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From the Scientific Council

Ladies and Gentlemen,

As the new school year started we would like to deliver to you 21st edition of the ‘Journal of Management and Financial Sciences’. As always we are trying to present articles which we hope will present a contribution to the development of economic thought and contribute to a fuller understanding of the complex economic issues.

Albania: Preparing for a Comprehensive Pension Reform is an article prepared by Arben Malaj (Prof. Assoc., Lecturer at University of Tirana), Teuta Baleta (PhD candidate, Advisor, Albanian Financial Supervisory Authority) and Rinald Guri (PhD, Head-Research, IT and Statistics Department, Albanian Financial Supervisory Authority) This paper adds to the existing literature on the pension system in Albania and the challenges it faces. It provides an overview of the Albanian pension system and preconditions to be met for pension reforms, especially in setting up a second pillar pension. The Albanian pension system is distinguished from the systems of other Central and Eastern European (CEE) countries due to an underdeveloped introduction to a multi-pillar pension system to replace the defined benefit (DB), pay-as-you-go (PAYG) system. This paper aims at assessing the preconditions to be met by the authorities in the country to be able to introduce and develop the private and voluntary pension funds, and the current level of fulfilling such preconditions.

Anna Kamańska from the Collegium of Management and Finance, Warsaw School of Economics in her article “The Lifewide Lifelong Learning (LLL) as an Imperative of Business Education. Lesson from Poland as Exemplified by Accounting” advances the thesis that contemporary business activity, including accounting is an excellent example of human professional activity, which on the one hand, in order to be successfully implemented, has to be subordinated to the LLL imperative, and on the other hand, on the basis of the scientific research on education resulting from this imperative, it is a driver for the emerging LLL paradigm which all academics refer to. In view of this, the text presents the macroeconomic conceptual LLL framework, which is important in Poland for the further development of professional business and accounting education. The review of selected facts, institutions and documents connected with it and important for the Polish economy and business education, is aimed at the presentation of the climate and effort accompanying the creation of the LLL systemic solutions. The article elucidates, on the basis of Poland and accounting,
the context important for the determination of the role of professional environment organisations (operating in Poland in the field of accounting) as LLL educators.

The main goal of an article **Taxation of Partnerships Limited by Shares (SKA): Legislative Objectives, Application Issues and Assessment Under the EU Law** by Stephan Kudert (Europa – Universität Viadrina, Frankfurt (Oder)), Marcin Jamroży (Collegium of Management and Finance Warsaw School of Economics) and Agnieszka Kopec (Europa – Universität Viadrina, Frankfurt (Oder)) is to deal with the tax implications of the recent tax law changes in respect to the Polish partnership limited by shares (‘SKA’). Despite a civil legal classification of the SKA as a partnership, the limited partners of SKA are treated similarly to shareholders of a limited liability company. The core of the law amendment was the introduction of taxation on two levels: firstly, the taxation of the income generated by the partnership itself and secondly, the taxation of the dividend paid out to its partners. With respect to the general partners of an SKA, the mechanism of double taxation avoidance was implemented in order to equalize their tax burden with the one borne by partners of other Polish partnerships. However, the application of the new tax provisions shows that this goal cannot always be achieved. The paper aims at a critical analysis of the new tax credit system related to general partners. The study highlights the practical limitations concerning the amended regulations and presents what are the reasons for the ‘defect’ legislation.

**Homo Oeconomicus versus Homo Ethicus** is an article presented by Monika Czerwonka and Paulina Łuba from Collegium of Management and Finance Warsaw School of Economics. The aim of this paper is to show the conflict between a traditional paradigm of homo oeconomicus and a new approach to finance – homo ethicus. The authors present the concept of rationality in economics, then show the important place of ethics in finance and in the ongoing financial crisis. Finally, the authors give some examples of homo ethicus in praxis by explaining the ethical theory of investment and the motives for ethical investing.

Andrzej Tokarski and Maciej Tokarski from Torun School of Banking in their article **“Barriers and Benefits of Financing Projects with European Funds by Micro, Small and Medium-Sized Enterprises (MSMEs) in Poland”** present the benefits and barriers of projects financing with the means of the European funds by MSMEs. The analysis was based upon the statistics data published in Poland by the Ministry of Infrastructure and Development, Eurostat and the European Commission. The analysis of the sources on the subject as well as observations of the business practices allowed for the formation of a thesis that Poland competently utilised the European funds between 2007–2013 and thereby benefited considerably.
From the scientific council

Maria Aluchna from the Collegium of Management and Finance, Warsaw School of Economics in her article “Corporate Governance Versus Ethics. The Case of Goldman Sachs” presents the case study of Goldman Sachs, one of the most successful and respected investment banks. It focuses on Goldman Sachs’ ethically questionable operations that are believed to be related to the outbreak of the credit crunch and severe problems in the euro zone due to the Greek sovereign debt. The originality of the paper is to be seen in several dimensions. It searches for mutual links between corporate governance and ethics emphasizing that the divergence from ethical values and the narrow focus on short term profitability affects the essence of the fundamental principles of corporate governance.

Measurement of Human Capital from the Perspective of Intellectual Capital is an article presented by Piotr Wachowiak, Agnieszka Sopińska, Wioletta Jakubowska from Warsaw School of Economics, Warsaw, Poland. The authors of the study find that, due to the complex nature of the human capital phenomenon, it is not possible to provide a method based on one index. They propose a multi-index, authors’ model for the analysis of human capital from several perspectives simultaneously: the perspective of costs; the perspective of time and quantity; the perspective of effectiveness; financial perspective and quality perspective. In total there are 28 indices, operationalised in detail, calculated in an annual perspective for the management staff and for the executive employees. Due to the simplicity of measures in the developed method, it can be applied by all enterprises, irrespective of their size.

We wish you pleasant reading.

Ryszard Bartkowiak,
Chairman of the Scientific Council and Dean of the Faculty

Piotr Wachowiak,
Vice-Chairman of the Scientific Council and Vice-Dean of the Faculty
Albania: Preparing for a Comprehensive Pension Reform

Abstract

This paper adds to the existing literature on the pension system in Albania and the challenges it faces. It provides an overview of the Albanian pension system and preconditions to be met for pension reforms, especially in setting up a second pillar pension. The Albanian pension system is distinguished from the systems of other Central and Eastern European (CEE) countries due to an underdeveloped introduction to a multi-pillar pension system to replace the defined benefit (DB), pay-as-you-go (PAYG) system. The political consensus to reform the pension system has been difficult to achieve. In addition, for years the authorities have been rather reluctant to provide incentives to support the emergence of a private pension system. With the extreme difficulties faced by the first pension pillar, Albania is on the brink of making major decisions with regard to fostering the development of its pension system. This paper aims at assessing the preconditions to be met by the authorities in the country to be able to introduce and develop the private and voluntary pension funds, and the current level of fulfilling such preconditions.

Keywords: Pension system, Pension pillars, Reform, Risks, Supervision

1 The following paper represents the point of view of the authors only and not that of the institution where they are employed.
1. Overview of the Albanian Pension System

Albania has a young population compared to other European countries, but with relatively high aging dynamics. As of 2014, the younger population aged 0–14 constitutes 18.9%, whereas at the age of 65+ constitutes 12.2% of the overall population. The portion of the young population is decreasing, whereas the portion occupied by the older population is increasing. The main factors for this phenomenon are, among others, the low birth rate and the increase in longevity. As of 2001 the younger population constituted 29.3% of the overall population, being 10% higher than in 2014. The opposite is observed with the older population, constituting 7.6% of the overall population in 2001, or 5% less compared to 20142.

The last two decades of emigration have also contributed to a fall in the working age population. Referring to the census of 2011 there has been an 8% fall in the overall population since 2001, from 3.1 million to 2.8 million inhabitants. The average age is 35.3, showing the aging dynamics whereas according to the 2001 census the average age was 30.6 and only 7.54% of the population was over the age of 653. By 2050, the share of the population over the age of 65 is forecasted to reach 25%, which is above the expected regional average of 23%. The dependency ratio (the population aged 65+ compared to the working age population), which is affected adversely by low birth rates and improved longevity, in 2014 was 17.8%, as opposed to 12% in 20014.

Official unemployment in 2014 was 17.5%, while the unemployment rate of the population aged 30–64 was 13%, and for the younger population aged between 15 and 29 it was quite high, close to 33%. The agricultural sector employs over 42.7% of the working force5, yet it consists of only 19.5% of the total contributors in the compulsory social insurance scheme, or 12.7% of the total income from direct contributions6.

There is also a considerable informal labour market that poses a huge challenge to the reformation of the system. Alongside these facts, as stated in the recent FSAP7, the system suffers collection issues, due to the weak incentives to contribute and the poor data collection.

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5 Ibidem.
The pension system in Albania consists primarily of the public PAYG system and the voluntary private pensions, i.e. the third pillar pensions, as defined in the World Bank terminology. There is no second pillar in place yet.

The compulsory social insurance system operates on a PAYG basis and is financed through direct employees and employers’ contributions, transfers from the state budget, incomes earned from investment of the reserve fund and other sources. The system covers both employed and self-employed workers. The Government contributes on the behalf of unemployed persons, for persons in compulsory military services and also for certain categories of persons, entitled to receive special state pensions (e.g.: persons with constitutional functions and civil servants of the central budgetary institutions).

Regarding the contribution structure for pensions (old-age, disability and survivors), employees contribute 9.5% of the covered monthly earnings, and the employers contribute 15% of the covered monthly payroll; whereas the self-employed contribute 23% of the monthly minimum wage. At the end of 2014, the minimum earnings used to calculate the contributions is the floor monthly minimum wage applicable throughout the country which stands at EUR 1578.

Full retirement benefits are paid on reaching the legal retirement age of 65 for men and 60 for women with at least 35 years of contributions. A partial pension can be paid from the legal retirement age with 15 years of contributions. Early pension is paid at the age of 62 (for men) or age 57 (for women) with at least 35 years of contributions. In the case of early retirement, the amount of the pension is reduced by 0.6% for each month paid before reaching the normal retirement age9.

With the recent legal changes, effective as of January 2015, the legal retirement age was increased to 67 for both men and women, with full effect by 205610. Instead a social pension will be offered to persons with less than 15 years of working history. Also, there is no longer a difference in pension benefits for urban and rural areas.

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9 IOPS: Country profile, Albania; Report issued on February 2013.
10 Compared with some countries in the Central, Eastern, and Southeastern European countries, clearly Albania has adopted stringent measures to improve pillar one performance. For example the retirement age in Slovenia has been increased to 65 years for both, men and women, or with a 40 years contribution if the individual is at least at the age of 60; in Croatia the retirement age is set at 67 years old, or if the individual has 41 years of service to qualify for a full pension; in Serbia the retirement age is lower at 64 and 59 for men and women respectively; while Hungary the standard retirement age for both men and women is 62 years and six months. (http://www.eurofound.europa.eu/observatories/eurwork/articles/other-industrial-relations/retirement-age-increase-as-reforms-take-effect; www.croatiaweek.com/croatia-to-up-retirement-age-to-67/; http://www.oecd.org/els/public-pensions/PAG2013-profile-Hungary.pdf; https://www.google.com/search?q=retirement+age+in+Serbia&ie=utf-8&oe=utf-8&q=t&rls=org.mozilla:en-US:official&client=firefox-a). For more information see http://info.worldbank.org/etools/docs/library/238283/wbialbania.pdf
At the end of 2014, the minimum monthly pension for urban insured persons (employed, self-employed, employer) amounted to EUR 85.9, and the maximum monthly pension was EUR 171.8; while for rural insured persons (self-employed) amounted to EUR 58.8, and the maximum monthly pension was EUR 85.9\textsuperscript{11}. Pursuant to the new law on the social insurance scheme, effective as of January 2015, there will be no more minimum or maximum pension\textsuperscript{12}.

In essence the compulsory system is composed mainly of four elements:

1. **The compulsory social insurance scheme**, which is administered by the Social Insurance Institute, and covers state and private employees, as well as the self-employed in urban and rural areas, with the condition that they contribute to the scheme.

2. A **voluntary scheme**, within the PAYG, that includes those who are no longer insured, but have been and are willing to continue participating in the scheme, groups that are not covered by the law, including university students.

3. A **supplementary scheme** for high-ranking constitutional functions, civil service, army and police officials, as well as intelligence services. Supplementary pensions are financed by the state budget.

4. So-called **special pensions**, for war veterans, awarded personalities in the area of culture, art, economy, politics as well as people persecuted by the communist regime. This segment is also financed by the state budget.

The compulsory system offers three types of payout: the pension upon retirement, invalidity and family pension. The invalidity pension is calculated based on the same rules as the retirement pension, but it may be full or in part, given the health condition, or the fulfilment of the minimum insurance period. The same applies to the family pension, which can be paid in full or in part, taking into consideration the family members. The social insurance law also provides for the protection of the employees in the case of disease, unemployment, accidents at work and birth.

There is no second pillar in place, but the law with regards to voluntary pension funds reformed the existing voluntary private pension institutes that were providers of private pensions, by creating an EU compliant law for voluntary private pensions, the so called third pillar. Despite continuous efforts and the drafting of strategies, such as the one drafted with the World Bank’s assistance in 2007, the political consensus for this reform seems to be lacking at least for the near future. Even the latest


first pillar pension reform was not widely supported politically, and was approved by majority vote only.

The voluntary private pension market in Albania is an underdeveloped segment of the financial market. Despite the year-after-year growth dynamics, there are only three pension funds on the market, managed by three pension management companies, with a combined EUR 4.5 million of Net Asset Value, representing a 29% annual increase. The three pension funds have 8,491 members as of 31.12.2014, or 7.7% more than a year ago\(^\text{13}\), representing 0.68% of the work force. The current pension funds operate based on Law no. 10197, as of 10.12.2009 on Voluntary Pensions. The law is harmonized with the EU directives, providing for a pure defined contribution system, which permits licensed pension management companies to operate voluntary pension funds subject to approval by the Albanian Financial Supervisory Authority and conditions specified in the 2009 Law.

It also allows employers to establish an occupational pension plan with its employees so long as there is a contract with a licensed pension management company to administer an occupational pension fund for the plan, with the same conditions applying for both, occupational and voluntary pension fund. In the case of occupational voluntary pension arrangements, both open and closed pension funds exist.

Each member owns units equivalent to the contributions paid in for him/her plus an equitable share of investment returns less fees paid. The total value of units must equal the total value of assets and hence the funds are ‘pure’ defined contribution (DC), that is, without any guarantee relating to performance or payout. This system replaced a previous private pension system operated by pension institutes, the funds in which have been transformed into the new system.

The 2009 Law incentivizes membership of a voluntary or occupational pension fund by providing tax relief on contributions up to a specified level as well as tax relief on investment earnings, but not pay-out, a so called EET (exemption-exemption-taxation) system. Despite that, these incentives for many years were not fully harmonized in the tax legislation, providing in practice lower thresholds and also requiring that contributions were taxed at source with each individual re-claiming their own tax, which in practice does not work well and has become a complex issue. This has removed the incentive for individual investors, distorted the mechanics of the system, and has put pension funds at a serious disadvantage to be seen as an investment for retirement. Tax incentives are very important to incentivize participation in these voluntary schemes. In 2014, private pension assets constitute only

0.05% of GDP and 0.04% of the financial sector assets in the country. These issues have also been identified by the FSAP in 2013 and were mostly undertaken with the tax legislation amendment effective in 2015.

There could be a number of factors that hinders the development of the voluntary private pensions, with some of them listed below:

- A relatively high level of informal economy that takes away the incentives of individuals and businesses to participate in the scheme;
- The inadequate tax incentives as elaborated above;
- The ongoing problems in the compulsory system i.e. PAYG, have undermined the public confidence in pensions overall;
- The relatively low level of income of the population. In 2012 the GDP per capita is estimated at EUR 3,276\(^{14}\) (and only EUR 3,330 in 2013), with the national poverty rate\(^{15}\) at 14.3%, from 12.4% in 2008, while inequality in income distribution stands at 0.29 in 2012\(^{16}\), with income share at 40% held by the highest 20% and income share at 8% held by the lowest 20%;
- Limited investment alternatives in the country, which yield returns slightly higher to bank deposits and treasury bills. For an approximate comparison we refer to the policy rate, which currently stands at 2.0%, T-bill yields at 2.9% and 3.39% respectively for 3 and 12 months of maturity, T-Bond fixed coupon rate at 4.72% of 2-years maturity\(^{17}\), at 5.7% of 3-years maturity, and variable coupon rate at 5.45% of 5-years maturity\(^{18}\), while average interest rate on time deposits stand at 0.72%, 1.46%, and 2.22 respectively for 3-, 12-, and 24-months maturity\(^{19}\);
- Low public awareness and financial education, which makes it difficult for the pension funds to obtain general acceptance as an investment for retirement;
- A weak, almost non-existent, union system in Albania, which cannot exert any pressure at all on employers to be more active in such schemes.

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\(^{15}\) The World Bank estimation, poverty headcount ratio at the national poverty line (% of population) http://data.worldbank.org/country/albania (2.06. 2014).


\(^{17}\) Bank of Albania http://www.bankofalbania.org/web/Interest_rates_11_2.php?kc=0,2,3,0,0, the most recent data published as of June, 2015 for T-Bills, T-Bonds, and policy rate, http://www.bankofalbania.org/web/Statistika_230_1.php?evn=agregate_detaje&evb=agregate&cregtab_id=130&periudha_id=1 as of April 2014 for deposit interest. All figures refer to Albanian currency (lek).


\(^{19}\) Bank of Albania, http://www.bankofalbania.org/web/Raporti_Statistikor_mars_15_7261_1.php?kc=0,3,6,0,0.
2. The Need for Reformation – Better Late Than Never

Based on the international experience and the analysis of the current situation of the pension system, as well as the risks it represents, a pension reform and the development of the alternative pension schemes became imminent. The state pension system (the first pillar) is considered unsustainable, due to a number of factors such as the speedy growth of pension benefits, the low number of contributors, informality, demographic changes, and early retirement phenomena observed in the early nineties, high unemployment, high migration rates, etc. In addition, the current deficit of around EUR 335 million\textsuperscript{20} places a large question mark on the financial viability of the scheme, unless urgent measures and reforms are undertaken. Under these circumstances the first pillar reform was urgent and a necessary precondition, before thinking of a second pillar introduction. The Government undertook a major reforming effort of the first pillar in 2014, effective as of January 2015.

Creating the necessary foundations for a robust and diversified pension system is a huge challenge for Albania, and should aim at (i) constructing the second pillar (ii) reviving the third pillar and making it more attractive for people to join. At the same time (iii) the development of the capital market, and (iv) ensuring the real independence and resourcing of the Albanian FSA are extremely crucial contributors to the long term sustainability and stability of the system.

The reforming of the pension system will be heavily reliant on certain preconditions that support the process, which primarily deal with consequent and a strong commitment at the political level to conduct such a reform, including also fiscal commitments and having, at the least, in place a basic financial infrastructure.

3. Necessary Preconditions – Do They Help?

Any country reforming its pension system, including the establishment of a second pillar, needs to consider the enabling conditions, which are the most important and have to be in place in the early stages of the reform. Such enabling conditions are divided into three basic sets of factors: (i) macroeconomic stability; (ii) a sound financial infrastructure; (iii) adequate supervisory and regulatory capacity. Obviously, there is a need to have a good understanding of the preconditions to be met, before launching a reform, to be able to improve its prospects. Yet on top of such factors,

\textsuperscript{20} Ministry of Finance, Consolidated budget 2014.
an important condition for a successful reform remains a **reliable and sustainable commitment by the authorities toward the reform**, which is considered an imperative given the length of the time span needed for the reform and its long-term effects.

**Referring to the case of Albania such preconditions are assessed to have a mixed impact in supporting the reform and in particular in establishing the second pillar.** Therefore, taking measures to fulfil such preconditions, especially those considered to be in a weaker position, constitutes, in fact, the action plan to be taken in the context of the reform.

**Sustainable commitment by the authorities.** Before commencing any reform, the first step to take is to reach a broad social and political consensus, to ensure the support for the timely measures to adopt in the context of reform. The consensus can be achieved through, at least:

- Holding extensive discussions with all relevant stakeholders on the concept of the reform and the legislation to be approved thereafter, giving also enough time for such discussions. The last reform of pillar 1 pensions also failed to reach a wide political consensus;
- Adopting the relevant legal framework through reaching a wide consensus among the stakeholders;
- Including in laws and other contractual documents, such provisions and conditions that protect the achieved consensus and prevent the breaking of it in the future.

The importance of meeting such conditions is emphasized even more, taking into consideration some of the experiences in the Central and Eastern European countries, where the authorities’ commitment instability have had reverse effects in the reform for developing the second pillar. The most typical case of the cost of a lack of wide consensus over the pension reforms was noticed in Hungary, the so-called reversal. As is already known, payments to the mandatory funded defined-contribution scheme were suspended, and all contributions were redirected to the public pension scheme, with members of the defined-contribution scheme having to decide by 31 January 2011 whether to remain in the scheme or transfer back to the pay-as-you-go public pension system. Clearly the lack of consensus for pension reforms can induce a reversal process even when the impact is considerable. So, before the reversal approximately more than 70% of the labour force in Hungary participated in the mixed system (until the end of 2010). After the reversal only 102,000, out 3.1 million, scheme members have decided to remain in the defined-contribution scheme\(^{21}\).

**Macroeconomic and fiscal sustainability.** The general economic conditions in Albania over the medium term are not considered as favourable to foster financial

depth in general and in particular to support the expansion of alternative pension schemes. The GDP growth reduced from an average of 6% before 2009, to 3.2% afterwards, to 1.9% in 2014. The inflation rate also reduced over the years, reaching 2.3% (annual rate) at the end of April 2015. Taking into consideration that the central bank mid-target for the inflation rate is 3%, the policy rate rests at a low historical level (at 2%), dragging down other rates in the economy. The low yield environment prevailing for many years does not support the expansion of a private pension market, as it slows the growth and returns of the pension funds. The transition process from the pension system consisting of the first pillar (i.e., PAYG) into the system that includes the second pillar is associated with costs. Such transition costs are to be paid by the state budget, i.e., the taxpayers, regardless of the chosen scheme. Albania is estimated to have a considerably high budget deficit, including grants, of 5.1% of GDP, a public debt level above 69% of GDP, and a current account deficit at roughly 13% of GDP. Almost all macroeconomics indicators deteriorated over the last five years (2010–2014, i.e. after the global financial crisis). Such numbers are considered relatively high, indicating that the fiscal sustainability is not secure. Under these circumstances, the preconditions are considered relatively unfavourable for the introduction of the second pillar, and the Government of Albania cannot rely on the debt financing of the reform. Therefore, in addition to carrying out the parametric reform for the 1st pillar, as an integral part of the pension reform, measures needed to be taken in this regard. They were the following:

- Improving public finances, based on the measures to be taken by the Albanian Government, in cooperation with the IMF;
- Using a mixed scheme for funding the transition costs into the second pillar, including the elements of debt and tax financing, taking advantage of the favourable low market interest rates environment.

Financial infrastructure. The preconditions related to financial infrastructure are two types: those that should be in place at the time of the launching of the reform, and those that should be met during the first five years of the reform implementation.

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24 Bank of Albania, http://www.bankofalbania.org/web/Dokumenti_i_Politikes_Monetare_7190_1.php?kc=0,2,9,0,0
The first type of conditions include, *inter alia*, the existence of a certain legal and institutional framework, or the availability of financial instruments. While the other type of conditions relates to an advanced level of development of the institutional arrangement and availability of the financial instruments. For reform purposes obviously the focus goes to the fulfilment of the first type of conditions.

Meeting the legal framework conditions in Albania is still unsatisfactory, due to the incomplete legislation and inefficient functioning of the judiciary. The basic legal framework in place, in addition to the legislation on commercial companies, banking and securities, should efficiently handle the contractual relations, property and creditors rights, as well as an appropriate regime for seizing collateral and bankruptcy procedures. This framework should be applied and interpreted by an independent judicial system, in an environment with a low level of corruption. The package of measures and reforms undertaken by the government in this area is expected to serve as a contributing factor to meet such conditions. However, the difficulty in elaborating and implementing the judicial reform is a clear signal that some obstacles will remain in place longer than previously thought.

The institutional framework deals with the development of payment systems, securities settlement systems and trading platforms, the existence of custodian and depository institutions, as well as the accounting, auditing and assessment standards. Albania has a relatively sound environment in the payments system. A number of licensed and operating banks are part of the system, which is considered solvent and well managed. Therefore, they can be used reliably by managers to make payments and contributions collected at large as well as small value (retail payments). Currently, the payment system is supported with information technology systems that facilitate the processing and reconciliation of the flow of funds and information. Also, the current practices with private pension funds have proved that the condition for depository and trust institutions is fulfilled. Referring to the securities’ settlement system and trading platforms, the situation appears less favourable, due to the underdevelopment of the capital market in general. With regards to the accounting and auditing standards, the condition is generally met because the legal framework in Albania recognizes the implementation of international standards.

The availability of financial instruments on the market implies the existence of some basic instruments, which serve as underlying assets to create investment portfolios for pension funds. In this regard, the condition is partly met. There are a number of banks in the country offering bank deposit and certificates of deposit products, as well as a number of outstanding government securities. However, investment alternatives remain limited and the secondary market for liquidity and diversification support is underdeveloped.
For this reason, the objectives for the development of alternative pension schemes are seen intertwined with the simultaneous fulfilment of the objectives for the development of the capital market.

It is worth mentioning the fact, that heavy investment of pension funds in government securities is to be avoided, since it will not allow a diversification of the system, but will simply turn it into a PAYG, since basically investing in government securities is the claim against future tax income. On the other hand, it is worth considering investing by all stakeholders in the country and strategic partners in fostering certain strategic sectors with development potential. Such investment, if properly structured through public-private partnerships, can be transformed into financial products, making a direct relation of the members of the pension funds, with the contribution to the economic growth, thus maximizing the return on their investment. In principle, pension funds should be looking for long-term financial instruments, which provide a balance between safety and liquidity premium. The ability of the potential of certain sectors in the country to attract the capital that is willing to be injected into the economy should be analysed in this context.

**Adequate supervisory and regulatory capacity.** Since the start of the reform, the regulatory and supervisory authority of the pension market is required to have sufficient personnel, with appropriate professional qualifications and to enjoy operational independence, as well as financial autonomy to be able to train and strengthen its human resources. Up to now, this condition has also been partially met. The Financial Supervisory Authority (AFSA) of Albania is the sole regulatory and supervisory authority for the pension market in the country. As a result of the emerging and functioning of some third pillar pension funds, the AFSA has strived to develop simultaneously its administrative capacity. In addition, the AFSA has a favourable position, as it supervises and regulates both the insurance and capital markets. Therefore, the experience gained in these markets can be transmitted without additional costs to the formation of a supervisory capacity for the pension market, and the AFSA is able to monitor the interaction of these three markets.

Despite this, the supervisory capacity of the AFSA remains limited, and its further long-term development was put at risk due to the lack of operational and financial independence. To overcome such an issue, the Albanian Government, in the framework of implementing the FSAP recommendations, committed themselves to adopt a legislative package aimed at re-emphasizing the independence of the Authority and establishing mechanisms for its protection. The Parliament of Albania: (i) passed the AFSA law amendments in late May 2014, with an objective to enhance its operational and financial independence; (ii) amended the law on salaries and organizational structure of independent institutions, with an objective
to create conditions for a \textit{de facto} financial independence for the AFSA; and (iii) excluded the AFSA staff from the scope of civil service law, to provide flexibility for the AFSA to attract and retain quality personnel.

With regards to this, the measures expected to be taken are:

- Committing the AFSA to behave as a \textit{de facto} independent regulatory authority;
- Develop a master plan for building and training the AFSA supervisory capacity, focusing on the supervision and regulation of the pension market, in collaboration with the World Bank;
- Streamlining of supervisory instruments, a process which depends on the model that will be selected for the second pillar and the speed with which the independence of the AFSA will consolidate, and become a real independent body.

Generally speaking, the supervisory model for the Authority will follow developments within the supervisory models in various EU countries, which are more and more oriented towards achieving results, managing risks, efficiency and transparency. The fundamental objective of pension funds’ supervision is for the pension funds to be able to meet the commitments or expectations that are communicated to their members, in line with the benefits and the risks to which the funds are exposed. The supervisory philosophy will shift from the control of individual agency risks to systemic financial risk management and portfolio management. Therefore, the first thing to do is to shift from a conventional supervisory approach, dealing with the compliance with tax laws and labour contracts, and using relatively simple methods to limit investment risk, to the risk-based supervision, to ensure a better risk management, inherent in the complex institutions. In addition, adopting a proactive approach for the supervision and regulation of the private pension funds market implies considering other objectives, such as fostering pension market expansion coverage.

**Conclusions**

The Albanian authorities are on the edge of taking fundamental decisions with regards to the pension system. The relatively high aging dynamics observed in the Albanian population, as well as the other management problem faced by the PAYG system, has made it difficult to sustain. Therefore, reforming the Albanian pension system is a challenge to be faced soon. Whether the pension reform will remain focused only on improving the parametric of the first pillar pension (i.e., the existing state PAYG system) or it will encompass the set-up of the second pillar pension, and foster the third pillar pension, remains unclear. The Government of Albania has already adopted the strategy to reform the PAYG system. In the short-term the
adopted fiscal treatment of the contributions to the third pillar pension are broadly attractive, aimed at boosting the private pensions. A step-by-step expansion in voluntary coverage through the route of employers offers considerable advantages. This will use the same route used in numerous countries when first developing their private pension systems. In the long-term the implementation of the capital market development strategy is expected to improve the chances for higher diversification and returns for the individuals participating in the private pension funds. The Albanian authorities are also taking into consideration the construction of the second pillar pension. However, the current status of meeting the enabling the pre-conditions does not support the immediate launch of a mandatory or quasi-mandatory pension system. Therefore, for the mid-term it seems logical to try to improve the environment to meet the pre-conditions needed for a successful second pillar reform. Positive outcomes in reforming the PAYG system and boosting the third pillar will become valuable inputs for the advancement of the second pillar reform. It will show results on the grounds that it will help build the experience, rationale and credibility for bolder steps in the coming years.

References


The Lifewide Lifelong Learning (LLL) as an Imperative of Business Education. Lesson from Poland as Exemplified by Accounting

Abstract

The article advances the thesis that contemporary business activity, including accounting is an excellent example of human professional activity, which on the one hand, in order to be successfully implemented, has to be subordinated to the LLL imperative, and on the other hand, on the basis of the scientific research on education resulting from this imperative, it is a driver for the emerging LLL paradigm which all academics refer to. In view of this, the text presents the macroeconomic conceptual LLL framework, which is important in Poland for the further development of professional business and accounting education. The review of selected facts, institutions and documents connected with it and important for the Polish economy and business education, is aimed at the presentation of the climate and effort accompanying the creation of the LLL systemic solutions. The article elucidates, on the basis of Poland and accounting, the context important for the determination of the role of professional environment organisations (operating in Poland in the field of accounting) as LLL educators.

Keywords: lifewide lifelong learning (LLL), professionalism in accounting, International Education Standards, certification system of accounting in Poland
1. Business and accounting as educational LLL imperative and paradigm

Doing business in the knowledge based economy, whose resources and accessibility are multiplying in a nearly geometric progress, poses a great challenge to business people. It requires professional competence thanks to which the knowledge may not only be selected and adequately used for business purposes but is also able to create its new resources. The problem of professional competence is important not only due to usual commercial purposes of doing business. The problem of professional competence is also essential in the context of business security and its social responsibility which should be present in the trend of sustainable growth. The context of sustainable growth explicitly determines educational tasks within the business sphere. Business requires a permanent updating of knowledge and skills as well as developing an ethical conduct expressing the concern for the environment and people who do not find its consequences indifferent.

Accounting focuses on business activity like a camera lens. This activity is expressed specifically, i.e. by the financial measures of the used assets, the sources of their financing and the achieved results. Accounting is a metalanguage of this activity. It creates specific and important databases which, when used professionally, provide essential knowledge of risks and other aspects of the business conducted. A professional accounting operation, which long ago stopped being a craft and became art, requires special competences whose specificity in comparison with other business jobs is doubtless and whose significance in business must not be questioned1.

Against this background, it is necessary to point to the need for the systemic solutions in the area of education of business aspiring people, which will not only provide the competence allowing for entering the business area (here: accounting) but should also allow for remaining in this business (here: accounting). Virtually, it means the necessity of lifelong learning, or at least for the whole period of professional activity, necessity of permanent updating of professional constantly changing substantive and technical knowledge of accounting as well as developing newer and newer skills (mainly connected with the recognition of risk factors, valuations and financial analyses crucial for business decision making). Under such conditions, only

when following the LLL necessity, can one speak about the desired adequacy of professional competences of the people conducting the accounting activity to meet the requirements of contemporary business. In view of the above, it seems well justified: (1) within the practice of business education – to use the term the LLL imperative, (2) within the science referring to business education – to recognize the research², which will more and more frequently refer to the paradigm of business education, evidently approached by the LLL, a commonly recognized concept of education (scientific achievements), which at present and at a certain time in the future will provide the community of scientists working on the problems of business education with the model problems and solutions³.

### 2. Prospects of Lifelong Learning – Polish Conceptual LLL Framework

„Human competences and qualifications⁴ are a specific kind of capital whose significance grows in the condition global competition. Competences and qualifications have to be constantly mastered in order to let people cope with the changing technologies induced challenges as well as the complexity of economic and social processes. Thus, learning in different forms, places and life-long, aimed at the development of competence and qualifications is becoming a key for a sustainable economic growth and development of civil society⁵. This excerpt of the document Perspektywa uczenia się przez całe życie⁶.

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⁴ Competence means actual knowledge and skills, and the ability to use them in the changing conditions of life. Qualifications are competences appraised and certified by respective institutions.

Prospects of lifelong learning adopted in Poland by the Council of Ministers on 10 September 2013 explicitly expresses the necessity of treating LLL as an important component of Poles’ educational policy. The implementation of the LLL, conducted also by professional organisations such as associations, committees and other initiatives associating professional environmental groups, has a realistic chance of being supported by the state. It may be assumed that thanks to this document, in the Polish practice, the LLL imperative based in a complex way on the legal foundations of the EU recommendations⁶, has acquired a serious position in the development of the Polish educational system.

The idea of Prospects of lifelong learning was born from the work on the National Qualifications Framework (KRK)⁷. The work was preceded (practically in 2006) by a large scale, primarily in the academic environment, information campaign conducted by a group of Bologna experts on the purpose the framework was to serve and why it was important to create it in a systemic way⁸.

There are three stages in the completion of activities for the purpose of preparation and implementation of the National Qualifications Framework⁹. At the first stage (October 2009 – January 2010) expert work was done, within the systemic project Study on the balance and competences available on the labour market in Poland and

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⁶ “In the course of development of the lifewide lifelong learning – LLL in the EU, general principles of the policy were adopted to be applied at different levels of administration in the member countries, i.e. central regional and local, and by different organisers of education (education and trainings) within educational systems and beyond them (organisers of non-formal education). These principles include: the appreciation of learning in different forms and places (lifewide learning); the appreciation of learning at every life stage (lifelong learning); universality – referring the LLL policy to everybody; appraisal and certification of the effects of learning irrespective of where, how and when it took place, the development of partnership in favour of lifelong learning, human centred policy or effective investment in learning.” See: The European Parliament and Council Recommendation, 2008; Perspektywa uczenia się przez całe życie (Prospects of lifelong learning), Annex to the Resolution of the Council of Ministers no. 160/2013 of 10 September 2013, http://www.men.gov.pl/index.php/uczenie-sie-przezcale-zycie/770-perspektywa-uczenia-sie-przez-calle-zycie (14.02.2014), p. 3.

⁷ The Polish Qualifications Framework is a description of eight levels of qualifications registered in the National Register of Lifelong Qualifications. This document coherently presents the educational effects obtained in different areas of education. At every level definite effects of learning are determined as required, i.e. the knowledge, skills and social competence. The persons who will confirm they meet the requirements at a given educational level, having passed a relevant exam, will obtain the qualifications: a diploma or certificate. The educational path (formal: schools, universities and other educational institutions; non-formal: trainings, traineeships and courses or informal: learning on the job, in everyday life, from books, the Internet or friends) as well as methods thanks to which the required competences have been obtained are not significant.

⁸ The author’s own experience and the time perspective allow for the statement that the work done by the Bologna experts in Poland was crucial for the comprehension of the idea on which the further development of the system of tertiary education in Poland was to be based.

the model of national qualifications framework, which was concluded with the study entitled\textsuperscript{10} presenting the model of qualification frameworks and preliminary guidelines for their implementation.

In order to create and implement the National Qualifications Framework on the basis of the Ordinance of Prime Minister of 17 February 2010 the Steering Committee for National Qualifications Framework in LLL (\textit{the second stage}). The task of the Steering Committee was to monitor the process of creation and implementation of the National Qualifications Framework not only with regard to the university education but the whole educational system\textsuperscript{11}. Further work was continued within the project Study on the technical and institutional assumptions about the implementation the National Qualifications Framework for LLL\textsuperscript{12}. They resulted in the Reference Report. Reference of the Polish Qualifications Framework for lifelong learning to the European Qualifications Framework prepared by the Institute for Educational Research\textsuperscript{13}.

In September 2013, the adoption of the document \textit{Perspektywa uczenia się przez całe życie} (Prospects of Lifelong Learning\textsuperscript{14}, began the \textbf{third stage} which focused on the implementation of the National Qualifications Framework and National Qualifications Register for lifelong learning. Many issues are to be dealt with. An integrated qualifications register is necessary as well as the solutions to the examination of qualifications quality and their validation (assessment or quality ”evaluation”). It is recommendable for entities from different sectors to cooperate in order to develop sectoral qualifications frameworks and pilot verifications of adopted solutions. According to the Educational Research Institute this stage will last till the end of June 2015. The work will be done within three new projects\textsuperscript{15}.

\begin{itemize}
\item \textsuperscript{11} An important settlement made by the Steering Committee was the adoption of recommendations with regard to entrusting to the Bureau for Academic Recognition and International Exchange the tasks of the National Focal Point for National Qualifications Framework. See: Tworzenie polskiej ramy kwalifikacji (Creation of the Polish Qualifications Framework), Educational Research Institute, 2011, http://www.refernet.pl/public/publikacje/_17.pdf (14.02.2014), p. 2.
\item \textsuperscript{15} Nowe projekty KRK (New Projects of National Qualifications Register), Educational Research Institute, 2013, http://www.kwalifikacje.edu.pl/pl/o-projekcie (14.02.2014). The conducted projects are: (1) Preparation of technical and institutional assumptions for the implementation of the National Qualifications Framework and National Qualifications Register of LLL, (2) Creation of the national qualifications
\end{itemize}
Prospects of Lifelong Learning is a programme document ensuring the cohesion of projects undertaken in Poland in the LLL area. It creates the holistic framework for different activities in this area\textsuperscript{16} also those activities undertaken by business environments in favour of the development of professions important in business activity, among which many are connected with accounting.

3. **National Professional Qualifications Standards and International Education Standards – Conceptual Framework for the Polish LLL in the Field of Accounting**

As stated in point 1, the tasks assigned to the professional group of accountants are more and more interdisciplinary and complex. In the new conditions, following the spirit of the time in Poland, it is important what is done within the educational activity of the Accountants Association in Poland\textsuperscript{17} and the National Chamber of Statutory Auditors\textsuperscript{18}, on which primarily the attention is focused in the text. These two professional organisations mainly associate the representatives of the Polish professional accounting and finance environments, and outside business universities


\textsuperscript{17} “The Association unites and brings together people involved in accounting or related fields in order to enable them to acquire knowledge and skills and improve the skills necessary to practice the profession in accordance with the law, professional standards, good practice and ethical principles and with due regard for the public interest.” The Association offers the opportunity to continually improve knowledge and become familiar with the latest Polish and international developments. See: \textit{Statutes of the Association of Accountants in Poland}, Association of Accountants in Poland, Warsaw 2009, p. 4. \textit{About AAP}, 2014, http://www.skwp.pl/About,AAP,1291.html (16.02.2014).

\textsuperscript{18} The National Chamber of Statutory Auditors undertakes activities in order to maintain a high professionalism of provided services by statutory auditors and to improve their research skills. According to the world trends, preparing materials important for the creation of professional improvement programmes it strives to systematically update knowledge and raise qualifications of statutory auditors in Poland. \textit{About KIBR}, 2014, http://www.kibr.webserwer.pl/en/index.phtml (16.02.2014).
running numerous postgraduate accounting studies they perform important functions in order to provide professionalism within the LLL. Since 1907 the Accountants Association in Poland (AAP), and since 1992 the National Chamber of Statutory Auditors (KIBR) have been making efforts so that their members could possess qualifications of superior quality and act according to the standards of ethics.

In Poland, substantive LLL programmes are developed in the spirit of the aforementioned Prospects of Lifelong Learning with important 1) official National Professional Qualifications Standards (Krajowe standardy kwalifikacji zawodowych)\(^\text{19}\), and (2) educational standards referred to later.

Professional qualifications (competence) standards\(^\text{20}\):
1) are norms defining the scope and level of the knowledge, skills and psychophysical features which are necessary to perform typical professional tasks according to the requirements of elementary positions or work stations. It is a norm accepted by the representatives of professional and industrial organisations, employers, employees and other key social partners,
2) are presented in the electronic description base\(^\text{21}\), which includes 300 professional competence standards, 253 standards of professional qualifications, 257 module professional training programmes,
3) they also include standards of jobs connected with accounting (e.g. accounting assistant, specialist for accounting or specialist for management accounting),
4) in the sphere of education standards they constitute the basis for the adjustment of programme foundation of professional training and examination requirements standards to the needs of the economy,
5) from the employer’s perspective – the design of work stations, the construction of the appraisal system, the remuneration system or the determination of career paths and personal development may be based on them,
6) they are also in favour of comparability and recognisability of qualifications of employees coming from different countries, they facilitate the confirmation of employees’ qualifications on different labour markets and in different educational systems; thus, they are in favour of professional mobility and professional development.


Offering the LLL accounting programmes, AAP and KIBR – being members of the International Federation of Accountants (IFAC)22 – follow, issued by the International Accounting Education Standards Board (IAESB)23: (1) the International Education

22 IFAC is a global organisation. Its activity, focused on contemporary accounting professionalism, well serves the public interest and international economic development. IFAC has 179 members and associates in 130 countries and jurisdictions, representing more than 2.5 million accountants. About IFAC, 2014, http://www.ifac.org/about-ifac (16.02.2014).

Standards (IESs), created since 2003 and (2) the Framework for International Education Standards for Professional Accountants, published in 2009. So far the IAESB has worked out eight IESs. (Afterwards, in October 2009 IAESB began a process of updating of all IESs. The process is being finished at present). On the global scale, the LLL harmonization with regard to accounting has been enforced by the international significance of knowledge and skills for business. Having this in mind, the IAESB prepares not only the IESs. It also presents guidelines and information materials such as the International Education Guidelines for Professional Accountants (IEGs) and the International Education Papers for Professional Accountants (IEPs). The relation of IESs to other documents and components of the system of LLL determinants in Poland in the area of accounting is presented in Figure 1. They create a model platform for the domestic (here: Polish) programmes of different educational proposals, primarily for professional organisations and other institutions dealing with accounting education. All this points to the significance of professional education and the complexity of related problems.

In 2009 the AAP made a resolution introducing an original system of accountancy certification in Poland. This most important LLL professional educator in Poland (besides academic centres) refers to the International Education Standards issued by IFAC, but the concept of certification is determined within the Polish codification of accounting jobs. Table 1 presents a synthetic characteristics of important IESs.

The educational path set by the Accountants Association in Poland includes four levels of education leading to four degrees of professional qualifications. The synthesis of this concept in presented in Table 2.

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Table 1. *International Education Standards* Within the Initial Professional Development

<table>
<thead>
<tr>
<th>ISE 1: (Entry Requirements to Professional Accounting Education Programs) (updating in progress) – effective as of 1 July 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>IES 2,3,4:</td>
</tr>
<tr>
<td>• jointly determine competence and learning effects describing professional competence required from aspiring professional accountants at the end of initial professional development</td>
</tr>
<tr>
<td>• include descriptions of learning effects of three levels of advancement and in this way help member organisations work out their accounting teaching programmes designed for different accounting positions and specialisations</td>
</tr>
<tr>
<td>Learning effects described by IES 2,3,4 standards concern situations connected with work at the level:</td>
</tr>
<tr>
<td>elementary</td>
</tr>
<tr>
<td>low</td>
</tr>
<tr>
<td>level of ambiguity, complexity and uncertainty; in particular IASs are presented for each of these levels on the list of skills specific to standard related area.</td>
</tr>
<tr>
<td>Professional competence exceeds the rules, standards, concepts, facts and procedures. They join and apply a) technical competence, b) professional skills and c) professional values, ethics and attitudes.</td>
</tr>
<tr>
<td>Technical competence (basic, intermediate and advanced) in:</td>
</tr>
<tr>
<td>financial accounting and reporting</td>
</tr>
<tr>
<td>economics</td>
</tr>
<tr>
<td>management, risk management and internal audit</td>
</tr>
<tr>
<td>business and organisation environment</td>
</tr>
<tr>
<td>Accounting teaching programmes may: (a) contain additional areas of competence, (b) raise the advancement level in certain areas of competence or (c) introduce additional learning effects not determined by this particular IES. It may happen in the case of preparing aspiring accountants for work in a specific industry (for example in the public sector) or for a definite function (for example management accounting specialist).</td>
</tr>
<tr>
<td>ISE 3: Initial Professional Development – <em>Professional Skills</em> (updating in progress) – becomes effective [date to be defined by IAESB]</td>
</tr>
<tr>
<td>Skills:</td>
</tr>
<tr>
<td>intellectual</td>
</tr>
<tr>
<td>The determination of necessary professional skills: protect public interest, raises profession credibility, supports IFAC member organisations and regulatory organisations in providing professional accountants with competences expected by the society, staff and customers.</td>
</tr>
<tr>
<td>ISE 4: Initial Professional Development – <em>Professional Values, Ethics, and Attitudes</em> (updating in progress) – becomes effective [date to be defined by IAESB]</td>
</tr>
<tr>
<td>Competence area:</td>
</tr>
<tr>
<td>professional scepticism and judgement</td>
</tr>
</tbody>
</table>
Professional Values, Ethics, and Attitudes include the involvement of aspiring accountants in: a) maintenance of technical competence, (b) ethical behaviour (e.g. independence, objectivism, confidentiality and honesty), (c) maintenance of professional attitude (due diligence, punctuality, courtesy, respect, responsibility and credibility), (d) striving for perfection (e.g. permanent progress and lifelong learning) and (e) public responsibility (e.g. awareness of public interest).

**ISE 5: Initial Professional Development – **Practical Experience** (updating in progress) – becomes effective on 1 July 2015**

Preferable attitude to practical experience measurement:

| attitude based on results of learning | attitude based on learning input | combination of both the attitudes |

Practical experience creates a professional environment in which aspiring accountants develop their competence through: (a) becoming familiar with the environment in which services are provided, (b) improvement of the knowledge of the organisation, rules of business operation and professional relations, (c) ability to refer accountancy to other business related functions and activities, (d) development of appropriate professional values, ethics and attitudes in practical and real situations (see also ISE 4 Initial Professional Development – Professional Values, Ethics, and Attitudes) and (e) possibility of development at higher band higher levels of responsibility with appropriate levels of supervision.

**ISE 8: Professional Competence of Engaged Partners Responsible for Audits of Financial Statements**
– (estimated completion of upgrading in the 4th quarter of 2014) – becomes effective in July 2016

Technical competence in:

| audit and financial reporting | financial accounting and reporting | management and risk management |
| business environment | taxation | information technologies |
| business law and regulations | finance and finance management |

Skills:

| intellectual | personal | organisational | interpersonal and communicative |

Professional values, ethics and attitudes:

| acting in favour of public interest | professional scepticism | ethical rules |

Competence based on learning effects defined in IESs 2, 3 and 4; however, required from persons responsible for financial reports analysis.

**MSE 6: Initial Professional Development—**Assessment of Professional Competence** (updating in progress)**
– becomes effective on 1 July 2015

Formal assessment of professional competence

| examinations | tests | assessment of competence made by employer at work place | review of set of proofs of completion of ordered professional activities |

Measurement of professional competence obtained in the course of learning and development. It includes the period of learning and development during which aspiring accountants primarily acquire competence allowing them to perform the functions of professional accountants. Learning and development are permanent processes of development and maintenance of professional competence throughout the career of a professional accountant. Therefore, they are continued within continuing professional development. Initial professional development focuses on the acquisition of professional competence, and continuing professional development

### General organisational and programme assumptions in the accountancy certification system in the educational path of the Accountants Association in Poland

<table>
<thead>
<tr>
<th>Level</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. accounting assistant</td>
<td>qualification code 4121102</td>
</tr>
</tbody>
</table>
| Initial requirements | - at least secondary education  
- high ethical values  
- involvement in continuing development and learning throughout the period of accountancy job |
| Knowledge | basic accounting |
| Skills | including among others:  
- collecting documents  
- preparing them for assignment  
- making sheets  
- running registers, using documents and register appliances |
| II. independent accountant | qualification code 3423201 |
| Initial requirements | - at least secondary education and certified knowledge and skills of accounting assistant  
- high ethical values  
- involvement in continuing development and learning throughout the period of accountancy job |
| Knowledge | of accounting and tax, business, labour and civil law |
| Skills | the aforementioned and others, e.g.:  
- source documentation examination  
- settlements analysis and monitoring  
- materials management and fixed assets settlements  
- costs accounts of different cost classification sections calculation of remuneration and related incidence  
- financial report related valuation  
- tax calculation  
- archivisation of accounting bases and documents |
| III. accounting specialist (chief accountant) | qualification code 241205 |
| Initial requirements | - tertiary or secondary education  
- certified knowledge and skills of accounting specialist |
| Knowledge | of accounting and related areas |
| Skills | the aforementioned and others, e.g.:  
- running company accounting  
- projecting related rules: policy and accounts  
- funds rational management  
- management and financial reporting  
- using financial information nin analyses |
| IV. certified accountant | qualification code NO CODE |
| Initial requirements | - tertiary or secondary education eligible for university studies  
- certified knowledge and skills of accounting specialist or  
- passing the test of the requirements for the 3rd level  
- accounting experience (at least 2 years with tertiary education or 5 years with secondary education) |
| Knowledge | of accounting and related areas |
General organisational and programme assumptions in the accountancy certification system in the educational path of the Accountants Association in Poland

<table>
<thead>
<tr>
<th>Skills</th>
<th>the aforementioned and others, e.g.:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>– running and supervising accounting of all types of entities</td>
</tr>
<tr>
<td></td>
<td>– financial reporting of any kind</td>
</tr>
<tr>
<td></td>
<td>– projecting optimal sources of financing and allocation of capital, optimisation of taxes and money flows</td>
</tr>
<tr>
<td></td>
<td>– drawing up expert opinions and economic and financial opinions</td>
</tr>
<tr>
<td></td>
<td>– preparation of complex analyses and budgets</td>
</tr>
<tr>
<td></td>
<td>– running management accounting and controlling</td>
</tr>
<tr>
<td></td>
<td>– applying for project financing or co-developing of capital group strategy</td>
</tr>
<tr>
<td></td>
<td>– cooperation with financial institutions, investors, analysts, investment and tax advisors or statutory auditors</td>
</tr>
</tbody>
</table>


In this context, it is worth mentioning data referring to the implementation of IESs in different countries. In comparison with them, Polish solutions appear original, and the concept of a four-level path of professional accountancy qualifications is unique on the world scale. Thus, Poland at the level of *Initial Professional Development*, like in 2011:

1) recognizes – as initial requirement – tertiary (optionally) or secondary education, (similarly to: Australia, Nicaragua, Trinidad and Tobago and Great Britain, while: (a) only tertiary education is recognized as initial requirement in Brazil, Denmark, France (Bachelor’s degree is not sufficient), Spain, Iceland, Lithuania, Malaysia, Norway, Slovenia, Ukraine and Italy, (b) examinations which make aspiring accountant eligible for qualifications procedure are conducted in India, Ireland, and Japan, (c) Zambia recognizes a professional title obtained abroad, and (d) different requirements are in effect in Finland,

2) there is a joint responsibility of academic centres and professional organisations for the course of education (like in Australia, the Czech Republic, Denmark, Spain, Iceland, India, Ireland, Kenya, Lithuania, Peru, Poland, Slovenia, Slovakia, Trinidad and Tobago, Uganda, Great Britain and Italy), while in Brazil, Fiji,

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Georgia, Japan, Malaysia, Nicaragua, Norway and Russia the responsibility is taken by universities, and in Finland and Ukraine by professional organisations.  

3) there are four levels in the path of professional accountancy qualifications, which is unique on the world scale. (There is one level in Brazil: university degree in accounting is enough, Denmark, Finland, France, Spain, Japan, Lithuania, Malaysia, Norway, Russia, Trinidad and Tobago, Uganda, and Great Britain. There are two levels in the Czech Republic (until 2008 – three levels), Fiji, Ireland, Nicaragua, Peru, Ukraine, Italy and three levels in Austria.

4) professional training is an element which completes the educational process (like in all analysed examples, the minimum period of professional training is 3 years, and difference between countries are reflected in the definition of mentor responsible for the development or possibly an additional period in the case of gap in the educational process).

At the level of Continuing Professional Development, i.e. after obtaining the qualifications of a professional accountant (in the presented system – certified accountant) everybody possessing the certificate is obliged to permanently upgrade the knowledge and maintain the professional skills at a relatively high level. It is described in IES 7 in the way synthetically shown in Table 3.

Table 3. International Education Standards – Continuing Professional Development

<table>
<thead>
<tr>
<th>IES 7</th>
<th>Continuing Professional Development (upgrading in progress) – comes into effect on 1 January 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preferable attitude to measurement effectiveness of continuing professional development:</td>
<td></td>
</tr>
<tr>
<td>attitude based on results of learning</td>
<td>attitude based on learning input</td>
</tr>
<tr>
<td>Continuing professional development is a process of education and development which follows the initial professional development and consists in the development and maintenance of professional competence so that professional accountants could continue to competently perform their roles. Continuing professional development means permanent development of (a) specialist knowledge, (b) professional skills, (c) values, ethics and attitudes as well as (d) competence acquired during this development. It is adjusted to the conducted professional activities and duties of a professional accountant, also when new professional roles, requiring new competences, are to be undertaken.</td>
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</tbody>
</table>

In Poland, certified accountants are obliged to follow the continuing professional development through the AAP’s resolution27. Thus, Poland respects IAS 7, i.e. Con-

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27 A certified accountant who does not do a job connected with accounting is not subject to continuing professional development, but is obliged to submit an appropriate statement to the Accountants Association in Poland. See: Uchwała nr 732/110/2009 Zarządu Głównego Stowarzyszenia Księgowych w Polsce z dnia 20 lipca 2009 r. w sprawie certyfikacji zawodu księgowego (Resolution no. 732/110/2009 of the AAP Board of 20 July 2009 on accountancy certification), in: Informator (Guidebook). Dokumenty
continuing Professional Development. There might be different educators at this level, not only the Accountants Association in Poland; however, they should be authorised by the Board of the Association.

The volume of continuing development training to be done by a certified accountant (in three successive years) amounts to at least 120 hours. "In every year 20 hours of verifiable training is to be passed, i.e. completed with an appropriate certificate stating that the training meets the requirements of continuing professional development. The duty of professional development begins in the calendar year following the year of obtaining the title of Certified Accountant." 29

Interestingly, in the case of a striking breach of the continuing development duty, the system allows for the case to be considered by the AAP arbitration panel. 30

A review of issues related to the system of accountancy certification within the business and accounting LLL trend allows for the formulation of what follows:

First, due to the fact that there is a broad deregulation of business related jobs, the system of continuing accounting development is an important element of providing accountancy staff with high professional competence. For numerous grown-ups active professionally and at the time involved in professional accounting services, this system may be the major source of new knowledge and may allow them to remain in the job which requires a permanent updating.

Second, the synthetically presented material above, the system of documents prepared by international organisations connected with problems of accounting on the global scale, containing patterns of conduct as well as technical and organisational guidelines important for the accounting LLL development in Poland, are professionally used and follow the Polish cultural determinants.

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29 Ibidem, p. 18.


31 Deregulation in accounting has become a fact in view of the Act of 9 May 2014 on easier access to certain regulated jobs (Journal of Laws 2014 item 768). The Act regulates the issue of certificates authorising to commercial bookkeeping. The key question here is the liquidation of the process of issuing an accounting certificate by the Ministry of Finance. After it becomes effective, i.e. 10 August 2014 commercial bookkeeping services may be provided by anybody possessing full ability to perform legal activities and with clear criminal record in relation to a clearly defined catalogue of crimes, i.e. offences against credibility of documents, property, business turnover, securities, treasury offences activities defined in the Act on accounting as well as possessing an TPL insurance policy covering the damage done in relation to the business activity conducted.
Third, in Poland the state of accounting LLL conducted by the key professional organisation – the Accountants Association in Poland positively differs from other important business educational areas and conducted by non-university educators. It may even be said that the system of accounting LLL solutions is well anchored in practice. It is reflected in a rich offer of trainings offered to numerous groups of people interested in accounting by practically all (26) local branches.

Fourth, the least developed component of the certification system in the path proposed by AAP, important from the LLL perspective, is the validation of qualifications acquired within informal education (trainings, traineeships or courses) and non-formal (learning on the job, in everyday life, from books, the Internet or friends). In the AAP presented path only at the fourth level it is possible to pass the test checking the third level requirements without the necessity of submitting a document confirming this level qualification. It means the validation of the competence acquired in the informal/non-formal way, initial for the fourth level of competence may be joined by a person who does not possess official confirmation of professional qualifications corresponding to the earlier level of the AAP certificate. It may be a “swallow” significant for the further development of the validation system of the acquired accounting competence.

Fifth, the validation of competence also in academic centres (even the leading ones in business education) is not well developed yet. The author’s own experience lets her state that to a large extent it is still in the conceptual phase, which seems well justified. It is necessary to carefully analyse the validation criteria and ascribing them to the cycle and field of study. Only in this way can the lack of objectivism and dishonest proceeding threat be avoided.

Sixth, in view of this, the study of the automated validation system of accounting competence, which could be an auxiliary validation tool, may sound a little futuristic, though useful. Formalised, objectivised and operating fast could be used as a kind of preliminary validation. It would not be sufficient in this process as it would not be able to assess a very important issue in accounting: attitudes and behaviour of the person whose competence would be assessed in this way.

Thanks to this system it would be possible to conduct, also by people connected with business and accounting, a self-assessment of possessed competences using the obtained results to create their own educational path. The preparation of such a system of validation may appear to be a task for the future, not really the coming years of work of accounting institutions and educators. Its creation and implementation would involve huge outlays of current work due to the necessity of: (1) monitoring of changes in business and accounting, (2) determining adequate competence changes in accounting, (3) updating the competence requirements already in the
validation system as well as the application of modern technical, communicative and information solutions. Certainly, the idea of an automatic validation system of accounting competence would have to be computer assisted and accessible all over the world. And this means that it would have to become subject to necessary international agreements. Who knows whether or not this idea will be accepted in the future as it is well matched with the IASEB and FASB missions. It may also take the interest of non-academic LLL educators, i.e. professional IFAC member organisations. Paying high membership fees, they may expect further IFAC activities, the idea of an automatic validation system of accounting competence presented here is not only compliant with LLL but also the economy, whose specific feature is innovative ideas and their implementation.

Conclusions

With regard to professionally active people the meeting of the LLL imperative requires: (a) motivation for LLL and (b) the basis on which LLL may be implemented. The motivation for accounting LLL results primarily from the need for professional activity which is preconditioned by professional level of competence. Synthetically, the context of accounting LLL is presented in Table 1. The conditions developed in accounting LLL in Poland (described in point 2) are determined systemically by: (1) Prospect of Lifelong learning (2) National professional qualifications standards and (3) educational standards and paths based on IESs (presented in point 2). The significance of these last ones has been shown in the context of attention paid to professionalism of accounting related jobs considered to be important in the contemporary business.

The article discusses not only related facts and the aforementioned frameworks. It also attempts to convey the climate and effort of numerous groups and organisations which are politically and professionally involved in the process of creation of model essential for the LLL organisation and meeting the challenges of the contemporary world and business, including also accounting. Furthermore, it underlines that the validation of important competences is a difficult problem in the accounting systemic LLL. This issue is complex and may constitute a challenge for those institutions which would try to solve it systemically. The text also presents the outline of the automatic system of accounting competence validation.
References


Taxation of Partnerships Limited by Shares (SKA): Legislative Objectives, Application Issues and Assessment Under the EU Law

Summary

This paper deals with the tax implications of the recent tax law changes in respect to the Polish partnership limited by shares (‘SKA’). Despite a civil legal classification of the SKA as a partnership, the limited partners of SKA are treated similarly to shareholders of a limited liability company. The core of the law amendment was the introduction of taxation on two levels: firstly, the taxation of the income generated by the partnership itself and secondly, the taxation of the dividend paid out to its partners. With respect to the general partners of an SKA, the mechanism of double taxation avoidance was implemented in order to equalize their tax burden with the one borne by partners of other Polish partnerships. However, the application of the new tax provisions shows that this goal cannot always be achieved. The paper aims at a critical analysis of the new tax credit system related to general partners. The study highlights the practical limitations concerning the amended regulations and presents what are the reasons for the ‘defect’ legislation.

Keywords: partnership limited by shares, Polish tax reform, supplementary taxation, tax imputation system, economic double taxation, freedom of establishment
Introduction

The Polish partnership limited by shares (spółka komandytowo-akcyjna, hereinafter referred as 'SKA') which is a partnership under commercial law¹ is a legal entity, which can be described as a hybrid. On the one hand, it has the features that are comparable with a typical Polish joint-stock company (spółka akcyjna). This applies in particular to the position of the limited partners (shareholders). On the other hand, it is characterized by features corresponding to a partnership. This similarity applies in particular to the responsibility and rights of the general partner. Comparable types of partnerships limited by shares can be found in a number of countries, such as the German KGaA (Kommanditgesellschaft auf Aktien) which is legally treated as a corporation, but taxed semi-transparently².

On the 28th of November 2013, the Polish Parliament adopted the amendments to the Corporate Income Tax Act (hereinafter referred to ACIT)³ and Personal Income Tax Act (hereinafter referred to APIT)⁴. The Amendment Act⁵ entered into force on the 1st of January 2014. According to the new tax regulations, SKAs became subject to Polish CIT. The main purpose of the introduced amendments was to eliminate aggressive tax planning⁶ and secure the principle of tax fairness, stemming from article 84 of the Constitution of the Republic of Poland. Due to the new rules the taxation of SKA’s earnings occurs, like a joint-stock company or a limited liability company, at two levels: the company level and the level of its partners or shareholders. However, in order to ensure one-level-taxation being characteristic for Polish partnerships, the general partner is able to deduct the amount of CIT paid by a SKA (according to the general partner’s share in the partnership) from the tax (PIT/CIT) due to the dividend payment (the so-called full imputation or credit system).

The following article aims to primarily examine the functioning of the new tax imputation system applied since 1st January 2014 to the SKA’s general partners. The

¹ See article 4 § 1 no. 1 in connection with article 125 of the Polish Commercial Code of 15.9.2000 (Journal of Law 2000, no. 94, pos. 1037).
² For taxation of the German KGaA see i.a. Kollruss, Besteuerung der KGaA: Klärung der Besteuerungssystematik in fünf Stufen, BB 2012, p. 3178 et seq.
⁶ The OECD project on Base Erosion and Profit Shifting (BEPS) published in February 2013 was the impulse for fighting tax abuses. The mentioned report sets standards for further actions at the national level. For the OECD-report see http://www.oecd.org/ctp/beps.htm (10.09.2015).
fundamental question addressed here is whether the Polish legislator has managed to create clear tax regulations that can be easily applied by taxpayers. Connected with this, we also investigate the question of whether the new law meets the compliance requirements for understandable and fair legal rules. For this reason, a critical analysis of new tax regulations will be conducted which identifies loopholes leading to potentially unclear and incoherent interpretations of the law. Furthermore, it will be shown that in some cases the objective of the legislator to grant a single taxation of the general partner’s income can be infeasible. Moreover, we briefly discuss, whether the new tax rules are compatible with European Union law (‘EU law’).

Two hypotheses can be formulated that will be reviewed below:

**Hypothesis I:**
The Polish tax legislator has reached the objective that the general partner of an SKA is taxed as a partner of any other partnership. Thus, comparable economic situations are taxed equally.

**Hypothesis II:**
The Polish tax legislator has reached his objective by codifying a comprehensive, easy-to-use technical procedure of tax imputation.

1. **Background to the tax amendments**

   Despite a civil legal classification of the SKA as a partnership, the tax treatment of its generated profits has always been disputed in Poland. The absence of legal norms being explicitly related to the tax treatment of SKA’s profit and simultaneously considering the hybrid character of the SKA itself, has led in recent years to an intensive discussion, which is apparent by the large number of judgements passed by the Polish administrative courts7. The subject of the most disputed cases heard by the judges was the question of the tax treatment of SKA’s profits attributable to the limited partners. This has been due to the fact that pursuant to the previous legal situation a principally contradictory approach between the transparent taxation of

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Stephan Kudert, Marcin Jamroży, Agnieszka Kopeć

an SKA at the time of generating profits on the one hand, and the passive position of the shareholder as a mere investor on the other hand, had existed.

The very inconsistent jurisprudence of the Polish administrative courts and a dissenting view from the tax administration\(^8\) moved the Supreme Administrative Court (NSA) to take a final decision on the tax treatment of shareholders profits. The two resolutions passed by the NSA composed of seven judges have confirmed that dividend obtained by shareholders should be taxed on the date of its actual receipt and not at the time of generating profits. These two judgments have strongly contributed to the attractiveness of the SKA. The opportunity of tax deferral has led to the increased number of entities dressed in this legal form\(^9\). This tax optimization potential was also recognized by the Polish legislator who adopted the Amendment Act\(^10\).

2. Taxation of the SKA Under the Amended Tax Law

As a result of the Polish tax reform 2014 the limited partners of an SKA are taxed similarly to the shareholders of a joint-stock company\(^11\). The taxation of income that is paid out to the SKA´s limited partners is hence simple. Firstly, the income generated by the SKA is taxed at the level of the company itself and again at a the moment of profit distribution at the level of the limited partners. This leads to an economic double taxation of the same profits. The resulting double taxation was, however, intended by the Polish tax legislator. It is the result of the so-called ‘separation principle’, which applies to the taxation of corporations and their shareholders.

According to article 30a para. 1 no. 4 in connection with article 17 para. 1 no. 4 of Polish APIT, dividend income received by shareholders is subject to a flat tax rate of 19%. However, a full tax exemption is provided for shareholders that are legal entities and fulfil certain criteria. Those requirements encompass possessing at least 10% of the shares in a paying company for a period of at least 2 years (article 22 para. 4 no. 3 and para. 4a of the Polish ACIT). That means that the change of

\(^{8}\) See the decision of the Polish Minister of Finance of 11.5.2012, DzUrz MF 2012, pos. 24.


\(^{10}\) See footnote 5.

\(^{11}\) For detailed considerations regarding the amended tax provisions and their functioning under the new law see S. Kudert, A. Kopec, Zmiany w sposobie opodatkowania SKA w świetle nowelizacji ustawy o podatku dochodowym od osób fizycznych i prawnych 2014, „MoPod” 2014, nr 3, pp. 21–28.
regulations will affect mostly individuals who are not able to profit from participation exemption and will be therefore liable to double taxation\textsuperscript{12}. The abovementioned tax exemption results from the implementation of the Parent-Subsidiary Directive\textsuperscript{13} into the national Polish tax law.

**Example 1:**

*In the tax year 2015 SKA generates an income of 100,000 PLN. So it is obliged to pay CIT of 19%. Hence, the SKA’s net income paid out as a dividend to limited partners being individuals\textsuperscript{14} is 81,000 PLN. Withholding tax (PIT or CIT depending on the legal status of shareholder) that must be charged on dividends amounts to 15,390 PLN (19% × 81,000 PLN) and has to be imposed by the SKA upon distribution of the dividend. The total tax burden equates to 34,390 PLN (19,000 + 15,390) which accounts for 34.39% of the gross income (Earnings before Taxes, ‘EBT’) generated by the SKA. It can be stated that the total tax burden of the SKA corresponds to that of limited liability companies or joint-stock companies.*

<table>
<thead>
<tr>
<th>EBT</th>
<th>100,000 PLN</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIT (19% of EBT)</td>
<td>19,000 PLN</td>
</tr>
<tr>
<td>Dividend</td>
<td>81,000 PLN</td>
</tr>
<tr>
<td>Withholding tax (19% of dividend amount)</td>
<td>15,390 PLN</td>
</tr>
<tr>
<td><strong>Total tax burden</strong></td>
<td><strong>34,390 PLN</strong></td>
</tr>
</tbody>
</table>

As far as the general partner is concerned, his status is comparable to the position of a partner of a transparent partnership, e.g. of a general partnership or of a limited partnership. This similarity results primarily from the extent of his liability for the debt of the company and his management entitlement. Due to the abovementioned comparability and according to the principle of tax fairness these two types of partners should be exposed to the same or at least comparable tax consequences. This means essentially a single taxation.

The partners of the Polish general partnership or a limited partnership are subject to tax on his income from business activities under article 5b para. 2 APIT at the time of the profit creation. They are required to pay monthly or quarterly tax advances

\textsuperscript{12} Because of the fact that the Amendment Tax Act on PIT and CIT entered into force on 1.1.2014 and it encompasses only income generated by SKAs after the date the Act entered into force, the dividends which have been paid out to shareholders and stemmed from the net income earned in 2013 are not included in the scope of application of the new tax provisions.

\textsuperscript{13} See the Council Directive 2011/96/EU of 30.11.2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, last amended by 2014/86/EU of 8.7.2014.

\textsuperscript{14} In example 1 it was assumed that the share of limited partners in the SKA amounts to 99.9%. The share of the general partner was excluded from calculations due to its insignificance in this case.
to the tax office (article 44 para. 1 APIT)\textsuperscript{15}. However, in the case of a general partner of an SKA there is some technical difference. Pursuant to new tax regulations, the SKA’s net income, paid out to the general partner for his share in the SKA’s profit, constitutes income form capital assets (articles 17 para. 1 and 4 APIT) and it is subject to a flat tax rate of 19\% (articles 30a para. 1 and 4 APIT; article 22 para. 1a ACIT). However, the income tax paid by general partner can be reduced. Due to the new imputation system introduced by the tax reform 2014 the general partner of the SKA is entitled to credit, against the withholding tax, that part of the underlying CIT levied on the income generated by an SKA that is proportional to his interest in the partnership and is attributable to the distributed earnings\textsuperscript{16}. It must be noted that there are some limits concerning the tax imputation. According to the new provisions the tax credit cannot exceed the amount of PIT calculated on the general partner’s profit from the SKA. The possibility of tax credit is also restricted in time – 5 years maximum\textsuperscript{17}. This means that whenever a dividend is paid to the general partner in a tax year other than the tax year after which the income was generated by the company, the deduction is possible only when the time between the income generation and dividend distribution has not exceeded 5 years. The tax deduction provided for general partners was implemented in order to equalize their tax burden with that of partners of other forms of partnerships.

Example 2:

\textit{In the tax year 2015, the SKA generates an income of 100,000 PLN which is subject to a CIT of 19\%. The remaining 81,000 PLN can be distributed as a dividend to limited and general partners. The withholding tax (PIT if the partner is an individual person) must be charged on dividends and amounts to 15,390 PLN (19\% \times 81,000). This amount has to be withheld by the SKA upon distribution of the dividend. However, the appropriate share of the CIT can be deducted from the PIT of the general partner. Therefore, finally no PIT has to be paid. Below it is assumed that the share of the general partner in the SKA amounts to 10\%.}


\textsuperscript{16} The tax credit for the general partner is regulated in article 30a para. 6a APIT (for the general partner that is an individual person) or in article 22 para. 1 no. 1c ACIT (for the general partner that is a legal entity).

\textsuperscript{17} According to the Polish tax legislator the period of five years for the tax deduction does not influence the economic strategy realized by an enterprise. The period of limitation is connected with the time of the expiration of tax liabilities. In this way, the possibility of an effective review of the imputed taxes is granted. See the justification to the draft of the Amendment Act of 17.9.2013, p. 30.
EBT  
CIT (19% of the EBT)  
Dividend 
– including the 10% share of the general partner 
PIT of the general partner (19% of dividend amount) 
CIT credit 
Total Tax burden of the general partner

In the opinion of the Polish tax legislator, the reason for the introduction of the imputation system is to realize the principle of tax fairness guaranteed by the Polish Constitution\(^{19}\). This rule is violated, when similar situations are taxed differently, e.g. at different rates or according to different rules and the resulting differences are not justified by any objective factors. Other Polish partnerships, such as a general partnership or a limited partnership, are treated as tax transparent entities, which means that their income is taxed only once, namely, at the time of profit generation. As the legal situation of partners of those partnerships is comparable to the situation of a general partner of SKA, it is necessary to treat them similarly for tax purposes\(^{20}\). It is important to note that the new regulation system aimed at eliminating tax optimization strategies made by the SKA shareholders being previously taxed only once despite their passive investor status. That was the reason why the tax reform granted the SKAs the legal personality for tax purposes and two levels of taxation were introduced. The implementation of the credit method for general partners’ profits now ensures the desired tax fairness. According to the legislator, in the case of general partners and partners of other Polish partnerships, the total tax burden will be the same, only the technique of tax collection varies\(^{21}\). This suggests that the legislator intended to achieve the same tax burden for the general partner as for the partners of other Polish partnerships.

\(^{18}\) Tax credit is made in the proportion to the interest in the SKA.

\(^{19}\) The principle of the universality of taxation as well as the principle of equality before tax law, stem from the principle of tax fairness. See J. Trzciński, L. Garlicki, Zasada równości w orzecznictwie Trybunaliów Konstytucyjnych, Wrocław 1990, p. 3. For the subject of tax fairness see also W. Sadurski, Równość wobec prawa, „Państwo i Prawo” 1978, no. 8–9; Z. Ziemiński, Sprawiedliwość społeczna jako pojęcia prawne, Warszawa 1996.


\(^{21}\) Ibidem, p. 30.
3. The applicability of the legal norm

Examples 1 and 2 presented above seem to confirm both hypotheses formulated at the beginning of this article. However, if these examples are only slightly modified, then four questions regarding the application of the new imputation method arise. These questions are discussed below.

3.1. Distribution of dividend: From which tax year should the dividend payments be made?

If the SKA generates profit, it is not necessary for the profit to be paid in full. The profit can be retained and paid out as a dividend at a later date. Thus, reserves may be built up in the course of time from taxed profits over several years.

Example 3:
The SKA generates profit of 100,000 PLN in each of the following 5 years. Each year CIT is paid (19%). After five years, retained profits of the partnership available for distribution (Earnings after taxes, EAT) account for: $500,000 \times (1-0.19) = 405,000$ PLN. If the SKA distributes a (proportional) dividend of 200,000 PLN to the general partner in the 6th year, the question is, from which EAT such a dividend should be paid out to the partners?

The tax credit for the general partner’s income is limited in time (5 years maximum). If the carry forwards of tax credit were not limited to five years, the question referred to above would be obsolete. Due to the time limit there is a risk that such a tax credit would expire. The similar problem of limitation to five years already exists in the Polish tax law in respect to loss carry forward. Article 9 para. 3 APIT and article 7 para. 5 ACIT also do not contain any guidance about the temporal order of the use of tax losses. In the case of tax loss carry forward, there is, however, consensus omnium that the oldest losses have to be carried forward first to avoid expiry. Therefore, in the opinion of the authors, the similar principle ‘first in/first out’ should also apply to the tax credit for the general partner of SKA for systemic reasons.

Otherwise, the impending loss of tax credit could lead to tax structuring actions aimed at the optimization of tax burden. For example, the application of the so-called ‘pay-out/get-back’ method would be possible. This means, that the SKA distributes additional dividends, provided that the expiry of tax credit threatens. A tax burden does not arise, if the profits of the SKA are pre-loaded with 19% of Polish CIT. Subsequently, the general partner puts the money back into the SKA as capital reserves. Thereby, the SKA is not worse-off than in the case of retaining profits. At the same
time the general partner has protected his tax credit. The capital reserve may be withdrawn free of tax later. Thereby, the result that the intertemporal tax credit is based on the 'first in/first out' principle is achieved.

3.2. Scope of Tax Credit: Is Only Polish CIT Creditable for the SKA’s General Partner?

In example 2 the credit of the general partner’s share of the Polish CIT paid by the SKA on account of the PIT due to the dividend payment was presented. A hitherto unanswered question is whether a new-implemented tax credit method also applies to taxes paid abroad. The question arises, when the SKA generates the part of its income outside Poland being tax-exempt in Poland, whether it is possible to credit tax paid abroad against the withholding tax imposed on a dividend distribution in Poland?

Example 4:

The SKA generates an EBT of 200,000 PLN. 100,000 PLN is subject to the regular CIT in Poland and the other part (100,000 PLN) was generated by a permanent establishment located in Germany. At the beginning of the next tax year the dividend is paid out to the general partners in the amount of 100,000 PLN.

According to the Double Tax Convention concluded between Poland and Germany (‘DTC Poland-Germany’), if the enterprise carries out business abroad through a permanent establishment, then income generated by this permanent establishment may be taxed in the place of its location (here: Germany)\(^22\). The total tax burden in Germany accounts for ca. 30% (15% of German CIT, 14% of German tax on economic activity (\textit{Gewerbesteuer} and solidarity surcharge (5.5% of the CIT)). That these taxes are comparable to the Polish CIT, should be beyond question\(^23\). Poland as the country of residence within the meaning of DTC, exempts income generated by a German permanent establishment from domestic taxation.

If the dividend is paid out from the EAT which was subject to the foreign CIT in the country of permanent establishment, the wording of Art. 30a para. 6a APIT (and article 22 para. 1 no. 1a ACIT, if the general partner is a legal person) preclude in our opinion the crediting of foreign taxes. Only the proportionate CIT on profits

\(^22\) See article 7, para. 1 in connection with article 5 and article 24, par 2 letter a) of the Agreement for the avoidance of double taxation with respect to taxes on income and on capital of 14.5.2003 between Poland and Germany ("Journal of Law" 2005, no. 12, pos. 90) – hereinafter referred to as DTC Poland-Germany.

\(^23\) See article 2 para. 3 letter a) cc) DTC Poland-Germany. According to the DTC provisions, corporate income tax, business tax, including surcharges imposed on them (e.g. solidarity surcharge) belong to those currently existing in Germany taxes on income and are comparable to Polish corporate income tax.
of an SKA paid in Poland can be credited against the Polish withholding tax. There is no direct regulation enabled credit of the foreign tax in the Polish tax law. For the purpose of determining the tax liability of the SKA, as a tax base is considered an income, in the calculation of which the revenues from foreign sources being tax-exempt in Poland, are not taken into account. Therefore, it can be concluded that the PIT of the general partner may only be offset by the CIT on domestic taxable and non-exempt income. The fact that the income of a foreign permanent establishment is not subject to CIT in Poland, makes the crediting of the foreign CIT on the part of the income of the SKA, which is received tax-exempt from abroad, inapplicable.

If the credit for foreign tax is barred by law, this could be viewed firstly as a violation of the freedom of establishment and the norm thus considered to be contrary to EU law. Secondly, it would also contradict the objective of the one-time taxation or equality with the shareholders of transparent partnerships. If a Polish transparent partnership runs a permanent establishment in Germany, these profits would also be exempt from tax in Poland. The monetary withdrawals would also not cause a recapture tax mechanism. In the case of the SKA’s general partner the recapture taxation could only be avoided if the proportional crediting of foreign CIT took place. This is shown on the following comparative calculation for the case that the EAT is distributed from a German permanent establishment. In the left-hand column the tax burden without foreign tax credit is calculated, and in the right-hand column – with the foreign tax credit.

**Example 4 – continuation**

<table>
<thead>
<tr>
<th>Tax burden without tax credit</th>
<th>Tax burden with tax credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>PE’s income</td>
<td>100,000 PLN</td>
</tr>
<tr>
<td>German CIT</td>
<td>30,000 PLN</td>
</tr>
<tr>
<td>Earnings after taxes</td>
<td>70,000 PLN</td>
</tr>
<tr>
<td>Dividend payment</td>
<td>70,000 PLN</td>
</tr>
<tr>
<td>Withholding tax (19% of dividend)</td>
<td>13,300 PLN</td>
</tr>
<tr>
<td>Tax credit (max. 13,300)</td>
<td>0 PLN</td>
</tr>
<tr>
<td>Tax in total</td>
<td>43,300 PLN</td>
</tr>
<tr>
<td></td>
<td>100,000 PLN</td>
</tr>
<tr>
<td></td>
<td>30,000 PLN</td>
</tr>
<tr>
<td></td>
<td>70,000 PLN</td>
</tr>
<tr>
<td></td>
<td>70,000 PLN</td>
</tr>
<tr>
<td></td>
<td>13,300 PLN</td>
</tr>
<tr>
<td></td>
<td>13,300 PLN</td>
</tr>
<tr>
<td></td>
<td>30,000 PLN</td>
</tr>
</tbody>
</table>

As we can see from example 4 the purpose of the legislator, which is avoidance of double taxation on the general partner’s income, is not reached when the SKA generates income abroad being tax-exempt in Poland. In conclusion, the general partner should not only be entitled to the crediting of the Polish proportionate CIT,
but also to the comparative foreign taxes, at least if these are paid in EU countries (see Section 5 below).

3.3. Order of Dividend Pay-Outs: In What Sequence Are EAT Used at the Payment Date?

If the income of the SKA originates from different sources and is taxed differently with CIT, the question arises, which earnings after taxes (EAT) should be distributed firstly at the time of payment. This question is illustrated by the next example.

Example 5:

*The SKA generates an EBT of 200,000 PLN. 100,000 PLN was subject to the regular CIT (19%) in Poland and the other part (100,000 PLN) was generated tax-free in one of the Polish Special Economic Zones (‘SEZ’). At the beginning of the next tax year the dividend is paid out in the amount of 100,000 PLN.*

The total earnings after CIT, amounting to 181,000 PLN (200,000 PLN (income) – 19,000 PLN (CIT)), may be distributed to the SKA’s partners as a dividend. It is necessary to answer the question whether the dividend should be paid out first from the tax-exempt income or from the taxable income. If at first a dividend is distributed from the tax-exempt income generated in the Polish SEZ, the general partner will have no right to deduct the CIT from withholding tax due on the dividend as that income was tax-exempt. In that case, the general partner of the SKA would be discriminated against in comparison with the partner of a transparent partnership for which the exemption of income generated in SEZ is maintained.

However, if a dividend is distributed from the taxable income, the whole amount of the CIT paid on income generated by the SKA (19,000 PLN) can be credited against the PIT on the dividend. The dividend of 100,000 PLN is distributed from the income after CIT (81,000 PLN) and the remaining part of the dividend – from the tax-exempt income (19,000 PLN). Thus the recapture tax mechanism is not triggered. Therefore, it is advantageous to the general partner when the EAT is initially paid out with a higher CIT on it. The higher the CIT burden of the SKA, the higher is its credit claim. In example 5, thanks to the partial financing of the dividend from the tax-exempt income, the deduction of total CIT was possible.

The advantage of this approach is that, by the simultaneous distribution of the tax-exempt and the taxable income, the occurrence of the tax credit surplus can be avoided. If the SKA would only use the taxable income for distribution, it would result in a tax credit surplus. This is due to the fact that the PIT tax base, as a result

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25 See article 17 para. 1 no. 34 of Polish ACIT.
of the CIT deduction at determining the distributable amount, is always lower than the tax base of CIT (see Section 3.4). In conclusion, the dividends should be made from the EAT with a decreasing CIT burden within a tax year.

Across tax periods, such a fiction of distribution sequence does not result principally in any tax savings, but only in a tax deferral. However, assuming that a tax credit amount expired after five years, this solution would mean a real tax saving. If the tax authorities or the courts wrongly resisted this fiction of the distribution sequence, the SKA could apply the so-called ‘pay-out/get-back’ method as described in Section 4.1.

3.4. Imputation of the CIT Against the PIT on Dividends Paid Out to General Partner: Per Basket or Overall Limitation?

Noteworthy in example 5 is that the tax exemption is not lost, though 19,000 PLN was distributed from the EAT generated in the SEZ. The reason lies in a combination of two different effects that neutralize each other. First, a tax-exempt income is discriminated against. If no CIT is charged on the income of the SKA, the general partner cannot also credit the CIT against his PIT burden. Thus, the tax privilege would be lost at the moment of profit distribution. Secondly, in the case of the taxed income of the SKA the technical procedure systematically leads to tax credit surpluses. The SKA pays 19% CIT on an income of 100,000 PLN, but the general partner pays withholding tax at the rate of 19% but on the dividend payment, i.e. on income after the CIT (81,000 PLN). If in addition the dividends were distributed from tax-free or tax-reduced income, the CIT credit can be made from such a surplus. Probably the tax legislator has not considered both effects. In any case, the Polish ACIT contains no rule as to whether an overall or a per basket limitation is applicable. To illustrate the difference, example 5 has to be taken up again.

Since the SKA paid a CIT of 19,000 PLN on its EBT (200,000 PLN), 181,000 PLN of the income is available for distribution. According to the results presented in Section 4.3, the dividend is first distributed from the taxable income of the SKA, so that the proportional CIT paid can be deducted from the PIT on the dividend. The dividend of 100,000 PLN is thus distributed from the income after the CIT (81,000 PLN) and from the tax-exempt income (19,000 PLN).

<table>
<thead>
<tr>
<th>Overall limitation</th>
<th>Per basket limitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>SKA income</td>
<td>200,000</td>
</tr>
<tr>
<td>– therein tax-exempt</td>
<td>100,000</td>
</tr>
<tr>
<td>CIT</td>
<td>19,000</td>
</tr>
<tr>
<td>dividend payment</td>
<td>100,000</td>
</tr>
</tbody>
</table>
When only a part of the income was taxed with CIT (81,000 PLN) and the other part was tax-exempt (19,000 PLN), it is not clear whether the whole CIT can be credited: 19,000 PLN (19% × 100,000) (so-called ‘overall limitation’) or only the part of CIT, corresponding to the income pre-taxed with CIT: 15,390 PLN (19% × 81,000) (so-called ‘per basket limitation’). In the second case, the problem is that the general partner of the SKA cannot credit the whole amount of CIT, which was paid, against his PIT. This statement is both, in one sense, straightforward but also vague.

Due to the separate determination of credit limits to the EAT from different sources, the two effects, described above, do not neutralize each other anymore and there is a full taxation of the formerly tax-free income. If the tax legislator had really wanted the ‘per basket limitation’, the goal was clearly contrary to the first hypothesis. If the legislator had preferred the ‘overall limitation’, the joint distribution of tax-exempt EAT and of taxable EAT means that at least a portion of the dividend remains tax-free. Only for this portion is the tax equality of the general partner of the SKA and partners of other partnerships given. However, this statement is also conditioned. If the remaining part of the dividend (81,000 PLN) is passed on to the general partner and it originates exclusively from non-taxed EAT, the possibility of crediting is forfeited because no CIT credit is available. Consequently, it can be stated that the ‘overall limitation method’ has a tax benefit only if the distributable amount were paid out partly from income taxed with the CIT and partly from income exempted from the CIT. The optimum ratio of the EAT-portion is 81% to 19%. Emphasizing, not more than 19% of the dividend should originate from tax-free income. Only in that case the whole amount of the CIT can be credited.

It is probable that the legislator consciously decided neither on the one nor on the other method, but simply has not seen the above described problem. In any case, the ‘overall limitation’ with skilful dividend policy means, that the objectives defined in the justification to the Amendment Act can be, to some extent, achieved. The occurrence of systematic tax credit surpluses at fully-taxed EAT can thus be utilized to obtain exemptions up to the level of the general partner. A side-effect of the regulation is that the practicability is increased by the ‘overall limitation method’.
In conclusion, if dividends originate from both tax-exempt and the taxable income within a single tax period, the ‘overall limitation’ should be applied.

4. Compliance of the New Imputation System With EU Law

With reference to example 4, it has been shown that the aim of avoidance of double taxation by an SKA if the dividend is going to be paid to the general partner is hardly feasible in the case that the partnership obtains tax-exempted income generated abroad. The new regulation explicitly provides for a tax credit for the general partner, but only in the case that the dividends are subject to the Polish CIT.

Should a dividend be paid from foreign income, which is tax-exempt on the basis of double tax treaties, there is no Polish CIT which could be credited against the PIT of the general partner. The consideration of foreign taxes into the imputation system is, however, as far as can be seen, not permitted by the new regulation. This raises the question whether the limitation of tax deduction does not violate the principle of freedom of establishment stated in article 49 of the Treaty on the Functioning of the European Union26 (‘TFEU’)27.

Primarily, it needs to be determined whether the scope of the freedom of establishment exists in the case at hand. According to the principle of freedom of establishment, companies established in a EU country, which were duly incorporated under the regulations of the home country, have the right to conduct economic activities with no limitations via permanent establishment located in another EU country (article 49 para. 2 TFEU). The literal meaning of article 49 of the TFEU applies to the prohibition of unfair treatment of the entrepreneur in the country of its permanent establishment (hosting country)28. However, the principle of freedom of establishment refers also to the actions of the state of residence29. When an SKA possesses permanent establishment abroad, from which it derives profits, it exercises

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27 Direct taxation falls within the area of competence of the EU Member States. They must, however, exercise their powers in respect of the EU law, since the full observance of fundamental freedoms (which forms the primary source of EU law) is one of their obligations. See the judgment of the European Court of Justice (ECJ-judgment) of 13.12.2005, case C-446/03, Marks & Spencer, ECR 2005, I-10837, point 29 or ECJ-judgment of 14.2.1995, case C-279/93, Schumacker, ECR 1995, I-225, point 21.
freedom of establishment as a legal person\textsuperscript{30}, so the material and personal scope of this fundamental freedom is fulfilled\textsuperscript{31}.

In order to analyse whether article 30a para. 6a of Polish APIT and article 22 para. 1 no. 1 of Polish ACIT discriminate against cross-border situations as opposed to purely national cases, a comparative analysis must be conducted aimed at finding an entity having a similar situation to the SKA conducting business abroad. An SKA generating its taxable income through a permanent establishment in Poland is contrasted with an SKA which derives its income through a permanent establishment located in another Member State. In the first case, the PIT of the general partner may only be offset by the CIT on domestic taxable income. Whereas, in the cross-border case, the deduction of the CIT paid abroad is not possible. As a result, the tax situation of the general partner of the SKA which has its permanent establishment in another Member State has to be seen as less favourable. Due to such differences in tax treatment, a Polish SKA can be discouraged from carrying on its business through a foreign permanent establishment. Consequently, article 30a para. 6a of Polish APIT and article 22 para. 1 no. 1 of Polish ACIT contain a restriction on the freedom of establishment.

We now need to consider the question of whether this restriction can be justified. The European Court of Justice (‘ECJ’) in its decisions referring to tax law admitted that maintaining the integrity of the tax system may be treated as a public interest. However in order for it to be true, there must be a direct link, referring to the same taxpayer, between obtaining tax relief and compensation of it by bearing this tax burden later\textsuperscript{32}. Primarily, a direct link between tax relief and subsequent taxation of income of the same taxpayer in the country of his residence is required\textsuperscript{33}. This condition is not met. In our case, tax exemption of income generated by a foreign

\textsuperscript{30} In accordance with article 54 TFEU legal persons may also fall within the scope of the freedom of establishment. The concept of a legal person in EU law should be interpreted widely so as to comprise, in addition to corporations, partnerships. See A. Haratsch et al, 2008, point 910.

\textsuperscript{31} Whether other freedoms (like e.g. freedom of free movement of capital) should be tested at this stage is controversial. According to the ‘exclusive theory’, facts of a single case can only be subsumed under one of the fundamental freedoms. Once the scope of a freedom is open, the scopes of other freedoms are automatically negated. See e.g. ECJ-judgment of 4.6.2002, case C-367/98, Golden Shares I, ECR 2012, I-4731, point 56. According to another theory, in the case of capital transfers carried out through an establishment, both freedoms are equal and should be cumulatively applied. This causes an expansion of the scope of protection, in which the further-reaching freedom will prevail. See e.g. ECJ-judgment of 1.6.1999, case C-302/97, Konle, ECR 1999, I-3099, point 55.


\textsuperscript{33} Tax relief and subsequent tax burden must occur in the territory of the same EU country. Cross-border compensation was rejected by the ECJ in its judicature. See the ECJ arguments in the case Sevic Systems AG, concerning the transfer of the company’s seat to another Member State. ECJ-Judgment of 13.12.2005, case C-411/03, ECR 2005, I-10805.
permanent establishment of the SKA is compensated by the lack of the possibility to deduct tax at the moment of dividend distribution to the general partner. However, for meeting the criteria, tax relief and subsequent tax burden must refer to the same taxpayer\textsuperscript{34}. In the presented case there are, however, two separate entities – the SKA and the general partner.

Additionally, the argument of the integrity of the tax system is not justified when there was a Double Tax Convention (DTC) concluded between the host state and the state of residence. As a result of the DTCs, the problem of tax integrity is considered within the frame of the reciprocity rule stated in those conventions\textsuperscript{35}.

Another argument, concerning the need for preventing tax evasion and combating artificial structure, is concerned, it must be noted that the action limiting freedom of an establishment may be justified only if it relates directly to purely artificial structures with no economic sense, where the exclusive purpose is to receive tax benefits\textsuperscript{36}. According to the ECJ, the desire to use freedom of establishment suggests that there is no intention to evade the tax law or use loopholes in order to receive tax benefits\textsuperscript{37}.

Therefore, no grounds for justifying the different tax treatment of income realized in an SKA’s resident country in comparison to that generated in another Member State may be found. Consequently, it must be stated that the fact that the general partner of the SKA residing in Poland, who is liable to unlimited tax obligation, has no right to deduct the CIT paid abroad from the dividend tax, may be seen as a violation of the principle of freedom of establishment guaranteed by the TFEU. In conclusion, an SKA should be enabled to count foreign CIT toward dividends paid to the general partner. In doing so, it may rely on the freedom of establishment\textsuperscript{38}.


\textsuperscript{38}Whether a state measure is incompatible with a fundamental freedom, it follows from the priority over the non-applicability of the law of the measure in question. For the priority of EU law over the Member State’s domestic law, see the basic decision of the ECJ in the case Costa/ENEL, ECJ-judgment of 7.15.1964, case 6/64, ECR 1964, p. 1269. The allocation of the foreign taxes will not be possible until the Court decides on the non-applicability of the disputed rule of law. This can be either due to infringement proceedings initiated by the EU Commission (article 258 of the TFEU) or a preliminary ruling of the Polish administrative courts (article 267 of the TFEU).
5. Practical Testing

At this stage the question arises of whether the new imputation system, in spite of the identified shortcomings and the answered open questions is workable and understandable, and results in a one-time taxation. Therefore, a some kind of case study will be constructed, which ultimately serves as a practical test.

For this purpose, the results of the hitherto economic analysis of tax law made in previous chapters, are now summarized:

- Crediting of CIT from one period against tax chargeable in another period should be based on the ‘first in/first out’ principle.
- In a taxable year, it is recommended to pay out the dividends from the EAT basket in descending order of the CIT burden.
- If, in a given taxable year, dividends are distributed from baskets with various tax burdens, an ‘overall limitation method’ should apply.
- When distributions are made to the general partner, by reference to the violation of fundamental EU freedoms it should be possible to credit the foreign CIT on account of the withholding tax due to the dividend payment.
- Retained earnings from the years before 2014 are not relevant for tax assessment made under the new legal situation.

Case 1

An SKA with three different permanent establishments generates in 2014 its EBT in the amount of 300,000 PLN. The EBT comes from three different sources. 100,000 PLN stems from a business activity performed in Poland (but outside a SEZ) and it is subject to CIT at the rate of 19%. Another 100,000 PLN is generated by a German permanent establishment and is subject to the German CIT at the rate of 30% and tax-exempt in Poland (article 24 para. 2 letter a) of the DTC Poland-Germany). A further 100,000 PLN is generated by a permanent establishment located in a Polish SEZ and is therefore exempt from the Polish CIT.

At the beginning of 2015, the general partner receives a dividend in the amount of 190,000 PLN. To simplify, dividends paid to limited partners are not considered

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39 At this juncture, it should be noted that the Polish regulation regarding profit determination differs from that in Germany. The profit made by the German permanent establishment that was determined based on German tax law may thus be different to the profit determined based on Polish law. However, the tax base differences are ignored in the following calculation.
herein. Further, it is assumed that the general partner is an individual person who is subject to the unlimited taxation in Poland. The SKA must withhold the tax on the dividend payment. The tax due is calculated as a difference between the provisional PIT (19%) and the creditable CIT determined by article 30a para. 6 letter a) of the Polish APIT or article 22 para. 1 no. 1 of the Polish ACIT.

The Auxiliary Calculation for Case 1

An auxiliary calculation is vital for the SKA’s computing the appropriate amount of tax to be withheld from the 2015 profit distribution.

The EBT is 300,000 PLN and is broken down into 3 x 100,000 PLN with the portions being subject to 30%, 19%, and 0% CIT, respectively. At the level of the SKA, this gives earnings after tax (EAT) of (70,000 + 81,000 + 100,000 =) 251,000 PLN. The dividend of 190,000 PLN is distributed to the SKA’s partners taking into account the results of the mathematical operation above in descending order of the said tax burdens. So, we take 70,000 PLN i.e. the portion of the EAT that came as a result of taxation at the highest rate (the portion from the German permanent establishment), then we include 81,000 PLN, i.e. the portion of the EAT obtained as a result of taxation at 19%, and the remainder of (190,000–70,000–81,000) = 39,000 PLN, i.e. the portion referring to the tax-exempt income from SEZ. Thus, the final EAT after dividend distribution is (0 + 0 + 61,000 =) 61,000 PLN.

<table>
<thead>
<tr>
<th>Year</th>
<th>EBT</th>
<th>CIT (%)</th>
<th>CIT in PLN</th>
<th>EAT</th>
<th>div. 2015</th>
<th>EAT after div.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>PE-GER</td>
<td>100</td>
<td>30</td>
<td>30</td>
<td>70</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td>PE-PL</td>
<td>300</td>
<td>100</td>
<td>19</td>
<td>19</td>
<td>81</td>
</tr>
<tr>
<td></td>
<td>PE-SEZ</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>39</td>
</tr>
</tbody>
</table>

A provisional PIT on the dividend payments amounts to (190,000 × 19% =) 36,100 PLN.

It remains questionable, how the appropriate portion of the CIT is composed that can be credited against the PIT of the general partner’s profits. As for the EAT subject to a CIT of 30% in Germany, the portion of CIT being maximal credited amounts for 30,000 PLN; as regards the EAT being subject to Poland’s CIT, will be 19,000 PLN. With regards to the SEZ-income, no CIT is creditable. Thus, the maximum of the creditable CIT equals 49,000 PLN.

40 The values in the table are in thousands of PLN.
However, the new tax law provides for some limit on the CIT that can be credited against the withholding tax imposed on dividends. The tax credit cannot exceed the amount of withholding tax payable on the dividend distribution (here 36,100 PLN). Thus, the portion of the CIT that can be deducted from the PIT paid on general partners profit share is 36,100 PLN. Consequently the dividend distribution is tax-exempt and the credit excess of (49,000–36,100 =) 12,900 PLN is forfeited41.

<table>
<thead>
<tr>
<th>Div. in PLN</th>
<th>Prov. PIT</th>
<th>Cred. CIT</th>
<th>min. [Prov. PIT; CIT]</th>
<th>PIT</th>
<th>Total tax burden of SKA</th>
<th>Total tax burden in the case of general partnership/limited partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>190442</td>
<td>36.10</td>
<td>30+19+0=49</td>
<td>36.10</td>
<td>0.00</td>
<td>49</td>
</tr>
</tbody>
</table>

Thus, for the investment carried out in the legal form of SKA, the total tax burden is 49,000 PLN and results from the tax burden components payable at the level of the SKA (CIT: 49,000 PLN) and the tax burden of the general partner due at the date of dividend distribution (PIT: 0). While comparing this tax burden with the tax burden resulted in the case of the investment involving another Polish partnership, e.g. a general partnership or a limited partnership, no tax burden differences can be identified. In all cases the over-all tax burden at the level of the partnership and its partners equals to 49,000 PLN. This is attributable to the fact that pursuant to the tax reform 2014 the general partner is entitled to credit, against the withholding tax, that part of the underlying CIT levied on the income generated by an SKA that is proportional to his interest in the partnership. Thus, the total tax burden is reduced to the CIT applied at the level of the SKA and the double taxation can be avoided. Because of the fact that the CIT rate payable by the SKA is the same as the PIT rate for a partner of any other Polish partnership (provided that linear income taxation option is exercised), and the full imputation method applies to the general partner’s profits, the total tax burden of participation in a SKA is initially at the same level as in case of any other Polish partnership.

Case 2

The SKA’s EBT in 2015 is 150,000 PLN. The EBT comes from two sources. The first 100,000 PLN stems from a business activity performed in Poland (but outside an

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41 According to Polish tax law, the tax credit limit cannot be carried forward to the next years, which is similar to the German law.

42 The values in the table are in thousands of PLN.
SEZ) and is subject to a CIT at the rate of 19%. A further 50,000 PLN is generated by the permanent establishment located in Poland’s SEZ and is therefore tax-exempt. The German permanent establishment does not make any earnings in 2015. At the beginning of 2016, the general partner of SKA receives a dividend in the amount of 150,000 PLN.

### Auxiliary Calculation for Case 1 and Case 2

<table>
<thead>
<tr>
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<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>PE-GER</td>
<td>300</td>
<td>100</td>
<td>30</td>
<td>30</td>
<td>70</td>
<td>70</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>PE-PL</td>
<td>100</td>
<td>100</td>
<td>19</td>
<td>19</td>
<td>81</td>
<td>81</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>PE-SEZ</td>
<td>100</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>39</td>
<td>61</td>
</tr>
<tr>
<td>2015</td>
<td>PE-GER</td>
<td>150</td>
<td>0</td>
<td>30</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>PE-PL</td>
<td>100</td>
<td>100</td>
<td>19</td>
<td>19</td>
<td>81</td>
<td>81</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>PE-SEZ</td>
<td>50</td>
<td>50</td>
<td>0</td>
<td>0</td>
<td>50</td>
<td>8</td>
<td>42</td>
</tr>
</tbody>
</table>

The EBT earned in 2015 accounts for 150,000 PLN and is broken down into 0, 100,000 and 50,000 PLN with the portions being subject to 30%, 19%, and 0% CIT, respectively. At the level of the SKA, this gives an EAT of \((0 + 81,000 + 50,000 =)\) 131,000 PLN. A dividend of 150,000 PLN is first distributed from the EAT that was made in 2014 and thus can still be carried forward, and then according to the results mentioned in the preceding sections, in descending order of the above-mentioned tax rates for 2015.

Thus, the SKA’s profits distribution made in 2016 consists first of the remaining 61,000 PLN carried forward from 2014 (‘first in/first out principle’). The remainder of the dividend should be paid from the EAT of 81,000 PLN generated by the Polish permanent establishment and taxed at a regular tax rate of 19%, and finally from the tax-exempt EAT generated by the permanent establishment located in one of the Polish SEZs in the amount of \((150,000–61,000–81,000 =)\) 8,000 PLN. Thus, the final EAT after dividend distribution is \((0 + 0 + 42,000 =)\) 42,000 PLN.

The provisional PIT amounts to \((150,000 \times 0.19 =)\) 28,500 PLN.

The amount of the CIT being credited against the general partner’s PIT due to the dividend distribution equals 19,000 PLN. With regard to the dividend payment, 81,000 PLN is paid from the EAT taxed at a regular tax rate (19%) and 69,000 PLN stems from the tax-exempt income generated by the permanent establishment maintained in the Polish SEZ. In this case 19,000 PLN is the lower of the provisional PIT

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43 The values in the table are in thousands of PLN.
and the payable CIT. This gives a withholding tax of (28,500 – 19,000 =) 9,500 PLN and the SKA’s and the general partner’s total tax burden of 28,500 PLN. If the same investment would be carried out through a Polish general partnership or a limited partnership, the over-all tax burden would be equal only to 19,000 PLN. The difference of 9,500 PLN results from the fact that for that part of dividends that comes mostly from the tax-exempt income (e.g. generated by a permanent establishment situated in SEZ), there is no or an insufficient CIT amount that could be credited against the general partner’s PIT.

<table>
<thead>
<tr>
<th>Year</th>
<th>Div. in PLN</th>
<th>Prov. PIT</th>
<th>CIT credit</th>
<th>min. [prov. PIT; CIT]</th>
<th>PIT</th>
<th>Total tax burden SKA</th>
<th>Total tax burden general partnership /limited partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>190⁴⁴⁴</td>
<td>36.10</td>
<td>30 + 19 = 49</td>
<td>36.10</td>
<td>0.00</td>
<td>49</td>
<td>49</td>
</tr>
<tr>
<td>2016</td>
<td>150</td>
<td>28.50</td>
<td>0 + 19 = 19</td>
<td>19.00</td>
<td>9.50</td>
<td>28.5</td>
<td>19</td>
</tr>
</tbody>
</table>

**Case 3**

The SKA’s EBT in 2016 accounts for 250,000 PLN. 100,000 PLN comes from a business activity performed in Poland (but outside an SEZ) and is subject to a CIT at the rate of 19%. A further 100,000 PLN was generated by the permanent establishment located in Poland’s SEZ and is for this reason exempt from the Polish CIT. The income generated by the German permanent establishment in 2016 is 50,000 PLN and it is subject to a German CIT at the rate of 30%. At the beginning of 2017, the general partner receives a dividend in the amount of 258,000 PLN. Thus the entire EAT is absorbed.

The EBT generated by SKA in 2016 amounts to 250,000 PLN and can be broken down into: 50,000 PLN being subject to the German CIT of 30%, 100,000 PLN from the business activity carried out by the SKA itself and being subject to the Polish CIT, and 100,000 PLN stemming from the Polish SEZ and being exempt from the CIT. The deduction of CIT from the SKA’s EBT results in EAT of (35,000 + 81,000 + 100,000 =) 216,000 PLN. A dividend of 258,000 PLN distributed to general partner in 2017 will be composed initially of the EAT whose excess from the year 2015 has not been yet absorbed (42,000 PLN) and can thus still be carried forward, and subsequently in descending order of the tax rates (30%, 19%, 0%) from the EAT generated in 2016. Thus, the SKA should first distribute the remaining and carried forward 42,000 PLN from 2015. The remainder of the dividend, however, should come from the EAT of 35,000 PLN generated by the German permanent establishment, the EAT of 81,000 PLN.

⁴⁴ The values in the table are in thousands of PLN.
taxed at a regular Polish CIT rate, and finally from the tax-exempt EAT of 100,000 PLN. Consequently, the final EAT after dividend distribution is \(0 + 0 + 0 = 0\) PLN.

### Auxiliary Calculation for Case 1, Case 2 and Case 3

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2014</strong></td>
<td>PE-GER</td>
<td>300</td>
<td>100</td>
<td>30</td>
<td>30</td>
<td>70</td>
<td>70</td>
<td>0</td>
<td></td>
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</tr>
<tr>
<td></td>
<td>PE-PL</td>
<td>100</td>
<td>19</td>
<td>19</td>
<td>81</td>
<td>81</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PE-SEZ</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>39</td>
<td>61</td>
<td>0</td>
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<tr>
<td><strong>2015</strong></td>
<td>PE-GER</td>
<td>150</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
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<tr>
<td></td>
<td>PE-PL</td>
<td>100</td>
<td>19</td>
<td>19</td>
<td>81</td>
<td>81</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>PE-SEZ</td>
<td>50</td>
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<td>0</td>
<td>50</td>
<td>8</td>
<td>42</td>
<td>0</td>
<td></td>
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<tr>
<td><strong>2016</strong></td>
<td>PE-GER</td>
<td>250</td>
<td>50</td>
<td>15</td>
<td>35</td>
<td>35</td>
<td>0</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>PE-PL</td>
<td>100</td>
<td>19</td>
<td>19</td>
<td>81</td>
<td>81</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PE-SEZ</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>100</td>
<td>0</td>
<td></td>
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<tr>
<td><strong>700</strong></td>
<td><strong>700</strong></td>
<td><strong>102</strong></td>
<td><strong>598</strong></td>
<td><strong>190</strong></td>
<td><strong>61</strong></td>
<td><strong>150</strong></td>
<td><strong>52</strong></td>
<td><strong>258</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Again, the PIT should be withheld from the dividend distribution (258,000 PLN) in 2017. The provisional PIT is 49,020 PLN, i.e. 19%.

<table>
<thead>
<tr>
<th>Div. in PLN</th>
<th>Prov. PIT</th>
<th>CIT Credit</th>
<th>min. [prov. PIT; CIT]</th>
<th>PIT</th>
<th>Total tax burden SKA</th>
<th>Total tax burden general partnership/ limited partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2015</strong></td>
<td>190 46</td>
<td>36.10</td>
<td>30+19+0=49</td>
<td>36.10</td>
<td>0.00</td>
<td>49</td>
</tr>
<tr>
<td><strong>2016</strong></td>
<td>150</td>
<td>28.50</td>
<td>0+19+0=19</td>
<td>19.00</td>
<td>9.50</td>
<td>28.5</td>
</tr>
<tr>
<td><strong>2017</strong></td>
<td>258</td>
<td>49.02</td>
<td>0+19+15+0=34</td>
<td>34.00</td>
<td>15.02</td>
<td>49.02</td>
</tr>
</tbody>
</table>

In this case, the amount of the CIT that can be maximal credited against the PIT imposed on general partner’s profit share in 2017 is 34,000 PLN (35,000 PLN is paid from the EAT generated by the German permanent establishment and subject to a German CIT of 30%, 81,000 PLN comes from the EAT taxed at a regular tax rate of 19%, and 142,000 PLN from the tax-exempt income generated by the permanent establishment situated in the Polish SEZ). 34,000 PLN is the lower amount of the provisional PIT and the creditable CIT. Therefore, the payable withholding tax will be equal to \((49,020–34,000 =) 15,020\) PLN and a total tax burden of the participation in the SKA would amount to 49,020 PLN. If the taxpayer decides to make the

45 The values in the table are in thousands of PLN.
46 The values in the table are in thousands of PLN.
same investment through an another Polish partnership, e.g. general partnership or a limited partnership, given the same case scenario, the total tax burden would be 34,000 PLN. The tax burden variance of 15,020 PLN results from the fact that over 50% (142,000 PLN) of the total dividend distribution (258,000 PLN) was generated by the permanent establishment doing business in the SEZ and thus was not pre-taxed with any CIT. In the case of the investment involving the legal structure of an SKA, the general partner loses the opportunity of full tax credit because the amount of the CIT that could be credited is insufficient. The extent of the supplementary taxation is therefore dependent on the volume of tax-exempt income generated by the SKA itself or by its permanent establishments.

Conclusions

At the beginning of this article (see Section 1) two hypotheses have been formulated:

**Hypothesis I:**
The Polish tax legislator has reached the objective that the general partner of an SKA is taxed as a partner of any other Polish partnership. Thus, comparable economic situations are taxed equally.

**Hypothesis II:**
The Polish tax legislator has reached his objective by codifying a comprehensive, easy-to-use technical procedure of tax imputation.

The theoretical considerations outlined in Sections 3 and 4 and by using the practical examples in Section 6 enable us to disprove Hypothesis I. The tax treatment of the SKA’s general partner is not the same as that of a partner of any other Polish partnership. Especially the case where an SKA generates tax-exempt income would usually lead to supplementary taxation, because no tax credit could be used. As a result, the comparable economic events are not subject to the same tax burden.

It would be easier to manage it if the taxation were to occur only at the level of the general partner. Thus, the single taxation would be ensured. Because Poland’s currently applicable CIT rate is 19% and natural persons with income from economic activity may opt for linear taxation based on 19% PIT, the general partner could be treated in the same way as partners of general or limited partnerships. A similar tax treatment can be actually found in Germany whose tax law charges a tax solely on the general partner. According to the German tax provisions only the company’s income assigned to the general partner is exempt from the CIT payment. This part of
earnings is then taxed solely at the general partner level. Such a tax system would also lead to the same tax treatment of comparable economic events.

In addition, the practical tests using in case study show that Hypothesis II cannot also be positively reviewed. The legislator has failed to implement a clear and simple procedure for computing the appropriate amount of withholding tax for a general partner. The considerations pointed out in Section 6 show that the computation system does not always achieve its intended aim or ensure the single level taxation of general partner’s profits. The newly introduced tax credit method begins especially then to fail if the SKA’s income stems from income sources that are not subject to the (Polish) CIT at regular rate of 19%. Therefore, in the article, a calculation formula was developed to help the taxpayer implement the legal norm in compliance with the relevant laws. In doing so, the following auxiliary conditions defined in Section 4 should be applied:

- Credit of CIT from one period against tax chargeable in another period is based on the ‘first in/first out’ principle.
- In a taxable year, dividends are paid from the EAT basket in descending order of the CIT rates.
- If, in a given taxable year, dividends are distributed from baskets with various tax burdens, an ‘overall limitation’ applies.
- When distributions are made to the general partner, the SKA may credit the foreign CIT on account of the withholding tax, also.

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**Judicial decisions**

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27. The decision of the Supreme Administrative Court (NSA) of 15.7.2010, II FSK 3/10.
28. The decision of the Supreme Administrative Court (NSA) of 19.11.2010, II FSK 1297/09.
30. The decision of the Supreme Administrative Court (NSA) of 21.11.2012, II FSK 548/11.
31. The decision of the Supreme Administrative Court (NSA) of 12.10.2012, II FSK 381/11.
Homo Oeconomicus Versus Homo Ethicus

Abstract

The aim of this paper is to show the conflict between a traditional paradigm of homo oeconomicus and a new approach to finance – homo ethicus. The authors present the concept of rationality in economics, then show the important place of ethics in finance and in the ongoing financial crisis. Finally, the authors give some examples of homo ethicus in praxis by explaining the ethical theory of investment and the motives for ethical investing.

Keywords: homo oeconomicus, homo ethicus, ethics, ethical investing subprime crisis
Introduction

When Eugene F. Fama and Robert J. Shiller, leading proponents of opposing views about the rationality of financial markets, shared the 2013 Nobel Prize in Economic Sciences, the dispute about what is nowadays considered as a paradigm in economics or finance began. Fama, a so-called father of classical finance and a founder of efficient market hypothesis and Shiller, a representative of the behavioural finance camp, started afresh a debate about homo oeconomicus and homo psychologicus\(^1\). It resulted in the fact that investors are more human and sentimental than was assumed in traditional economic models.

The need for an interdisciplinary approach in science requires incorporating more academic disciplines into finance. The boom of new trends in finance e.g.: behavioural and experimental finance, neurofinance, cultural finance, ethical or socially responsible investing, demonstrates that we can expand our knowledge of finance by studying biology, psychology, cultural studies or ethics.

The aim of this paper is to show the conflict between a traditional paradigm of homo oeconomicus and a new approach to finance – homo ethicus. The authors present the concept of rationality in economics, then show the important place of ethics in finance and in the ongoing financial crisis. Finally, the authors give some examples of homo ethicus in praxis by explaining the ethical theory of investment and motives for ethical investing.

1. Homo Oeconomicus

One of the most important assumptions in classical and neoclassical economics is the concept of homo oeconomicus – an economic man. This term is a set of traits and certain behaviour that are attributed to a man acting in various economic roles\(^2\).

In economy the concept of homo oeconomicus stands for a model, that aims to select out of countless factors influencing consumers’ decisions only those which

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can be defined as “economic relations”. Thanks to this operation, the relations can be expressed as mathematical calculus and formed into economic theories.

Homo oeconomicus is therefore a rational, narrowly self-interested and selfish individual. He aims to achieve the best possible economic results. This means that if he is a producer, he wants to maximise his profit. If he is a consumer, he strives for the maximum utility. The utility is narrowed here to consumption of such a combination of goods that ensures the most satisfaction.

John Steward Mill was one of the first authors that presented the idea of economic man. In one of his essays he states: “It does not treat of the whole of man’s nature as modified by the social state, nor of the whole conduct of man in society. It is concerned with him solely as a being who desires to possess wealth, and who is capable of judging of the comparative efficacy of means for obtaining that end. (...) It makes entire abstraction of every other human passion or motive.

The concept of homo oeconomicus is a reflection of the typical behaviour of a man in a capitalistic world. Such an understanding of human nature is vaguely attributed to Adam Smith because of his famous work “The Wealth of Nations”. Many economists selectively chose quotations from this work to justify their views on the liberalisation of the market. According to Smith “it is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity, but to their self-love, and never talk to them of our own necessities, but of their advantages”.

Describing an ideal economic man Smith states that: “he intends only his own gain; and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it”.

There are some more definitions that can be found in the literature: “He is neither tall nor short, fat nor thin, married nor single. There is no telling whether he loves his dog, beats his wife or prefers a push bin to poetry. We do not know what he wants.

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3 Therefore a model of homo oeconomicus cannot take into consideration all factors that influence individuals’ decisions, especially qualitative elements, eg. moral motives.


7 Ibidem, p. 364.
Be we do know that, whatever it is, he will maximise ruthlessly to get it. (...) He is the child of Enlightenment and so the self-seeking individualist of utility theory”. Or this quotation: “The hedonistic conception of man is that of a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. He has neither antecedent nor consequent. He is an isolated, definitive human datum, in stable equilibrium except for the buffets of the impinging forces that displace him in one direction or another”.

The notion of homo oeconomicus has its reflection also in the finance and investment theory. It is assumed that investors act rationally and prefer more to less. They make optimal choices, taking into account the risks and returns as well as the costs and benefits. They require greater returns as a compensation for higher risk. It is crucial to note that traditional theory focuses on the concept of maximising returns at the given risk aversion of an individual and does not state any other factors influencing investment decisions. Personal values are of no importance in the investment process. These conclusions can be drawn from works from many influential authors, e.g. research by Miller and Modigliani, and Markowitz.

The traditional concept of the economic man has very few human traits. It is a simplification that is very different from real-world behaviours. Olsen notes that “economic incentives are not, to be sure, the only incentives; people are sometimes also motivated by a desire to win prestige, respect, friendship, and other social and psychological objectives”.

Economists often tend to forget that Adam Smith, known as the father of economics, was in fact a professor of moral philosophy. He left a versatile and contradictory set of works, that are not presented as often as “The Wealth of Nations”. In “The Theory of Moral Sentiments” he focuses on ethics as an important driver for a man’s behaviour: “No matter how selfish you think man is, it’s obvious that there are some principles in his nature that give him an interest in the welfare of others,

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and make their happiness necessary to him, even if he gets nothing from it but the pleasure of seeing it”\textsuperscript{13}.

2. Homo Ethicus

Ethics is a field of science that involves systematizing, supporting and recommending concepts concerning right and wrong conduct. Philosophers distinguish three subject areas of it: normative ethics, applied ethics and methaethics. Normative ethics states moral standards regulating right or wrong behaviour. Applied ethics concerns examining specific issues that are controversial. Metaethics involves studies of the origin of ethical principles and their meaning\textsuperscript{14}.

As mentioned before, the notion of homo oeconomicus is widely attributed to Adam Smith. However, it is vital to know that economics was very much connected with ethics during the times of Adam Smith. Economics did not exist without moral values – these fields of science existed together\textsuperscript{15}.

In “The Theory of Moral Sentiments”, Smith presented his view of self-interest in people: “The wise and virtuous man is always willing for his own private interest to be sacrificed to the public interest of his own particular order or society. He is always willing, too, for the interests of this order or society to be sacrificed to the greater interests of the state of which it is a subordinate part”\textsuperscript{16}.

Hawtrey and Johnson note that both works by Smith – “The Theory of Moral Sentiments” and “The Wealth of Nations” – are not contradictory\textsuperscript{17}. The idea of Smith should be understood as an enlightened self-interest meaning that the best interest of a businessperson and their stakeholders can be achieved simultaneously. Solidarity with business partners can improve the situation of a company. The same effect might have promoting justice and ensuring the prosperity of the community at large. That is why ethical behaviour is desirable and can be in the interest of a company\textsuperscript{18}.

\textsuperscript{14} http://www.iep.utm.edu/ethics/ (8.09.2013).
\textsuperscript{16} A. Smith, \textit{The Theory of Moral...}, op.cit.
\textsuperscript{18} Ibidem.
In the early 20th century Pesch discussed the concept of homo oeconomicus in the following textbook for economics: “Teaching Guide to Economics”\textsuperscript{19}. He underlined the fact that self-interest must have constraints in the moral law. This law should be understood as a framework supporting justice and charity, and establishing social responsibility and a sense of moral obligation. Such moral standards ought to be applied by all actors at all stages of the economic process\textsuperscript{20}.

Some authors claim that people are both homo oeconomicus and homo ethicus (ethical man) – simultaneously. Both those roles coexist and are in a strong relationship with each other. This relationship becomes strong when an economic decision of an agent is seen also from the ethical point of view. If the agent is free and conscious, they ask themselves moral questions. They tend to wonder if they are good and honest in their actions. Some anthropologists are of the opinion that human beings are open to the world and have the abilities to go beyond the reality that they see – they possess the ability to see life in its many dimensions\textsuperscript{21}.

P. Koslowski presented his idea of creating a new field of science that would be ethical economics. This would be a new stage of the development of economic science. It would combine traditional effectiveness and optimisation with morals and ethics\textsuperscript{22}.

### 3. Subprime Crisis Versus Moral Crisis

The subprime crisis brought acute losses to the financial markets all over the world starting in 2007 and continuing during the first months of 2009. The cause for the crisis was the breakdown of the markets for Collateralized Debt Obligations (CDO’s). These instruments were bonds secured by the mortgage loans on houses in the United States. The entities that decided to buy these bonds were U.S. banks, municipalities and European banks. The purchase of these instruments was very attractive because of higher interest rates compared to Corporate Bonds or U.S. Treasuries\textsuperscript{23}.


\textsuperscript{20} Ibidem.


\textsuperscript{22} G. Szulczewski, \textit{Rozważania o miejscu etyki i moralności w teorii i praktyce gospodarczej}, Oficyna Wydawnicza, Szkoła Główna Handlowa w Warszawie, Warszawa 2012, pp. 141–142.

Immense defaults on the mortgages that were supporting the CDO’s caused the collapse of this market. The CDO’s turned out to be worthless leading to the insolvencies of the banks possessing vast quantities of them. The situation was so serious that the U.S. Government needed to bailout more than 200 banks and financial institutions to avoid the breakdown of the entire financial system of the United States. Governments in Europe were forced to take similar steps²⁴.

Wargo, Baglini and Nelson name several reasons for the outbreak of the financial crisis²⁵. They blame the actions of the issuers of the Collateralized Debt Obligations: financial institutions such as mortgage companies, investment banks and commercial banks. These organisations completely neglected the risk connected to the CDO’s. They did not perceive any risk attached to these investments because it was passed onto the buyers. What is more, the originators of the CDO’s falsely presented these bonds as very safe investments. Similarly, investors who purchased the CDO’s – investment funds, banks, municipalities and individual investors did not pay any attention to the risk involved. A contribution to the fact is the certainty that these bonds were insured by insurance taken out at the AIG Insurance Company. As a result of many mortgage defaults, the AIG insurance company went bankrupt and was nationalized by the government of the United States²⁶. Rating agencies, such as Moody’s and Standard and Poor, were blamed for being unreliable and not protecting the public by issuing excessively good ratings for the CDO’s²⁷.

Hawtrey and Johnson suggest that in the years before the financial crisis, a group of managers with no ethical values started to play an important role in the economy. Their presence had an influence on the whole market, infecting it with moral contagion. Increased economic activity at that time offered greater opportunities to benefit from the unethical conduct. The influence of the unethical directors had enormous space to flourish passing it on to other actors of the market²⁸.

Paul Krugmann, an economist from Princeton University and the winner of the Nobel Prize wrote an article in 2002 in which he expressed his opinion on the system that contributed to the financial crisis, predicting the start of it: “a system that lavishly rewards executives for success tempts those executives, who control much

²⁴ Ibidem.
²⁵ Ibidem.
²⁶ Ibidem.
of the information available to outsiders, to fabricate the appearance of success. Aggressive accounting, fictitious transactions that inflate sales, whatever it takes\textsuperscript{29}.

Many authors claim that the subprime crisis in the United States was not only a financial crisis but also a moral crisis. Financial institutions are considered to be the first to blame because of taking risky actions, being greed-driven and dishonest about them in their financial statements. Many negative traits of institutional and individual investors contributed to the financial crisis. Liberal laws gave rise to such an attitude, too\textsuperscript{30}.

In the discussion about the reasons for the crisis, Paul H. Dembinski highlighted the exploitation of relationships for transactional purposes. This involves people being distrustful and less committed to relationships. He also emphasised the pursuit of efficiency perceived as the only option and motive for human activity\textsuperscript{31}.

The scale of the financial crisis made Pope Benedict XVI express his opinion about it in his encyclical Caritas in Veritate. The Pope indicated that the situation of the economy in crisis showed that there is a need for a reflection on the economic goals, the currently followed model of development as well as the economy as a whole. It is necessary to recognise all defects and deviations, and correct them\textsuperscript{32}.

The Pope emphasized that the world is becoming more and more globalized and interdependent. The problem is that this interdependence is not coupled with truly human, ethical progress. There is a need to seek development goals with humane, moral values. The Pope enumerated several values that both people and businesses should incorporate in their conduct: responsibility, honesty, transparency, truth, fraternity and charity. All phases of the economic cycle have ethical implications and all economic decisions have moral consequences. The Pope underlined that there is a need for a people-centred ethics in the economy. Furthermore, the adjective “ethical” should be protected from the abuse of it. It ought to be used for choices and decisions that are just and contribute to the true human welfare\textsuperscript{33}.

\textsuperscript{29} P. Krugman, \textit{Greed Is Bad….}, op.cit.
\textsuperscript{33} Ibidem, pp. 9, 36, 37, 45.
4. Ethical Theory of Investment

A.B. Carroll wrote many scientific works in which he strived to define the corporate social responsibility (CSR) of a company. Later, in 1991, he created a pyramid model of corporate social responsibility based on his previous works\textsuperscript{34}.

Carroll divided total social responsibilities into the following categories: economic, legal, ethical and discretionary. Those groups are not mutually exclusive and they have always existed simultaneously for all companies. However, it is crucial to note that this order presents the evolution of the importance of those responsibilities: the history of business shows that economic and legal responsibilities were the very first to be fulfilled. The remaining two categories: ethical and discretionary started to be a subject of concern much later\textsuperscript{35}.

The business organisation, as a basic economic unit in the society, has a social responsibility to fulfil its economic function and to be profitable. This is a fundamental assumption and a base for all other business roles. Business institutions have always aimed at producing goods and services that societal members want and at selling them at a profit. After some time the idea of creating profit was modified into the notion of maximising profit. Economic responsibilities consist of several components e.g.: maximum earnings per share, a strong competitive position and commitment to being as profitable as possible\textsuperscript{36}.

The next level of corporate social responsibility is the fulfilment of legal responsibilities. Every business organisation is expected to adhere to laws and regulations at local, state and international levels. These laws and regulations are considered to be “codified ethics” describing fair behaviour. The requirements for a business institution are to fulfil its economic function within the legal framework. Despite the fact that legal responsibilities are listed as a second layer of the pyramid, they are a crucial part of every free market economy and they coexist with economic responsibilities\textsuperscript{37}.

The following layer above the legal responsibilities are ethical ones. These are not codified into law activities and practices that are either expected or forbidden by members of society. Thus, this could be seen as the higher level of performance of

\textsuperscript{34} M. Czerwonka, \textit{Behawioralna i etyczna teoria inwestowania}, Studia i Prace Kolegium Zarządzania i Finansów, Zeszyt Naukowy 111, Szkoła Główna Handlowa w Warszawie, Warszawa 2011, p. 57.


\textsuperscript{37} Ibidem.
a company, above the standards included within the law. Being ethically responsible means following the norms that various stakeholders regard as fair and just. Stakeholders are a large group of subjects that are under the influence of the activities of a business. These can be the following: clients, business partners, employees, local communities and others. It is crucial to emphasise, that companies, which seek to be ethically responsible, take steps so as not to allow ethical values to be compromised with their business goals.38

Usually the presence of ethical values precedes the creation of laws covering them. What is more, societies constantly add some new ethical values and change and discuss the established ones. That poses a huge challenge to businesses because they are expected to be fully alert to recognise and adhere to the newly emerging ethical standards39.

The highest level of the presented pyramid are philanthropical responsibilities. These come within the realm of being voluntarily involved in humanitarian programmes and actions by allocating financial resources or dedicating corporate time to serve them. There are plenty of fields in which business can be engaged: education, environmental protection, art, and programmes for the local communities. Societies expect companies to meet philanthropical and charitable responsibilities, but these responsibilities are of a voluntary nature and different from ethical ones. If a business is not active in philanthropy, it is not considered to be unethical or immoral40.

Based on the Carroll’s pyramid of social responsibility and behavioural portfolio theory by Shefrin and Statman, Czerwonka created an ethical theory of investing41. This theory assumes that investors see their portfolios in the form of a pyramid of assets. The maximisation of profit holds first place when it comes to their investing. This is true also according to the Carroll’s pyramid – making profit is the very first and basic responsibility of a business. It is also crucial to ensure the safety of an investment and this is reflected in the first level of the pyramid of assets. Investors decide to invest their financial resources in both safe instruments like bonds and higher-yield instruments like shares. Safety is indicated as an underlying trait of an investing according to the behavioural investment theory42.

Beyond the basic profit making principle, there is also a need to serve ethical and moral causes by the act of investing. This is the next level in the pyramid of ethical investment and corresponds with the second level of the Carroll’s pyramid of corporate

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38 Ibidem.
39 Ibidem.
40 Ibidem.
41 M. Czerwonka, Behawioralna etyczna…op.cit.
42 M. Czerwonka, Behawioralna etyczna…, op.cit., p. 59.
responsibility. Investors select assets to add to their portfolio in an alternative way e.g. by choosing socially responsible investing (SRI). Such investments, apart from bringing profit, seek to consider social or ethical good, implementing the so called ESG (Environment, Social, Governance) factors into the investment process. The social responsible investment of an individual investor can take two forms: depositing financial resources in ethical funds or choosing assets in their portfolios according to the socially responsible indexes provided by a stock exchange\textsuperscript{43}.

The highest level of the pyramid of ethical investment is philanthropy, similar to the philanthropic responsibilities presented in Carroll’s pyramid. This is reflected in donating money to people or institutions in need. Such activities are voluntary and bring satisfaction to people when they know that they can help others and make an impact on their lives\textsuperscript{44}.

The profitability of investments made according to the ethical pyramid of investment tends to decrease as one progresses up the pyramid. On the contrary to profitability, personal satisfaction grows for the investments made on the higher levels of the pyramid\textsuperscript{45}.

5. Motives for Ethical Investing

Anthropologists claim that people’s emotional reactions have been formed after living in small groups for millions of years when they needed to cooperate. It has influenced the interactions and choices that they make now: this could contribute to the fact that there are many investors who choose to invest ethically and contribute to the well-being of a society\textsuperscript{46}.

Investors that make socially responsible investments, want their investment to be both profitable and serve a good social or ethical cause. Such investing gives them better satisfaction and fulfilment, because of doing something morally good, and according to their conscience and their world view\textsuperscript{47}. Investors can benefit personally and emotionally from their feelings for the support of good causes\textsuperscript{48}.

\textsuperscript{43} M. Wolska, Czerwonka M, Społecznie odpowiedzialne inwestowanie – analiza rentowności funduszy SRI w Polsce, Studia i Prace Kolegium Zarządzania i Finansów, Zeszyt naukowy nr 126, SGH, Warszawa 2013, s.9.
\textsuperscript{44} Ibidem, p. 61.
\textsuperscript{45} Ibidem.
\textsuperscript{47} M. Czerwonka, *Behawioralna i etyczna...,* op.cit., pp. 60–61.
\textsuperscript{48} D.J. Beal, M. Goyen, P. Philips, *Why Do We...,* op.cit., p. 68.
Furthermore, people believe that the popularity of responsible investing can raise the awareness of important environmental and social issues\(^{49}\). It is supposed that it can make an impact on the whole corporate world by the so called domino effect. Demand from investors can influence the actions of corporations.

From the point of view of the traditional finance theory, the existence of ethical investment would only be connected with a chance for an equal return at a lower risk. Another possibility would be that such investments could provide higher profits for the same degree of risk as common funds\(^{50}\). In reality, the profitability of socially responsible investments is versatile. Many investors agree to receive smaller profit knowing that the investment is morally or ethically good\(^{51}\).

Beal, Goyen and Phillips present three approaches of the understanding of ethical investment from the economic point of view:

1. “By treating the psychic returns from ethical investing as equivalent to the gambler’s fun of participation.

2. By including the perceived level of ethicality of an investment in the investor’s utility function.

3. By treating the psychic returns from ethical investing as equivalent to the happiness or well-being derived from other pleasurable activities”\(^{52}\).

The first approach focuses on the psychic returns derived from ethical investing seen as an analogy to the pleasure of participation that could be felt by some gamblers taking part in a game of chance. As some observations suggest, taking gambles that are small compared to the level of wealth of a person, can bring satisfaction from the experience. The fact of winning or losing has no influence on it. In the case of winning, players see it only as an added bonus\(^{53}\).

Another perspective is treating the ethicality of an investment as a factor that has its reflection in the utility function of an investor. The total utility obtained from a particular ethical investment is composed of two parts: the expected financial gain from the investment and the additional utility derived from the ethicality of an investment. It is important to note that those two sides are independent\(^{54}\).

According to the standard analysis, investors require superior returns for taking additional risk, but it is crucial to admit that investors take the level of the ethicalness

\(^{49}\) M. Czerwonka, *Inwestowanie społecznie…*, op.cit., p. 139.
\(^{50}\) D.J. Beal, M. Goyen, P. Philips, *Why Do We…*, op.cit., p. 67.
\(^{52}\) D.J. Beal, M. Goyen, P. Philips, *Why Do We…*, op.cit., p. 72.
\(^{53}\) Ibidem.
\(^{54}\) Ibidem.
of a given investment into consideration, also. Knowing that, investors can agree
to accept a smaller return if the degree of ethicalness is higher. However, not all ethical
investors can behave in such a way. There may be investors who are not agreeable
to compromise on the level of ethicalness regarding their investments, irrelevant to the
possible profit it could bring. Based on that, Beal, Goyen and Phillips distinguish the
following types of investors:

- paying attention to risk, return and ethicalness and being ready to make con-
cession between all three factors (according to the survey carried out by Beal,
Goyen and Phillips, these are 62% of their respondents who ‘sometimes’ take
ethicalness of their investment into consideration);
- concerned with return, risk and level of ethicalness, but not agreeable to making
trade-offs between profit and ethicalness (the 84% of the surveyed are of the
opinion that some companies are too immoral to invest in);
- not paying attention to profit or risk (these are NGO activists, for instance);
such investors would be willing to maximise the degree of ethicalness of their
investments55.

Scientists who conduct research on happiness make use of the term “experimental
utility”. This concerns the flow of pleasure (or negative feelings of displeasure) that
a particular person experiences when being engaged in a given activity. This concept
can be used when trying to explain the reasons behind ethical investing: it can bring
psychic return, happiness or experienced utility56.

On balance, the motives presented here can coexist together and they are
not exhaustive. Certainly, there can be more reasons, as there are many various
ethical investors57.

Conclusions

To summarise the analysis presented in this paper, it should be emphasised that
the traditional concept of homo oeconomicus as a perfect description of an economic
man ought to be modified. Research based on psychology show that investors’ behav-
iour cannot be fully based on rationality and must acknowledge the role of emotions
(happiness, fear or regret) or ethical needs (satisfaction, fulfilment, acting according

55 Ibidem, pp. 73–74.
56 Ibidem, p. 75.
57 Ibidem, p. 76.
to one’s religion/faith). The authors stress the importance of interdisciplinary as the key to the better understanding of human nature.

References


Barriers and Benefits of Financing Projects with European Funds by Micro, Small and Medium-Sized Enterprises (MSMEs) in Poland

Summary

The main aim of the article is to present the benefits and barriers of projects financing with the means of the European funds by MSMEs. The analysis was based upon the statistics data published in Poland by the Ministry of Infrastructure and Development, Eurostat and the European Commission. The analysis of the sources on the subject as well as observations of the business practices allowed for the formation of a thesis that Poland competently utilised the European funds between 2007–2013 and thereby benefited considerably. The EU funds have been a useful instrument in reducing the impact of the economic crisis. Well invested EU funds have also had a positive effect on GDP growth in Poland and have increased the competitiveness of the Polish economy. An enterprise applied for co-financing of projects relating to various fields. Beginning with the purchase of tangible assets, through land purchase or immaterial and legal assets purchase up to consulting and training activities (via subsidizing personal development and the improvement of vocational training for staff). Nonetheless, despite the significant influence of the funds into the GDP growth dynamics and the increase in the standard of living, in the overall view the Polish economy has not gained much in the innovation aspect due to the fact that the financial resources acquired by the Polish companies from the subsidies were largely earmarked to purchase the already existing western technologies, thus, making them dependent upon the know-how of the huge western conglomerates – which must be disapprovingly assessed.
Lack of innovation among Polish enterprises hampers their competitiveness and leads to economic stagnation. Thus, activities aimed at the increase of innovations and the competitiveness of the Polish economy shall be of significant importance for the years 2014–2020. Four issues will have to be fulfilled: research, development, implementation and the expansion onto foreign markets.

**Keywords:** structural funds, cohesion policy, European Union, operational programme, micro, small and medium-sized enterprises

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**Introduction**

Market economy is characterized predominantly by the majority of private ownership and a significant role of micro, small and medium-sized enterprises\(^1\) in producing goods and providing services\(^2\).

To begin with, they are mainly perceived as entities creating new jobs and allowing for fair competition which, consequently, compels them towards the high quality of the manufactured goods and rendered services according to customers’ expectations. MSMEs fill in any market gaps and demonstrate high elasticity in adjusting to any changes occurring in their business environment and, as a result, generally

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\(^1\) Pursuant to the European Commission Directive (2003/361/WE) of 6\(^{th}\) May 2003. C(2003)1422 commencing as of 1.01.2005 in EU countries the following enterprises shall be included into MSMEs sector: micro enterprises employing no more than 10 people and with annual turnover and/or balance sheet total not exceeding 2 million EUR; small enterprises employing no more than 50 people and with annual turnover and/or balance sheet total between 2–10 million EUR; medium-sized enterprises employing form 51 to 250 people and with annual turnover between 10–50 million EUR and/or balance sheet between 20–43 million EUR, in: "Official Journal of the European Union", L 124/39 as of 20.5.2003. The recommendation introduces three types of enterprises: autonomous enterprise, partner enterprise and linked enterprise. That constitutes a novelty in relation to previous recommendation KE 96/280/WE of 3\(^{rd}\) April 1996, which required.

\(^2\) In the UE the MSMEs sector UE constitutes more than 98% (micro-enterprises constitute 92.2% of that) out of all enterprises (circa 20.7 million of entities employing more than 87 million workers), in: A. Karmańska, *Accountancy for Small and Medium Enterprises – Background for Changes*, „Accountancy” 2013, no. 6, p. 5; In the year 2012 there were 3 975 334 enterprises registered within the REGON system (National Register of Economic Units) in Poland, out of which microenterprises constituted 3 794 489 units, small enterprises constituted 146 489 units, medium enterprises constituted 29 787 units and large enterprises constituted 4 569. However, there were only 1 784 603 units economically active. A conclusion may be drawn than firms in the sector of small and medium enterprises in Polish economy in the year 2012 constituted the staggering 99.8% of all entities registered within the REGON system. Thus, that sector was significantly dominated by microenterprises, in: *Entrepreneurship in Poland*, Ministry of Economy, Warsaw 2013, p. 139.
contribute to the increase of competitiveness. In comparison to large enterprises, they are characterized by greater mobility and the ability to flexibly adjust to any demand alterations. Moreover, many small and medium-sized enterprises cooperate as subcontractors of large enterprises. Due to their role in job creation and swift adjustment to any market changes, small and medium-sized enterprises occupy a significant position in local and regional development. In addition, they are considered the main factor of economic growth and poverty reduction. It is them which are above all responsible for the economic growth and competition increase. Owing to their flexibility, innovations and openness, MSMEs constitute a significant component of the economy. Micro, small and medium-sized enterprises operating particularly in a business environment changing so rapidly, when the world’s markets are dominated by global competition, perform the prominent role of a booster towards the economic growth and technological progress.

Micro, small and medium-sized enterprises have the capacity of enormous potential for growth capability and job creation within the modern society of tomorrow founded on qualifications and know-how.

The increase of importance of that sector of the economy may be strongly supported by the fact that MSMEs are recognised as holding 99.8% of the total number of all enterprises in the European Union economy and employ 75% of the working population as well as generating approximately 70.5% of the gross domestic product, performing the most significant role in trade and services. In comparison to large enterprises, MSMEs are characterized by greater mobility and the ability to flexibly adjust to any changes in demand.

The competitiveness of micro, small and medium-sized enterprises constitutes one of the most crucial factors of the dynamic development of entrepreneurship in any state. The accession of Poland to the European Union structures entailed the

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4 The role of the MSMEs sector in Poland is significant. MSMEs employ over 6 million people and generate approximately 50% of GDP.

5 For detailed data regarding the number of entities and the number of employees both in Poland and the UE see: M. Waga, Financing Small and Medium Enterprises in the Context of Their Financial Situation, „Studia BAS” 2014, vol. 37, no. 1, p. 30; P. Wymenga, V. Spanikova, A. Barker, J. Konings, E. Canton, EU SMEs in 2012: At the Crossroads. Annual Report on Small and Medium-Sized Enterprises in the EU, Rotterdam 2011/2012: Ecorsys Nederland BV.
increase of the importance of the competitiveness of Polish enterprises within the EU markets. Expanding operation onto those markets represents one of the means of constructing a strong and stable position of any enterprise, which, as a result, may thrive on not only regional but also global markets. That, however, requires sufficient resources which are not always within the reach of micro and small, or even medium-sized enterprises. One of the fundamental obstacles which the MSMEs sector encounter is restricted access to the capital indispensable for the performance of the investment tasks. Tasks which aim at the improvement of production innovative processes or implementing new or enhanced products. One of the possible solutions is the opportunity of the utilization of European funds by the micro, small and medium-sized enterprises within a given operational programmes’ framework, whose objectives are precisely directed towards the improvement of competitiveness and innovativeness of the MSMEs sector, as well as the professional qualifications of their employees.

Furthermore, business entities which have been recognized as micro, small and medium-sized enterprises (MSMEs), are given preferential treatment in obtaining the European funds. In the financial perspective for the years 2007–2013, the MSMEs sector acquired a substantial portion of the financial means earmarked for, inter alia, the boost of growth of innovations and investments. Moreover, as far as the assistance in regional investments of the majority of voivodships in Poland is concerned, the level of the co-financing of the ventures undertaken by the MSMEs [Tab. 1] reached up to 70% of the classified project costs reimbursement. It should also be emphasized that some of the programmes have been devised only and solely for the needs of the MSMEs sector.

6 Development of MSMEs in Poland is crucial to expand local entrepreneurship, establish well-structured, effective economy, and increase competitiveness of the Polish companies on the common European market
7 In most cases, large enterprises are not eligible to apply for operational funds, which were earmarked for utilisation by micro, small and medium-sized enterprises.
8 Regional assistance refers to beneficiary’s economic performance and the fulfilment of an investment within particular area. The assistance is directed for development and co-financing of investment operations as well as jobs creation. EU Commission Ordinance (WE) no. 800/2008 as of 6 August 2008, acknowledging certain assistance as consistent with the common market as pursuant to Art. 87 and 88 of the Treaty, “Official Journal of the European Union” 2008, no. 9.8, L. 214, Brussels 2008.
9 The regional assistance intensity depends on the regional assistance’s framework approved for a particular EU member state for the years 2007–2013. The framework differentiates with regard to the amount permissible as well as it depends on the location of a project in a particular voivodship.
Table 1. Public Assistance in Projects’ Costs Co-Financing for MSMEs Enterprises for the Years 2007–2013

<table>
<thead>
<tr>
<th>Region</th>
<th>Micro and Small</th>
<th>Medium</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>Warsaw – Capital City Masovian [Mazowieckie] – since 01.01.2011</td>
<td>50%</td>
<td>40%</td>
<td>30%</td>
</tr>
<tr>
<td>Masovian Voivodship excluding Warsaw, Lower Silesian [Dolnośląskie]</td>
<td>60%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>Pomeranian [Pomorskie] Silesian [Śląskie]</td>
<td>70%</td>
<td>60%</td>
<td>50%</td>
</tr>
<tr>
<td>Greater Poland [Wielkopolskie] West Pomeranian [Zachodniopomorskie]</td>
<td>80%</td>
<td>70%</td>
<td>60%</td>
</tr>
</tbody>
</table>


The main aim of the article is to present the benefits and barriers of projects financing via the means of the European funds by MSMEs. The analysis was based upon the statistics data published in Poland by the Ministry of Infrastructure and Development, Eurostat and the European Commission. The analysis of the sources on the subject as well as observations of the business practices allowed the formation of a thesis that Poland competently utilised the European funds between the years 2007–2013 and thereby benefited considerably. The EU funds have been a useful instrument in reducing the impact of the economic crisis. Well invested EU funds have also had a positive effect on the Polish GDP growth and have increased the competitiveness of the Polish economy. Nonetheless, despite the significant influence of the funds within the GDP growth dynamics and the increase in the standard of living, in the overall view the Polish economy has not gained much in the innovation aspect due to the fact that the financial resources acquired by the Polish companies from the subsidies were largely earmarked to purchase the already existing western technologies, thus, making them dependent upon the know-how of the huge western conglomerates – which must be disapprovingly assessed. Moreover, it should be indicated that while transferring the funds to the beneficiaries there was a lack of determination to expect viable relations between the projects and the economic development. So far, we have not been able to devise an effective mechanism of transferring scientific research into the Polish economy. The deficiency in innovations among Polish enterprises hampers their competitiveness and finally leads to the stagnation of economy.\(^\text{10}\) Business entities have to be innovative in order to be recognised

\(^\text{10}\) According to the Innovation Union Scoreboard 2014 latest report Poland achieved the synthetic rate of innovation at the level of 0.279 and, thus, entered the group of countries of reasonable innovation.
in the world due to the fact that the scheme of low pay, low cost and cheap product is no longer an effective one. Therefore, the new financial perspective for the years 2014–2020 shall also focus on activities aimed at the increase of innovations and the competitiveness of the Polish economy. Four issues will have to be fulfilled: research, development, implementation and the expansion onto foreign markets. Only the projects that are complete starting from the very idea to their market expansion, shall receive funds and support.

1. Allocation of European Union Funds for the Period 2007–2013

The UE funds are allocated to the member states over 7 years based on a series of criteria: eligible population, national wealth, regional wealth and unemployment rate. Then, each country decides how to distribute the resources among its regions. For the period 2007–2013, ten new EU countries (which joined the UE in 2004) received on average 166% more than they did in 2004–2006. On the other hand, the 15 countries that were members before 2004, received on average 30% less funds than they did in 2000–200611.

Poland was the biggest beneficiary of EU grants for 2007–2013 (see: Figure 1)12. From the total amount of more than € 347 billion, Poland received € 67.3 billion, that is the highest, so far, financial support granted for one country during a period of seven years13. The second biggest beneficiary of EU grants under the cohesion policy is Spain, which received € 35.2 billion, that is less than half the support granted usually referred to as “moderate innovators”. Out of all EU countries Poland only outran Romania (0.237), Latvia (0.221) and Bulgaria (0.188). In year on year comparison Poland moved from the group of weak innovators to the group of moderate innovators. However, it is not a source of great optimism. Poland with its innovation rate still lags behind the EU average in most categories (Innovation Union Scoreboard 2014). It is true that Poland noted an increase in the SII rate of innovations for the years 2006–2013 (on average 0.9% annually), but the increase was much slower than the growth of the same index for the whole EU (on average 1.7% annually) so the innovative gap between Poland and the EU has actually widened.  

12 Poland is the largest recipient of the UE funds. Every fifth Euro will come to Poland. It can be seen that the amount of support for Poland per capita is not the highest when compared with other new Member States (funds per capita ratio is the highest in the Czech Republic, Estonia and Hungary). It is worth noting, however, that Poland is the largest of the new Member States in the enlarged European Union, both in terms of its territory and population. Importantly, the funds available from the EU budget may, on average, account for nearly 4% of the Polish GDP per year.
13 On average (until 2015), EUR 9.5 billion will be spent in Poland annually, which is the equivalent to approximately 5% of the Gross Domestic Product, [in:] Poland and its funds (2009), Ministry of Regional Development, Warsaw, p. 21.
to Poland. The smallest recipient of funds is Luxembourg, which received about € 65 million i.e. one-hundredth of the funds allocated to Poland. With regards to the funds granted to the CEE countries that joined the EU in 2004 and 2007, there is also a large discrepancy. The Czech Republic and Hungary received funds amounting to € 25–26 billion, while the other five countries (Lithuania, Bulgaria, Latvia, Slovenia, Estonia) each received less than € 7 billion\(^\text{14}\).

**Figure 1. The Value of EU Support from the Structural Funds and the Cohesion Fund for the Period 2007–2013 (million €)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Value (million €)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>67,284</td>
</tr>
<tr>
<td>Spain</td>
<td>35,216</td>
</tr>
<tr>
<td>Italy</td>
<td>28,812</td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>26,691</td>
</tr>
<tr>
<td>Germany</td>
<td>26,339</td>
</tr>
<tr>
<td>Hungary</td>
<td>25,307</td>
</tr>
<tr>
<td>Portugal</td>
<td>21,510</td>
</tr>
<tr>
<td>Greece</td>
<td>20,420</td>
</tr>
<tr>
<td>Romania</td>
<td>19,668</td>
</tr>
<tr>
<td>France</td>
<td>14,320</td>
</tr>
<tr>
<td>Slovakia</td>
<td>11,588</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10,613</td>
</tr>
<tr>
<td>Lithuania</td>
<td>6,884</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>6,853</td>
</tr>
<tr>
<td>Latvia</td>
<td>4,621</td>
</tr>
<tr>
<td>Slovenia</td>
<td>4,205</td>
</tr>
<tr>
<td>Estonia</td>
<td>3,456</td>
</tr>
<tr>
<td>Belgium</td>
<td>2,257</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1,907</td>
</tr>
<tr>
<td>Sweden</td>
<td>1,891</td>
</tr>
<tr>
<td>Finland</td>
<td>1,716</td>
</tr>
<tr>
<td>Austria</td>
<td>1,461</td>
</tr>
<tr>
<td>Ireland</td>
<td>902</td>
</tr>
<tr>
<td>Malta</td>
<td>855</td>
</tr>
<tr>
<td>Cyprus</td>
<td>640</td>
</tr>
<tr>
<td>Denmark</td>
<td>613</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>65</td>
</tr>
</tbody>
</table>


Among the 12 new EU members, 10 countries that joined the EU in 2004 received funds in the previous period 2000–2006, while Bulgaria and Romania, due to the accession in 2007, have less experience in disposing of the grants. These are also the poorest countries in the EU, however, some improvement can be seen in their economic situation. The following table shows the basic macroeconomic data related to the CEE countries in 2004 and 2013.

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Table 2. Basic Macroeconomic Data of the CEE Countries in 2004 and 2013

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>6</td>
<td>35</td>
<td>47</td>
<td>12.1</td>
<td>13.1</td>
<td>37.0</td>
<td>18.9</td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>8</td>
<td>75</td>
<td>80</td>
<td>8.3</td>
<td>7.6</td>
<td>30.1</td>
<td>46.0</td>
</tr>
<tr>
<td>Estonia</td>
<td>1</td>
<td>57</td>
<td>72</td>
<td>9.7</td>
<td>8.4</td>
<td>5.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Hungary</td>
<td>7</td>
<td>64</td>
<td>67</td>
<td>6.1</td>
<td>8.7</td>
<td>59.1</td>
<td>79.2</td>
</tr>
<tr>
<td>Latvia</td>
<td>1</td>
<td>46</td>
<td>67</td>
<td>10.4</td>
<td>11.5</td>
<td>14.9</td>
<td>38.1</td>
</tr>
<tr>
<td>Lithuania</td>
<td>1</td>
<td>50</td>
<td>74</td>
<td>11.4</td>
<td>10.9</td>
<td>19.4</td>
<td>39.4</td>
</tr>
<tr>
<td>Poland</td>
<td>16</td>
<td>51</td>
<td>68</td>
<td>19.0</td>
<td>10.0</td>
<td>45.7</td>
<td>57.0</td>
</tr>
<tr>
<td>Romania</td>
<td>8</td>
<td>34</td>
<td>54</td>
<td>8.0</td>
<td>7.3</td>
<td>18.7</td>
<td>38.4</td>
</tr>
<tr>
<td>Slovakia</td>
<td>4</td>
<td>57</td>
<td>76</td>
<td>18.2</td>
<td>14.1</td>
<td>41.5</td>
<td>55.4</td>
</tr>
<tr>
<td>Slovenia</td>
<td>2</td>
<td>87</td>
<td>83</td>
<td>6.3</td>
<td>9.7</td>
<td>27.4</td>
<td>71.7</td>
</tr>
</tbody>
</table>

1 GDP per capita in Purchasing Power Standard (EU27 =100).
2 Unemployment rates represent unemployed persons as a percentage of the labour force.
3 Public debt as a percentage of gross domestic product.


It is worth noting that the fundamental indicator of the wealth of a country or region (GDP per capita in PPS) increased in 2013 compared to 2004 in 9 countries (decreased by 4 percentage point only in Slovenia). The largest increase of 24 percentage points was recorded in Lithuania. The financial means received within the funds and EU programmes played a significant role in the national economies of these countries and aided them in solving key social and economic issues.

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15 The leaders of the European Union are: (data for 2011) Luxembourg (271% of the Union average), Holland (131%) as well as Austria and Ireland. The aforementioned information cannot arouse optimism as it shows enormous discrepancies in the well-being of the European Union member countries, and the distant position of Poland (see: J. Ostaszewski, E. Malinowska-Misiąg, P. Russel, Economic Crisis in the European Union. and the General Government Financial Situation with Particular Focus of Poland. Part 1, ”Journal of Management and Financial Sciences” 2013, vol. VI, no. 13, pp. 70–71).
2. European Funds for Enterprises in the Financial Framework for the Years 2007–2013

Between 2007–2013 Poland was granted more than 85.6 billion Euros in European aid and that includes:

- € 67.3 billion allocated from the EU budget,
- € 11.9 billion allocated from domestic public funds (including circa € 5.93 billion from the state budget),
- about. € 6.4 billion to be allocated from private business entities16.

This constituted almost 1/5 of the total amount earmarked for the Cohesion Policy of the European Union for the years 2007–2013. Poland was a major beneficiary of the European funds among the “new” member states of the European Union and the aid for entrepreneurs was granted within the Operational Programmes. The detailed division of the structural funds and Cohesion Funds in Poland in reference to particular operational programmes is as follows:

Table 3. Division of Structural Funds and Cohesion Fund According to Operational Programmes

<table>
<thead>
<tr>
<th>Programme</th>
<th>Financial Resources</th>
<th>Financial Resources (% of the total amount)</th>
<th>Source of Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational Programme Infrastructure and Environment (OPI&amp;E)</td>
<td>€ 27.9 billion</td>
<td>41.9%</td>
<td>European Regional Development Fund (ERDF), Cohesion Fund</td>
</tr>
<tr>
<td>16 Regional Operational Programmes (ROP)</td>
<td>€ 16.6 billion</td>
<td>24.9%</td>
<td>ERDF</td>
</tr>
<tr>
<td>Human Capital Operational Programme (HCOP)</td>
<td>€ 9.7 billion</td>
<td>14.6%</td>
<td>ESF</td>
</tr>
<tr>
<td>Innovative Economy Programme</td>
<td>€ 8.3 billion</td>
<td>12.4%</td>
<td>ERDF</td>
</tr>
<tr>
<td>Operational Programme Development of Eastern Poland (OP DEP)</td>
<td>€ 2.3 billion</td>
<td>3.4%</td>
<td>ERDF (including € 992 million granted by the European Commission)</td>
</tr>
<tr>
<td>Technical Assistance Operational Programme (TAOP)</td>
<td>€ 0.5 billion</td>
<td>0.8%</td>
<td>ERDF</td>
</tr>
<tr>
<td>European Territorial Cooperation Operational Programme</td>
<td>€ 0.7 billion</td>
<td>1.12%</td>
<td>ERDF</td>
</tr>
</tbody>
</table>


16 Additionally, in 2011 Poland received means within the so called technical adjustment scheme which increased the available financial resources for about € 0.6 billion furthermore. That resulted from the fact that Poland achieved better economic performance than it had been estimated by the European Commission at the time of the budget planning for the years 2007–2013. Thus, the allocation sum toward which we shall refer the level of contracting and payments amounts to € 67.9 billion.
The remaining financial resources within both the structural funds and Cohesion Fund were earmarked for the creation of the national performance reserve (2% of the total value of the allocation, i.e. €1.3 billion).

Each particular name of the programme immediately suggests their purpose. The general assumption has been that each programme defines specific goals, the means of their achievement, the viability to financial costs and the scope of operation, beneficiaries (recipients of the operations) and the implementing entities (institutions and organizations which are eligible to apply for financing)\textsuperscript{17}. Moreover, the inclusion of the European funds into the state budget as budget revenues constituted a principle amendment in the financial framework for the years 2007–2013\textsuperscript{18}.

All projects financed with the means of the European funds must bear an added value, i.e. produce additional results, such as changes in the technological process, innovative operation, rendering novel services or offering an uncommon range of products or the creation of new workplaces. Additionally, the enterprises may be granted subsidies to co-finance the ongoing projects in the form of reimbursements or advance payments\textsuperscript{19}.

The National Cohesion Strategy (NCS) for the years 2007–2013 (National Strategic Reference Framework) sets forth the directions and the amount of the financial support earmarked for the implementation of development processes on the part of the European Funds. It is a strategic document stipulating the priorities and areas of utilisation as well as the methods of implementation of the European Regional Development Fund, European Social Fund and Cohesion Fund in Poland within the European Community budget for the years 2007–2013.

According to the NCS, the creation of favourable conditions for the Polish economy competitiveness increase based on know-how and entrepreneurship, providing employment growth and increase of the level of social, economic and special development cohesion, constitute strategic objectives.

Funds directed to MSMEs are intended to amplify both their competitiveness and investment capacity. In order to achieve that, the entrepreneurs may perform fundamental alterations of their products or of the whole production process, particularly via rationalisation, diversification or modernisation. Therefore, both micro,

\textsuperscript{17} A. Jankowska, A. Kierkowski, R. Knopik, \textit{Aid Funds for Poland after its EU Accession – Structural Funds and Cohesion Fund}, Polish Agency for Enterprise Development, Warsaw 2004, p. 11.

\textsuperscript{18} M. Borkowska, \textit{Presentation of the European Funds for the Entities in the Public Finance Sector}, “Accountancy” 2010, no. 4, p. 20.

small and large enterprises must take into account innovations in the management system or environment protection. All work associated with the preparation and implementation of the production process as well as the phasing in of the new or improved products and services can be classified as innovations. Moreover, projects which aim at the creation of favourable conditions of collaboration between private investors and entrepreneurs who seek financial means for either the execution of innovative ventures or the implementation of their own or purchased new technological solutions or even launching the production of new products, may be subsidized with EU funds. However, during the preparatory stage of the project eligible for support from regional programmes, specific problems of each particular voivodship shall be taken into account. In many circumstances only those projects which, from the point of view of the local governments, are perceived as the ones contributing to the development of the voivodship or unravelling the voivodship's problems to the utmost degree will be given priority and thus subsidized. Priority may also be granted to projects which contribute to the creation of jobs or projects which are located in the areas of a particularly unfavourable socio-economic background. It is worth mentioning that projects which can be completed through EU financial means might be divided into investment projects and research projects, which is presented in the following table.

Table 4. Types and Examples of Projects Co-Financed with EU Funds

<table>
<thead>
<tr>
<th>Investment Projects</th>
<th>Research Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>– formation and development of an enterprise</td>
<td>– purchase of the results of the research and development work (R&amp;D), intellectual property rights such as patents, licences, know-how or any other non-patented technological knowledge</td>
</tr>
<tr>
<td>– expanding the scope of business of an enterprise</td>
<td>– support granted for the acquisition of the exclusive rights (e.g. patents) for own technological solutions</td>
</tr>
<tr>
<td>– implementation of fundamental alterations in the output or the production process or alterations within the scope of the services rendered</td>
<td>– investment support for R&amp;D activities within enterprises</td>
</tr>
<tr>
<td>– purchase of tangible assets necessary for the modernisation process and further development of the economic activity</td>
<td>– support for the implementation of innovative processes of goods and services manufacture, organisational structures and market solutions (including implementation of the results of own R&amp;D work)</td>
</tr>
<tr>
<td>– adjustment of the goods to the market needs</td>
<td>– support for the implementation and commercialisation of innovative goods and services as well as product-technological platforms</td>
</tr>
<tr>
<td>– construction, expansion or reconstruction of the devices, machinery and installations both conducing energy and raw materials efficiency as well as reducing emissions of harmful substances</td>
<td></td>
</tr>
<tr>
<td>– improvement of business operation via development of IT infrastructure</td>
<td></td>
</tr>
<tr>
<td>– adjustment of standards compliant with the mandatory domestic and international regulations (certification of goods and services)</td>
<td></td>
</tr>
</tbody>
</table>

Source: own work based on research.
MSMEs enterprises are eligible to acquire financial means to finance a variety of projects within numerous operational programmes. Thus, European Funds constitute ample opportunities for entrepreneurs. It should also be emphasized that the reimbursement of the sustained costs (equal the amount of the subsidy) once the investment process is completed may constitute splendid investment capital for further enterprise’s development activities. Unfortunately, the path for the funds acquisition is paved with numerous barriers and obstacles, which are frequently difficult to overcome.

3. Barriers and Benefits of Financing Projects for MSMEs Within the EU Funds

Co-financing of the project implementation with the means of European funds involves numerous benefits. The primary benefit is the fact that subsidies constitute an additional lucrative source of financing for enterprises, which enables them to accomplish an investment at a significantly lower cost than if they utilised other sources such as credit or a lease. Such financial means which need not to be returned certainly constitute an alleviating factor for one of the most serious side effects of the economic downturn such as restricted access to financial means in the economy. Entrepreneurs were well aware of the fact and readily reached for the European funds support. Apparently, even the restrictions in the banks’ lending did not hamper the process. The opportunity to use advance payments not only increased access to cash but also lowered the costs of its gaining. The entrepreneurs learnt that European funds were a splendid way to develop their businesses. Subsidies allowed them to implement the investment faster and purchase and utilize state-of-the-art technologies, which otherwise an enterprise financing the purchase only with its own contribution could not afford. They also allowed the creation of new jobs. Moreover, European funds favourably influenced companies’ development and improved their competitiveness on the international markets. The funds enabled enterprises to become more innovative and gain a competitive edge. The wide range of aid provided by the EU funds was a crucial factor here as well. An enterprise might apply for the co-financing of projects relating to various fields. Beginning with the purchase of tangible assets, through land purchase or immaterial and legal assets purchase up to consulting and training activities (via subsidizing personal development and the improvement of vocational training for staff).

It should be noted that the financial means of the EU funds were earmarked not only for existing enterprises but also for start-up companies entering the market.
Thus, subsidies may significantly contribute to job creation and as a result to unemployment reduction. That is why, it is essential to utilize EU financial means granted to Poland between 2007–2013 in an effective and efficient manner.

Nonetheless, apart from benefits related to the subsidies’ utilization, some drawbacks may be pointed out\(^\text{20}\). These include:

- **Formalism and complexity of the application procedures.** In the first place, one should emphasise strict and too short deadlines for application submissions as well as difficulties in both completing application forms and submitting the required documents. Enterprises have considerable difficulty in submitting application forms correctly. The application forms are too complex and additionally they require numerous appendices, which may be obtained no sooner than after several months. Appropriate documentation submission entails a dozen or more of weeks of concerted effort of a team of people. In addition, frequent changes in the competition documentation; including changes of opening dates, changes in guidelines for applicants or alterations of instructions for applications’ completion, incomprehensible and unintelligible language of the applications, all that makes the interpretation of regulations even more difficult. All the above generates the need to resort to the help of consultancy firms, whose services are expensive and do not guarantee the granting of the subsidy. Many enterprises cannot or could not afford their services anyway. It must also be emphasized that when it comes to the initial assessment of the application, especially its formal stage, it is marked by significant formalism and bureaucracy, which results in the fact that any amendments to the applications frequently concern irrelevant matters. That resulted in the prolongation of the assessment procedure itself and generated additional costs or, in some cases, it resulted in a complete application rejection. The formal criteria at the regional level were too complex and focused upon the requirements of a bureaucratic nature. Additionally, they are subject to specialization within check lists, which in return causes the formal assessment scheme to be unclear and complicated. For example, in the Kujawsko-Pomorski region a 31-pages long table sets forth the formal criteria. It is also worth mentioning that the time between the documentation submission and receiving the information on a positive application assessment is relatively long and varies from several months to even a year.

• Once we joined the European Union a new strategy was coined: “Let us blame Brussels for everything” by increasing bureaucracy. Complicated by-laws were created to hedge officials against decision-making and thus against responsibility. “Because the Union requires that” – in that way the clerks explain the necessity to fill in a table or some additional documents, which is a clearly Polish innovative contribution.

• Lack of clear information concerning deadlines and institutions servicing a specific EU programme as well as complicated guidelines concerning a given programme. Each programme usually had separate guidelines and as a result an entrepreneur had to familiarise themselves with a number of requirements referring to a specific project completion.

• More than 170 institutions are involved in the EU funds utilisation. In most cases, the potential barriers related to human factors and administrative work. The people servicing the EU funds pile up the procedures.

• Insufficient financial means allocated from the European Union to the entrepreneurs and fears that the resources might have depleted much sooner than it had been stipulated in the operational programme timeframe. For instance, government experts predicted that the financial resources within the HCOP would suffice until the end of the year 2011 if the number of applications kept increasing at such a rate as had been seen recently. In reality, it meant the significant dominance of EU funds demand over their supply. The intensity of financial means allocation for the projects’ completion within programmes devised for enterprises was far too small in relation to the needs, which was reflected in the number of applications submitted. Frequently, the allocation of financial means within a specific programme was exceeded several or even more times. That caused disgruntlement among entrepreneurs who, encouraged to utilize the EU support programmes, decided to submit the application. It often resulted in the fact that once the competition was closed the budgets of the programmes had been depleted due to the large number of applications submitted by the entrepreneurs.

• Difficulties in classifying costs as those eligible for reimbursements from the EU funds.

• Many programmes required one’s own contribution and as a result, due to lack of some financial means, some entrepreneurs were unable to apply for support and resigned at the very initial stage of applications. Most projects were subsidized on the principle of a refund, i.e. an enterprise receives a subsidy in tranches, providing that the sustained expenditures had already been settled. That required additional means during the project completion in the form of pre-financing. As we have frequently learnt from experience, a tranche is transferred after a few
months after the costs had been sustained. Moreover, it was impossible to foresee even an approximate date of the tranche transfer, which hindered proper financial planning and could influence the higher risk of financial liquidity loss.

- Formal requirements concerning a business plan and application for the EU subsidy frequently constituted a considerable barrier, especially in the case of micro businesses or individuals commencing their economic performance for the first time.

- Obstacles related to the so called “human factor” and particularly:
  - carelessness while preparing the application documents and disregard for the guidelines for the compilation of particular documents;
  - difficulties in supervising timelines of the support contract fulfilment;
  - lack of habit of becoming acquainted with the signed contracts and difficulties in the contracts comprehension;
  - inability to plan crucial stages of the project implementation and ineptitude to foresee possible ways of the enterprise development resulting from the venture;
  - lack of sufficient knowledge in the field of financial planning. That particularly concerns micro enterprises which were unable to assess the project within its financial perspective and its possible outcome. Entrepreneurs merely had a business idea and the required resources. However, when one takes advantage of European funds, they have to plan everything precisely. Failure to attain the objectives or inability to sustain them, results in the necessity to return the funds;
  - lack of sufficient synergy effect between projects’ evaluation conducted by the institution managing the operational programme and the projects’ attainability verification conducted by the bank granting the loan. As we learn from experience, numerous ventures, which had been granted a project financing commitment from the bank, were not approved by the experts as projects of economic viability;
  - insufficient “business culture” such as not adhering to deadlines or lack of supervision concerning documentation and correspondence.

- Extended waiting period for the financial means, which resulted in subsidy final settlement difficulties. Obtaining the decision on the subsidy approval and signing the project financing commitment agreement does not and did not end the application process. Lack of clearly stated regulations concerning the subsidy settlement and the amount and complexity of documentation which must be collected and submitted by the entrepreneurs to the institutions managing a specific project, constituted a significant obstacle which hampered access to the funds at the stage of their settlement.
European funds are subject to taxation, hence the amount of the received EU subsidy constituted a tax base for income tax.

If an entrepreneur took the opportunity to utilise European funds, they were obliged to perform the economic activity for at least 5 years, which could be difficult to fulfil in the case of small scale ventures. If a project had been devised to sustain an investment or jobs, the period amounted to 3 years counting from the date of the project’s completion.

The European subsidies have not invigorated the development of the innovation among Polish enterprises either. The financial means acquired within subsidies by Polish companies were largely earmarked for the purchase of the already existing western technologies. Thus, in practice the enterprises just utilized the novel solutions becoming merely their consumers. In that way they not only became dependent on the know-how released by large conglomerates but also essentially drove the development of the economies of the well-off countries. Yet, investing in your own inventions and implementing new solutions in the production constitute the primary condition for the development of innovation in general. Only then may the enterprises gain the competitive advantage and offer their products at higher prices not only in their own countries but also abroad. Clients are willing to pay more for innovative, earlier unknown solutions and as a result not only the company becomes richer but also the domestic economy. So, basically Poland still remains a potential large sales market for the well-off countries of the European Union. Consequently, any activities aimed at the increase of the innovation and competitiveness of the Polish economy shall be crucial for the new financial perspective for the years 2014–2020.

In conclusion, it may be stated that despite all the difficulties in applying for the European funds Polish entrepreneurs displayed a growing interest in absorbing the financial means year by year. That comes as a great merit and EU subsidies are regarded as exceptionally attractive among the other sources of financing of economic activity. The funds were nonreturnable and constituted a crucial factor in alleviating one of the most severe drawbacks of the economic downturn, namely the restricted access to financial means in the economy.

**Conclusion**

To date, Poland has been granted €85.6 billion of European aid within the European Social Fund, European Regional Development Fund and European Agricultural Fund for Rural Development to implement a variety of projects. The money was utilized
by Polish enterprises, farmers, local governments, non-governmental organizations and other institutions. Finance received from EU funds and programmes was vital for the national economy as it helped solve crucial socio-economic problems.

The current experiences of acquiring financial means from EU funds by Polish entrepreneurs indicate their substantial impact on the increase of competitiveness in the European markets. Considering the economic downturn, EU subsidies are worth their weight in gold as subsidies may support enterprises during hard times. They are nonreturnable and constitute a crucial factor in alleviating one of the most severe drawbacks of the economic downturn, namely the restricted access to financial means in the economy. Unfortunately, the satisfaction is blurred by numerous barriers mentioned above in the article. However, each announced competition held within specific programmes and operations not only raised awareness among entrepreneurs regarding requirements set by the implementation entities, but also improved the attitudes of these entities towards their beneficiaries.

The financial perspective of the European funds absorption for the years 2007–2013 approached its end. At this point it is difficult to draw any unequivocal conclusions regarding the accomplishments of the projects’ objectives and the efficiency of utilizing of the granted subsidies within particular programmes. Such analysis would have been feasible once the programmes’ period is completed (in accordance with the principle of the n + 2 in 2015)\(^{21}\). Then, we will be able to clearly point out the obstacles encountered and formulate recommendations concerning routes for their possible elimination in the future. Nonetheless, Polish entrepreneurs displayed a growing interest in absorbing the EU financial means year by year, which was noticeably confirmed by the much sooner depletion of the funds than it had been initially anticipated in the current programmes’ duration period.

The accomplished projects allowed for the further development of numerous enterprises, modernisation of the production processes due to the purchase of machinery and the utilisation of cutting-edge technologies or, basically, they permitted the increase of the output capacity. As a result, the funds ensured increased revenues for the beneficiaries, created countless jobs and provided opportunities for further

\(^{21}\) In the period of 2007–2013 a rule of n+3 was introduced for the first three years of the operational programmes implementation. That meant that the funds granted for Poland for the year 2007 (n year) could have been utilised up to the year 2010 (n+3), the funds granted for the year 2009 up to the year 2012 and the funds granted for 2010 up to the year 2013. For the following years (i.e. 2011–2013) a rule n+2 applies, so this means the final deadline of the disbursement of the funds comes in 2015. Therefore, the ultimate and precise assessment of the utilisation of the funds in the 2007–2013 perspective shall be viable no sooner than in the year 2016.
extensive collaboration with other businesses and research institutions. Taking these facts into account, they speak favourably of the advantages concerning EU funds.

Poland was granted €82 billion within the two financial perspectives and that amount translates onto 189 thousand projects, out of which 70 thousand were completed by the entities from the MSMEs sector. After ten years of EU membership the financial balance between Poland and the European Union is quite favourable for Poland. It may be unequivocally stated that the Polish economy benefited significantly due to the skilful utilisation of the European funds in the years 2007–2013\(^{22}\). That undoubtedly enabled Poland to avoid economic recession which occurred as the aftermath of the global financial crisis that affected at that time most of the EU countries.

Nonetheless, despite the significant influence of the funds onto the GDP growth dynamics and the increase in the standard of living, in the overall view the Polish economy has not gained much in the innovation aspect due to the fact that the financial resources acquired by the Polish companies from the subsidies were largely earmarked to purchase the already existing western technologies, thus, making them dependent upon the know-how of the huge western conglomerates – which must be disapprovingly assessed. While transferring the funds to the beneficiaries there was a lack of determination to expect viable relations between the projects and the economic development. So far, we have not been able to devise any effective mechanisms of transferring scientific research into the Polish economy.

Let us hope that once we draw the correct conclusions and eradicate the shortcomings, Poland shall also succeed in the forthcoming financial perspective for the years 2014–2020.

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\(^{22}\) 10 Years in the EU – 10 Years of EU Funds, “European Funds in Poland” 2014, no. 34, pp. 4–5 and 35; http://mapadotacji.gov.pl/statystyki-i-porownania


10. Innovation Union Scoreboard 2014.


Corporate Governance Versus Ethics. The Case of Goldman Sachs

Abstract

The purpose of this paper: The purpose of this paper is to addresses corporate governance shortcomings identified in the pre-crisis period using the example of Goldman Sachs, it attempts to reveal the company’s divergence from fundamental ethical values of the prime interest of shareholders and clients.

Design/methodology/approach: This paper presents a case study of Goldman Sachs, one of the most successful yet the most controversial investment banks known for its strategy in linking politics and business. The practice of Goldman Sachs is identified within the corporate governance and business ethics framework.

Findings: The case study presents and discusses Goldman Sachs’ ethically questionable operations which include helping Greece in the creative accounting for hiding the real debt level though the use of currency swaps, betting against credit default swaps while selling those instruments to clients (ABACUS scheme) and the instrumental treatment of customers referred to by the company as ‘muppets’.

Research implications: The paper proposes an analysis of the structural corporate governance failures which led to the outbreak and development of the credit crunch relating them to unethical and irresponsible behaviour noted in the pre-crisis period. The lack of integrity and strong values, dominant public respect based on the level of consumption and personal wealth as well as the prime priority of generating short term profits proved to be the key drivers for the inefficiencies in corporate governance. The phantom declaration
of ethical conduct and the lack of the internalization of codes of best practice led to trust crisis on the market and resulted in the deterioration of economic performance. 

Originality/value: The paper contributes to the development of the knowledge on both corporate governance and business ethics tracking patterns for the convergence or potential divergence of these two notions. Using the case study of Goldman Sachs it also attempts to understand the behaviour of the largest players on the stock market with regards to their business ethics and corporate governance practice. Finally, the paper studies the causes of the financial crisis rooted in the corporate quest for the highest profitability.

Keywords: corporate governance, business ethics, Goldman Sachs, financial crisis

Introduction

The outbreak of the financial crisis which started in 2007 with the credit crunch and was followed by the sovereign debt of the majority of developed economies raises questions on the macroeconomic policies and market rules. The scope of the systemic problems as well as the depth of the economic slowdown post crucial doubts on the efficiency of corporate governance standards and the degree of their enforcement on the financial markets. The crisis proved that despite the vast set of best practice and recommendations, the main failures causing the credit crunch and leading to the global economic slowdown relate mostly to the systemic shortcomings of corporate governance and the unethical and irresponsible behaviour of public listed companies and financial institutions. The scenarios of companies heavily hit by the financial crisis show clearly that neither the regulation nor the guidelines assure sound corporate governance unless these recommendations are put into force under the conditions of high morale and ethical standards of the executives, board directors and other market participants.

This paper presents the case study of Goldman Sachs, one of the most successful and respected investment banks. It focuses on Goldman Sachs’ ethically questionable operations that are believed to be related to the outbreak of the credit crunch and

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severe problems in the euro zone due to the Greek sovereign debt. The originality of
the paper is to be seen in several dimensions. It searches for mutual links between
corporate governance and ethics emphasizing that the divergence from ethical values
and the narrow focus on short term profitability affects the essence of the fundamental
principles of corporate governance. The paper addresses the corporate governance short-
comings identified in the pre-crisis period and using the example of Goldman Sachs it
attempts to reveal the company’s divergence from the fundamental ethical values of the
prime interest of shareholders and clients. It is important to stress, that the paper does
not intend to blame Goldman Sachs for the systemic corporate governance shortcomings –
rather it shows how the visible example of the bank mirrors the most significant
changes in the investment banking sector implemented within the last 20 years as well as
indicate the most severe ethical and governance challenges in the financial market.
Ultimately, the case of Goldman Sachs illustrates the recurrent problem of the lack of
ethical standards on the stock market and departure from the fundamental rules of the
prime responsibility towards the interest of shareholders and clients.

The paper is organized as follows: the first section discusses the main tasks of
corporate governance pointing at its inefficiencies which contributed to the out-
break of the financial crisis and the uncertainty on the stock market. The second
section analyses the existing links between corporate governance and ethics empha-
sizing the fundamental requirement of the convergence of both notions. The third
section presents the case study of Goldman Sachs, the most successful and most
profitable investment bank which proved not to be hit by the financial crisis yet
encountered itself in problems due to the large controversies of unethical behaviour
and insufficient disclosure to its shareholders and customers. The final remarks are
presented in the conclusion section.

1. Corporate Governance

Corporate governance definitions differ depending on the perspectives they are
derived from. In general, corporate governance is perceived as a “system by which
organizations are directed and controlled and which specifies the distribution of
rights and responsibilities among shareholders and managers and rules and pro-
cedures for making decisions on corporate affairs”4. The shareholder perspective

4 S. Ayuso, A. Argandoña, Responsible Corporate Governance. Towards a Stakeholder Boards of
rooted in the financial model of a corporation understands corporate governance as mechanisms assuring investors receive a return on their investments\textsuperscript{5} or as “a set of constrains that forms the ex-post distribution of wealth”\textsuperscript{6}. However, the growing complexity of business and the rising importance of concepts such as corporate social responsibility and sustainable development emphasize the need to adopt a broader perspective on corporate governance as the role of the company and its board is not only to provide for the value creation for the shareholder but also to assure for high social performance and incorporate the shareholders’ expectations into the company’s strategy and operation. Therefore, the perspective based on the social model of a corporation defines corporate governance as a structure to balance within the relations and interest fulfilment of various groups\textsuperscript{7}. As formulated in “Corporate Governance Principles” by the OECD\textsuperscript{8} “corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”.

The practical dimension of corporate governance sees it as a structure to monitor and motivate executives and to tie their interests with those of the shareholders. Corporate governance consists of a set of monitoring mechanisms including both internal (such as the board of directors, ownership structure and votes, cross shareholdings) and external mechanisms (such as the stock market, the market for corporate control, the market for executives and the debt market) as well as incentive mechanisms such as executive compensation and motivation schemes\textsuperscript{9}. The extensive empirical research and practical debates have led to the formulation of corporate governance recommendations which refer to the board (structure, composition, committees, work, accountability), executive compensation (structure and size) and transparency (information policy, disclosure, investor relations, dialogue with shareholders and stakeholders). As suggested in previous academic studies and emphasized by regulators and practitioners the main corporate governance guidelines include the following\textsuperscript{10}:


• Fulfilling the interests of shareholders while paying attention to the interests and expectations of stakeholders,
• Proving accountability for executives and board directors to both shareholders and stakeholders,
• Responsibility for the actions undertaken,
• Providing transparency and corporate disclosure,
• Assuring sound control and monitoring system via the board of directors which should include directors of an appropriate level of skills and experience, a sufficient number of independent directors, a sufficient degree of board diversity and specialized committees (e.g. audit, remuneration) formed within the board,
• Balancing short term and long term perspectives,
• Providing for an efficient communication and information policy via investor relations,
• Delivering an annual report on corporate governance compliance,
• Assuring an effective compensation system.

Although the best practice contributes significantly to the effective monitoring and control, it does not prevent severe crises and inefficiencies. The recently observed failures indicate the recurrent crisis of corporate governance and call for more studies in order to enhance the effectiveness of the monitoring and control structures. Table 1 presents the main shortcomings with regards to corporate governance mechanisms.

Table 1. Main Corporate Governance Shortcomings

<table>
<thead>
<tr>
<th>Corporate Governance Area</th>
<th>Main Shortcomings</th>
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</thead>
<tbody>
<tr>
<td>Shareholders</td>
<td>Poor shareholder control. Weak shareholder activism.</td>
</tr>
<tr>
<td>Board of directors</td>
<td>Lack of sufficient information – information asymmetry due to the poor quality of data/materials/documents. Inefficient leadership, the lack of separation of the CEO and Chairman. Inadequate board composition – lack of derivative experts, insufficient financial expertise.</td>
</tr>
<tr>
<td>Executive compensation</td>
<td>Lack of the incentive function of executive compensation – decreasing intrinsic motivation, while increasing extrinsic motivation, maximizing total payoffs as the main managerial drive, inefficient use of stock options. Compensation packages motivating high risk taking (large portion paid in cash and tied to short term results). Growing gap between the average CEO compensation and average worker pay from 280 times in 2004 to as much as 520 times in 2008. Poor work of the board and remuneration committee. Low efficiency of independent directors on remuneration committee.</td>
</tr>
</tbody>
</table>
As presented in Table 1 corporate governance failures were not attributed to the lack of know how and the insufficient access to empirical materials. The control and monitoring inefficiencies related mostly to the short term orientation for profit maximization and the lack of the fundamental responsibility of executives towards companies and shareholders. One of the corporate governance inefficiencies refers to poor shareholder control and weak shareholder activism as investors tend to be focused on the increase of firm value over the short term and do not engage in monitoring and governance. The main shortcomings of corporate governance relate mostly to the practice of board work, its structure and composition as the independent directors neither perform effective monitoring nor possess the adequate industry knowledge and experience which leads to severe information asymmetry and the insufficient knowledge on company operation. Without reliable data the board is not able to evaluate and control executives effectively. The lack of the separation of the CEO and Chairman functions impact the board agenda and may be seen as detrimental.

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to board objectivity and independence. The other problematic area of corporate governance is the executive compensation characterized with decreasing incentive function such as the remuneration packages tend to lower the intrinsic motivation of executives, while increasing the extrinsic motivation\textsuperscript{13}. This leads to perceiving the maximization of total payoffs as the main managerial drive. Moreover, compensation packages tend to motivate executives to engage in highly risky activities as a large portion of their remuneration is paid in cash and tied to short term results\textsuperscript{14}. These inefficiencies were not identified early enough by the remuneration committee directors who either lack independence or have remained on the board for many years\textsuperscript{15}. Other listed corporate governance failures refer to inefficient risk management procedures adopted by the board, the audit committee and the company management system as the risk management procedures do not pay adequate attention to the operational activity and financial policy\textsuperscript{16}. The cooperation between the sell side and the buy side which stays at the very fundamentals of corporate governance revealed severe shortcomings with regards to the rating agencies, financial, analysts and investment funds motivated by the maximization of turnover and not by the soundness of the financial system\textsuperscript{17}. These inefficiencies included problematic relationships between companies, financial analysts and investors revealing conflicts of interest and the pressure on sales increase and profitability growth\textsuperscript{18}.

The scope and the impact of the financial crisis which is believed to be heavily rooted in the corporate governance inefficiencies of public listed companies and financial institutions boosted changes in regulations and corporate policies. Newly adopted regulations (e.g. US Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010) and recommendations (e.g. UK Code, EU Green Paper on Corporate Governance, CRD III Directive) are targeted at improving corporate governance standards and increasing transparency to eliminate severe pathologies. The crucial recommendations addressing the failures identified above are listed in Table 2.

\textsuperscript{13} K. Rost, M. Osterloh, \textit{Management Fashion Pay-For-Performance for CEOs}, “Schmalenbach Business Review” 2009, vol. 61, pp. 119–149.


\textsuperscript{16} T. Clarke, J.F. Chanlat, \textit{Introduction}…, op.cit.

\textsuperscript{17} D. Kansas, \textit{Guide of the End of Wall Street as We Know It}, Collins Business, New York 2009; G. Kirkpatrick, \textit{The Corporate Governance}…, op.cit.; M. Isaksson, \textit{Corporate Governance}…, op.cit.

Table 2. Current Directions of Corporate Governance Reforms

<table>
<thead>
<tr>
<th>Corporate Governance Shortcoming</th>
<th>Suggested Reforms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders</td>
<td>Enhancement of shareholder execution rights, adoption of a whistle blowing system. Increase of shareholder activism via the adoption of IT technologies.</td>
</tr>
<tr>
<td>Board of directors</td>
<td>Improved quality of corporate documents/reports. Separation of the CEO and Chairman, lead director function. Improved board composition with the participation of industry experts and members with financial/derivatives expertise.</td>
</tr>
<tr>
<td>Executive compensation</td>
<td>Adequate proportion on fixed and variable pay. Adequate proportion of cash bonus, deferred compensation. Extension of the time period of the remuneration package – balancing short, middle and long term targets. Introduction of claw backs and malus. Increased independence of the remuneration committee.</td>
</tr>
<tr>
<td>Other</td>
<td>Improvement of risk management procedures and reporting. Increased transparency of the rating agencies. Constrains and increased transparency of relations between the rating agencies, financial, analysts and investment funds.</td>
</tr>
</tbody>
</table>

Source: own compilation.

Finally, it is important to mention that corporate governance inefficiencies identified with the outbreak of the financial crisis question the fundamentals of the capitalist economy\(^\text{19}\) and assert pressure for significant changes with respect to the role of business in society\(^\text{20}\). The corporate governance failures cast doubt not only on the effectiveness of the shareholder value approach, but also on its economic and social argumentation. The growing importance of corporate social responsibility as well as the incorporation of stakeholder interests into firm operation adds to the evolution of the company role in society and business. This has impact on the current critic and influences the corporate governance practice and regulation\(^\text{21}\).

2. Corporate Governance and Business Ethics

Ethics is a branch of philosophy with its roots dating back to at least 2500 (BCE) and the seminal works of Socrates, Plato, Aristotle, Kant, Locke which provide a set


of moral values or principles of human conduct. Ethics is a matter of ethos, participation in a community, a practice, a way of life. Ethics as a moral philosophy includes meta-ethics, normative ethics and applied ethics. Despite the extensive studies of ethics the majority of the issues raised by this discipline are neither answered nor solved. The authors debate on the evaluation of egoism, the differences between approaches proposed by utilitarianism and property rights, the problems of ethical relativism. The variety of theories and perspectives (such as deontological, theological, autonomic) stress different points of reference for the evaluation of behaviour. As a result, “there is no consensus as to which behaviours are ethical and which are not” with the emphasis put on the impact and role of culture, social system and religion influencing the framework of the understanding of ethics and morality. The discipline of ethics incurs significant methodological challenges as the content of main issues, their evaluation and personal dedication and motivation can differ significantly depending on the individual and his or her context. However, three dimensions of ethics include: the ethics of social utility, the ethics of human rights and the ethics of justice and fairness.

Business ethics remains one of the most debated aspects in management and finance which faces dramatically diverse statements and opinions ranging from Peter Drucker’s (1981 as quoted in Murthy) declaration that “there is neither a separate ethics of business nor is one needed” to a highly dedicated statement emphasizing that “business ethics becomes a prerequisite for conducting any type of business, particularly in the global marketplace”. Business ethics is understood as “the application of everyday moral or ethical norms to business” although some researchers point out that a company can not be ethical or unethical as this assessment applies only

to individuals or may be used for a description of an activity or behaviour\textsuperscript{32}. The basic assumptions of business ethics are derived from the fundamental notions of respect and dignity assured for every individual in the practical and instrumental solutions applied for everyday work\textsuperscript{33}. Business ethics evolved the development of the importance for addressing the expectations of stakeholders by any organization in the opposition to shareholder capitalism and dominant statements praising greed, profit maximization and self interest\textsuperscript{34}. Its principles are debated with the references to a set of tasks to be fulfilled by the state (on the macroeconomic level), by a company and by an individual (on the microeconomic level). However, the instrumental adoption of business ethics by corporations results in the emergence of the narrow approach to compliance\textsuperscript{35} the so called “tick box mentality”\textsuperscript{36} where ethics is viewed as a component of marketing and PR activities targeted at brand management and image improvement.

The dynamic changes of the essence of business and the development of new responsibilities and expectations addressed towards companies lead to the global phenomenon of the philosophy of business and the emergence of business ethics and social responsibility\textsuperscript{37}. Many corporate failures and scandals as well as existing social and environmental problems result in the understanding of the necessity for the convergence (or at least link) between business and ethics. This leads to the incorporation of ethics and corporate social responsibility into strategies in order to create “an emotional and intellectual bond with a number of stakeholders and acts as the source of authority and credibility for all the company’s dealings”\textsuperscript{38}. Business


\textsuperscript{38} P. Verhezen, \textit{Integrity as Good Reputation}, International Conference on Ethics and Integrity of Governance: A Transatlantic Dialogue, Belgium 2005.
relationships are then built on trust and mutual respect\textsuperscript{39}. The basic fundamentals of ethics can be formulated as following\textsuperscript{40}:

- Transparency, disclosure and consistency – goods and services must conform to all the commitment promised to customers. Business must be realistic and truthful in stating claims,
- Respect and fairness in business service and treatment towards the customers,
- Selflessness, integrity, objective, accountability, openness, honesty and leadership are essentials of business operation,
- Self-regulation as one of the crucial business principles to serve as voluntary guidelines towards the quality of life and advanced standards of business practices.

This approach drives the willingness of companies to declare and list documents defining the responsibilities of organizations to their stakeholders known as the code of ethics\textsuperscript{41}. The code of ethics also referred to the code of conduct or code of business conduct and ethics declaring the major philosophical principles and values in an organization and function as policy to play an essential role for company management in strategy formulations, motivation and communication systems and corporate culture. More importantly, the strong ethical values should assure integrity and accountability which are viewed as the integral components of sound corporate governance and effective leadership\textsuperscript{42}. Thus, the code of ethics while implemented and communicated effectively may contribute to a company’s strengths and its competitive advantage. The observance of business practice indicates also that the best practice of corporate governance which refer to board work, executive compensation, transparency and shareholder activism are closely related with the fundamental assumptions of the ethical behavior of companies. Although ethics and morality are not often stressed in the code of best practice, the essence of corporate governance and the core of their tasks require an ethical approach in all company operations\textsuperscript{43}. Thus, the ethical dimensions of company behaviour or at least formal documents and bylaws providing declaration on the company direction and values should also refer to corporate governance practice. It should be noticed that corporate governance as


\textsuperscript{40} S. Verma, U. Prakash, \textit{Corporate Governance…}, op.cit.


\textsuperscript{43} W. Gasparski, \textit{The Ethical Issue…}, op.cit.
a control and motivation structure formulates a set of rules which are to shape the
operations and the behaviour of companies, investors and executives. While corporate
governance provides for the bottom line requirements and goals of the mechanisms,
business ethics ranges beyond the fundament of the shareholder value and stakeholder
expectations addressing the values of trust, equality, mutual respect, responsibility
and long term orientation. The convergence of values shared by corporate govern-
ance and business ethics should contribute to the development and strengthening of
the organizational culture which implicitly and explicitly describes and shapes the
corporate and employee behaviours explaining which activities are right and which
are wrong. The corporate architecture, communication and motivation systems are
advised to assure for integrity and internationalization of the formulated principles
into practical dimensions of corporate and individual activities. Therefore, the main
assumptions and tasks of monitoring and incentives mechanisms can be described
both from the perspectives of corporate governance and business ethics. Despite
some international and regional differences a set of commonly recognized princi-
pies have found consensus. Using the framework proposed by Verma and Prakash the
ethical principles of corporate governance can be listed as presented in Table 3.

As shown in Table 3 ethical dimensions of corporate governance refer to obeying
essential principles and value including loyalty to shareholders, fairness in dealings
with respect to the company’s matters as well as concern and respect for other share-
holders and stakeholders. The ethical dimension of the board work assumes keeping
promises, trustworthiness and excellence in operation, reputation and morale as well
as a responsibility towards internal stakeholders. Executive compensation should
be structured in a responsible and honest way and should assure for accountability
and excellence in operation in all aspects of the package. A crucial element of ethical
corporate governance lies in the principle of reliable information accessible for all
constituencies, honesty and integrity in operations and disclosure which constitutes
the fundamental assumption of the financial market function. Finally, the ethical

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45 J. Llopis, M. Gonzalez, J. Gasco, Corporate Governance…, op.cit.;
48 S. Verma, U. Prakash, Corporate Governance…, op.cit.
standards of corporate governance require fairness in dealings, concern and respect for all stock market participants and stakeholders\textsuperscript{49}.

\begin{table}[h]
\centering
\begin{tabular}{|l|p{7cm}|p{7cm}|}
\hline
Corporate Governance Mechanism & Main Assumption of Best Practice & Business Ethics Perspective \\
\hline
Shareholder structure & Involvement in the company’s matters, active participation in shareholder meetings, decision upon executive pay and company development. & Loyalty of the shareholder to the company, fairness in dealings with respect to the company’s matters, concern and respect for other shareholders and stakeholders. \\
\hline
Board & Efficient work, adequate composition and structure, accountability. & Promise keeping, trustworthiness and excellence in operation, reputation and morale as well as a responsibility towards internal stakeholders (shareholders, employees etc.) and external stakeholders (customers, communities, creditors etc.). \\
\hline
Executive compensation & Tying interests of the executives with those of the shareholder, motivation towards creating long term sustainable shareholder value. & Responsibility, honesty, accountability and excellence in operation with respect to the pay size, structure and measurement criteria. \\
\hline
Transparency & Providing the required data and reports on the company’s operation, strategy and financial performance. & Providing reliable information accessible for all constituencies, honesty and integrity in operations and disclosure. \\
\hline
Other constituencies & Compliance with the law and best practice, avoiding conflict of interest. & Fairness in dealings, concern and respect for stock market participants (here mostly investors, rating agencies, stock market analysts, media) and business partners (auditors, lawyers, suppliers). \\
\hline
\end{tabular}
\caption{Ethical Perspective on Corporate Governance}
\end{table}

Source: own compilation.

3. The Case of Goldman Sachs

3.1. The Case Study

Goldman Sachs (Goldman Sachs Group Incorporated) is one of the largest, most prominent and most profitable investment banks known for its “culture of success” and strong corporate values\textsuperscript{50}. Founded in 1869 Goldman Sachs operates globally having its headquarter in New York City and its branches in the largest cities worldwide with

\textsuperscript{49} C. Mayer, \textit{Firm Commitment}..., op.cit.

total assets of $923 billion, a total equity of $72.7 billion and revenues estimated at $28.8 billion, operating income $6.1 billion and net income of $4.4 billion. It is an investment banking and securities firm that engages in global investment banking, securities, investment management and other financial services dealing primarily with institutional clients. Its products also include asset management, commercial banking, commodities, mutual funds and prime brokerage. Goldman Sachs as opposed to its peers of Lehman Brothers and Merrill Lynch did not suffer severely from the financial crisis and although covered by the TARP, the bank paid the loan very quickly returning to the path of growth and profitability.

Goldman Sachs is not only the most successful investment bank but remains a mysterious and controversial financial institution also. Being the most prominent investment bank it is also known for its close connections between business and politics (several former Goldman employees work or used to work for the US government) which may raise doubts on the potential for conflict of interest and the threat of influence exerted by the bank over regulations or policies. Goldman Sachs was criticized for its active engagement in introducing the wide range of sophisticated derivatives such as CDOs, synthetic CDOs, CDSs, MBOs etc. which departed the Wall Street services from the Main Street economy.

Although these financial instruments allowed the generation of the highest profits in the industry and achieve the highest ROE indicators as compared to the sector competitors in the industry, these innovations are viewed as a contributor to the credit crunch and outbreak of the financial crisis. The study of the corporate governance of Goldman Sachs delivers however a positive view – the company adopted the corporate governance code of best practice amended in 2011 which includes the following issues:

- The board of directors (independence and oversight, experience and qualifications, engagement and depth of access),
- Director selection and committee structure (accountability, board committees),
- Board oversight (role of the presiding director),
- CEO evaluation,
- Succession planning,
- Compensation,
- Risk management.

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The company follows best practice, assures the full independence of the board whose directors possess the adequate education and experience. Moreover, the board follows the recommendation on separation of the CEO and Chairman functions and forms specialized committees. The Goldman Sachs code of business conduct covers the aspects of the ethical behaviour of the company and its employees addressing the importance of the compliance and reporting, personal conflict of interest, public disclosure, compliance with laws, rules and regulations, corporate opportunities and confidentiality saying that “integrity and honesty are at the heart of our business. We expect our people to maintain high ethical standards in everything they do, both in their work for the firm and in their personal lives”.

However, the case study of Goldman Sachs reveals departure from ethical assumptions and indicates some shortcomings referring to the limited corporate disclosure and unethical attitude towards clients, shareholders and other market participants (Doria et al., 2010). The analysis of the Goldman Sachs strategy shows that its largest problems affecting the company’s reputation as well as the recent stock performance relate to unethical behaviour. Firstly, the bank involved itself in consultations with the Greek government and helped the country to significantly lower its public debt and budget deficit in a short time solely for reporting purposes in order to join the euro zone. Using the derivative deals called cross currency swaps Goldman Sachs helped the Greek government to borrow billions of dollars in 2001 in order to hide the public debt. The transaction was legal (other countries use cross currency swap as well but the size of these deals are much smaller) and the service appeared to be highly lucrative (although Goldman never revealed the money earned on the Greek deal), the bank has come under severe criticism for enabling the government to mislead other countries and institutions. Moreover, the long term result may have severe, negative repercussions on the Greek budget and the euro zone economy.

Secondly, Goldman Sachs offered its clients financial products based on subprime mortgages called the ABACUS scheme causing losses to clients and business partners (IKB Deutsche Industriebank AG). The ABACUS 2007-AC1 was an investment vehicle structured by Goldman Sachs and the hedge fund John Paulson & Co. It was “a bundle of derivates Goldman brought to market for parties to either bet for or against” (Doria et al., 2010). The hedge fund selected bonds which Goldman packed into synthetic collateral debt obligation (CDOs) and which Paulson’s fund bet against. The investors provided capital thinking so that an independent third party selected the CDOs portfolio and assuming that Goldman was selling financial instruments targeted for

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54 J. Doria, K. Musselman, J. Haskins, Ethical Issues…, op.cit.
55 Ibidem.
increase as Moody’s Investors Service rated the deal triple A\textsuperscript{56}. While Paulson’s fund was betting against these CDOs predicting the collapse of the subprime mortgage system in the US they enjoyed the profit of $1 billion while the other investors incurred substantial losses estimated at more than $1 billion. The main problem was that Goldman should have provided full disclosure and transparency about the whole picture of the ABACUS vehicle. In line with the SEC investigation Goldman Sachs has been penalized with a fine of $500 million for insufficient disclosure of its CDO related products\textsuperscript{57}. The ABACUS fraud is viewed as a fundamental shareholder vs. stakeholder conflict where Goldman Sachs focused on shareholder value not providing full disclosure to its customers. Moreover, as the investigation showed the bank employees were aware of the poor quality of the financial instruments and as the emails disclosed were encouraging the bank’s departments to withdraw from the investment. It is important to emphasize that the ABACUS scheme was not the first problematic investment vehicle managed by Goldman. The bank had dealings with Raja Rajaratnama, the founder of the Galeon fund accused of insider trading. Goldman was also sued by its shareholder, an employee pension fund who accused the bank of excessive executive compensation paid at the cost of shareholders. In 2010 alone the bank spent $2.7 billion in compensation and fines\textsuperscript{58}.

Finally, Goldman Sachs was forced to face another image crisis and share price drop lowering the Goldman market capitalization by $2 billion in 2012 as Greg Smith, one of the former directors leaving the company after 12 years disclosed the essentials of corporate culture and customer service standards. In an open letter Greg Smith revealed the instrumental treatment of customers by the bank employees. The customers who were referred to as “muppets” were viewed as a target for “ripping eyeballs out” in order to increase the payoffs to bank employees\textsuperscript{59}. As Greg Smith puts in his letter “No humility? I mean, come on. Integrity? It is eroding. I don’t know of any illegal behavior, but will people push the envelope and pitch lucrative and complicated products to clients even if they are not the simplest investments or the ones most directly aligned with the client’s goals? Absolutely. Every day, in fact”\textsuperscript{60}.

\textsuperscript{60} Ibidem.
3.2. The Discussion

The analysis of the practical dimensions of Goldman Sachs’ activities presented above indicate that while following corporate governance recommendations several ethically controversial cases can be identified. The practice of corporate governance confronted with cases where the behaviour of the bank’s employees raises questions of their integrity and the values which direct the company are presented in Table 4.

Table 4. Ethical Perspective on Corporate Governance at Goldman Sachs

<table>
<thead>
<tr>
<th>Corporate Governance Mechanism</th>
<th>Goldman Sachs Corporate Governance Practice</th>
<th>Goldman Sachs Business Ethics Perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholder structure</td>
<td>Involvement in the company’s matters, active participation in the shareholder meetings, decision upon executive pay and company development.</td>
<td>Questions on effective monitoring and control.</td>
</tr>
<tr>
<td>Board</td>
<td>Separation of CEO and Chairman function. 100% independent directors. Acceptance for controversial activities: – consultations with the Greek government, – derivatives underwritings and dealing within the same institutions, – betting against the US subprime mortgage market (the ABACUS scheme), – speculation on currencies.</td>
<td>Questionable responsibility towards shareholders with respect to trustworthiness, reputation and morale (controversies, drop in reputation, SEC investigation impact on share price) and external stakeholders (customers, communities).</td>
</tr>
<tr>
<td>Executive compensation</td>
<td>Incentive aggressive executive compensation strongly tied to corporate performance.</td>
<td>Controversies with respect to responsibility, honesty, accountability principles.</td>
</tr>
<tr>
<td>Transparency</td>
<td>Sufficient disclosure to shareholders. Good IR website, company bylaws and presentations.</td>
<td>Lack of disclosure to customers and business partners (the ABACUS scheme), questions on the integrity in operations and disclosure.</td>
</tr>
<tr>
<td>Other constituencies</td>
<td>Strong links between business and politics, potential for a conflict of interest and lobbying. Poor social involvement. Poor disclosure.</td>
<td>Lack of fairness in dealings, lack of concern and respect for others (instrumental approach, customers treated as ‘muppets’).</td>
</tr>
</tbody>
</table>

Source: own compilation.

As shown in Table 4 the controversial activities of Goldman Sachs’s employees refer to the layers of both corporate governance and business ethics conduct. There are two indicated shortcomings of Goldman’s corporate governance. The first one refers to the relatively limited disclosure towards shareholders and stakeholders. The
other questioned corporate governance practice at Goldman Sachs refers to the bank's remuneration policy criticized mostly for its excessive size. In 2007 when “Goldman earned a net profit of $11.4 billion, its top 5 executives split $322 million, while the CEO, Lloyd Blankfein, took home $70.3 million. In 2008 with a net profit of $2.3 billion, executives resigned from their bonuses, while the CEO pay accounted for $1.1 million (owing still shares worth $570 million). In 2009 the bank earned a net profit of $13.2 billion, while paying out bonuses for its employees of $16.2 billion. The size and the structure of executive compensation contributes to controversies with respect to responsibility, honesty, accountability principles as the remuneration packages are perceived as excessive and at the cost of shareholders and stakeholders. As presented in Table 4 the controversies of Goldman Sachs business conduct constitute a longer list. The ethically questioned activities referring to the framework provided above in Table 3 to indicate the issues of responsibility towards shareholders with respect to trustworthiness, reputation and morale (controversies, fall in reputation, the SEC investigation impact on the share price) and external stakeholders (customers, communities). One of the most problematic issues relates to the lack of disclosure to customers and business partners as observed in the ABACUS scheme which raises severe questions on the integrity in operations and disclosure. Finally, the recent scandal of the former director revealing the bank’s policy towards clients indicates the lack of fairness in dealings, lack of concern and respect for others as the bank adopted an instrumental approach, where customers are seen as ‘muppets’ to generate turnover.

Despite good standards of corporate governance Goldman Sachs illustrates the identified problem of a narrow focus and aggressive incentive policy targeted at increasing turnover and contributing to shareholder value. Using ethical shortcuts is justified as long as the company generates profits to report every quarter. This leads to an observation that the code of conduct and ethical principles, corporate governance best practice remain to a large extent the phantom declaration and the listed values of trust and concern are not internalized throughout the company. Such behaviour is not welcome by other constituencies as it lowers ethical standards and mutual trust on the market. Moreover, it undermines the standards of the cooperation, the responsibilities of the banking sector and the accountability of companies towards shareholders and stakeholders. The ethically controversial activities are in opposition to the fundamental values of responsible business such as honesty, integrity and

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62 W. Cohan, Money and Power…, op.cit.
63 Ibidem.
trust. As shown in the CNBC poll 61% of the 20,000 respondents of the poll think Goldman Sachs “did something either ethically or criminally wrong”\textsuperscript{64}.

Addressing the problems of ethics and integrity in the company and responding to the public critics in reaction to the detriments for corporate reputation Goldman Sachs not only involved itself in the PR activities assuring high standards of business operation and praising the interest of shareholders. The bank’s reaction also included internal reforms stressing that “clients’ interests always come first. Our experience shows that if we serve our clients well, our own success will follow”. Moreover, Goldman Sachs implemented a new 2011 code of business conduct which emphasizes that “No financial incentive or opportunity – regardless of the bottom line – justifies a departure from our values. In fact, loosening our ethical standards in pursuit of business is a betrayal of our duty to clients, shareholders and colleagues and compromises everything we aspire to as a firm”. This message seems to address the case of the unethical practice of the ABACUS investment scheme as well as trading derivatives by the bank and its hedge funds which proved to be significantly profitable for Goldman Sachs though remaining highly controversial\textsuperscript{65}. However, it is too soon to praise these changes and relate the shift of market regulation and (again) corporate declaration to the factual reforms of their practice.

Conclusion

The outbreak of the financial crisis which began in 2007 with the credit crunch and was followed by the sovereign debt of the majority of developed economies raises questions on the macroeconomic as well as the systemic policies and rules and their enforcement. The long list of corporate governance shortcomings indicates the inefficiencies in companies control structure as well as in the institutional order. However, neither the essential problems are solely rooted in the corporate governance practice nor are the remedies targeted at only the board work or executive compensation structure and size. As shown in the case study of Goldman Sachs the severe problems are detected with reference to the internationalization of corporate governance best practice and fundamental ethical values. The bank’s practice of helping the Greek government to hide its debt and mislead the international institutions, the investment vehicles which offered products of poor investment quality and were characterized by a conflict of interest and insufficient disclosure and finally the instrumental treatment

\textsuperscript{64} J. Doria, K. Musselman, J. Haskins, Ethical Issues…, op.cit.
\textsuperscript{65} How Goldman Profited…, op.cit.
of customers mirror severe problems identified on the financial markets. Without the change in the ethical stance no governance reforms prove to be effective.

References


Measurement of Human Capital from the Perspective of Intellectual Capital

Abstract

Nowadays the value and the market position of an enterprise is more and more commonly a derivative of human capital of a given organisation. The development of human capital requires appropriate reporting and measurement. An analysis of instruments of identification and reporting human capital applied so far, in the light of intellectual capital, allows to state that there is no single universal instrument of identification and reporting human capital. Most researchers opt for multi-index tools, without specifying the way of calculating each index. Additionally, models developed so far focus, in a selective manner, on individual areas of human capital and provide separate indices for particular categories of human resources (e.g. only for management staff, or only for the clericals). Most methods are based both on qualitative and quantitative indices.

The authors of the study find that, due to the complex nature of the human capital phenomenon, it is not possible to provide a method based on one index. They propose a multi-index, authors’ model for the analysis of human capital from several perspectives simultaneously: the perspective of costs; the perspective of time and quantity; the perspective of effectiveness; financial perspective and quality perspective. In total there are 28 indices, operationalised in detail, calculated in an annual perspective for the management
staff and for the executive employees. Due to the simplicity of measures in the developed method, it can be applied by all enterprises, irrespective of their size.

**Keywords:** Intellectual capital, human capital, measurement, index

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### 1. Human Capital (HC) As One of the Components of Intellectual Capital (IC)

The concept of human capital is interpreted and defined in various ways both in the reference literature and the economic practice. According to Edvinsson and Malone\(^1\) human capital is the knowledge, skills, innovation and the ability of enterprise employees to perform their tasks efficiently. In his opinion, human capital is inseparable and integrated with the man (employee). When an employee leaves a company, the latter loses certain skills, experience and informal relations of such employee. Human capital therefore is not the property of a company, it can only be leased by an enterprise. Saint-Onge\(^2\) defines human capital as knowledge that each individual has and creates in an organisation. This knowledge is comprised of the following elements: *know-how*, the education level, professional qualifications, knowledge and skills related to the work performed, professional predisposition, psychometric predisposition, as well as entrepreneurship, enthusiasm, innovation and abilities. On the other hand, Pietruszka-Ortyl\(^3\) identifies human capital with knowledge, experience, skills, intellectual capacity and talents of the organisation employees. According to Bontis\(^4\) human capital includes knowledge competences, skills, innovations and experience of employees. It is the most important asset of an organisation, it ensures products and services for the clients and it solves problems. An organisation does not possess it, it can only lease it. Also Sveiby\(^5\), considers that people are the most important asset of key significance for the market success or failure.

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5. N. Brennan, B. Connel, ibidem, p. 3; J.C. Miller, R.H. Whiting, ibidem.
of an enterprise. Individual competences determine the abilities, skills of employees, as well as their knowledge and experience. Unfortunately, the skills belonging to employees are not the property of an organisation, thus when employees leave, an organisation loses them irrevocably. Stewart\textsuperscript{6} defines human capital as everything that is able to think, i.e. the part of a company which leaves it for the weekend. According to him, the essence of human capital is the introduction of innovations, creating new products and services and improvement of processes. According to Roos and Roos\textsuperscript{7} human capital, composed of knowledge capital, skills capital, motivation capital and tasks capital, is the source of creation of knowledge in a company. In the opinion of Bratnicki and Strużyna\textsuperscript{8}, human capital is created by competences resulting from theoretical knowledge, experience and talent; by motivation depending on personal predispositions, power, involvement, the will to act and the inclination to behave in an ethical manner; as well as so-called intellectual dexterity, i.e. innovation of people, their ability to imitate, entrepreneurship and ability to change.

Authors of the article define human capital as employers’ competences. The competences consist of qualifications, skills, experience and the attitude of the employees. In their opinion human capital covers three areas:

- the area of professional, social competences,
- the area of relations determining the possibility to transform knowledge into action,
- the area of values, which are a filter through which actions are perceived as appropriate or not.

Human Capital (HC) is closely related to the concept of Intellectual Capital (IC), since it is one of the components of the Intellectual Capital (IC).

There are many definitions of intellectual capital in the reference literature\textsuperscript{9}. The authors hereof propose the following definition: intellectual capital is knowledge capable of being transformed into value.

The lack of a universal definition of intellectual capital causes ambiguity of its components classification. Two trends prevail among numerous typologies of intellectual capital components. The first one assumes that intellectual capital comprises


two basic categories of components: human capital (also called intellectual capital); and structural capital (also called organisational capital), which are further divided. The second trend assumes the division of intellectual capital into three or more basic categories, where one of them is always human capital. The authors hereof opt for the division of intellectual capital into three components: human capital, organisational capital and market capital, where each of them is subject to further classification: market capital comprises: client bases, client relations and client potential; organisational capital comprises: process capital, innovation and organisational culture; while human capital comprises competences, relations and values\textsuperscript{10}.

The most frequently quoted concepts of typologies of intellectual capital components are presented in table 1.

<table>
<thead>
<tr>
<th>L. Edvinsson</th>
<th>human capital</th>
<th>structural capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Pietruszka-Ortyl</td>
<td>social capital (human capital + human relationships)</td>
<td>organisational capital</td>
</tr>
<tr>
<td>H. Saint-Onge</td>
<td>human capital</td>
<td>client capital (relation-related)</td>
</tr>
<tr>
<td>N. Bontis</td>
<td>human capital</td>
<td>relation capital</td>
</tr>
<tr>
<td>K.E. Sveiby</td>
<td>individual competence (later called human capital)</td>
<td>external structure</td>
</tr>
<tr>
<td>C. Molloy</td>
<td>Human capital</td>
<td>Client capital</td>
</tr>
<tr>
<td>T. Stewart</td>
<td>human capital</td>
<td>client capital</td>
</tr>
<tr>
<td>G. Roos, J. Roos</td>
<td>human capital</td>
<td>client capital</td>
</tr>
<tr>
<td>M. Bratnicki</td>
<td>human capital</td>
<td>social capital</td>
</tr>
<tr>
<td>Sopińska, P. Wachowiak</td>
<td>human capital</td>
<td>market capital</td>
</tr>
<tr>
<td>A. Fazlagić W. Kurowski</td>
<td>human resources</td>
<td>intellectual assets</td>
</tr>
<tr>
<td>A. Brooking</td>
<td>assets relating to people</td>
<td>market assets</td>
</tr>
</tbody>
</table>


Since human capital is one of the components of intellectual capital, methods of reporting intellectual capital should also allow for human capital measurement. The evaluation presented below refers to the usefulness of models and methods of IC measurement applied so far for human capital reporting.

2. Evaluation of Usefulness of IC Measurement Methods and Models Applied So Far for the Measurement of Human Capital (HC)

There are many methods and models of intellectual capital measurement. According to Sveiby, most of them can be classified in one of the four categories:

The first category covers Market Capitalisation Methods (MCM) which make it possible to indicate differences between the book value and the real value of a company, reflecting the value of intellectual capital of an enterprise; these are such methods as: Market-to-Book Value (MV/BV) index, Tobin's q index and Investor Assigned Market Value (IAMVTM) model.

The second group comprises Return on Assets Methods (ROA), which divide average income before tax for a given period by average value of tangible assets in a given period; the result is compared to the average for the industry, and the obtained difference is multiplied by average value of tangible assets, whereby average annual income from intangible assets is determined; the value of intellectual capital is obtained by dividing these incomes by an average cost of capital; they cover such

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indices as: Economic Value Added (EVA™), Calculated Intangible Value (CIV) method, Knowledge Capital Earnings (KCE) method, Value Added Intellectual Coefficient (VAIC™) method in its basic and advanced version, Human Resources Costing and Accounting (HRCA) model, called also Human Resources Costing (HRA) model, Future Growth Value (FGV).

The third group of methods comprises Direct Intellectual Capital Methods (DIC), which allow for identification and further assessment of financial value of particular components of enterprise’s intellectual capital; they can be assessed with several indices or one combined measurer; these are, inter alia: Broker Technology model, Citation-Weighted Patents, Inclusive Valuation Methodology (IVM™) model, The Value Explorer™ model, Intangible Assets Valuation (IAV) model, Total Value Creation (TVC™) model, Accounting for the Future AFTF model, The Estimated Value Via Intellectual Capital Analysis (EVVICAE), a dynamic monetary model for evaluating employees, Statement of Financial Accounting Standards (SFAS) no. 142, outsourcing method, externalisation method.

The last group comprises Scorecards Methods (SC), covering particular models of intellectual capital assessments referring mainly to qualitative measures of particular intellectual capital components, these are, inter alia: Balanced Scorecard (BSC), Skandia Navigator™, Intangible Assets Monitor (IAM), Value Chain Scoreboard (VCSTM), Intellectual Capital Index (ICI, IC–Index), Holistic Value Approach (HVA) method, IC-Rating™, Danish Intellectual Capital Statement, set of indices by J. Mourigsen, MERITUM Guidelines, The Guideline for Intellectual Property Information Disclosure (GIPID), Dynamic Value of Intellectual Capital (IC-dVAL™), The Value Creation Index, Indices by L. L. K. Lim and P. Dallimore, Value Maps.

In spite of such a large number of instruments for identification and measurement of intellectual capital, only some of them can be applied for human capital measurement. Instruments enabling human capital measurement are:

- Human Resources Costing and Accounting (HRCA) model, also called Human Resources Accounting (HRA) model

The HRCA model is a method based on return on assets but it measures the value of particular elements of intellectual capital. Costs attributed to employees are calculated, with special consideration of the necessity to have knowledge about calculation of costs and revenues at a company, as well as financial and non financial indices referring to human resources. The HRCA method enables identification and reporting of investments in human capital which are not disclosed when

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Measurement of Human Capital from the Perspective of Intellectual Capital

traditional accountancy methods are applied. This method has been developed for years. Today, two models can be distinguished within the Human Resources Accounting model\(^\text{14}\): a cost based model and a value based model.

- **Technology Broker model**
  In the Technology Broker model, components of intellectual capital are measured in three steps. The first step is a diagnostic analysis, where a company has to answer 20 questions. The result of such test allows to create a human capital indicator. The smaller the number of positive answers to the questions asked, the more a company should focus on enhancing its intellectual capital. The second step is an audit of intellectual capital in respect of four elements. These are: human assets, market assets, infrastructure assets and intellectual property assets. Each element is thoroughly analysed with the use of special audit questionnaires comprising in total 178 questions. In the third step all identified intellectual capital components presented in the form of grades in Likert scale should be valued according to cost-based, market-based or income based method. This way, the financial value of the enterprise intellectual capital is determined, including human capital.

- **The Value Explorer\(^\text{TM}\) model**
  The model is based on key competences of an enterprise, which, according to the authors are: knowledge, skills, processes and cultural aspects. Applying a calculation formula created by them, the authors of the method have assessed the value of each key competence, using gross profit, durability, potential, resistance and capital cost\(^\text{15}\).

- **A dynamic monetary model for evaluating employees**
  A dynamic model for evaluating employees proposed by Milos\(^\text{16}\) is based on the idea of economic value, according to which the value of particular goods depends on present and future benefits related to them. It also refers to employees, thus the value of employees depends on the present value of their expected services in the future. The value of an employee can be calculated on the basis of the following formula:

\[
\text{Value of an employee in an enterprise} = \text{value of employee purchase} + \\
+ \text{Value of investments in an employee} - \text{employee value adjustment}
\]


\(^{16}\) F. Milos, *A Dynamic Monetary..., op.cit.*, pp. 124–137.
The employees evaluation is therefore carried out similarly to the evaluation of tangible assets. The model is a dynamic one, which means that it allows to determine the value of an individual employee or all employees of a company in any moment.

- **Outsourcing method**
  According to the method proposed by Morariu\(^\text{17}\) intellectual capital is understood as a basic feature of employees, comprising skills, abilities, experience, knowledge and morals. Simultaneously, knowledge is not only what each man knows, it is also an attribute of an enterprise as a whole. This view is also extrapolated to skills and abilities and it refers to particular units of a company.

- **Skandia Navigator\(^\text{TM}\)**
  The Skandia Navigator model consists of five groups of indicators covering five focus areas from which the enterprise intellectual capital value stems in the competitive environment. The human focus is one of them. A set of specific measurements has been created for each area; originally there were 160 measurements, later the number was limited to 111. The human focus is characterised by 21 parameters\(^\text{18}\).

- **Intangible Assets Monitor – IAM**
  The model is based on the division of intellectual capital into three categories: external structure, internal structure and individual competences. Each category comprises the following subcategories: growth, renewal, efficiency and stability\(^\text{19}\). Depending on the company strategy and industry sector it operates in, indicators are chosen to be applied in the company that would reflect changes and knowledge inflow. It is suggested that there are no more than two indicators for each subcategory\(^\text{20}\).

- **Intellectual Capital Index (ICI, IC–Index)**
  It is based on a scorecard, but it can also be applied for intellectual capital measurement at the general organisation level\(^\text{21}\). It combines a long, 111-item list of individual indicators (including those referring to human capital) in one synthetic indicator. Thus, it requires that an enterprise understands particular measurements, their significance hierarchy and relations.

- **Measurement of possessed knowledge resources developed by Stankiewicz with the team (4)**

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20 K.E., Sveiby, *The New Organizational..., op.cit.
Measurement of possessed knowledge resources with the use of a survey questionnaire evaluating 213 basic components of knowledge resources, grouped in 21 categories, according to a 3-level scale, where 1 means insufficient knowledge, 2 means average knowledge and 3 means fully sufficient knowledge. This method allows managers to refer to a benchmark, i.e. international competitors.

- **Set of indicators according to Mouritsen (4)**
  A set of indicators for the measurement of particular categories of intellectual capital was proposed by a Danish scientist Mouritsen\(^\text{23}\) in 1997 as a part of work in the Danish Trade and Industry Development Council. The proposed indicators for intellectual capital measurement referred to four categories: human capital (employees), customer capital, technology capital and process capital. Human capital indicators reflect both its level and potential of renewal and development.

- **MERITUM Guidelines**
  A collection of guidelines on reporting intangible resources proposed under MERITUM project\(^\text{24}\) carried out under the auspices of the European Union. The MERITUM project guidelines are based on the observation of good practices in 80 European companies. The first part of the MERITUM report is a description of intellectual capital management model. The second part of the MERITUM project provides guidelines on how to report intellectual capital, including human capital. It is recommended to write a report broken down into three areas: vision of an enterprise, resources and actions, system of indicators. Resources include, among others, human resources. The MERITUM project avoids providing specific indicators, it only gives examples. It indicates the necessity to build an appropriate set of indicators each time, adjusted to a given enterprise. The indicators should only meet the criteria listed in the project.

- **Indicators by Lim and Dallimore (4)**
  A very extended set of hundred and twenty indicators for the measurement of intellectual capital was proposed by Lim and Dallimore\(^\text{25}\). They divided intellectual capital into six main areas: human capital, corporate capital, business capital, customer capital and capital of agreements. For each area intellectual capital measurement indicators were distinguished in cooperation with financial analysts.


\(^{23}\) In A. Jarugowa J., Fijałkowska, Rachunkowość i zarządzanie kapitałem. Koncepcje i praktyka, ODiDK, Gdańsk 2002, p. 120.


specialised in measurement of intangible assets. Simultaneously, a research among young managers was carried out, allowing to evaluate which of the proposed indicators they consider most significant for intellectual capital measurement and which of them are comprehensible.

- **Intellectual Capital Measurement Model by Sopińska and Wachowiak (4)**

  Intellectual capital measurement proposed by Sopińska and Wachowiak\(^ {26} \) comprises two elements: a basic model of enterprise intellectual capital measurement; and a supplement with additional intellectual capital criteria, typical for a given enterprise activities sector. Within the basic model of intellectual capital measurement, 45 criteria are distinguished (15 per each form of intellectual capital), which, according to experts, are the best to characterise this kind of enterprise assets. A starting point for distinguishing them was to divide intellectual capital into the following components: human capital, composed of competences, relations and values; organisational capital, which, apart from the process capital and innovations, comprises also organisational culture; and market capital, comprising customer bases, relations with customers and customer potential. Particular criteria were marked with significance scores from 1 to 3. In order to reduce the subjectivity of evaluation, individual criteria were operationalised, based on the assumption that the scale of evaluation is from 1 to 3 scores.

  A short review of instruments listed above allows to say that methods of direct intellectual capital measurement and scorecard methods are more useful from the point of view of possibility of identification and measurement of human capital. A common feature of direct measurement of intellectual capital is the attempt to seize the financial value of particular intellectual capital elements in an enterprise. Scorecard methods, however, are based on the score evaluation technique. A basis to create a measurement method is to define a list of major criteria, according to which a given element will be evaluated. These methods focus not on the financial value of intellectual capital, but on a thorough examination and description of intellectual capital elements so that it can be better used by the company. Unfortunately, they are considerably subjective.

  In such situation, it seems necessary to develop a multi-index model aimed only at human capital reporting and measurement.

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3. HC Reporting and Measurement From the IC Perspective – a Multi-Index Authors’ Model

Based on the instruments presented above used for human capital identification and reporting from the intellectual capital perspective, three conclusions can be formulated:

1. There is no universal instrument for human capital identification and measurement.
2. Most researchers opt for a multi-index instrument.
3. Many researchers propose human capital measurement indices without determining an exact way of their calculation and operationalisation.
4. Individual researchers focus on various areas of human capital in models proposed by them.
5. Some researchers propose separate indices for particular categories of human resources, separated due to an employee’s position in the organisational structure or his/her form of employment.
6. Most of the proposed human capital measurement methods provide qualitative and quantitative indices simultaneously.

The authors of the article find that, due to the complex nature of the human capital phenomenon, it is not possible to provide a method with one index. They also comply with the view that it is necessary to combine quantitative and qualitative indices. They propose a multi-index, authors’ model for the analysis of human capital from various perspectives, comprising indices from both categories. Table 2 shows a list of detailed indices. It comprises detailed indices of human capital measurement; their categorisation; the method of measurement of each index; the method of operationalisation; and the possibility to use it in particular enterprise categories.

The authors made the following assumptions when describing human capital measurement and identification instruments:

- We propose to apply all indices in two dimensions: for the management staff and for the clericals.
- All indices are measured in an annual perspective.

All the indices described above allow for a comprehensive measurement of human capital. They refer to index categories most important from the point of view of enterprise activities: cost indices, time and qualitative indices, efficiency/effectiveness indices, financial indices and qualitative indices. Data owned by each enterprise will be enough to calculate most of these indices. More complex indices are recommended to be used by medium-sized or large enterprises.
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<td>Index of training costs</td>
<td>Costs of trainings per one employee</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>
### Measurement of Human Capital from the Perspective of Intellectual Capital

<table>
<thead>
<tr>
<th>Source: own study.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th><strong>Index of efficiency/effectiveness</strong></th>
<th><strong>Index of employees' creativity</strong></th>
<th>Number of initiatives per one employee</th>
<th>X</th>
<th>X</th>
</tr>
</thead>
<tbody>
<tr>
<td>Index of use of employees creativity</td>
<td>Number of implemented initiatives per one employee</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td><strong>Financial indices</strong></td>
<td>Index of employees' profitability</td>
<td>Added value per one employee</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Index of employees' incomes</td>
<td>The size of income per one employee</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Index of value generated by employees</td>
<td>Market value of an enterprise per one employee</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Quantitative indices</strong></td>
<td>Index of industry experience</td>
<td>Average number the enterprise's employees' years of work in the industry</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Index of company experience</td>
<td>Average number of the enterprise's employees' years of work in a given enterprise</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Index of the employees' diversity in respect of age/ gender</td>
<td>Percentage share of employees in particular age ranges (an age range covers ten years)</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Percentage share of women in the total number of employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Index of education level</td>
<td>Number of employees with higher education in relation to the total number of employees</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Index of competence adjustment of the employees</td>
<td>Number of people employed in accordance with their education in relation to the total number of employees</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Index of unique competences</td>
<td>Share of experts with significant position in the industry in relation to the total number of employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Index of job satisfaction</td>
<td>Number of satisfied employees in relation to the total number of employees</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Index of mentorship scope</td>
<td>Number of employees covered by mentorship in relation to the total number of employees</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Index of employee attitude</td>
<td>Number of employees considerably involved in the company issues in relation to the total number of employees</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>
Recapitulation

The presented method of measurement of human capital perceived as a part of intellectual capital allows to measure it in a comprehensive manner. It is important that it regards employees not as a resource but as an organisation capital requiring investments. It takes into account all the basic indices that reflect the employees’ usefulness for the organisation and the necessity of investing in them. The first group of indices shows the costs related to possessing human capital. The second group refers to investing in employees and their identification with their organisations. The third group refers to the employees’ creativity. The fourth group presents the employees’ impact on financial results of the employees. The last group of indices evaluates human capital according to qualitative criteria. The advantage of this method is a simple way of calculating indices and their interpretation. The authors also suggest which indices can be applied in small, medium-sized and large enterprises, which is also an advantage of the method.

References


