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# **Economic Transformation of Forestry and Management of Forest Joint-Stock Companies in the Czech Republic<sup>1</sup>**

## **Abstract**

The basic motive of the economic reform in state forests of the Czech Republic after 1990 was to separate management in forests from the implementation of production activities. A state company Forests of the Czech Republic with its headquarters in Hradec Králové was charged to manage state forests. From the present 7 enterprises of state forests 78 joint-stock companies have been established which carry out silvicultural and logging activities in state forests and in forests of other owners under conditions of the competition environment and on the basis of contracts. The paper deals with the exact evaluation of partial and present results of the development of forestry economic reform with the orientation to study the behaviour of transformed forest joint-stock companies privatized by the method of coupon privatization .

## **Introduction**

The forestry economic reform in the Czech Republic was started immediately after November 1989. The basic idea of the reform was separation of forest ownership from management activities in the forests. The implementation of the last version of the reform consisted in the idea that a newly formed state enterprise Forests of the Czech Republic with its headquarters in Hradec Králové will be the manager of state forests after settling all restitutive requirements. Practical activities in the forests will be then carried out by private companies originating from transformation and privatization of forest enterprises, i.e. forest joint-stock companies (FJSC) and other entrepreneurial entities of the market environment. The relationship between FJSC and Forests of the Czech Republic state enterprise is established on a contract basis, on the basis of realized selection procedures for particular territorial units.

The process of the economic reform in relation to FJSC developed in the following time scale:

1990–1991 preparation and modification of the reform conception;

1992 transformation of state forest enterprises to state joint-stock companies; the origin of the Forests of the Czech Republic State Enterprise;

1994 privatization of FJSC within the second wave of coupon privatization<sup>2</sup>;

1995 admission of FJSC to a capital market, the origin of new ownership structures.

From the very beginning of the transformation, there are two markedly different and polarized opinions in the forestry and professional public. The first group is formed by the supporters of the reform who point out particularly the following factors:

- treating social aspects of employment in the course of enterprise restructuring;
- increasing the preconditions for sustainable forestry through the separation of forest ownership from silvicultural and logging operations carried out in the forests;
- formation of the market environment in timber trade;

- formation of the competition environment and thus increasing the work quality in forest operations
- allocation and restructuralization of the property of forest joint-stock companies allowing to increase the effectiveness of its use;
- the reform conception has been prepared according to the basic trends of government policy for privatization;
- the reform follows the formation of conditions for the admission of the Czech Republic into the European Union.

The second group is represented by opinions with substantial reservations:

- the division of forest management entities into a state enterprise and joint-stock companies where besides actual problems resulting from the imperfection of contract relations an argument dominates of separating the responsibility for the forest from profitable activities and also division of the profit obtained between the entities;
- unconditional conception of market principles can have negative effects on the condition of forests when only a forest law and relevant authorities of the state administration serve as a tool of response (feedback) and when the objective evaluation of basic parameters of forest condition is rather problematic;
- worsening the condition of forests caused also by some owners of private (restituted) forests of small area (< 2 ha). The owners do not take care of the forest in due form or the area of their property does not allow to form adequate financial sources for its reproduction; in this connection a general historical experience is stated that forests of larger owners are better managed;
- non-transparent mechanism of timber trade as a natural resource as well as the result of the activities of past generations;
- non-transparent process of forming ownership relations in FJSC and the problem of evaluation of the contribution of actual owners for the condition and particularly conceptional development of the companies;
- the division of economic results does not always follow the development of forest companies and profit is often allocated into subsidiary firms and financial sources in forestry as a whole are lost.

## Methods

If we return to the genesis of the forestry economic reform then the decisive objectives of the reform ought to be on the one hand increasing the level of forestry and the condition of forests including the solution of negative problems of forestry in the seventies and eighties and on the other hand, economic transformation of forest enterprises as companies of a market type. Objective and exact evaluation of the implementation of the two tasks is very difficult with respect to the character of forestry. From the viewpoint of methodology, it is difficult to separate the complex of objective effects from the general effects of man as an initiation and realization factor of the reform.

As for the evaluation of the activity of transformed FJSC, the situation appears to be less difficult. The companies provide exact economic outputs which can be analyzed by methods of the standard market environment. The starting points are, however, easier at the first glance only. It is caused particularly by the fact that the trajectory evaluated continually develops together with the trend for fusing and capital connecting the companies. Another important problem consists in a relatively short time period serving for assessing economic factors and conditions for the development of the companies.

Economic data on FJSC characterizing both the process of their transformation and basic parameters for assessing the companies in the market environment were collected in the Department of Economics and Management of Forestry and

Timber Industry, Faculty of Forestry and Wood Technology, Mendel University of Agriculture and Forestry, Brno. Thus, time series of data have been prepared characterizing the period 1991–1996.

The source for the data used is generally available information published in statistical surveys. The course and results of the coupon privatization including the structure of owners are based on data published in economic journals.

The study of the problems was initiated particularly from the following reasons:

- possibility to compare and analyse basic program steps of the reform with the reality and economic results obtained;
- the necessity to analyse results of the privatization of property amounting to about CZK 8 milliard including the expression of the role of new owners;
- to provide information according to international standards (e.g. IASC) in association with the expected admission of the Czech Republic into the EU;
- to provide information on the participation and evaluation of FJSC on capital market.

The first integrated attempt at exact and objective evaluating the present results of forestry economic reform with respect to the research into economic parameters of forest joint-stock companies originated from the transformation of state forest enterprises and privatized in the second wave of coupon privatization appears to be the centre of research activities. Both standard and non-standard methods of the market environment have been used in the analyses [3].

The analyses aimed at 78 FJSC mentioned above were orientated to methods of comparisons between particular enterprises illustrated on actual available data [2].

In the first step, the description of the course of transformation was carried out including the structure of newly arisen legal subjects and their owners.

In the next step, basic selected economic parameters of the market environment and their development in the time series were discussed (indicators of capital market, economic results and their level, the development of indebtedness).

### **Transformation of state forest enterprises**

Based on the privatization projects of 7 state forest enterprises (operating on the territory of the former Regions of the Czech Republic) 90 joint-stock companies and 2 limited companies were established and recorded into the Commercial Register of the Ministry of Justice of the Czech Republic in 1992. These entities took over the delimited infrastructure of forest and specialized companies of the former enterprises in the total property book value of CZK 7.7 milliard. In the group, 78 FJSC represented forest production as a basic business activity. Other FJSC originated from former building companies or companies of forest technology.

Central-Bohemian State Forests Benesov consisted of 13 Forest Companies, Building Company Olesovice and Nursery Production Company Brandys n. Labem. After the transformation, 8 FJSC and Building Company Olesovice were established.

South-Bohemian State Forests České Budejovice consisted of 14 Forest Companies, Forest Technology Company České Budejovice and Building Company Trebon. After the transformation, 11 FJSC, Lesostavby Trebon Co. and Strojírna Sedlice Co. were established.

West-Bohemian State Forests Plzen consisted of 18 Forest Companies, Forest Technology Company Tachov and Building Company Plzen. After the transformation, 15 FJSC, Building Company ELTOP Plzen, Lesostavby Plzen Co. and Forest Technology Company Tachov were established.

North-Bohemian State Forests Teplice consisted of 10 Forest Companies, Forest Technology Company Chomutov and Building Company Dubí. After the transformation, 6 FJSC were established.

East-Bohemian State Forests Hradec Králové consisted of 16 Forest Companies, Service Company Tyniste nad Orlicí, Nursery Production Company Recany and Building Company Hradec Králové. After the transformation, 11 FJSC and Lesostavby Hradec Králové Co. were established.

South-Moravian State Forests Brno consisted of 16 Forest Companies, Building Company Brno and Forest Technology Company Velké Mezířící. After the transformation (as of 1 October 1992), 10 FJSC and Ekostavby Brno Co. were established.

North-Moravian State Forests Krnov consisted of 20 Forest Companies, Special-Purpose Company Senov u Ostravy, Forest Technology Company Krnov and 4 Building Companies (Frydek-Místek, Valasské Mezířící, Sumperk and Olomouc). After the transformation (as of 1 July 1992), 17 FJSC, Lesostavby Sumperk Co., Forest Technology Company Krnov, Lesostavby Frydek-Místek Co., Valasské Forest-Technical Reclamation Valasské Mezířící Co. and Lesta Olomouc Co. were established.

After finishing the coupon privatization, three groups were markedly differentiated from the viewpoint of the structure of FJSC owners:

- T.C.I. – 1st IN investment funds having decisive proprietary share in 18 FJSC mainly in southern Bohemia, northern Bohemia and eastern Bohemia;
- Forestinvest – Kredital having decisive proprietary share in 37 FJSC largely in northern Moravia, southern Moravia, Central Bohemia and western Bohemia;
- other FJSC having no clearly defined group of owners after finishing the coupon privatization.

Thus, the most important ownership group (in relation to FJSC and their privatization) was Forestinvest Co. Zlín. The investment fund obtained in total 13% of all shares of forest joint-stock companies, other funds obtained 34% of the shares. Part of the strategy of Forestinvest Co. was further increasing the proportion of shares in FJSC, largely through the purchase of shares from other funds and participants of the coupon privatization. In addition to this, there was an effort to obtain the decisive share in wood-processing industry as well as obtaining the control over timber market in general. Last but not least, there was also a tendency (within the portfolio structure optimization) to obtain shares in companies of other branches.

## **Results of the evaluation of selected economic data**

In the admission of FJSC shares to the capital market on 1 March 1995, a trend was followed of relatively low valuation expressed by the quotation of shares. As for FJSC evaluated, increase in the introductory share quotations occurred only in Foresta Velké Karlovice Co. In Frydlantská lesní Co., Lesní společnost Broumov Co., Lesní společnost Buchlovice Co., and Lesní společnost Plasy Co., a stable share quotation was recorded for a certain time, however, in all other FJSC, a marked decrease occurred already in the first months of trade.

As for the dynamics of share quotations caused due to trade on capital market, the most important and interesting FJSC analysed in the period 1 March – 31 December 1995 were: Lesy Krivoklát, Lesy Nizbor, Jihočeské lesy, Lesy Cesky Krumlov, Lesy Vyšší Brod, Lesy Jindřichuv Hradec, Lesy Pelhřimov, Lesy Tábor, Lesní společnost Horšovský Týn, Lesní společnost Teplá, Lesna Liberec, Lesní společnost Litomerice, Krušnohorské lesy, Lesní společnost Přebyslav, Lesy Chlumec n. Cidlinou, Lesní společnost Broumov, Lesní společnost Jihomoravské lesy, Lesní společnost Strážnice, Lesní

spolecnost Telc, Lesní společnost Buchlovice, Hanusovická lesní, Zábřezská lesní, and Vítkovské lesy. Trade with the FJSC titles mentioned above was particularly connected with the development of their ownership structure initiated from the part of investment funds.

From the viewpoint of market capitalization, large FJSC originated from the former headquarters of state forest enterprises appear in the first places. The fact is closely associated with the number of bankable shares derived from the amount of capital of the company. In balancing the first year on the capital market, however, only 3 of 55 FJSC obtained a converted positive discount (as of 31 December 1995).

One of the most important data being of great interest to owners of companies, managerial staff but also investors are economic results. According to the development of the economic results for the period under study 13, 4 and 6 companies (of a total of 78 FJSC) had losses in 1991, 1992 and 1993, respectively.

In 1994, 61 of 73 FJSC achieved profit (after taxation) and 12 companies had losses. The highest profit, CZK 25 712 000, showed Lesní společnost Jihomoravské lesy Co. and the highest loss, CZK 55 035 000, Krušnohorské lesy Co.

In 1995, 63 of 72 FJSC achieved profit and 9 losses. The highest profit, CZK 16 084 000 showed Lesní společnost Jaromerice Co. and the highest loss, CZK 6 827 000, Lesy Hluboká Co.

The year 1996 was the last year in our valuation. In this year, an abrupt change occurred when 44 of 66 FJSC showed loss. The highest profit of CZK 5 958 000 was achieved in Lesní společnost Trhanov Co. and the highest loss, CZK 107 443 000, in Krušnohorské lesy Co.

In addition to the facts given above (as compared with the period 1991–1992), a marked decreasing trend is evident in the level of economic results in the majority of FJSC. If in 1991, 1992, 1993, 1994, and 1995 the mean profit of a FJSC amounted to CZK 15 863 000, 15 946 000, 3 784 000, 1 714 000, and 2 990 000, respectively then in 1996, a loss occurred amounting to CZK 8 279 000.

Based on the analysis of the period 1991–1996, some other trends result indicating worsening the basic economic parameters and thus also the conditions for the development of FJSC. The increase in indebtedness due to bank credits is an important accompanying phenomenon resulting from the fact that the level of profit does not create necessary financial sources in FJSC. In 1991, 1992, 1993, 1994, 1995, and 1996 mean indebtedness amounted to CZK 1 194 000, 1 996 000, 7 146 000, 10 370 000, 11 581 000, and 18 713 000, respectively.

The alarming development of the economic parameters including relationships to other macroeconomic conditions caused that in 1997, a number of FJSC amalgamated and further measures were carried out with the aim to increase profitability. The first unofficial economic results for 1997 indicate slight improvement of the parameters.

The partial results evoke further problems which should be studied using more detailed and sophisticated analyses and research. In addition to the description of the course of the transformation an information basis have been established for using evaluation methods such as factor analysis and particularly gnostic analysis of indefinite data [1]. Procedures were initiated allowing to provide objective answers to substantial questions as e.g. if the principle of separating state forests administration from production activities fulfilled supposed expectations or in the method of coupon privatization was the most suitable way for determining the optimum ownership structure, restructuring and increasing the efficiency of forest enterprises.

For the objective evaluation of the problems and results obtained and further conditions of economic transformation in forestry as a whole, however, a certain time distance is also necessary. j

## Literature used

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