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## The problem of managers' remuneration in state-owned enterprises in the context of corporate governance

### Introduction

The issue of *corporate governance* and remuneration system of the top management that is attached to it, has been for years attracting considerable interest, both in the scientific environment as well as in the area of economic practice. This phenomenon became more significant at the turn of the 20<sup>th</sup> and 21<sup>st</sup> century when a privatization boom took place in the developed countries and a need arose for the appropriate representation of the interests of investors, mostly institutional ones, with a diversified investment portfolio. It was an impulse for the development of *corporate governance*. In Poland, the issue of *corporate governance* appeared in the period of transformation and has been developed since, especially in the area of privatization, internationalization of the economy and freedom of capital flow. A number of new voices in the discussion regarding the rules of *corporate governance* appeared in the period of the last financial crisis. The reasons for disturbances on the financial markets include the following: the way in which the top management was operating and the oversight of public enterprises and especially, taking too much risk by the top management. The factor that has a particular influence on the actions of the governing bodies is the system of managers' remuneration. Its incorrect form can be a source of negative schemes of behaviors of the top management. This system should put the interests of shareholders and stakeholders first,

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while in many cases it prefers results achieved without tying them to long-term effectiveness criteria (European Commission 2004). Therefore, there is a need of looking for more effective mechanisms of motivating the managers. Such needs have been identified on the market, which is evidenced by the attempts of a thorough reform of the managers' incentive system made in a number of countries. The effects of these actions are best practices codices. In Poland, the first steps were also made in the direction of improving the supervision system and especially, of creating an effective remuneration system for managers. The Ministry of Treasury designed a **Supervision Professionalisation Programme**, as a part of which, among others, Good Practices in the area of rewarding members of management boards were included (Supervision Professionalisation Programme 2013). Some other legal acts were also introduced that referred to the remuneration issue of management personnel who run some of the companies (Commercial Companies Code, Act of March 3, 2000; Commercial Companies Code, Act of June 6, 2016) or to the issues of awarding yearly bonuses for such personnel (Resolution of Ministry of Energy of September 22, 2017).

The purpose of this work is to diagnose the remuneration system of managers in State-owned enterprises with an analysis of tools verifying the effectiveness of management and constituting the basis for granting bonuses to managers, as well as presenting propositions of optimizing the assessment of management effectiveness for the needs of creating an effective parametric motivational system. Such a system should be based on the values for shareholders.

## 1. The genesis and models of corporate governance (corporate supervision)

The term *Corporate governance* is used interchangeably with the terms “corporate supervision” (Rudolf et al. 2002) and “corporate order” (Dobija and Kołodkiewicz 2011). The basic definition of this term, describes it as a “system by the use of which corporations are directed and controlled” (Lis and Sterniczek 2005). The genesis of corporate governance is related to the phenomenon of separating the ownership of the economic subject from managing it. The separation of ownership and managerial functions was the impulse for creating certain mechanisms directed at managers (in the hereby work, “manager” is understood as a member of the board). Their objective was to provide effective management of entrusted capital (Karbownik and Turek 1999).

There are few theoretical *corporate governance* models and each of them explains the meaning of this term in a different way and in a specific way defines it and sets different goals. These models can be differentiated by using a different criteria of division. The most important ones are presented in Table 1. Basically, all models are grounded on the division of tasks, competencies and responsibility between the bodies of supervision and corporation management.

**The single-level corporate governance model** occurs most often in the United States, Great Britain, Japan, Australia, Sweden, Belgium, Ireland, Spain, Portugal, Greece and in

Table 1. Typology of the corporate governance models

Tabela 1. Typologia modeli nadzoru korporacyjnego

| Criterion of division                                | Type of models  |
|--|---|
| Institutional and legal solutions                    | <ul style="list-style-type: none"> <li>◆ single-level (monistic)</li> <li>◆ double-level (dualistic)</li> </ul> |
| The ownership structure and the mechanism of control | <ul style="list-style-type: none"> <li>◆ open</li> <li>◆ closed</li> </ul>                                      |

Source: Urbanek 2006.

Russia. The characteristic feature of this model is the board of directors. This is a body representing the interests of shareholders, its functioning is based on the rule of the majority of votes. The board of directors sets strategic goals of the corporation and oversees their realization. The board of directors consists of people functioning in the given enterprise, most often holding managerial positions in the enterprise itself or in subsidiaries as well as people from outside the enterprise, e.g. retired employees, management of other enterprises, employees of financial institutions, also of the public sector and lawyers. The shareholders of the enterprise can also be a part of the board of directors. The board usually does not engage in the day-to-day management of the enterprise, which is delegated to the executive board (excluding situations when the board of directors consists of members of the executive board – in such case they perform two roles, which often raises controversies). The board of directors mainly maintains the functions of strategic control and oversight over the decisions of the management.

**The double-level corporate governance model** appears mainly in Germany, Switzerland, the Netherlands, Austria and the majority of the countries from the former Eastern Bloc, including Poland. Its specific feature is two-tier enterprise management, the consequence of which is a clear separation of the oversight and control functions from the managerial functions. The former are held by the supervisory board, the latter by the management board. There is a clear separation of personnel in this model. People on the supervisory board cannot hold the executive positions in the given environment or be subordinate to the members of the management board. They are chosen by the shareholders.

The management board is an executive body, which may constitute of shareholders as well as of people from outside this group. The management board is appointed and dismissed by the supervisory board. A member of the management board can also be dismissed by the general meeting of the shareholders ([Commercial Companies Code, Article 368, 2000](#)). The decisions of the management board are adopted by the absolute majority of votes, except in situations when the statute of the enterprise states something different. The statute may provide that in case of an equal number of votes, the chairman of the board has the deciding vote; the statute may also grant him particular power in the area of directing the work of the management board ([Commercial Companies Code, Article 371, 2000](#)). The

management board makes decisions in the strategic and operational area. Different solutions are possible here. One of them is that the management board manages the enterprise through the directors. They, in turn, are subordinates to the Chief Executive Officer, the function of which is held by the chairman of the board. In such a case, a combination of strategic and operational management is present. Another solution can be dividing those two areas. This is based on the performance of duties by the management board in the area of strategic management of the enterprise, while the day-to-day management is done by people from outside the management board, occupying the main managerial positions in the enterprise (Urbaneck 2006). The choice of the management model influences the rules of hiring and rewarding the members of the management board. For example, combining the membership in the management board with the role of the director can be done either in one or in two separate contracts (Patulski 1997). Both functions can be subjected to different motivational systems.

The criterion of dividing the ownership and control mechanism assumes a division of the *corporate governance* models into open and closed. **The open model** is characterized by a dispersed ownership and is typical for such countries as the United States and Great Britain. In this model the dominant type of investors are pension and insurance funds as well as individual investors. The control over the actions of the corporation in this system is conducted mainly by the use of market mechanisms, e.g. the stock market. Due to the dispersion of ownership, monitoring conducted by shareholders is low. However, the clarity of the actions of the corporation, due to the pressure of market supervision mechanisms is high.

**The closed model** is characterized by the concentrated ownership and appears, among other places, in Central Europe. In this model the institutional investors are dominating such as other enterprises and banks. In contrary to the open model, in the closed model the internal control mechanisms are the most important. In this situation the basic factors of corporate supervision are the internal mechanisms of control. The dominant investors have the possibility to monitor the management board directly.

In relation to the enterprises operating in Poland and belonging to the State Treasury, *corporate governance* has been precisely described in the document ‘The rules of ownership supervision over the State-owned enterprises’, issued by the Ministry of State Treasury. According to it, *corporate governance*, described as corporate supervision, constitutes an element of ownership oversight. Apart from the corporate supervision, the ownership oversight also encompasses economic-financial oversight which is based on the monitoring of the economical-financial situation of the overseen subjects, conducting an analysis of the effectiveness of their activities, both of which constitute a basis for recommending specific actions. The main objectives of the ownership oversight, suggested by the Ministry of State Treasury include (Rules of owner supervision over the State-owned enterprises, 2013):

- ◆ increase of effectiveness of actions, management and an increase of the value of the State-owned enterprises as well as optimization of the value of the supervised assets,

- ◆ preparing subjects to transformation and privatization process, removing privatization barriers – determining the approximate schedule of actions, aimed at achieving the target model of the public sector in the economy,
- ◆ providing transparency of the actions of State-owned enterprises.

In order to achieve the aforementioned objectives the following can be of assistance (Rules of owner supervision over the State-owned enterprises, 2013):

- ◆ the use of forms and procedures of ownership oversight by the Minister of State Treasury, which are broader in scope in comparison with the existing legal regulations,
- ◆ selection of properly prepared members of the supervisory boards, taking a balanced share of women and men in order to provide correct functioning of ownership oversight into consideration,
- ◆ perfection of selection criteria for the management in State-owned enterprises,
- ◆ design and implementation of new standards and mechanisms of monitoring and assessing economic and financial activities of State-owned cooperatives allowing for a quick reaction to negative phenomena.

In order to meet the goals of the ownership oversight the proper actions of the Commercial Companies Code are of significance: the stakeholder general assembly or assemblies, the supervisory board and the management board. Direct supervision over the actions of the State-owned enterprises is conducted by the supervisory boards and to some extent, the agents of the partner. They have a statutory designated position in the system of the ownership oversight over the enterprises. Such a system of supervisory boards and agents of the partner in the system of ownership oversight is the instrument of the Minister of State Treasury creating a possibility to monitor and control the processes taking place in the enterprises. As a result, special attention is paid to the issue of competencies, procedures and criteria of selection, organization and assessment of work as well as rewarding the members of supervisory boards and the agents of the partner in the policy of ownership oversight over the State-owned enterprises.

## **2. The remuneration system of executives as the basic tool of corporate governance**

The remuneration system of executives is one of the most important tools of *corporate governance*. Its task is to eliminate conflicts of interest between the shareholders and executives. Such conflicts are the main assumption on which the theory of agency is based and in the literature they are called *agency conflicts* (Weber 2012). They have two main sources: discrepancy of the objectives of shareholders and executives as well as a different approach of those two parties.

Executives can have other goals than the shareholders. The goal of the shareholders is to maximize their benefits by maximizing the market value of the enterprise. On the other

hand, the managers may form their goals in a different way, preferring short-term goals such as the maximization of sales, expansion or the goals that directly correspond to the utility functions of executives, such as prestige, executive's employment security, professional success and remuneration etc., over value maximization.

The second source of *agency* conflict is the different approach of executives and shareholders to the issue of risk. In this situation the executives may show two types of attitudes towards risk. The first attitude is reluctance to taking risks, caused by fears of losing the position as well as lack of stimuli encouraging making risky decisions. For example, a constant salary and the lack of stimuli in the form of bonuses for increasing the effectiveness of actions of the enterprise or realizing an effective investment, causes them to be reluctant to taking risks. Executives prefer securing their position in the enterprise instead of taking risky decisions which will not bring them any actual, financial benefits and can potentially pose a threat to their position. Conservative management of the enterprise may prevent it from developing and increasing value, undermining the interests of shareholders. Executives may also show an excessive affinity towards taking risks. Poorly constructed motivational systems, dependent on the short-term results of the enterprise can be the reason for such behavior (Bajończyk 2010).

The system of corporate governance is tasked with creating such a mechanism that makes it possible to eliminate the conflicts of interests and ensures the convergence of goals of those two groups: shareholders and executives (Urbanek 2006). The system of rewarding those managing the corporation is such a mechanism. It constitutes one of the main tools of corporate governance. This system should be absolutely tied to the effectiveness of managing the enterprise, but it can be analyzed in different contexts (not only in the context of financial results but also in the social context).

The construction of optimal remuneration systems is the subject of numerous research conducted both in Poland and in the world. This research indicates the size of factors determining such a system. The basic factor taken into consideration in the remuneration system of executives is the effect of their work expressed by a number of different indicators of effectiveness. However, apart from this element, the system of remuneration of executives is influenced by such factors as: the size of the enterprise, industry, labor market. The remuneration system is also to a large extent dependent on the corporate culture which consists of such elements as: the structure of ownership, the composition of the board of the cooperative, public opinion and many others (Kaczmarzyk 2006).

Furthermore, one should remember that the remuneration system encompasses not only the monetary components, but also all the other material benefits that are connected with performing duties in the enterprise, including non-monetary components which have a form of securities or benefits in kind. The most important components of the remuneration system of executives are (Urbanek 2006):

- ◆ basic salary,
- ◆ bonuses and rewards,
- ◆ ownership participation programs,

- ◆ share of the profit,
- ◆ savings incentives and retirement benefits,
- ◆ additional benefits,
- ◆ severance payments.

**The basic salary** is a fixed component of the total remuneration dependent on the position held, area of responsibility, the size of the enterprise and the type of activities.

**Bonuses and rewards** are variable components of remuneration that executives receive for a certain effect of their work. The financial result achieved by the enterprise or another indicator can be an example of such effect. The selection of sets of measures is the main problem here. These measures should make it possible to capture the cause and effect relationship between the individual input from the manager and the effect. Furthermore, the results should be precisely connected with the size of the bonus and the conditions of being awarded a bonus have to be determined (Beck-Krala 2008). The issue of choosing measures in the process of granting bonuses to executives will be elaborated in the further part of this work. Bonuses and rewards can be granted on a monthly, quarterly, semi-annual and annual basis. The internal regulations of the company, e.g. work regulations, remuneration regulations, collective agreement and employment contract may be the bases for awarding them. The employer can also grant bonuses and rewards without any specific internal regulations. Bonuses and rewards differ from each other to a significant degree. However, these benefits are often mistakenly treated as if they were the same and those terms are used interchangeably. Rewards are granted at the discretion of the employer and internal regulations as well as the employment contract often do not regulate any specific rules of granting them. Rewards can be given in cash, in kind or in the form of another benefit e.g. extra vacation days. A reward does not have a form of a claim and its amount is freely determined by the employer. On the other hand, the rights of being granted a bonus arises with the moment in which the employee meets the conditions determined in the internal regulations and this does not depend on an employer's opinion. Awarding a bonus by the employer is only declaratory, confirming the circumstances justifying granting it to the employee. With the moment of meeting the conditions of getting the rights for a bonus, the employee is entitled to have it paid.

**The ownership participation programs** are the elements of the motivational system that most often take the form of options for purchasing shares. The standard option program gives the executives the right, but not the obligation, to purchase the shares of the company on the market price at the moment of launching the program. The executive may exercise this right in the following few years. If the market price of the shares increases the options are realized and this brings significant benefits to their owner. If the market share price falls the options are not realized. The prospect of the value of shares increase motivates the executive to care for a long-term increase in the value of the company. Apart from the option program, the remuneration based on ownership may take a form of free shares. The allocation of such shares is usually surrounded by a number of limitations, e.g. prohibition from selling them or restriction in the allocation of dividend or in exercising the right to vote.



Such an element of remuneration motivates the executive to be tied with the company for a longer period and makes it possible to connect the interests of shareholders with the interests of those managing the company.

**Share of the profit** is another component of the remuneration system. The payment of this salary component usually depends on the assumed economic effects, expressed by using measures other than profit.

**Savings incentives and retirement benefits** are a form of deferred remuneration. This is based on the employees saving a part of their salary on a special fund that is additionally supplied by the enterprise, usually in a specific relation to the input from the employee. Such programs encompass a number of solutions that differ from one other by the rules of creating funds, managing them, relations between inputs from the employees and from the enterprise.

**Additional benefits** are usually the non-monetary elements of remuneration systems, aimed at people holding highest executive positions. They take a form of a number of different privileges, such as: free use of the company car, mobile phone, business apartment, insurance and many others.

**Severance payments** are a specific element of the remuneration system. They are granted when the employee is dismissed. They can take a form of salary payment for a couple of months or even for a couple of years as well as non-cash forms of remuneration such as shares, options, additional retirement systems or insurance. Such packages are often describes as “golden parachutes”.

### 3. Formal and legal considerations of managers' salary in the State-owned enterprises

The main focus of this article is on managers' remuneration systems in the State-owned enterprises. Specific stock ownership of the shareholdings builds up a special system of formal and legal considerations for managers' remuneration which makes a great impact on the final shape of the remuneration system. In a company with Treasury shareholding, the same as is in all other companies, the foundation for remuneration system is **labor code** ([Labor Code 1974](#)). It defines salary and points and that it may include all components, regardless of their name and nature, as well as other benefits connected with work which are paid to employees in cash or other form (benefits in kind) ([Labor Code, Article 18, 1974](#)). Simultaneously, the labor code states that remuneration should be paid in cash and it is allowed to be partly paid in kind only if relevant statutory provision or collective labor agreement state so ([Labor Code, Article 86, 1974](#)). Taking into consideration the remuneration system with regards to a specific group of employees such as managers, one can find further general regulations referring to this question in the **Commercial Companies Code** ([Commercial Companies Code, Act of September 15, 2000](#)). Regulations of this code refer to remuneration of the members of the board determining that they are constituted by the supervisory



board and these regulations may include the right to participate in corporate annual profits which are intended to be shared among shareholders. The supervisory board may establish the right to profit sharing after it was entitled to do that by the general meeting ([Commercial Companies Code, Article 378, Act of September 15, 2000](#)).

Further narrowing the research problem to managers' remuneration in companies with Treasury shareholding it is advisable to refer to the provisions of **the Act of March 3, 2000 on The Remuneration of Persons Managing Certain Legal Entities** (Commercial Companies Code, Act of March 3, 2000) (the so called public sector Salary Cap Act). Provisions of this act regulate the amount of remuneration as well as the rules for remuneration of, among others, directors, presidents, members of management bodies and board of trustees in state-owned enterprises. Furthermore, the Act of June 9, 2016 on The Remuneration of Persons Managing Certain Legal Entities ([Commercial Companies Code, Act of June 9, 2016](#)) regulates the rules of remuneration for the members of management bodies and supervisory bodies in, among others, state-owned entities or the ones executing public orders. These acts define the amount of remuneration of such people, the way of dividing pay into a fixed and variable part as well as the criteria that may determine the amount of remuneration (so called management goals).

Additionally, the Ministry of Treasury in an aim to enforce shareholder supervision in companies with Treasury shareholding, launched Supervision Professionalisation Programme (Supervision Professionalisation Programme 2013), that was in force in years 007–2015 and included:

- ◆ Best practices in shaping the amount and components of remuneration when concluding management contracts with members of management boards of selected companies with Treasury shareholding (hereinafter called Best Practices for Management Remuneration),
- ◆ Best Practices to ensure balanced participation of women and men in the governing bodies of the companies with Treasury shareholding,
- ◆ Best Practices in choosing the candidates for the members of governing bodies in the key companies with Treasury shareholding.

In view of the object of this research, the first of these elements of Supervision Professionalisation Programme was of the upmost importance. Best Practices for Management Remuneration were created with reference to European Regulations ([European Parliament Resolution on July 7, 2010](#)) and determined the expected standards for the amount and the components of remuneration of the board members when concluding management contracts in the largest enterprises with Treasury shareholding. This document detailed the regulations covered by the Act of 2000 on Remuneration of Persons Managing Certain Legal Entities, it also was the grounds for new regulations in this area (for, among others, the Act of June 9, 2016 on The Remuneration of Persons Managing Certain Legal Entities) ([Turek and Michalak 2014](#)).

The continuation of Good Practices is the Resolution of the Ministry of Energy on The Remuneration of Persons Managing Certain Legal Entities ([Resolution of the Ministry of](#)

Energy 2017). The remuneration system is supposed to motivate the managers to operate effectively, which should be reflected in a steady growth of the value of the companies with Treasury shareholding.

#### **4. Experience in the area of creating motivational systems of managers in State-owned enterprises based on the example of enterprise X**

The motivational system of managers should be strictly tied to the effectiveness of managing the enterprise. In practice the system consists of basic remuneration and extra elements, the most important of which is the bonus. The system of granting bonuses to the managers of State-owned enterprises is the focus of further research, under the assumption that this element of the motivational system is to the largest degree connected with effectiveness of managing the enterprise. The identification and measuring of this effectiveness becomes critical in this situation. To this end, objective measures such as market, economical and accounting indicators can be used. The base for calculating them should be a sufficiently long period, allowing the best possible assessment of long-term actions. In this work, the system of granting bonuses for members of the management board of a chosen mining industry enterprise (enterprise X) has been analyzed. This company is a single-person joint-stock company wholly owned by the State Treasury,

The management board of the enterprise X consists of 6 members:

1. Chairman of the Board.
2. Vice President of the Board for Administration and Development.
3. Vice President of the Board for Economics and Finances.
4. Vice President of the Board for Sales and Marketing.
5. Vice President of the Board for Employment.
6. Vice President of the Board for Manufacturing.

The system of granting bonuses to the management board in enterprise X is based on solidarity indicators assessing the effectiveness of managing the enterprise by all of the members of the management board in solidarity as well as on individual indicators, ascribed to the particular areas of activity, for the management of which the particular members of the management board are responsible. According to the Agreement for the provision of services, the members of the management board are entitled to a bonus in the amount of up to 50% of the annual salary, paid in the year for which the bonus is granted. The amount of the annual bonus is calculated by summing the addends of the bonus, where each one corresponds to one separate objective (assessment indicator). Achieving the minimal level of meeting the given assessment indicators determines awarding part of the annual bonus corresponding to this assessment indicator. In a situation where the minimal level of the given indicator is not achieved, the bonus is diminished in the part diminished by the given addend.

The effectiveness of the work of the Chairman of the Board is assessed based on four solidarity indicators, while each of those indicators influences the level of the bonus in the same way, i.e. the percentage share of evaluations conducted based on particular solidarity indicators equals 25%. In the case of the assessment of vice-presidents, the particular solidarity indicators have 20-percentage share in the amount of the bonus (four indicators constitute 80% of the bonus), while the other 20% is determined by individual indicators (The rules for bonus granting and calculation were elaborated on the basis of internal documentation of enterprise X (Agreement on providing services in terms of management of June 1, 2012)).

The bonus system of the board members assumes the following **solidarity indicators**:

**1. EBITDA** – that is result on operational activity (result on coal sales, other sales and other operational activity) increased by depreciation. The assessment, using this ratio, is conducted by comparing the EBITDA level achieved with the level assumed in Strategic Documents (Technical-economic plan and Strategy) for a particular year. The amount of the bonus component for the realization of this objective is decreased by 10% for each full 1% of achievement of the objective below the level assumed in Strategic Documents. The maximum percentage of the share of this ratio in the bonus amount for the Chairman of the Board equals 25% and is 20% for the other board members.

**2. Return on equity (ROE)** =  $\text{net income} \cdot 100 / \text{equity capital}$ .

The amount of the bonus component for the achievement of this objective is decreased by 10% for each full 1% of the achievement of the objective below the level assumed in the Strategic Documents. The maximum percentage of the share of this ratio in the bonus amount for the Chairman of the Board equals 25% and is 20% for the other board members.

**3. Unit production cost** =  $\text{coal production cost without depreciation} / \text{coal production}$ .

The amount of the bonus component for the achievement of this objective is decreased by 10% for each full 0.2% of the achievement of the objective below the level assumed in the Strategic Documents. The maximum percentage of this assessment component in the amount of the bonus is the same as in the two first criteria, that is 25 % of the bonus amount for the Chairman of the Board and 20% for the other board members.

**4. Preparation to start the process of enterprise privatization – entering the Warsaw Stock Exchange** (preparation of the concept and schedule of enterprise privatization). The maximum percentage of the share of this ratio in the bonus amount for the Chairman of the Board equals 25% and is 20% for the other board members. The amount of the bonus component for the achievement of this objective is decreased by 100% in the case of the lack of the objective's achievement.

Apart from the solidarity indicators there are also individual indicators included in the bonus system for board members, serving the assessment of work of the particular board members. The total percentage share of individual ratios in the bonus amount for each board member equals 20%.

Individual assessment indicators of **Vice President of the Board for Administration and Development** are as follows:

1. **Consolidation of enterprises** – understood as a decrease in the of number of capital links. The percentage of this component in the bonus amount equals to 10%. The amount of the bonus component is decreased by 10% for each full 1% of the achievement of the objective above the level assumed in the Strategic Documents.
2. **Achievement of yearly sales revenues on non-productive assets**, constituting a maximum of 5% of the bonus amount. The amount of the bonus component is decreased by 10% for each full 1% of achievement of the objective below the level assumed in the Strategic Documents.
3. **Return rate on capital engaged in dependent enterprises** – calculated as a quotient of net incomes gained by dependent enterprises calculated proportionally into the shares of enterprise X in these enterprises divided by the total amount of capital bought, engaged by enterprise X in these enterprises. The share percentage of this component in the bonus amount constitutes 5%. This premium component is decreased by 10% for each full 1% of objective achievement below the level assumed in the Strategic Documents.

Individual assessment indicators of **Vice President of the Board for Economics and Finances** include:

1. **Accounts receivable turnover ratio in days** = average level of receivables in a period \*360/sales revenues.  
The level of 30 days was accepted as the objective, according to trade contracts concluded by enterprise X with the coal recipients. This ratio decides about 10% of the final bonus amount. The level of this bonus component is decreased by 10% for each full 1% of the objective's achievement above the assumed level.
2. **Result on cash management** = (financial revenues – financial costs) – operations connected with financial fixed assets (e.g. investment sales, update of investment value, dividends) – discount rate of liabilities under restructuring – provisions.  
The share percentage of this component in the bonus amount constitutes 5%. The amount of the bonus component is decreased by 10% for each full 1% of the achievement of the objective below the level assumed in the Strategic Documents.
3. **Cost level ratio** = share of the costs of coal sales in the total value of the coal sales.  
The share percentage of this component in the bonus amount constitutes 5%. The amount of the bonus component is decreased by 20% for each full 1% of the achievement of the objective above the level assumed in the Strategic Documents.

**Vice President of the Board for Sales and Marketing** is evaluated using the following individual indicators:

1. **Sales amount** = total amount of coal sold in the period.  
This ratio decides about 10% of the total bonus amount. The amount of the bonus component for the achievement of the objective is decreased by 20% for each full 1% of the objective's achievement below the level assumed in the Strategic Documents.

- 2. Average price of coal sales** = total coal sales revenues/total quantity of coal sold in the period.

The share percentage of this component in the bonus amount constitutes 5%. The bonus amount on these grounds is decreased by 33.333(3)% for each full 1% of the objective's achievement below the level assumed in the Strategic Documents.

- 3. Certified fuel sales and thick and medium coal grades** = share of heating coal sales amount in total sales.

This component decides about 5% of the bonus. The bonus amount on these grounds is decreased by 10% for each full 1% of the objective achievement below the level assumed in the Strategic Documents.

Individual assessment of **Vice President of the Board for Employment** is based on the following individual indicators:

- 1. Efficiency per 1 employee** = net coal production in the period/average employment in the period.

This ratio determines 10% of the final bonus amount. If the objective assumed in Strategic Documents is not achieved, then, for each 1% of the objective achievement below the assumed level, the bonus amount is decreased by 33.333(3)%.

- 2. Share of surface employees in total employment** = number of surface employees at the end of period/employment quantity at the end of the period.

The share percentage of this component in the bonus amount constitutes 5%. The amount of the bonus component is decreased by 33.333(3)% for each full 1% of the achievement of the objective above the level assumed in the Strategic Documents.

- 3. Remuneration profitability** = sales revenues and other revenues/remuneration costs.

This ratio decides about 5% of the total bonus amount. The amount of the bonus component is decreased by 10% for each full 1% of the achievement of the objective below the level assumed in the Strategic Documents.

The assessment **Vice President of the Board for Manufacturing** is grounded on the following indicators:

- 1. Net coal production in the period.** This ratio determines 10% of the final bonus amount. The value of the bonus component is decreased by 50% for each full 1% of the achievement of the objective below the level assumed in the Strategic Documents.

- 2. Preparation works** = the length of audits in the period.

This ratio has 5% of share in the bonus amount. The bonus amount for this ratio is decreased by 50 % for each full 1% of the achievement of the objective below the level assumed in the Strategic Documents.

- 3. Ratio of accidents per 1000 employees.** This ratio decides about 5% of the bonus amount. The value of the bonus component is decreased by 100% in case of the lack of achievement of the objective assumed in the Strategic Documents (Turek and Michalak 2014).

## 5. Assessment of the managerial bonus systems functioning in state-owned enterprise on the basis of enterprise X

There has recently been a rise in interest in motivational programs for managers, and especially in bonus systems. The discussion also regards effectiveness criteria adopted in the assessment. In general, there is a change in attitude observed towards the business objectives and putting higher pressure on linking motivators with the business strategy, not only with the results of enterprises. The introduction of long-term motivational programs is becoming more common as well as linking a pro-effectiveness system with the value management of an enterprise.

The presented bonus system for the board members of enterprise X is mostly based on aggressive awarding of short-term incomes and other short-term parameters specific for the activity at the expense of long-term development and stability. The suggested ratios, being the basis of the assessment, do not include many important aspects of the enterprise's activity (more in: [Jonek-Kowalska and Nawrocki 2016](#); [Jonek-Kowalska 2014](#)). Above all, they are related to the enterprise's value management to a small degree. It is a concept showing the best integration of managerial objectives and owners (in the case of enterprise X – the owner is represented by the State Treasury). It is also considered to be the best link connecting enterprise's strategy with financial results achieved.

Taking the idea of enterprise's value management into account, managerial processes should be focused on maximizing the value from the point of owner's interests' view as well as capitals engaged in the activity (more in: [Turek and Jonek-Kowalska 2013](#)).

The measures proposed in the frames of solidarity assessment and individual assessment are concentrated on operational activity – short-term one. The relation to long-term objectives or parameters determining value increase in a long perspective seem to be insufficient. In this context, the following may be indicated: lack of a clear relation to the evaluation of investment activity and an insufficient reference to the completion of the long-term strategy of the enterprise. Here the evaluation should be extended by ratios informing about the scale of the investment (including innovations) undertaken to provide value creation ([Świadek 2010](#)).

Another important issue connected with enterprise management in view of its value maximization is leading to the achievement of an optimal capital structure ([Kędzior 2012](#)). Among the ratios proposed for assessment of the board, this issue was omitted although the problems of excessive debt of state-owned enterprises is still present also in terms of the analyzed enterprise X. Consequently, the introduction of debt ratios should be considered in the assessment of the board's performance.

Effective enterprise management is to search for economical financing sources next to leading to the optimal capital structure. An enterprise is able to increase its value if the return on invested sources is higher than the cost of capital. In the evaluated ratios, there is a lack of measures reflecting the cost of enterprise's capital. The introduction of the return on assets (ROA) ratio should be considered (showing general return on total capital engaged

in the enterprise) in relation with the cost of the capital rate. The return on equity ratio (ROE), proposed in the current form is not reliable as, in a situation in which the enterprise possesses a relatively low value of equity in relation with the debt incurred, the value of equity compared with income (net income/equity ratio) allows to show quite a high profitability. However, it should be analyzed in the view of the cost of capital, especially foreign capital which, dominating in the financing structure, may generate a much higher cost of capital than a return on total assets.

In terms of the assessed measures in enterprise X, the ratios related to debt and costs are avoided. For example, using EBITDA, that is the result on operational activity (result on coal sales, other sales and other operational activity) with the inclusion of amortization, for the assessment omits effectiveness of debt management. In order to include the interest paid on debt, the EBIT measure should be used in this place (net income + interest + income tax). However, these two ratios are a look at the enterprise through a prism of the financial result. A better solution is the assessment through an achieved surplus. For this reason, free cash flow is adjusted by the cost of capital. This is calculated according to the EVA (economic value added) Concept. This ratio definitely informs whether the enterprise achieved a value increase in a particular period.

## Conclusions and recommendations

On the basis of the analysis conducted on the bonus system for managers in enterprise X owned by the State Treasury, the following changes may be proposed:

1. In terms of a solidarity assessment, the **EBITDA ratio should be replaced by the EVA ratio.**

Using the EBITDA measure, that is the result on operational activity (result on coal sales, other sales and other operational activity), with the inclusion of amortization, for the assessment is a short-term look through a prism of the financial result. Moreover, it omits the effectiveness assessment of debt management (it does not include the interest paid). A much better solution is assessment in the view of achieved surplus. For this purpose free cash flow is used, adjusted with the cost of capital. This is calculated according to EVA (*economic value added* – EVA is in fact a category of income, however a modified one, in literature it is often defined as residual income (RI) or economic profit (EP)) Concept. It is a measure of the enterprise's result on activity other than a traditional book income because it constitutes a surplus which remains after adjusting it with the whole capital invested in the enterprise. This ratio informs whether the enterprise achieved the value increase for shareholders in a particular period in a rather simple manner. It is considered to be one of the best formulas for enterprise pricing (Boulton et al. 2001).

In order to make the measurement objective, EVA includes many vital modifications related to the balance income. It may be stated that this reflects a real potential of



the enterprise concerning value creation (Malinowska 2000; Marcinowska 2000). Moreover, the economic value added also takes the interest of the investor groups into account by including expected benefits in its formula. It involves the cost of capital engaged in the enterprise's activity.

Economic value added (EVA) may be written in the following way:

$$EVA = NOPAT - WACC \times IC$$

- ↳ *NOPAT* – Net Operating Profit After Taxes,
- WACC* – Weighted Average Cost of Capital,
- IC* – Invested Capital.

NOPAT income in the EVA formula is sensitive only to changes of strictly operating factors which makes the income category objective and reflects a real potential of the enterprise resulting from its basic activity (Sierpińska 1999). In practice NOPAT is net operational income after taxes, that is income before subtracting the cost of the activity financed by foreign capital but after decreasing it by the taxes expressed in cash. NOPAT may be indicated after operation income adjustment by taxes:

$$NOPAT = EBIT \times (1 - T)$$

- ↳ *NOPAT* – Net Operating Profit After Taxes,
- EBIT* – Earnings Before Income Taxes,
- T* – Income Tax Rate.

Measurement based on EVA is a much better solution than the assessment grounded on EBITDA. It is mostly connected with value creation for shareholders. An assessment conducted on this basis could be more effective because the higher value of this measure in each case means situation improvement for shareholders (this does not concern EBITDA). EVA is recommended in literature as a measure playing the basic role in constructing the motivational systems for a managerial group as it links the interests of shareholders and managers (Urbanek 2006).

2. In the frames of solidarity assessment, the return on equity (ROE) may be replaced by the return on assets (ROA) in relation to the **cost of capital (WACC)**. Effective enterprise management is, among others, searching for more economical financing sources. An enterprise is able to increase its value if the return on the invested capital is higher than the rate of the cost of capital. However, it may happen that the enterprise obtains economic loss even if it achieved a positive operational income. This means that the income achieved is lower than the shareholders expect. It does not cover the capital invested by shareholders (cost of equity). Consequently, the value of an enterprise measured by EVA increases only when the income achieved is higher than the shareholders

expect. A surplus in a form of the difference between the real and expected income therefore decides about the enterprise value increase (Małuszyńska 2004).

In connection with the above, the introduction of a measure based on the relation of two ratios: ROA and WACC into the motivational system instead of ROE is suggested. They show a general return on the whole capital engaged in the enterprise in the view of the cost of capital. Enterprise value maximization takes place only when the enterprise provides a return higher than the weighted average capital for the whole capital invested, that is:

$$ROA > WACC$$

where:

$$ROA = \text{net income} / \text{total assets}$$

$$WACC = \frac{(E \times C_e + D \times C_d \times (1 - T))}{E + D}$$

- ↳  $E$  – equity,
- $C_e$  – cost of equity,
- $D$  – foreign capital (debt),
- $C_d$  – cost of debt,
- $T$  – income tax rate.

The ratio used for solidarity assessment, that is the return on equity (ROE), in the current form is not reliable as the enterprise has a relatively low value of equity in comparison with the debt incurred. The value of equity, which constitutes 13.9% in the financing structure, compared with income in relation with net income/equity capital allows a relatively high profitability to be indicated but it should be analyzed in view of the cost of capital, especially foreign capital, which dominates in the financing structure (in 2012 it constituted 86.1% of all the capital).

3. In terms of individual assessment of the Vice President of the Board for Administration and Development, one should additionally refer to investment activity and extend the scale of assessment with the **ratio informing about the range of investment** (including innovations) undertaken for providing value increase.
4. Another important issue connected with enterprise management in the view of maximization of its value is leading to achieving an **optimal capital structure**. Among the indicators suggested for the board's assessment this issue was omitted although the case of excessive debt of the enterprise is still present. Therefore, the introduction of the debt ratio should be considered in the assessment of the Vice President of the Board for Economics and Finances.

Apart from the multi-criteria system of managers assessment described above, there should also be an issue raised regarding the form of reward payment. The current motivational system assumes cash payment – bonus, determined as a percentage of remuneration. However, observing the trends in developed countries, there may be a rising popularity seen in long-term motivational programs. They consist of: granting rights to shares, registered bonds, investment certificates. In Poland managerial options are becoming less popular. They consist in offering rights to shares purchase, mostly at a preferential price, that is lower than the market price but not lower than the nominal price, for the key group of the enterprise's employees. Such form of bonus payment would be an additional motivator for undertaking actions which may lead to the value increase of an enterprise in a long-term perspective.

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**PROBLEM WYNAGRADZANIA MENEDŻERÓW SPÓŁEK Z UDZIAŁEM SKARBU PAŃSTWA  
W KONTEKŚCIE CORPORATE GOVERNANCE (NADZORU KORPORACYJNEGO)**

Słowa kluczowe

ład korporacyjny, wynagrodzenie kadry menedżerskiej, system motywacyjny

Sreszczenie

Problematyka *corporate governance* i związanego z nią systemu wynagradzania kadry menedżerskiej zyskuje szczególne znaczenie w odniesieniu do spółek z udziałem Skarbu Państwa. Właściwa konfiguracja tego systemu umożliwi efektywne zarządzanie przedsiębiorstwem, jednak błędy w jego konstrukcji mogą być źródłem negatywnych schematów zachowań kadry zarządzającej i mogą prowadzić do zakłóceń na rynkach finansowych, a nawet do kryzysu finansowego. Wśród przyczyn zawirowań na rynkach finansowych wymienia się między innymi: sposób sprawowania zarządu i nadzoru w spółkach publicznych, a zwłaszcza podejmowanie przez organy zarządcze nadmiernego ryzyka. System ten powinien preferować interesy akcjonariuszy i interesariuszy, tymczasem w wielu przypadkach bierze pod uwagę osiągnięte wyniki bez powiązania ich z długofalowymi kryteriami efektywnościowymi.

Dlatego istnieje potrzeba poszukiwania skuteczniejszych mechanizmów motywowania menedżerów. Także w Polsce podjęto pierwsze kroki w kierunku poprawy systemu nadzoru, a zwłaszcza stworzenia skutecznego systemu wynagrodzeń dla menedżerów. Celem niniejszego artykułu jest diagnoza systemów wynagradzania menedżerów w spółkach z udziałem Skarbu Państwa wraz z analizą narzędzi weryfikujących efektywność zarządzania i będących podstawą do uzyskania premii. Publikacja prezentuje genezę oraz modele nadzoru korporacyjnego uwzględniając różne kryteria podziału. Ponadto pokazano uwarunkowania wynagrodzeń menedżerów w spółkach z udziałem Skarbu Państwa wraz z oceną systemów premiowania menedżerów. Autorzy przedstawiają również propozycję optymalizacji oceny efektywności zarządzania na potrzeby budowy skutecznego, parametrycznego systemu motywacyjnego. Taki system powinien opierać się na wartości dla akcjonariuszy.

**THE PROBLEM OF MANAGERS' REMUNERATION IN STATE-OWNED  
ENTERPRISES IN THE CONTEXT OF CORPORATE GOVERNANCE**

**Keywords**

corporate governance, managers remuneration, motivational system

**Abstract**

The problem of corporate governance and the connected executive remuneration system gains a special significance in relation to state-owned enterprises. A proper configuration of this system enables effective enterprise management, however, mistakes in its construction may be a source of negative behavior patterns of managers and may lead to disturbances on financial markets or even to financial crisis. The reasons for disturbances on the financial markets include the following: the manner in which the top management was operating and the oversight of public enterprises and especially, taking too much risk by the top management. This system should put the interests of shareholders and stakeholders first, while in many cases it prefers results achieved without tying them to long-term effectiveness criteria (European Commission 2004). Therefore, there is a need of looking for more effective mechanisms of motivating the managers. In Poland, the first steps were also made in the direction of improving the supervision system and especially, of creating an effective remuneration system for managers. The purpose of the hereby article is to diagnose the executive remuneration system in the state-owned enterprises and to analyze the tools verifying the efficiency of management and being a basis for bonuses. The publication presents the genesis and models of corporate governance taking into account various criteria for division. In addition, the conditions of remuneration of managers in companies with Treasury shareholding and assessment of managerial bonus systems were presented. The authors also present a proposal for optimizing assessment effectiveness regarding management for the purpose of constructing an efficient, measurable motivational system. Such a system should be based on shareholders' value.