



CROATIAN ROAD SECTOR MANAGEMENT CHALLENGES

Ksenija Čulo¹, Vladimir Skendrović², Goran Puž³

¹University J.J. Strossmayer of Osijek, Faculty of Civil Engineering and Architecture, Osijek

²Freelance Consultant

³Croatian Roads

Abstract

The road network in the Republic of Croatia is well developed and largely responds to traffic needs. The motorway network is largely built up and no major new investment is needed in the short term. The national road network is in good standing according to national and EU standards. However, public road management companies face operational and financial challenges in terms of: (a) overinvestment in the network; (b) weak governance; (c) high operating costs; (d) large debt stock; (e) short tenor of existing loans; (f) currency risk and (g) insufficient credit strength to access the loan market for long tenors on a stand-alone basis. The Government of the Republic of Croatia has therefore decided to address these challenges and launched a project funded by IBRD called the Modernization and Restructuring of the Road Sector (MARS) aiming to enhance operational efficiency and improve the financial sustainability of the road sector. To these ends, the Government has approved a Sector Policy Letter, which contains a set of planned reforms. To ensure the contribution of the road sector to the overall economy, in addition to the financial sustainability of the sector itself, operational improvements are needed in the following key areas: (a) management of the road infrastructure sector; (b) planning, financing and implementation of investments in the road sector; (c) corporate governance and business operations. Much of the reform has already been implemented, but some of the most important are still in the process of being implemented.

Keywords: road sector, road management companies, restructuring

1 Introduction

In general, the road network in the Republic of Croatia is well developed and mostly responds to traffic needs. The motorway network in Croatia is largely built up compared to the country's initial plans, and no significant new investment is needed in the short term. The national road network is also comprehensive and in good standing according to national and EU standards. The modal split of inland public transport indicates that 73 percent of freight and 71 percent of passengers are carried by road. When added to individual transport, more than 90 percent of travel is by road. It should be emphasized that the road infrastructure is the most valuable public good.

Companies operating the road network, Croatian Motorways (HAC), Rijeka-Zagreb Motorway (ARZ) and Croatian Roads (HC), face operational and financial challenges such as network over-investment, under-management, high operating costs, high indebtedness, short maturities of existing loans, currency risk and insufficient creditworthiness to access credit markets for long-term loans on a stand-alone basis. The Government of the Republic of Croatia

has therefore decided to introduce reforms in the road sector, strengthen supervision and planning within the sector, increase the operational efficiency of companies and improve the financial image of the sector. In order to ensure the contribution of the road sector to the overall economy, in addition to the financial sustainability of the sector itself, operational improvements are needed in the following key areas:

- a) Management of the road infrastructure sector,
- b) Planning, financing and implementation of investments in the road sector,
- c) Corporate governance and business operations.

The government has sought the support of the International Bank for Reconstruction and Development (IBRD) and has made excellent cooperation with the IBRD and other International Financing Institutions (IFIs) in identifying elements of the road sector restructuring. The Government also consulted the European Commission (Directorate General for Competition). As a result of this co-operation, the Modernization and Restructuring of the Road Sector (MARS) project has been defined [1], which aims to support the Croatian Government in enhancing operational efficiency and improving the financial sustainability of the road sector. The project is funded by IBRD in the form of an investment loan and guarantees. Part of the investment loan is used to restructure public road management companies, i.e. HC, HAC and ARZ. For the purpose of operationalizing the MARS project, the Government on 16 March 2017 prepared and approved a Letter of Sector Policy [2], which contains a set of reforms to put the sector on a financially sustainable path and reduce the need for state support.

2 Main elements of business and financial restructuring of the road sector

The Letter of Sector Policy [2] covers the following elements:

a) Road sector management

- The Transport Development Strategy of the Republic of Croatia for the period 2017 to 2030
- Unique system of categorization and standards of maintenance / management of public roads to ensure proper and cost effective maintenance of the property
- Strengthening the role of the Ministry of the Sea, Transport and Infrastructure as the body responsible for planning and controlling the operation of publicly traded companies in the road sector
- Reorganization of the companies in the road sector
- Debt optimization strategy of HAC, ARZ and HC.

b) Planning, financing and implementation of investments in the road sector

- Road Property Management System (RPMS) for the purpose of ensuring the accuracy of investment planning
- Approved road sector investment plan for the period 2017-2020.
- Revenue and toll collection
- Road safety.

c) Management of companies and their operations

- Applying principles of corporate governance
- Human resources management instruments
- More efficient maintenance system.

In order to achieve the above objectives, deadlines for specific activities are defined in the table annexed to the Sector Policy Letter.

3 Road sector management

The Government adopted the Transport Development Strategy of the Republic of Croatia for the period from 2017 to 2030. The strategy gives the vision, main goals, long-term investment plans and principles of business of the road sector and other modes of transport. The main guidelines of the Strategy are in line with the European Commission. The strategy was adopted following the implementation of the Strategic Environmental Assessment and public hearings during the period of June-July 2017. The strategy is also a requirement of the European Commission for accessing sectoral funding under Operational Program 2014-2020.

The government on 24 March 2017 adopted a Decision on the implementation of technical categorization of public roads in the Republic of Croatia. The purpose of the Decision is to establish, on the basis of unique criteria, clear functional road categories, independent of current administrative and geographical frameworks, to allow the application of maintenance and construction standards. Roads with a certain traffic load and functional importance within the system receive the same level of quality of maintenance no matter who manages the road.

Road maintenance standards have, over time, become too extensive and have been interpreted differently by contractors. Therefore, it was decided to develop standards that will regulate the regular and periodic maintenance of all state, county and local roads, regardless of the way of contracting maintenance works. Standards should include winter maintenance, but would not include rehabilitation works. The standards should be defined in such a way as to ensure a satisfactory level of road maintenance, similar to that applicable to other road networks in the EU. The standards will contribute to improving quality, rationalizing unit prices and promoting better competition. The standards would refer to the Technical Specifications of Maintenance Works, which have not yet been drafted. The terms of reference for the development of maintenance standards have been prepared, but the procurement process has not yet been initiated.

The Public Roads Network is being developed based on the following planning documents:

- a) The Transport Development Strategy of the Republic of Croatia for the period 2017-2030 sets long-term development priorities. It deviates from its previous focus on infrastructure development and moves on to transport planning with a focus on multimodality, safe and sustainable transport services, improving regional links and completing the Croatian part of the Trans-European Corridor Network (TEN-T).
- b) The medium-term objectives are set out in a four-year Maintenance Program, adopted by the Government on the basis of a proposal from the Ministry of the Sea, Transport and Infrastructure.
- c) Annual construction and maintenance plans are defined by the companies operating the road network with the approval of the Ministry.

In order to meet the requirements of sustainability and future development of the road network, the Ministry will propose to the Government of the Republic of Croatia long-term strategic goals of the road sector, as well as a long-term coordinated plan of these goals, to ensure the coherence of the companies investment plans. To this end, the Ministry had to set up a separate Department and ensure that the medium-term plans of the companies operating the road network were aligned with the work of the Department. The department will also coordinate investment plans, improve control of public investment management by applying high principles of public investment management, and will control the effectiveness of project management through beneficiaries. Consequently, the Ministry, by Decree of 24 November 2017 decided to set up a Strategic Planning Department.

The efficiency of the State as the owner and contracting authority of the road sector companies can be improved by establishing a monitoring system and defining criteria for business and financial performance of companies. For this purpose it has been planned to improve the accounting and financial management instruments used by the sector companies. This includes activities to strengthen the ownership role within the Ministry, define key performance indicators (KPIs) to determine the level of business performance of the companies, and establish monitoring of companies business by the Ministry. These elements will also be referred to in the so-called. "Performance Agreements" to be signed by the Ministry with HAC and HC, the implementation of which will make publicly available and transparent reporting. Following an analysis of the results of the Business and Financial Restructuring Study funded by the European Bank for Reconstruction and Development (EBRD), the Government decided in 2017 to carry out the merger of HAC and HAC-ONC companies and the transfer of ARZ's operations to the HAC through delegation of responsibilities. The merger of these companies optimizes business processes, ensures economies of scale and reduces overall costs. Along with the implementation of the merger, the legal changes have defined the monopolistic position of new companies in the area of their individual motorway networks. Amendments to the law have defined, among other things, the principles of financial management to ensure that bookkeeping assets are carried on a business-to-business basis. The expected end result of these measures will be a lower operational cost of maintaining roads for a given level of service and a significant streamlining of the number of jobs. The rationalization of the number of employees and the optimization of business processes are carried out according to the developed guidelines of the said Study. The rationalization began in 2018 and should be completed by the end of 2020.

Based on a project proposal prepared by the Ministry and through a public tender, a consultant was selected to work on the restructuring of Croatian Roads. The analysis of the situation and the proposal for restructuring are expected to be submitted to the Ministry at the beginning 2020.

In 2017, the Ministry of the Sea, Transport and Infrastructure, through an international public procurement, selected and signed a contract with a financial advisor with the aim of: (i) endorsing and improving the strategic financial guidelines adopted in 2016, (ii) defining debt financing guidelines in line with strategy (iii) proposing a road sector financing strategy and structure for approval, and (iv) helping to implement optimization of the debt of the road sector companies. The objective of this strategy is to optimize the debt guaranteed by the Republic of Croatia while facilitating long-term financing of the road sector.

4 Planning, financing and implementation of investments in the road sector

The Road Property Management System (RPMS) for motorways, state and county roads will be developed through a contract that, after collecting data on property and condition of property, should be operationally implemented in the coming period. The RPMS will use all existing elements of the road asset management company. The RPMS will ensure the availability of up-to-date network status information and serve as a basis for the continuous updating of estimated periodic maintenance plans for highways and state roads. The RPMS will also be available for county-managed roads to enter property and condition information and to adopt its own future maintenance programs. The reconstruction and emergency maintenance of roads and highways will be programmed in this approach based on the actual state of the roads, not according to predefined standards.

The Ministry has proposed, and the Government has adopted, the Public Roads Construction and Maintenance Program for the period 2017-2020. Its main features are: (i) financing of periodic maintenance by each company on its own resources, without borrowing; (ii) the restric-

tion of construction in the motorway sector to ongoing projects and investments financed by EU funds; (iii) limitation of HC construction to already started projects and investments financed by EU funds, supplemented by projects selected on the basis of agreed criteria within the specified funding limit. New debt will be repaid from the state budget.

The Ministry of Finance has achieved significant success in refinancing the debts of companies created by financing the construction of the motorway network, owing to the favorable situation on the financial market, but also to the improved credit rating of the Republic of Croatia.

In addition to the 2017-2020 plan, companies, with the approval of the Ministry of the Sea, Transport and Infrastructure and the Ministry of Finance, prepared an annual indicative investment plan using justified economic and social criteria to evaluate and prioritize all proposed new investments, in accordance with the defined multicriteria framework. Future investment plans will also include the costs of emergency, investment maintenance and renovation under the RPMS by March 2020.

HC and HAC generate revenues from fuel excise taxes. HC uses its share of excise taxes for maintenance and financing of investments, while HAC uses its share of excise taxes exclusively for investments. These funds will continue to be available, taking into account the needs of these two companies, at the level set by the Roads Act.

A seasonal increase in toll prices of 10 % was introduced between 01 July and 30 September for HAC and ARZ motorways starting in 2017 onwards. Further changes, such as the reduction of the Electronic Toll Payment (ENC) discount, will be introduced gradually, in order to comply with EU standards. Additional sources of revenue for the road sector will also be analyzed.

A fully automated electronic toll collection system has been defined in accordance with the EBRD Study. Tender documentation has been prepared and a consultant selected for the new toll collection system with the aim of putting the system into operation by 2020/2021. The future automated electronic toll collection system will retain the basic distance-based toll collection principles, which are mainly applicable to the current toll collection system, but will reduce the toll collection and traffic jams, especially during the summer, and improve environmental solutions. Toll rates will be considered at least once a year.

Implementation of road safety and road safety initiatives in line with EU Directives for the Croatian part of the Trans-European Road Network (TEN-T) is an integral part of road sector plans and EU funding is already being used. The goals of the national road safety plan 2011-2020 are being realized by the action plan adopted by the Ministry. The Action Plan includes various measures for highways and state roads such as upgrading guardrails, controlling axle loads and removing black spots. Common activities on the road network include road safety audits and inspections, improvement of tunnel safety and the extension of traffic management information systems at the level of the Republic of Croatia. Audits and inspections will be carried out to cover the entire TEN-T network by the end of 2020.

5 Management of companies and their operations

Corporate governance depends primarily on a balanced division of roles and implementation of internal and external planning, control, management and decision-making mechanisms. This ensures a balanced relationship between the owner, the supervisory board and the management of the company. This results in effective governance mechanisms and addresses the problems and potential conflicts that arise between management structures.

Corporate governance plans based on the principles of the Organization for Economic Co-operation and Development (OECD) should be adopted by all companies in the road sector. The plans will be in line with the existing Decision on the adoption of the Corporate Governance Code for companies in which the Republic of Croatia holds shares or interests (Official Gazette 112/2010). Corporate governance plans include the application of contracts with com-

pany management based on operating results, as well as increased transparency through more frequent disclosure of decisions, financial data and performance and annual monitoring of their implementation. Corporate governance plans relating to boards of directors will also include defining and implementing the following elements: structure and management, supervisory committees, transparency and disclosure of information, audits and internal controls, remuneration of supervisory board members, risk management and corporate social responsibility.

Adoption of corporate plans according to the principles outlined above by road network companies has been started but not yet completed.

Human resource management is a key element in the management of the road sector. To this end, modern human resources and work management systems are being introduced, including payroll policies, and systems for controlling work, planning and job evaluation. In the context of business and financial restructuring of the road sector, job cuts and / or retraining will be done in an efficient and socially acceptable manner.

The restructuring of the companies is expected to bring about a more efficient and cost-effective maintenance of the motorway network. In other parts of the road network, public road maintenance and traffic management will be organized to optimize operating costs and the number of jobs. Further steps in operational improvement will be defined taking into account, inter alia, experience in a pilot project in Istria (performance based contract) and maintenance standards and specifications.

HC and County Roads Administration (ŽUC) continue their cooperation with the aim of developing technical road categorization and maintenance standards applicable throughout the Republic of Croatia. The agreement on the terms of the joint procurement of maintenance services defines the basic principles and conditions for the joint procurement of maintenance services in such a way that HC and ŽUC remain responsible for their individual maintenance contracts while the procedure will be carried out at the level of regional business units within an independent joint procurement committee which includes HC and ŽUC representatives. This increases competition in the market and opens opportunities for local contractors.

6 Conclusion

As a result of the cooperation of the Ministry of the Sea, Transport and Infrastructure with the International Bank for Reconstruction and Development, the Road Sector Modernization and Restructuring Project (MARS) has been initiated and is aimed at supporting the Croatian Government in enhancing operational efficiency and improving the financial sustainability of the road sector. The Ministry approved a Sector Policy Letter defining the activities of the MARS project, as well as the deadlines for their implementation. Much of these activities have already been implemented, but some significant activities are only in the initial stages. The restructuring project has so far yielded the best results in refinancing companies' debts.

References

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