

# MANAGEMENT OBJECTIVES OF A MUNICIPAL COMPANY – THE SOLUTION TO GOOD MANAGEMENT?

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**Abstract:** The provisions of the new salary cap act entered into force on 9 September 2016 (Ustawa z dnia 9 czerwca 2016). The new provisions apply to State Treasury Companies and some municipal companies. One of the basic assumptions of the act is the obligatory enforcement of management objectives in companies by the owners. The variable part of management salaries will depend on the degree of completion of individual objectives. In the first part, the article presents the results of studies of the texts of owner regulations concerning the method of formulating and the type of management objectives in municipal companies. The second part includes the author's considerations concerning possible economic and social effects of the implementation of management objectives in companies. In the conclusions, the author attempts to answer a question whether objectives formulated in this manner can actually improve the quality of management of municipal companies?

**Keywords:** management objectives, municipal company, management salaries.

## 1. Introduction

The justification of the Act of 9 June 2016 on the methods of determining the salaries of the managers of some companies in Poland includes a provision that the purpose of implementing new principles for determining salaries is to increase the quality of management, among others, by conditioning the payment of a part of the management salaries on the completion of specific management objectives. Furthermore, according to the authors, the act can help determine the correct proportion between the need to create an elastic mechanism for determining the salaries and to approximate it to the principles adopted on the market and the need to fully exercise the constitutional principle of social security (Druk nr 514). The latter refers to the factual reasons for the emergence of new regulations. The direct cause for introducing the changes in the law was a media event. In 2016, a member of the management board of one of leading State Treasury companies was dismissed after a very short term (several weeks) in office. The problem was that this person received a severance that was considered

incommensurate with the circumstances and excessive. However, could regulations introduced shortly after the subject event prevent any similar irregularities in the future. Could new laws contribute to new problems emerging in municipal companies in the future? These errors can stem from the method of determining management objectives and the method of paying the salaries related to the completion of these objectives. After it was published, the provisions of the new act were widely criticized (Widera; Tyczyńska). They were however press publications only. Until the end of 2017, no studies have emerged in literature which would discuss the economic effects of the new approach to employing and remunerating the members of management boards of companies, which is understandable, considering that the majority of management board members signed management contracts until the end of the first half of 2017. We will have to wait at least a year from the implementation of the new solutions for the ultimate conclusions to clarify. However, the full texts of by-laws written for companies which are legally obligated to formulate such objectives are available online. An analysis of individual regulations forming these by-laws for 84 municipal companies representing various industries situated in different parts of the country has led to a preliminary assessment of the new legal solutions in terms of possible impact on management. The purpose of the article is to answer a question whether management objectives formulated in practice can improve the quality of management of municipal companies?

## **2. Objective and subjective scope of the changes**

The act of 9 June 2016 on the principles of determining the salaries of managers in certain companies applies to companies representing: the State Treasury, local government units or their associations, legal bodies and municipal bodies. The article is devoted to local government units in the form of limited-liability companies and joint-stock companies. As of 31 December 2015, 2324 limited-liability companies and 273 joint-stock companies with shares or stocks owned by local government units were registered in Poland (Ministerstwo Skarbu Państwa).

According to the provisions of the Act, the body which is entitled to exercise the rights vested in the shares is obligated to take measures to develop and oversee the implementation of principles of remunerating management board and supervisory board members. Exercise of this obligation involves:

1. leading to a voting at the general meeting of shareholders on draft resolutions concerning the principles of remunerating management board and supervisory board members according to the provisions of the act and passing votes to adopt the resolutions,

2. collecting a statement on the adoption of obligation to determine the remuneration principles for supervisory board members according to the provisions of the act from each candidate for the position of supervisory board member indicated by the body entitled to exercise the rights vested in the shares.

The draft resolution concerning the principles of remunerating members of the management board should stipulate that the total salary comprises a fixed part, i.e. the basic monthly salary specified in a per-quota rate, and a variable part, i.e. supplementary salary paid for the company's financial year.

The fixed part of the management board member's salary is determined in consideration of the scale of company operations, particularly the value of its assets, revenues and employment. To determine the remuneration of a management board member, serving as the factor of their salary basis, the company should fulfill at least two of the three premises indicated in table 1 in at least one of two of its last financial years.

**Table 1.**

*Fixed salary part depending on company size*

Remuneration as the factor of salary basis	Premises concerning company size		
	Average annual employment	Annual net revenue (equivalence in PLN)	Total balance assets (equivalence in PLN)
1-3	> 10 employees	< 2 M euro	< 2 M euro
2-4	≥ 11 employees	≥ 2 M euro	≥ 2 M euro
3-5	≥ 51 employees	> 10 M euro	> 10 M euro
4-8	≥ 251 employees	> 50 M euro	> 43 M euro
7-15	≥ 1251 employees	> 250 M euro	> 215 M euro

Source: developed on the basis of pertinent regulations of 9 June 2016, op.cit.

A draft resolution concerning the remuneration of management board members can stipulate a different fixed part of the management board member's salary if this stems from extraordinary circumstances pertaining to the company or to the market, on which the company operates, particularly when the company:

1. has implemented a program of consolidating individual companies belonging to its capital group, the purpose of which is to change the structure of its assets or revenues,
2. has implemented an investment program which significantly exceeds the value of its fixed assets,
3. has implemented a restructuring program with a time horizon of at least 3 years, leading to a significant change in the structure of the company's assets or revenues,
4. has its registered office outside the Republic of Poland, or its statutory activities are governed by an international agreement, to which the Republic of Poland is a party,
5. has operated up to a year,
6. was established to complete a project, particularly when co-financed by the European Union or under a non-refundable financing scheme operated by the member states of the European Free Trade Association (EFTA) or when financed under other non-refundable financing schemes.

Passing a vote in favor of a resolution determining the fixed part of a management board member's salary in excess of the value specified in table 1, the body entitled to exercise rights vested in its shares should draw up a written justification and publish it on its website in the Public Information Bulletin (Ustawa z dnia 9 czerwca 2016).

The variable of each board member's salary which serves as a supplement to the basic salary for the company's financial year, depends on the level of achievement of management objectives. The importance of individual management objectives as well as the objective and measurable criteria for their completion and settlement are laid down for individual board members or for all of them, collectively. Pursuant to the act, the variable salary part must not exceed 50%. In turn, in public companies and in other, largest municipal companies (the last row in table 1), the variable salary part must not exceed 100% of the basic salary determined for the management board member in the preceding financial year.

Article 4 section 6 of the said act specifies model management objectives concerning companies assumed by the provisions of the act. These objectives can include, among others:

1. an increase of the net profit and pre-tax profit to include interest, taxes and amortization, or acceleration of the growth rate for one of these results,
2. achieving or changing the production or sales volume,
3. revenues, particularly sales revenues, operating revenues and revenues from other operating or financial activities,
4. a reduction of losses, reduction of management costs or the costs of business activities,
5. the completion of a strategy or a restructuring plan,
6. the achievement or charge of specific indicators, and particularly profitability ratios, financial liquidity ratios, management performance indicators or solvency ratios,
7. the completion of investments, considering their scale, rate of return, innovativeness and timely completion,
8. a change in the market position of the company, counted as a share on the market or according to other criteria or relations with contract parties classified as key partners according to specific criteria,
9. the successful implementation of human resources policies and an increase in employee involvement.

According to the provisions of the act, draft resolutions concerning remuneration principles lay down management objectives, the importance of these objectives and the objective and measurable criteria for their completion and settlement. A draft resolution concerning the remuneration of management board members can further stipulate that the detailed objectives, importance and criteria will be provided by the body or entity which is responsible for determining the salary of the management board member and concluding an agreement for management services with this member. The legislator further decided that draft resolutions concerning board member remunerations should include provisions stating that the supplementary salary of a management board member, i.e. the variable part, is payable after the

management board has approved the management board's report on company operations and the financial statements for the preceding financial year, and after this management board member has received a general meeting of shareholder's vote of approval for their fulfillment of their responsibilities.

### 3. Types and methods of formulating management objectives in companies

A study of resolution provisions was carried out in December 2017 for 84 municipal companies. Among the studied bodies, the largest number of management objectives was identified for Port Lotniczy Radom SA (10), and the smallest number of objectives was specified by Pomorska Specjalna Strefa Ekonomiczna Sp. z o.o. with its registered office in Sopot (2). The total number of objectives in the studied resolutions was 427, which means that, in average, local government bodies would set 5 objectives for each of the companies (table 2). The majority of objectives were economic in character (more than 50%) and referred to: profits, revenues, costs, economic indicators, or the market position of the company. A slightly smaller number of objectives referred to material issues (more than 30%): completion of investments, restructuring plans, achievement of specific operational indicators. Other objectives were the rarest (approx. 17%) and concerned various areas: management, innovativeness, human resources policy. In five instances only objectives were encountered which could be described as socially-oriented (improvement of the quality of life of local residents), and which assumed a very narrow scope. Economic objectives were predominant in companies from the following industries: municipal waste (71.0%), public transport (58.4%) and water supply and sewage companies (53.8%). In turn, material objectives recurred in resolutions concerning social housing and development companies (53.2%).

**Table 2.**

*Number and types of management objectives in companies assumed with the study*

Company type	No. of companies	Average no. of management objectives in %		
		Economic	Material	Other
Water supply and sewage	24	53.8	37.6	8.6
Heating distribution	14	44.1	39.0	16.9
Social housing and development	12	23.4	53.2	23.4
Public transport	9	58.4	15.6	26.0
Municipal waste	9	71.0	16.1	12.9
Multi-industry (municipal management)	9	52.5	35.0	12.5
Sports and recreation centers, aquaparks	4	55.6	22.2	22.2
Economic zones	2	40.0	40.0	20.0
Health care facilities	1	57.1	42.9	0.0
Airports	1	60.0	10.0	30.0
In total	<b>84</b>	<b>52.5</b>	<b>30.7</b>	<b>16.8</b>

Source: own study.

An analysis of the management objectives for municipal companies, as specified in the resolutions of managing bodies has pointed to the dominance of economic objectives. This means that the authors of management objectives paid little attention to the specific character of their municipal companies. This specific character stems from the fact that these companies provide so-called public services as part of their public utility. A definition of public utility is laid down in the Municipal Government Act of 8 March 1990 (Ustawa z dnia 8 marca 1990). Pursuant to article 9 point 4 of this act, a public utility provides generally accessible services according to the tasks attributed to a municipality, the purpose of which is to continuously and incessantly satisfy the collective needs of the population. These tasks were literally listed in article 7 of the said act. In turn, article 1 of the Municipal Management Act of 20 December 1996 lays down principles and forms of municipal management of local government units, consisting in their performance of own tasks to satisfy the needs of the local government community (Ustawa z dnia 20 grudnia 1996). This mutual contradiction of the economic objectives of a municipal company, as resulting from its situation within the provisions of the Code and the said acts was confirmed in a sentence of the National Administrative Court from 2003. In the sentence, the Court ruled that the primary difference between municipal management and business activity is in that the purpose of this management is not gainful (Wyrok NSA z 9 stycznia 2003).

An analysis of the provisions of resolutions adopted by the bodies of local government units and pertaining to their management objectives has led to other remarks. It was found that these provisions had been reproduced without any deeper consideration of the specific character and the actual need for setting specific management objectives in individual companies. Table 3 presents selected examples of management objective formulations. One could venture a claim that the majority of the objectives specified in these resolutions adopted by other municipal companies in Poland was no different to the formulations quoted in the table. Copying objectives in resolutions adopted by a single office or company is common. There are multiple examples available. For instance, the Public Information Bulletin in Suwałki lists 6 resolutions concerning the remuneration of management board members in municipal companies. These refer to the following companies: Parku Naukowo-Technologicznego, Przedsiębiorstwa Energetyki Ciepłej, Przedsiębiorstwo Gospodarki Komunalnej, Przedsiębiorstwo Gospodarki Odpadami, Przedsiębiorstwo Wodociągów i Kanalizacji and Zarząd Budynków Mieszkalnych TBS. Each of these resolutions specifies identical management objectives. This is not an isolated case in Poland. What is more, analyzing the provisions of these resolutions, we will instantly notice that objectives are not only copied within cities, but include the objectives which have been included in earlier issues. The same formulations are found in documents issued by companies headquartered in Radom and Suwałki. This proves either the lack of actual knowledge of the objectives which should be set for individual companies, or, simply, the lack of professional commitment from the authorities and officials. Although municipal companies are included in the sphere of public finance due to the role and the tasks they fulfill on the local market, this behavior must be clearly condemned.

**Table 3.***Examples of management objectives in selected municipal companies*

Company	Management objectives
Zakład Komunikacji Miejskiej w Elblągu Sp. z o.o.	Achievement of a positive financial result; Increase in sales volume and value; Lowering of operational costs; Undisturbed and correct completion of tasks; Achievement or change of specific indicators, particularly key performance indicators and solvency ratios; Achievement of the planned revenues and financial result; Completion of the strategy or adopted restructuring plan; Completion of human resources policy adopted.
Port Lotniczy „RADOM” SA	Increase of net profit or pre-tax profit minus interest, taxes and amortization, or increase of the growth rate for one of these results; Achievement or increase in sales volume and value; Revenues, particularly from sales, operating activities or financial activities; Reduction of losses, reduction of management costs of business costs; Completion of the company development strategy or a restructuring plan; Achievement or change of specific indicators, including profitability ratios, financial liquidity indicators, management performance indicators and solvency ratios; Completion of investments, considering the scale, the rate of return, the innovativeness and timely completion; Completion of human resources policy and increase in employee involvement; Change in the market position of the company, counted as a share on the market or according to other criteria or relations with contract parties classified as key accounts according to specific criteria; Completion of human resources policy and increase in employee involvement; Degree of completion of public tasks.
Pomorska Specjalna Strefa Ekonomiczna Sp. z o.o. with its registered office in Sopot	Completion of the zone development plan; Improvement of economic and financial indicators.
Towarzystwo Budownictwa Społecznego – Przedsiębiorstwa Mieszkaniowego Sp. z o.o. w Krośnie	Preparation and implementation of investments in the construction of apartments for rent; Completion of the company's annual plans; Creation of a positive image of the company; Development of an effective system for charging municipal waste collecting services provided to Municipal resourced managed by TBS, in cooperation with the Municipality.
Chemwik Sp. z o.o. w Bydgoszczy (oczyszczalnia ścieków)	Improvement of operational indicators and the quality of services provided, Improvement of financial indicators, including: a) achievement or change of specific indicators, particularly key performance indicators and financial liquidity ratios, b) reduction of management costs or the costs of business activity; Conformity of the financial plan with its execution; Implementation of investment and capital renovation plan; Completion of investments, considering their innovative character and completion dates.
Chorzowsko-Świętochłowickie Przedsiębiorstwo Wodociągów i Kanalizacji Sp. z o.o.	Achievement of a positive financial result; Completion of investment and renovation tasks essential to the city of Chorzów or the city of Świętochłowice; Acquisition of additional sources of income or financing; Rationalization of operating costs.
Przedsiębiorstwo Gospodarki Odpadami w Suwałkach Sp. z o.o.	Increase of net profit or pre-tax profit minus interest, taxes and amortization or increase in growth rate for one of these results; Achievement or change in production or sales volume; Revenue, including from sales, operating activities or financial activities; Reduction of losses, reduction of management costs or the costs of business activities; Completion of the company development strategy or a restructuring plan; Achievement or change of specific indicators, including profitability ratios, financial liquidity indicators, management performance indicators and solvency ratios; Completion of investments, considering the scale, the rate of return, the innovativeness and timely completion; Completion of human resources policy and increase in employee involvement.

Source: own study on the basis of: Resolution no. 2/2017 of the Extraordinary General Meeting of Shareholders of Zakład Komunikacji Miejskiej w Elblągu Sp. z o.o., [www.zkm.elblag.com.pl/](http://www.zkm.elblag.com.pl/); Public Information Bulletin of the Radom City Council, <http://bip.radom.pl/>; Resolution no. 2/2017 of the Extraordinary General Meeting of Shareholders of Pomorska Specjalna Strefa Ekonomiczna sp. z o.o. with its registered office in Sopot, [https://mr.bip.gov.pl/fobjects/download/247502/psse\\_zarzad-pdf.htm](https://mr.bip.gov.pl/fobjects/download/247502/psse_zarzad-pdf.htm); Public Information Bulletin of the Krosno

City Council, <http://www.bip.umkrosno.pl>; Resolution no. 4 of the Extraordinary General Meeting of Shareholders of Chorzowsko-Świętochłowickie Przedsiębiorstwo Wodociągów i Kanalizacji Sp. z o.o. <http://www.chspwik.pl/>; Resolution no. 8/2/2017 of the Extraordinary General Meeting of Shareholders of „Przedsiębiorstwo Gospodarki Odpadami in Suwałki” Sp. z o.o. dated 9 May 2017r., <http://bip.umsuwalki.pl>.

#### 4. Discussion

Considering that the purpose of these changes, at least in the official version of the above quoted justification, was to improve the quality of management of municipal companies, it would be difficult not to notice the flaws of the new regulations in this aspect, and the resulting flawed formulations concerning management objectives.

The biggest error in the management objectives formulated is that municipal companies are treated as if they operated in market conditions, and as if they were oriented at profit, revenue or goodwill increase. In this aspect, comparing State Treasury companies operating on the competitive market and aiming at producing the best results with municipal companies is completely inexplicable for the managers of these companies. What is more, the contradictions between economic and social objectives predating the effective date of the act were not only not refuted, but will soon magnify problems related to having to choose between individual economic objectives. Until recently, one of the basic problems of managing municipal companies was that they were governed by the provisions of two acts: the Municipal Management Act of 1996 and the Code of Commercial Companies. So far, the majority of company managers would make a choice between public utility, thus making decisions which were not necessarily as profitable (e.g. construction of sewage in non-developed areas or opening of bus lines in non-developed areas), but which improved the quality of life of their residents and the working conditions for local business owners. If however new management objectives are now to stipulate revenue increase, cost reduction and profit increase, then they are contradictor for one of the municipal companies. A company can increase its revenues twofold: by increasing its tariffs (prices), thus increasing its profit, but is this the expectation of the society? The second method involves e.g. the construction of water supply networks in low-development areas. This will increase revenues, but will also increase costs and reduce profits. The act therefore introduced an additional problem for municipal company boards which will be forced not only to choose between economic and social objectives, as was the case so far, but also between economic objectives themselves.

Its authors were not able to implement separate evaluations of board members' performance or the assessment of the company's economic status. Identifying the evaluation of board's performance with the evaluation of the company's performance is, unfortunately, a common error. In the foreseeable future, this will mean that the management boards of municipal companies which have found themselves in good economic standing for various reasons



(considering that a large number of these companies are monopolists), will be entitled to higher salaries compared to the boards of companies which are not in such a good condition despite taking efforts and risks to improve this situation.

The introduction of provisions stipulating the measurable character of management objectives should be also construed as an error. For municipal companies, this will result in eliminating management objectives involving social issues, at least according to the by-laws of these companies. In turn, as public utility companies, municipal units should be focusing on these social issues that benefit the residents and business owners operating in the region. The dominance of economic objectives (primarily profit) at the cost of social objectives places municipal companies next to one-person State Treasury companies which base their activities solely on commercial principles and which are governed by the provisions of the Code of Commercial Companies. Some of the board resolutions do in fact contain such objectives as, e.g. increase of employee involvement or the completion of human resources policies, but a question which could be asked here is how could employee involvement be actually measured (what is expected here are original indicators), and whether the people who formulate these objectives will violate the provisions of this act, one that clearly bans the application of other objectives.

Another problematic issue concerns the introduction of the one-time payment of the variable part. The variable salary can be paid as a one-time amount after the management board's report on company operations and the financial statements for the preceding financial year have been approved, and after a specific management board member has received a general meeting of shareholder's vote of approval for their fulfillment of their responsibilities, provided that the supervisory board has claimed that the management board member has completed the management objectives and that the payable sum has been determined. It should be noted here that this applies to a municipal company whose revenues are paid by the residents of the municipality. This contradicts the basic intention of the act, which was to eliminate such one-time payments made to management board members.

## **5. Summary**

In conclusion, management objectives formulated in this manner will not improve the quality of management of municipal companies. Such improvement would be possible when objectives considering their specific market character and their public utility would be created for municipal companies. It is therefore likely that, incorrectly formulated, these objectives will be neglected and marginalized. The worst situation would be when the presidents of municipal companies focused on profit being the ultimate objective of their activities. Furthermore, it is

not possible to state when the boards which had formulated such objectives would actually realize the economic consequences of their decisions on the local communities.

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