bank and the bank has to grant loan for this purpose to avoid losses for the enterprise resulting from the disturbance in production processes.

Therefore, in most cases the amount of the increase of inventories did not affect the amount of investment outlays of separate industrial enterprises - lower increase of inventories did not cause higher decentralized investments in fixed assets, and higher increase of inventories did not diminish the decentralized investment outlays, which were considered as necessary to maintain the normal conditions of production.

In discussions now under way in the country some economists have proposed the elimination of the development fund as a joint source for financing the increases of inventories and decentralized investments and to form out of the net profits two separate funds one for increases in working capital and the other to finance decentralized investments.

2. Financing of fixed assets.

There are three kinds of investments in fixed assets in state-owned industry:

- centralized investments
- corporation investments
- enterprise investments

Centralized investments are decided individually by the government. They contain investments most important for the growth of the national economy, for example the construction of new large plants. Centralized investments are financed by bank credit during the course of their realization, that is, from the commencement to the commissioning of a given investment. Granting credit for the course of realization of an investment was designed to increase the bank's control over costs and terms in which the investments are made. Credit for centralized investment is repaid after the commissioning of a given investment from the budgetary subsidies and, partially, from the centralized part of the depreciation fund, the part of this fund over and above the outlays for major repairs and for corporation investments.

Credit for centralized investments is interest-free if the actual cost of the investment is not higher than it was planned in the investment project and the period of the accomplishment is not longer, than the normal term for such kind of investments; or not longer than it was originally planned in cases where there is no established normal period. If the planned cost of a given investment or planned period of accomplishment is exceeded, the bank charges credit for centralized investments with a penalty interest up to 3%.

Corporation investments are decided by the head office of a corporation or trust. They include investments resulting in the major increase of output as well as major modernization schemes. They are financed from the investment fund of the corporation. This investment fund of the corporation is formed from two main sources: transfers from profits of enterprises and depreciation fund of these enterprises.

A corporation can also obtain bank credit for financing of corporation investments, such credit is repaid from the investment fund of the corporation. Normal term of repayment is 10 years with interest rate of 3%. The interest rate can be increased by the bank if the planned cost of given investment is overstepped. Penal interest is considered as an element of investment outlays thus increasing the cost of a given investment. Penalty interest is considered as a loss and is entered on the debit side of the profit and loss account.

Enterprise investments or decentralized investments are financed from the development fund of an enterprise after covering the established part of the increase in working assets. All decisions concerning this kind of investment are made independently by the enterprise. These enterprise investments are mainly the purchases of replacement machinery, investments resulting in a relatively small increase of production and minor modernization schemes. The enterprises can obtain bank credit to finance these investments. Credit thus obtained carries an interest rate of 3% repayable within five years from the development fund of the enterprise.

Figures on the amounts of investment outlays in industry with their division into various kind of investments are not available. To give a general opinion on the relations between the magnitudes of several kinds of investment, we can use however the figures concerning the investment outlays of all the branches of state-owned enterprises and their administrative institutions. These figures for the year 1967 are as follows:

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- 3/Profit transferred by the enterprises to the head office of the corporation is divided, accordingly to the normatives of its division set for the corporation by a responsible ministry, into:
- investment fund
 - reserve fund providing securities to cover eventual losses or unplanned outlays
 - transfer to the state budget.

Depreciation fund of an industrial enterprise is divided into two parts: for major repairs fund for this enterprise and the other is transferred to the investment fund of the corporation. The eventual excess of depreciation fund can be used as a source of repayment of the loans for centralized investments.

	<u>Investment outlays</u>	
	<u>Million zlotys</u>	<u>Percentages</u>
Total	<u>91,310</u>	<u>100,0</u>
Centralized investments	47,773	51,9
Corporation investments	27,344	29,9
Enterprise investments	16,193	18,2

Various methods of planning are applied to different kinds of investments. Centralized investments are planned in details in national economic plans. Corporation investments are planned in national economic plans only in general terms under the different ministries. Enterprise investments are planned only in general terms without any further division. According to an established regulations corporation investment outlays and enterprise investment outlays can exceed the figures fixed in the national economic plan but not more than by 5-10% of the national sources of investment financing are accordingly high. The banks conduct a credit policy that can grant to banks few resources from the plan, i.e. the banks should grant correspondingly less investment credit, if the corporation and enterprises dispose higher investment funds, than it was anticipated in the plan.

In practice the possibilities of exceeding the figures fixed in the plan had to be more limited, when it was anticipated in regulations referred to above, because of the difficulties on the investment goods market we have already discussed.

The main investment projects and the branch structure of the great part of other investments are included in the national economic plans to cover centralized investments and corporation investment. In this way the government is able to control very strictly the directions of investments.

In the course of decision-making certain special preferences are taken into account. These preferences concern first of all:

- investment for increasing production of goods for export;
- investments in those branches of industry, which are considered as most important for the technical progress (electronics, automation, chemical industry); and
- investments aiming at making use of the country's raw-material resources (copper mining, sulphur mining, coal mining).

The share of industry in total investment outlays is about 40%. It would be very interesting to compare the investment outlays and the gross value of fixed assets in several branches of industry.

Based on 1 July 1960 data the following table follows:

	Investment outlays in million zlotys	Investment in fixed assets in million zlotys	Ratio of investment outlays to fixed assets
Total socialized industry	60,940	152,119	3,7
Fuel industry	11,273	157,777	3,2
Chemical industry	9,098	62,990	14,3
Electrotechnical industry	1,575	17,492	9,0

Before they could be put into operation all investment projects are submitted to the State Investment Committee (centralized investment) or by the works to operative and enterprise investments). This scrutiny examines and controls the planned effectiveness of the project investment. The planned effectiveness is calculated according to the formula:

$$E = \frac{\left(\frac{1}{T} \right)^T + 1}{T}$$

where:

E - coefficient of the effectiveness

T - maximum period of return of the investment outlays; it is generally accepted for 6 years.

J - investment outlays

The following is a list of the items which have been received from the various sources mentioned in the report of the committee on the subject of the proposed amendment to the constitution of the State of New York. The items are as follows:

1. A copy of the proposed amendment to the constitution of the State of New York, as proposed by the committee on the subject of the proposed amendment to the constitution of the State of New York.

2. A copy of the report of the committee on the subject of the proposed amendment to the constitution of the State of New York, as proposed by the committee on the subject of the proposed amendment to the constitution of the State of New York.

3. A copy of the report of the committee on the subject of the proposed amendment to the constitution of the State of New York, as proposed by the committee on the subject of the proposed amendment to the constitution of the State of New York.

	<u>Amount</u>	<u>Balance</u>
Total working capital	\$ 100,000	\$ 100,000
Less working capital	(50,000)	50,000
Less interest	(25,000)	25,000
Other items	(25,000)	25,000

The above items are the only items which have been received from the various sources mentioned in the report of the committee on the subject of the proposed amendment to the constitution of the State of New York.

Approved by the committee on the subject of the proposed amendment to the constitution of the State of New York, this 1st day of January, 1912.

4. Mobilization of household savings

There is no direct connection between mobilization of household savings and financial industry in Poland. Two institutions in Poland mobilize household savings: General Savings Bank, a State bank, operating mainly in towns and Independent loans and savings co-operatives which mobilize savings and grant loans mainly for agricultural production. General Savings Bank deposits all accumulated savings on account with National Bank of Poland, which as well as one of the sources of credit granted to the different sectors of the economy. National Bank of Poland is the bank of issue, but also grants credit directly to socialized enterprises. Loans and savings co-operatives use part of the accumulated savings as a source for their credit activity, and deposit part on accounts with National Bank of Poland.

There are various kinds of savings deposits in Poland. Normal savings books paid at sight, 9% interest rate of 3% per annum. Term deposits pay interest rate of 4,5% annually. There are also special savings deposits, which pay their depositors no interest rate at all, but part of them in lotteries. Most popular among the special savings deposits are those deposits which part of it is left over for prizes such as cars.

Total savings deposits by the end of 1967 were as follows: 8/

General Savings Bank	63.021 million zlotys
Loans and savings co-operatives	13.731 million zlotys
Total	<u>76.752 million zlotys</u>

The structure of savings deposits in General Savings Bank was by the end of 1967 as follows: 9/

Total savings deposits	63.021	100,0
Paid at sight	31.217	49,5
Term deposits	18.999	30,2
"Lottery" deposits	10.404	16,5
Other deposits	2.401	3,8

8/ Rocznik Statystyczny Finansow 1945-1967 p.252

9/ Rocznik Statystyczny Finansow 1945-1967, p.256

5. Management of financial resources
in enterprise

According to the law, a manager of a state enterprise is appointed by a responsible minister. A minister can however hand over his power to the manager of the corporation.

In practice the managers of big state industrial enterprises are appointed by **their** respective ministers, all the others by managers of corporations.

The enterprise managers run the enterprise, make decisions, and are responsible for the effective operation of the enterprise. The independence of enterprise management is however limited in two ways:

- because of targets and limits of the plan set for the enterprise by the supervising institutions or the head office of the corporation,
- because of regulations determining the conditions of economic activity.

Within the last few years there has developed a tendency to enlarge the powers of enterprise management as well as those of corporation management. There is a widespread opinion that decision-making in most important issues should be left to the large economic units i. e. corporations or combines.

Practically, enterprise management dispose relatively independently of working capital but they are limited in decision-making in the field of investments in fixed capital. Only a relatively small part of investments is centralized to the management of individual enterprises.





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