

## **EXAMPLES OF THE UNIFORM MANAGEMENT OF LOCAL GOVERNMENT OWNED COMPANIES IN HUNGARY**

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**Abstract:** It is a trend in Hungary in the 21<sup>st</sup> century that the local government owned business organisations are uniformly managed. The successful implementation of the uniform management system provides the city and its citizens with great economic advantage. Different alternatives may be found within the domestic practices of the uniform corporate management; however, the experience so far imply that management within the framework of a holding system enables the most efficient operation of the assets of the local governments.

International and domestic examples likewise prove that the local governments are not able to properly manage and control their economic organisations within the traditional framework due to their several other base tasks. The local government shall keep their main powers related to their ownership rights by establishing the uniform management model; however, the management, coordination and controlling tasks related to the companies are delegated to another organisation specialised in the field outside the local government.

Several advantages of the uniform management of the local government owned companies are known. The interest enforceability of the owner increases, asset management becomes more effective, savings are realised through synergies, and the level of the services is improved. While the employees of the organisation performing the uniform management perform expert management, the expectations towards the economic organisations are differentiated; and so they may be incited for the efficient operation, and for the higher level satisfaction of the consumer needs.

### **As a result of the uniform management:**

- the owner's interest enforcement ability of the local government increases;
- the strategic management and control of the companies is established;
- the operation of the local government companies becomes more transparent;
- the efficiency of the operation of the companies improves;
- the efficiency of the asset management improves, and the management of the local government assets in an entrepreneurial attitude becomes possible;
- the establishment of the conditions of the operation for the new local government investments and companies, and the employment of the tender opportunities becomes easier;
- the work of the local government owned institutions and companies with similar profile (e.g. public education and sports) may be harmonised;
- savings deriving from the joint operation may be utilised;
- the level of the services for the public improves;
- the uniform IT system of the companies may be implemented;
- the operational and development support of the local government may decrease or extinguish as a result of the available economic savings and through the bettering profitability, that is, the company group may become self financing.

### **The alternatives of the uniform management:**

There are different alternatives to the uniform management, which are all successful within the international and Hungarian practices. The alternatives to the uniform management are as follows:

- Uniform company: The different business activity areas (the present companies) are unified into one business organisation, that is, their previous legal independence extinguish. A uniform company may be established if the local government has 100% ownership in all of the companies to be involved in the merger.
- Company group: concern type management: the managing company has double function: first of all, they perform the basic activity within the framework of the company, and they likewise perform the management of legally independent companies.
- Company group: holding type management.

In the literature the concept of a concern is defined clearly, whereas no standardised interpretation has been established regarding the concept of the holding either in theoretical or in practical spheres. The Holding means such a company group, where the centre basically financially manages (as an owner, ~ as an asset manager) the otherwise separate economic organisations with legal entity, holding a portfolio attitude, without performing any basic activity. A holding is the managing company of a concern, and likewise the entire company group is provided the same name. When examining the original meaning of the holding, we may encounter a concept definition, according to which the holding is such a managing company, which manages the member companies only with the tools of asset management on the basis of its share within the member companies. However, we shall note with regard to this definition, that the managing company does not only apply asset management in many cases related to the companies managed, but they enforce other aspect as well during their management. According to the most commonly accepted definition of the holding, it is the legally separated managing company of the concern, which manages the whole concern organisation with strategic and/or financial-asset management tools. In case of a holding, the managing company only performs the management of the member companies and it does not perform any basic activity. All the economic units performing basic activities are legally independent. We may encounter two solutions when establishing a holding. First, the holding is created by using one of the local government companies by separating the basic activity. The other solution, which is more commonly applied in practice, is when the local government establishes a brand new business organisation and they empower this company to practice the ownership rights.

In Hungary it was Debrecen, who first committed themselves to introduce the new company management attitude back in 2000. The management and the asset management of the 100% local government owned shareholding companies and limited liability companies are performed by a separate private limited company (shareholding company established with closed foundation) founded for this reason. In Miskolc, the local government decided to launch uniform management in 2006, in case of which the formation of the holding system and the implementation of the management is rather similar to the one in Debrecen. The reason thereof is that the Debrecen Asset Management Plc. (Debreceni Vagyonkezelő Rt.) holds an outstanding role among the solutions provided for the asset management of the shareholding of the local government companies considering the size, the significance and the realised results thereof, and

likewise the expert team supporting the foundation thereof participated in the formation of the holding structure in both cities. The Debrecen 'recipe' is spreading; the ones in power (independent on their parties) are devoted followers of the holding structure in case of several local governments throughout the country. In 2004, Székesfehérvár decided to form a construction similar to the one in Debrecen. However, this management structure did not fulfil their expectations; therefore, they terminated it later on.

The advantages of the holding structure:

- It means a management form without the burden of any basic activity neutral to the companies performing heterogeneous business activities.
- The holding may mediate and harmonise both the professional interests of the member companies and the strategic interests of the owners objectively.
- The aim of the establishment of the holding is to improve the management, with special respect to the financial management of the member companies by actually practicing the ownership functions with the support of corporate planning and controlling tools and to take an active part in the formation of their future.
- However, the holding is an economic organisation itself as well. It is open individually as an organisation established for asset management. Contrary to its member companies, the thinking constraints deriving from the business activity and the profession of the expert staff do not bind the holding. Therefore, it may be explicitly open to either money market operations, company buyouts or for the management of the bankruptcy procedures of other companies.
- The holding clearly only manages, it has no role confusions on management levels and no conflicts of interest arise within the organisation.
- The performance of the companies may be seen without distortion as each of the member companies prepare their own balance sheet, that is they have extraordinary transparency. This is an inevitable expectation towards uniform management for the owner to found their decisions.
- It has excellent strategic and business flexibility as it may adapt to the legal regulatory environment and to the prevailing strategies of the town as well. The holding may act successfully on the money markets. It is flexible in participating within public procurement or other tenders; therefore, it has advantageous conditions compared to concern and uniform companies.
- Efficient money management may be achieved by the establishment of the treasury function and the cash-pool system.
- There may be an opportunity for the operation of a so called 'internal bank', that is the member companies may provide loans to one another upon terms and conditions advantageous for both parties.
- It is a form operative on the long run (it is not a temporary form), the holding may provide a good operation framework for the company group.

Disadvantages:

- The establishment generates great expenses.
- The operation is expected to be at higher cost compared to a uniformed company due to the staff costs of the supervisory boards and auditors, and likewise the time need for the technical realisation of the member meetings may increase the lead time of the decision processes.

- The holding 'only' manages; therefore, the member companies may feel, they need to finance it, and they may lack the continuous company management practice from the side of the holding management.
- The running companies may finance the weaker ones.
- The operational frameworks of the holding are missing, that is legal changes are necessary for the implementation of the alternative (e.g. company formation, or legal separation).
- Great financial and asset power conglomerate may be formed.

### **The assessment of the alternatives**

The followings may be determined on the basis of the above-presented arguments and counter-arguments.

- The previously expressed ownership targets may be satisfied with the operation as a uniform company to the least. The expectation for the 100% ownership limits the sphere of the companies that may be merged and it over-limits the usual flexibility of the economic organisation units of heterogeneous business activity.
- The operation of the managing company as a concern is able to implement the aims of the owners and the legal independence of the companies provides the necessary flexibility to their operation. However, it may be suggested only as a temporary solution due to the limitation to the transparency of the operation, the expected role conflicts of the management and their overload. In addition, the company selected to perform the management needs to learn and establish many more professional tasks and functions compared to their present management activities.
- The holding type promising the most advantages in most respect ensures the necessary flexibility and transparency for the owners in the long run. The holding may mediate the interest of the owners without any distortion and without any prejudices, and it is the authentic supporter and coordinator of the professional ambitions and strategic initiations of the member companies.

### **Summary**

We may see more and more examples for the formation of uniform corporate management systems within the Hungarian and international practices with regard to the management of the local government owned public utility business organisations. Altogether, the Hungarian examples provide a good example. The operation of the company groups has become more transparent and efficient. It is of great importance that their management is based on professional grounds instead of political ones. We may encounter a cultural change within the management of the local government owned companies by the spreading of the uniform management models. The experiences in Hungary so far show that the holding type management structures are the ones providing real breakthrough in the successful operation of the entrepreneurial assets of the local governments.

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