



EFFICIENCY OF CAPITAL FORMATION OF UTILITY ENTERPRISES: THE CASE OF UKRAINE

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ABSTRACT

The paper aims to analyze the approaches to capital formation of Ukrainian utility enterprises, identify their impact on the financial results of entities and formulate recommendations to ensure the efficiency of utility enterprises. The methodological basis of the study is comparative analysis, theoretical studies, statistical information, analytical data prepared by governmental and non-governmental bodies, the best practices. In the course of the research were collected and processed empirical data of 30 utility enterprises from 11 regions of Ukraine with different economic, demographic, climatic and administrative conditions. The conducted research confirms that the capital invested in the municipal enterprises does not increase their efficiency. Funding from a municipal budget without disclosure of the criteria for providing such resources does not enlarge the profitability of utility enterprises and often used to cover their losses, which lead to capital disruption.



In order to increase the efficiency of utility enterprises and the fair distribution of municipal budget funds it was proposed to introduce the disclosure of additional information about capital formation; to strengthen the managers' responsibility for the quality of publishing information with the introduction of special KPIs; and to conduct financial and performance audit, including in terms of capital formation.

Keywords: Municipal (communal) enterprise; Utility enterprise; Capital; Housing and utility services; Efficiency; Audit

1. INTRODUCTION

In recent years, Ukraine has been reforming local self-government in accordance with the provisions of the European Charter of Local Self-Government. State policy in this area provides for decentralization – changes in approaches to the formation of local communities and their funding, accompanied by the transfer of a significant part of powers, responsibilities and resources from the executive authorities to local governments. The effective development of local communities directly depends on the quality of their property management. In this regard, there is an ongoing public debate on how to find solutions to the problems of functioning of municipal-owned enterprises.

Municipal (communal) enterprises in Ukraine traditionally play a significant role, as most of them belong to critical infrastructure. These enterprises operate in such industries as energy, transport, health care, utilities, which are strategically crucial for the economy functioning and state security. The incapacitation or destruction of such entities affects national security and defense, the environment, and leads to significant material and financial losses. Simultaneously, the results of Ukrainian utility enterprises indicate their inefficiency and show signs of political corruption.

In Ukrainian law, the term "communal" is used as a synonym for the term "municipal". Therefore, in this publication we will use the terms "municipal ownership", "municipal enterprise". The separation of municipal (communal) ownership from state ownership in Ukraine took place in the early 1990s. Currently, in accordance with the requirements of the Commercial Code of Ukraine (2003), utility enterprises can be organized in the form of a municipal unitary enterprise (commercial or non-commercial) or a business company (joint stock company or limited liability company). The property of a municipal unitary enterprise is municipal property and is assigned to a municipal commercial enterprise on the right of economic management, to a municipal non-commercial enterprise on the right of operative



management. Such a mechanism makes it possible to ensure the ownership of municipal property by the relevant community and to secure the community's rights. For instance, property on the right of economic management cannot be pledged, secured, and cannot be seized. Local councils carry out all transactions with the utility enterprises' property on behalf of the community.

As of September 1, 2020, 14,182 municipal companies are registered in the Unified State Register of Enterprises and Organizations of Ukraine (State Statistics Service of Ukraine, 2020). Unfortunately, generalized data in terms of these enterprises' types and activities are not collected and published by official statistics. However, as noted by Tulchynska and Solosich (2019), municipal enterprises have different functional purposes, which allows them to be divided into social entities (educational and health care institutions, sports complexes, parks, media, etc.), infrastructure enterprises (utility enterprises, urban passenger transport, etc.) and commercial companies (provision of rent services, construction, parking, pharmacies, hotels, markets, etc.).

Municipal enterprises of various types differ in terms of financing, performance results, and the presence of social and environmental effects. Nevertheless, the discussion around finding an effective model for organizing the functioning of infrastructure utility enterprises is the most acute. Recently the need to privatize utility enterprises has been increasingly discussed. Nowadays various successful models of providing utility services are known. However, according to experts, none of them can be fully implemented in another country without taking into account national specifics. In addition, over time, some countries become convinced of the need to modify previously effective approaches as they cease to be active in a rapidly changing environment. Considering this, it is essential to explore the best international experience in this area.

2. LITERATURE REVIEW

Different countries have various models of housing and utility services – from a state monopoly to a competitive market. Technological features, traditions and government policy in this area significantly influence the choice of one or another model. For example, central heating is typical for countries with transition economies. In the EU countries, as of 2013, the share of central heating was 12%, while in Ukraine this figure was 66%, in Latvia – 65%, in Belarus – 50% (Ministry of Energy and Coal Industry of Ukraine, 2016).



Summarizing the study of foreign experience, we identify three main models of housing and utility services (water supply and sewerage, energy supply, heat supply, waste disposal, urban passenger transport, etc.):

- 1) state (municipal) property is used worldwide, is typical for small communes in the European Union, is the basic model for most Ukrainian entities providing services in this area (excluding energy supply);
- 2) delegated management – provides for the establishment of a joint stock company, the controlling stake of which belongs to the local government (municipality), is typical for the Netherlands, Germany, Greece, Belgium, etc.;
- 3) private property – the most common in the UK and some states in the United States. Private companies provide utilities to the population. In addition, municipalities and the state monitor the quality of such services by licensing and establishing performance criteria, followed by monitoring their compliance. In Ukraine, this model is not applied, since there is a legislative restriction on the privatization of engineering networks and facilities, equipment, which is associated with the supply of water, gas, heat, the removal, and treatment of wastewater.

It should be noted that the advantages of one or another model have been discussed since the late 1980s. The widespread theory that private ownership is more effective than state or municipal ownership is not supported today by numerous empirical studies in different countries.

Thus, Boardman and Vining (1989) note that partial privatization (mixed companies) is the most inefficient form of ownership, which performs less profitability than private or state-owned companies. The reasons for this are the limitations identified by the authors on the example of North American companies, including the following: 1) some companies operate in the field of natural monopoly (electric and water utilities, fire services, and refuse collection); 2) in some areas there is a regulated duopoly (airlines, railways, financial institutions); 3) output of such companies cannot be assessed from a competitive standpoint.

Bartel and Harrison (2005) reached a similar conclusion, and based on the calculations, confirmed that mixed companies are the most inefficient. However, the authors support the need to privatize companies because the state is a less efficient owner due to monitoring problems, as well as the environment in which state-owned companies operate, as measured by soft budget constraints or barriers to competition.

It is important the experience of countries that initially preferred the private ownership of enterprises operating in the housing and utility sphere, but eventually carried out re-privatization (re-municipalization) due to the results of privatized enterprises did not meet the expectations of local authorities and the community (Wagner & Berlo, 2015; Clifton et al., 2019). Examples of such countries are the United States and Germany (energy companies), France (water supply and sewerage), the Netherlands and Spain (waste disposal services).

The reasons for the return of enterprises to municipal ownership are the features of services provided in the housing and utility sphere, which differ in the presence of not only economic but also social and environmental effects. Private businesses are often unprepared to fully upgrade their infrastructure, revise technologies to improve their energy efficiency or provide services continuously under tightly regulated tariffs, which significantly limit revenue and lead to low profits or even losses.

Proponents of municipal enterprises privatization argue their point of view the advantages of a competitive market environment, the need to improve the management of these enterprises, depriving them of political involvement, and the need to reduce the burden on municipal budgets supporting such enterprises (Villalonga, 2000; Bartel & Harrison, 2005). Nevertheless, there is still no clear answer on how to stimulate the achievement of social and environmental effects in the process of providing services by private entities in the field of housing and utility sphere.

According to the authors of the study (UNDP, 2015), privatization is often, but not always, associated with efficiency gains. The most convincing evidence of increased privatization efficiency is observed in high-income countries. In contrast, in low- and middle-income countries, the evidence is limited and ambiguous. Research identifies a group of factors to increase privatization effectiveness, including competition, regulation, financial and legal institutional development, and enforcement property rights.

The operation of utility enterprises after their privatization is characterized by negative consequences, such as a sharp, sometimes tenfold increase in tariffs (Hungary, Poland, Czech Republic), significant job losses (UK, Bulgaria, Philippines), low level of technological re-equipment, the need to continue providing subsidies from local budgets to support activities, etc. At the same time, the main advantages of privatization were not achieved, such as reduction of budget expenditures for the maintenance of municipal property, development of the housing

and utility services market, improvement of service quality and efficiency of enterprise management in this area (Warner, 2012; Yelisieieva, 2012).

In our opinion, it is necessary to take into account the results of the study by Ostrom, the Nobel Prize laureate in economics (2009). In research that has lasted since the late 1950s, Ostrom used an interdisciplinary approach that combined economic, legal, sociological, and geographical methods and was based on official statistics and field research results. Consequently, she concluded that communities are able to manage public resources based on mutual trust more effectively than the state or private owners (Ostrom, 2009). E. Ostrom's research gave impetus to the development of ideas for the preservation of municipal ownership and support for decentralization.

Moreover, Voorn, Genugten and Thiel (2017) summarize different studies on the effectiveness of municipal-owned companies and emphasize the ability of these companies to realize large efficiency gains, especially in utility sector.

Therefore, the continuation of empirical research, especially comparative between countries, will deepen the understanding of the processes taking place in modern municipalities, in order to find effective ways to further their functioning with increasing the role of sustainable development.

Recently, the number of scientific and practical publications devoted to finding ways to solve problems in the field of housing and utility services and improving the efficiency of utility enterprises has significantly increased in Ukraine. Specialists discuss the following areas:

– at the level of individual economic entities – the presence and amount of profits and losses, the structure and dynamics of accounts receivables and payables, assessment of financial security of enterprises and its modeling (Bagatska, 2020);

– at the state level – the assessment of the impact of the aggregated loss of utility enterprises on the economy (Mykhailyshyna, 2019); state policy in the field of pricing for housing and utility services (Tarasiuk & Liskova, 2019); the need to privatize most utility enterprises (except natural monopolies) in order to reduce the burden on local budgets, the implementation of effective state control and regulation in this area (Prokhorov, Lonevskyi & Vartovnyk, 2020).

Despite numerous studies in the field of utility enterprises in Ukraine, the issues of efficiency of their capital formation are not considered. According to the authors, these issues

have a significant impact on the stability of utility enterprises and their sustainable development and therefore require additional research. Thus, the purpose of the study is to analyze the approaches to capital formation of Ukrainian utility enterprises, identify their impact on the financial results of entities and formulate recommendations to ensure the efficiency of utility enterprises.

3. DATA AND METHODOLOGY

The methodological basis of our research is comparative analysis, theoretical studies, statistical information, and analytical data prepared by governmental and non-governmental bodies. The desktop study of documents is combined with the processing of empirical data collected by the authors during the analysis of primary data and financial and non-financial reporting of the 30 utilities from 11 regional centers of Ukraine. Utility enterprises were selected for analysis from all the geographical areas covering regions with different economic, demographic, climatic and administrative conditions, which are essential for providing utility services. The data, including financial statements for 2017-2019 years, have been obtained from open sources, as well as by sending written requests to enterprises. Financial statement analysis was applied to 30 municipal utility enterprises with emphasis on the capital formation ratios.

The paper aims to analyze the approaches to capital formation of Ukrainian utility enterprises, identify their impact on the financial results of entities and formulate recommendations to ensure the efficiency of utility enterprises.

4. RESULTS AND DISCUSSIONS

Ukrainian utility enterprises are the largest in terms of assets and equity volume compared to other local-owned enterprises in the same municipality. Because of providing vital resources and services, these enterprises are essential for social protection and safety, so the cost of services is critical to the population, and price changes can profoundly affect social sentiment. Moreover, these enterprises have the following features common to all regions:

– a significant part of enterprises belongs to natural monopolies (energy supply, water supply and sewerage, public transport (subway, trolleybuses, and trams)). In Ukraine, an electricity supply is also a monopolized industry concentrated in private ownership. The rest of the infrastructure enterprises are municipal-owned and are managed by the executive committees of the city or regional councils;



- technically obsolete and worn-out networks prevail, which affects the extremely high loss of resources in the process of their supply to the consumer (so-called losses in networks);
- regulation of tariffs, the mechanism of calculation and approval of which is inefficient and often non-transparent, has corruption features;
- inefficient management, along with other features, leads to unprofitable enterprises financed from local budgets and affects the cost and quality of services provided;
- in order to ensure utility enterprises' ability to continue as a going concern their losses are actually covered at the community's expense, which is directly contrary to current legislation. However, it is executed in a way that is not prohibited (an increase of share capital, financing the acquisition of fixed assets or other assets, compensation the difference in tariffs, etc.);
- peculiarities of financing and election of heads of utility enterprises often provoke political interference and involvement, which leads to a low professional level of appointed managers and general inefficiency of the enterprise;
- lack of effective levers of influence and the ability to control utility enterprises' activities by the community.

These peculiarities affect the method of capital formation of utility enterprises and some financial ratios. In previous research (BAGATSKA, 2020), financial statements of the 206 municipal enterprises were analyzed and revealed extremely low profitability (almost 50% of enterprises got losses during several years until 2017). The low profitability of Ukrainian municipal enterprises is proved in the Mykhailyshyna's study (2019), where the author investigated the ROE of 5,244 municipal enterprises and detected the lowest value of this indicator compared to the state-owned and private enterprises. Study of Yakimova and Kuz (2019) also proved the financial unhealthy of most Ukrainian water and energy utilities.

Low margin leads to the lack of capitalized income, which causes the significant differences in the capital formation and equity structure of municipal enterprises compared with the private and public joint stock companies: substantive permanent predominance of invested capital over accumulated capital; low level of using debt financing, large amount of uncovered losses. As the invested capital of municipal enterprises is replenished from the local budget, the problem of the disproportion of capital formation and expenditure is a subject of

external stakeholders' interest, primarily the community's population due to taxes of which the local budget is formed.

We investigated the reasons for this disproportion on a sample of the 30 largest and most meaningful utility enterprises for community: water supply and sewerage, heat supply and urban passenger transport enterprises. The choice of such enterprises is due to the fact that they all belong to the critical infrastructure, they also have similar features of functioning and formation of their capital in all regions of Ukraine. It should be noted that although electricity and natural gas supply companies belong to the critical infrastructure, they are not municipal-owned. Enterprises that provide waste disposal services in Ukraine are small enterprises with insignificant budgetary investments; in addition, in many regions they are often private entities or companies in a concession. Therefore, such enterprises were not included in the sample for research aims.

As the purpose of our research concerns capital formation, in this paper, we did not consider the problem of capital expenditures and utilization, so such ratio groups as liquidity and turnover ratios are not included in the desktop analysis. However, according to the previous study (Bagatska, 2020), most of the municipal enterprises of Ukraine have satisfactory liquidity performance, and their turnovers ratios vary depending on the sphere of activity (from extremely low by the housing companies to high by the municipal farmer markets, tourism and advertising agencies).

Two capital structure ratios and ROA (Return on Assets) were chosen for analysis: Equity to Assets and Debt to Assets. It should be noted that Debt to Equity ratio and ROE (Return on Equity) are not appropriate for the sample because 20% of surveyed enterprises have negative equity volume. To highlight the peculiar properties of equity formation, two ratios are proposed: Retained Earnings (Losses) to Assets and a ratio that represents the quota of Cumulative invested capital from the local budget to Assets. Cumulative invested capital includes registered capital, additional capital, and special-purpose financing. The average values of report items for three years were used to calculate ratios.

It should be added that during the last three years (2017-2019), all the companies from the sample received significant investments in equity (registered capital or additional capital). Twenty-three enterprises (77%) have negative ROA, though only thirteen enterprises (43%) got losses during the period of analysis. Five enterprises achieved profitability in 2019, but the profits were not enough to get a positive average result. Only four companies (13%) had

retained earnings during the last three years. Results of empirical analysis summarized in the Table 1.

As for the first ratio – Equity to Assets, significant predominance of the equity is not observed. 43% of enterprises have more than 50% of equity in total capital, and 20% have less assets than liabilities. Under market conditions, these enterprises would already be under the threat of bankruptcy and might not be able to continue as a going concern.

The median value of the Equity to Assets ratio is 43,09% (including enterprises with negative equity). However, this does not mean that enterprises from the sample are highly leveraged: 50% of enterprises did not use debts as the source of financing or used them less than 5% in total capital on average. The median of the Debt to Asset ratio is 3,06% for the sample, and the median for those enterprises that use debts more than 5% in total capital is 22,5%. Such relations confirm some atypical capital structure compared to the private sector and contradict the bankruptcy legislation requirements.

Regarding the overall capital efficiency, the sample data confirm the conclusions made by Mykhailyshyna (2019) about the lowest return on capital of utility enterprises. Only 23% (7 enterprises) were profitable in average for three years.

The median ROA for profitable companies is 1,9%; the median ROA for unprofitable enterprises is -7,5%. Low and negative profitability values lead to capital losses for the enterprises, which negatively affects operating activities and investment opportunities.

Table 1: Capital formation analysis of the Ukrainian municipal utility enterprises, %

Ratios	Equity to Assets	Debt to Assets	Capital invested by the local government to total Assets	Retained Earnings (Losses) to total Assets	Return on Assets
Cities					
Water supply and sewerage enterprises					
Zaporizhzhia	87.0	0	86.3	16.0	0.3
Odesa	38.1	0	33.2	5.0	15.9
Sumy	48.8	0.6	80.6	-31.7	-1.5
Lutsk	62.4	5.0	95.1	54.1	-1.2
Chernihiv	-19.8	94.4	53.7	-73.4	12.0
Vinnitsia	52.7	6.1	60.8	-8.0	-3.2
Ivano-Frankivsk	21.3	63.0	71.6	-68.6	0.1
Kropyvnytskyi	37.4	24.0	51.8	-13.0	-5.0
Zhytomir	43.4	23.7	107.5	-44.0	-0.3
Chernivtsi	77.9	0	138.8	-60.9	-13.3
Urban passenger transport enterprises					
Zaporizhzhia	42.8	0	108.6	-29.6	-12.6
Odesa	24.4	30.1	20.7	7.2	1.9
Sumy	96.5	0	139.1	-31.7	-7.5
Lutsk	-95.6	33.6	403.0	-489.5	-8.0
Chernihiv	93.8	0	119.8	-26.0	-2.8

Vinnytsia	77.1	1.1	109.1	-32.0	-7.5
Ivano-Frankivsk	59.5	32.2	108.6	-16.4	-6.7
Kropyvnytskyi	86.8	0	84.0	2.8	1.1
Rivne	94.3	0	123.6	-26.1	-6.2
Zhytomir	79.8	0	308.3	-44.0	-28.7
Chernivtsi	89.1	17.3	167.0	-44.3	-8.1
Heat supply enterprises					
Zaporizhzhia	17.4	0.1	20.4	-35.7	5.3
Odesa	-43.3	9.2	16.6	-59.9	-20.0
Sumy	38.4	5.7	32.1	7.3	-0.2
Lutsk	-10.6	22.5	31.0	-35.7	-6.1
Vinnytsia	62.0	0.9	138.0	-32.7	-8.3
Ivano-Frankivsk	-11.7	20.8	51.6	-92.7	-10.7
Kropyvnytskyi	-66.2	0	8.2	-74.4	-13.5
Zhytomir	14.1	10.4	77.7	-51.4	-0.4
Chernivtsi	8.9	0.9	96.8	-62.4	-23.8
Median	43.09	3.06	85.15	-32.36	-5.53

Source: calculated by the authors based on the enterprises' financial statements

Thus, the ratio of Retained Earnings (Losses) to Assets (Figure 1) shows that only 23% of the sampled enterprises capitalized their value through operating results. The rest of the enterprises disrupted invested capital. The median value of this ratio is negative (-32,36%).

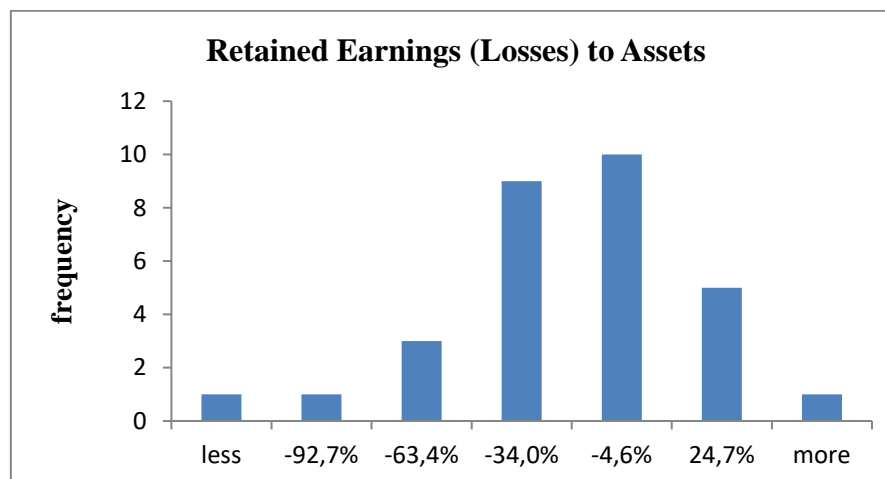


Figure 1: Retained Earnings (Losses) to Assets distribution
 Source: calculated by the authors based on the enterprises' financial statements

57% enterprises from the sample have more than 80% average volume of invested capital in total assets used to cover negative operating results. At 40% of enterprises the amount of investments in registered and additional capital exceeds the total balance value. This median ratio is 85,15%. It should be added that all examined enterprises received investments in registered or additional capital in 2017-2019 years from the municipal budget.

Thereby, the vast majority of examined enterprises decapitalized their value and accumulated large losses. Moreover, these losses were covered from the municipal budget

through investments in registered and additional capital, as evidenced by the latter ratio (Fig. 2).

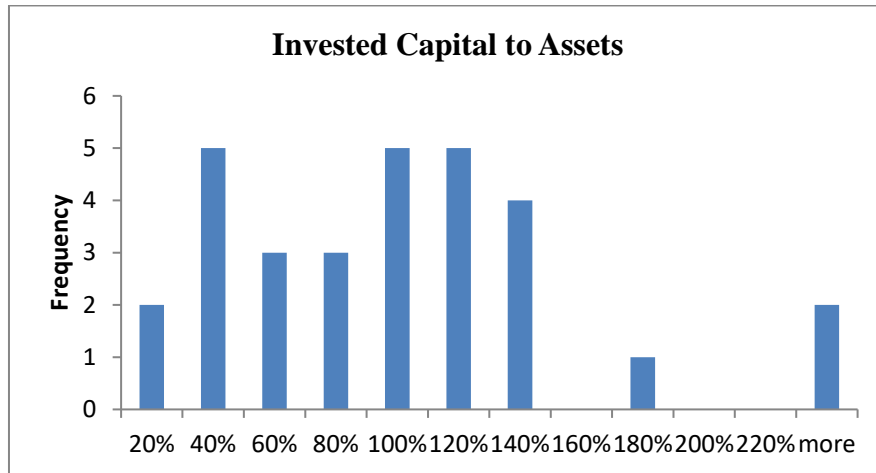


Figure 2: Invested Capital to Assets distribution
 Source: calculated by the authors based on the enterprises' financial statements

Consequently, calculations of the five ratios allow us to get empirical evidence of the municipal utility enterprises' inefficient capital formation. Constant replenishment of equity from the municipal budget does not increase the efficiency of enterprises, which are unprofitable in 77% of cases. The critically low level of using debts makes it impossible to diversify the sources of financing of the municipal utility enterprises. This method of financing enterprises contradicts the theory of company efficiency and does not fit any theory of capital structure.

Ukrainian joint-stock companies publish information about the correspondence between registered and total equity capital in the yearly public reports. They are given one year to rectify the situation if equity is less than registered capital. We cannot demand compliance with this ratio for utility enterprises due to the high risks of violating the principle of going concern. However, it is advisable to propose separate disclosure of information about the correspondence of registered capital to equity, for example, in management reports on utility enterprises' performance.

Thus, study results indicate that the problem of the utility enterprises capital formation has a long-term nature, is currently unresolved, and is transferred from one municipality to another. The lack of a strategy for capital formation and utilization leads to significant budget resources overspending. As emphasized in studies by Mykhailyshyna (2019) and Tarasiuk and Liskova (2019), the problems of Ukrainian utility enterprises over time only exacerbate and not only pose an economic threat, but also can provoke related social and environmental

problems such as a climb in debt of recipients of housing and utility services; loss of access to services due to disconnection for non-payment; inability to comply with the requirements for pollutant emissions as a result of income shortfall by service providers and lack of funding for relevant programs, including energy conservation.

The importance of strategy formation as a basis for continuity in utility management is also highlighted by Sandoval-Minero (2019), who emphasized that budget subsidies provision without commitment to improving efficiency prompt utility enterprises to ignore administrative and financial expertise they would if they were competing for funding on capital markets.

With regard to operating income, municipal councils usually approve rates, usually without linking the income plan to the investment program. The Mexican experience proves that the possibility of obtaining budget resources in the absence of clear distribution criteria salvages potential bankrupts and causes shortcomings in the administration, operation, and assets management of municipal enterprises. As a result, the quality of services is deteriorating and infrastructure is becoming inadequate and outdated.

In Ukraine, utility tariffs are set by the state regulatory body – National Energy and Utilities Regulatory Commission (NEURC) on the base of the investment programs approved by the local authorities except for urban passenger transport enterprises, tariffs of which are directly set by the local authorities. The majority of the investment programs are not published, and even in the programs available for review, tariffs calculation approach are not explained. It should be emphasized that despite the legislation requirements to publish financial statements and other information, many utility enterprises often violate the terms of promulgation or even do not comply with the law, as confirmed in the paper (Gurt Resource Centre, 2019). For our sample, at least 20% of enterprises' financial reports were obtained through the direct request. Thus, information that should be public becomes challenging to access for stakeholders. This situation violates transparency, which is a fundamental principle for developing effective communication with service consumers based on trust. The lack of utility enterprises' transparency causes a deficiency of stakeholders' concern and provides opportunities for enterprises' malversation, which leads to inefficient formation and utilization of public resources. According to Ostrom (2009), the effectiveness of municipal (communal) property is only possible under transparent and confident communication with stakeholders – residents of the community who are service consumers.

Unfortunately, the analysis of the financial statements and managers' reports published on the official websites of utility enterprises and local councils revealed the low quality of the disclosed information, its incompleteness, and management's formal approach to its preparation. The lack of real managers' responsibility for non-disclosure or disclosure of incomplete and inaccurate information devalues data placement in the public domain, aiming to provide truthful information to the public and build trust in the state's actions. Instead, the real levers of public influence on the management of communal property are lost, and citizens are removed from making important decisions, including in the housing and utilities sector.

The solution to this problem may be to conduct audits of the financial statements of utility enterprises since audit is an effective tool to increase confidence in disclosed information. Currently, the Commercial Code of Ukraine (2003) stipulates that local councils can require a statutory audit of the financial statements of a utility enterprise, and they have the right to determine the criteria for selecting an auditor. Nevertheless, this legislation has not become widespread. The main reason for refusing to conduct an audit is called the lack of funds to purchase audit services. However, such a position clearly contradicts the community interests, which, based on the results of an independent audit, can obtain not only confirmation (or refutation) of the financial statements reliability, but also an objective assessment of the effectiveness of the utility enterprise management. In addition, the application of management audits proposed by Junevicius et al. (2017), as well as performance audits, including the efficiency of capital formation of utility enterprises, can be actual.

5. CONCLUSIONS AND RECOMMENDATIONS

Based on the study of scientific publications and analysis of empirical data, the authors came to the following conclusions and suggestions:

- 1) We consider that the widespread privatization of municipal (communal) enterprises is inexpedient, given their social role and importance for the functioning of the municipality. Furthermore, it is necessary to consider the potential for improving the efficiency of such enterprises in the long term.
- 2) To increase the efficiency of capital formation of utility enterprises, it is necessary to ensure transparency of information about the applied approaches and their effectiveness.

The solution can be additional disclosures in the notes to the financial statements on the amount, sources of replenishment of registered and additional capital (municipal budget



funds, donations, other contributions), and justification for the decision to replenish. Additional information that reveals the correspondence between invested and accumulated capital, as well as their growth rates will allow users to draw a conclusion about the formation of municipal enterprises capital. In our opinion, outpacing the growth rate of accumulated capital over invested capital will indicate capital formation efficiency. Such disclosure allows for the establishment of communication between local authorities, citizens, and municipal-owned enterprises.

- 3) To ensure transparency and accountability of the utility enterprise management, it is crucial to introduce a mandatory KPI, which will provide the correspondence between changes in the enterprise's capital structure and financial results. Directors of utility enterprises should be required (under the terms of the contract) not only to publish their report on the website, but also to conduct a public reporting procedure with open access for community members, answers to the questions, and information on responding to auditors' recommendations. KPIs should include financial indicators such as return on capital invested, increase in profitability, or increase in cost savings. If the enterprises have objective limitations in the ability to generate profit, KPIs should include qualitative indicators (reduction of losses in networks, an increase in quality service, customers' satisfaction, etc.).
- 4) It is also necessary to strengthen the responsibility of the management of utility enterprises for non-disclosure, incomplete and/or untimely disclosure of financial statements and other reports (including management reports) in the public domain, providing for appropriate sanctions and control mechanisms by local councils (for example, by adding to the contract of the director).
- 5) It is essential to start conducting financial and performance audits of the utility enterprises, based on the results of which it is possible to decide on the feasibility of changes in capital, as well as taking other organizational and economic measures to meet the interests of the community.

The implementation of these recommendations, in our opinion, will not only increase the efficiency of capital formation of utility enterprises but also help ensure their stable and efficient development.

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