

Expert Guide

OPPORTUNITIES IN CENTRAL AND EASTERN EUROPE 2013

October 2013

CORPORATE *LiveWire*



The Inside Story: Is There a Private Equity Industry in Serbia?

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After the democratic changes in 2000, Serbia began a long transitional process, during which the country began to create a market based economy, which included an appropriate financial system. The financial system's basic role is to create adequate financial instruments to allow capital transfer between sources of investment capital and prospective investment projects. These instruments are organised through several channels, beginning with bank credit, financial securities, private equity and venture capital investment funds, as well as state-funded financial programs.

Looking at Serbia, 13 years later, one can say that the financial system is underdeveloped because of the high concentration of financial assets in the banking sector. According to the National Bank of Serbia, 94% of financial assets in the market reside in banks. At the same time, for a number of reasons, the Belgrade Stock Exchange was not able to completely fulfill its role of collecting and transferring capital from investors to businesses, through initial public offerings (IPOs). The stock market has had no initial public of-

ferings by which businesses could finance development or expansion. Aside from these issues, state programs are more focused on developed businesses with good track records.



In this situation of high asset concentration, interest rate decline is not expected, thus Serbia currently has a 12% interest rate on Euro lending, which is one of the highest in Europe.

From one perspective it could be said that Serbia is not fertile ground for private equity investment. On the other hand, recent research published by the Serbian Private Equity Association (SPEA) reaches a different conclusion. In 2003, according to SPEA, the first private equity deal was closed, a privatisation deal in the food & beverage industry by Salford Investments. Since then, SPEA has found 14 investment funds in-

vesting close to €280 million for equity acquisitions and expansion of business activities in 22 companies. Two of the most active players in the market, SEAF South Balkan Fund and Salford Investments have made approximately €112 million in direct investments in Serbian companies in different stages of development.

The average deal in Serbia includes €4.5 million for equity investment and an additional €9 million investment into the company for improvements in business operations. Regarding the sectors most invested in, the funds have been focused on the food & beverage industry (nine deals), the IT industry (six deals), telecommunications and broadcasting (two deals), financial intermediary (two deals), retail (one deal), transport (one deal), and securities industry (one deal).

The key question is whether or not Serbia is attractive for private equity investment? On the positive side the key points are as follows:

- Serbia has traditionally enjoyed a much higher standard of living when compared to many of the adjacent countries and as the economy tran-

sitions it is expected to regain many of the productivity losses incurred during the troubles of the 90s;

- A bank centric financial system creates difficulties for companies to obtain competitive credit lines for expansion. When a company needs capital to expand it often does not have the option of obtaining bank debt in this market unless there are material physical assets that can be leveraged. Further there is no developed financial market for IPOs. This implies that PE funds could have a very strong bargaining position during the investment process;

- A very low credit default rate before 2010 among Serbian companies has shown that companies were able to pay high interest rates and continue to grow. The same perspective applies for assessing the management capabilities in the market. A management team able to deliver strong growth while paying high interest rates is often a prospective management team for private equity investors as well;

- The entire economy is still lagging in productivity in comparison to developed countries, so private equity

funds have the opportunity to invest into traditional industries where domestic and international demand is growing and resources are present (agricultural, natural resources, food & beverage, manufacturing);

- Favorable international trade agreements with several large markets (Russia and Turkey are two good examples) provide the opportunity for growth strategies beyond national borders. A strategic geographic position and developing infrastructure gives Serbia the opportunity to serve these markets effectively;

- A very clear Government strategy towards EU accession and efforts to create an institutional framework affords opportunities for private equity investors to work in a friendly and familiar environment.

These are certainly advantages that Serbia currently has in attracting private equity funds but, like every country, Serbia does have its challenges:

- There is a low level of understanding of the private equity industry, the industry's legal and financial structures as well as the industry's

key objectives. One study showed that owners and managers are afraid of additional investors in their companies because they fear that this will lead to a takeover of their company. Most among them do not understand the concept of investment from private equity funds and their interest in companies' growth.

- Managers and owners have great difficulty in understanding the intrinsic value of their company. The problem with many private equity deals in Serbia is how to manage two opposing positions in calculating a company's value. This is a problem for private equity investors in any geography, but it is greatly exacerbated by a number of factors in Serbia.

- Variation in accounting standards in relation to developed countries can be an issue, and the ability of a private equity investor to 'normalize' the financial records of prospective investment can prevent an otherwise promising deal from happening.

In looking at both the positive and negative aspects of the market, Serbia is a country with opportunities

for increased private equity investment, in which investors will have issues in reaching an understanding with prospective investment targets. The success of deals will depend on improved cultural understanding, a firm commitment to being present in the market and a track record that is built over time. For those private equity funds that are willing to commit to developing the Serbian market, many challenges and opportunities await.

David Schoch has more than 13 years experience working in the emerging markets of Europe, and over 18 years experience working in technology



and investments. He currently serves as a member of the board of directors of Orion Telekom; a telecommunications investment holding vehicle set up and funded by an investment consortium lead by the European Bank for Reconstruction and Development to facilitate the consolidation of the alternative telecommunication sector, and capitalize on telecommunications liberalization in the western Balkans. Mr. Schoch is also a found-

ing shareholder.

In addition, Mr. Schoch is a founding board member of the Serbian Private Equity Association and has been the president since January 2012.

In the early 90's Mr. Schoch worked as a project manager for a private investment group in Prague, Czech Republic. In the second half of the 90's, Mr. Schoch was instrumental in the pre and post-liberalization development of one of the largest alternative telecommunications operators in Central Europe: GTS. Over a five year period, Mr. Schoch helped lay the foundation that allowed the Czech and Slovak subsidiaries of GTS to enjoy a more than twenty-five fold increase in growth from a small base in 1996 when he joined. He spent the first half of this decade in London working as the Director of Business Development and Strategy for Cable & Wireless' £350m enterprise division.

Working as a partner with a small UK based investment group, Mr. Schoch was responsible for initiating the Orion Telekom project by developing the concept, identifying and closing the initial targets and putting the business plan, management team

and overall strategy into place with the existing investors.

Mr. Schoch received a Bachelor of Science with distinction from the California State University in Sonoma and a Master of Business Administration with honors from the University of Chicago Booth School of Business.

Mr. Schoch speaks native English, intermediate Czech/Slovak and advanced Serbian/Croatian.

Mr. Schoch – a US citizen – was born in Frankfurt Germany, and lives in Belgrade with his wife and two children.

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