

# South East Europe: High Growth Region



The inevitability of growth in South East Europe has come to the forefront over the past several years; now a stable, secure and economically viable region located near vast European resources and markets, will SEE continue on its successful path along transition of the economy? Will prevailing market turbulences disrupt the positive trends, or can one of the fastest growing emerging markets prove its potential?

The rapid transformation and economic development of countries in Central Europe and the Baltics, and their ultimate accession to the European Union, laid bare a path for SEE countries to follow. As those economies slow to match their new EU counterparts, investors have increasingly been looking south, while using the knowledge learned in Europe's past emerging markets to capitalise on vast opportunities still within reach. Now one of the fastest growing regions in the European sphere, speculation of SEE's success has been replaced by solid trends, uncovering an optimism in those staking their claims in a frontier that continues to post growth numbers at least double that of Western Europe.

Looking simply at the picture of GDP growth, the markets of South East Europe appear rosy. Romania continues to be the focal point in the region; its large population and relatively low starting point of per capita GDP have contributed greatly to its appeal and substantial growth, which came in around 6.3 percent again last year. Hav-

ing entered the EU in 2007, a large capital influx in the country continued throughout the year. Retail companies, led by international giants like Carrefour and Auchan, but as well supported by domestic players in the fast-growing consumer electronics market, are making a high-profile impact on the country, and having added nearly 100 new outlets in 2007, predictions for 2008 call for an additional 150-170 outlets having an estimated total value between €750-900 million. Though a growth in consumer spending will continue to fuel the economy and attract investors, the Romanian market is expected to cool off a bit in 2008 as expected hikes in real wages, combined with an opening of new credit avenues, will contribute as much to inflationary pressures as will the increasing trade imbalance and world credit crunch.

The echo effect of EU membership continued to push growth in Bulgaria as well, and despite lingering problems (or at least a widespread perception) of corruption, 2008 is predicted to be another record-setting year for FDI inflows.

After growing nearly 20 percent in 2007 to reach €5.3 billion, Bulgaria's State Investment Agency is expecting 10 percent growth of FDI in 2008, and of the total amount to be invested in the country, nearly 60 percent of that will be in property. Bulgaria's booming property market experienced turnover of €11 billion in 2007, up from €9 billion in 2006, with values in residential property surging 35 percent. UK property speculators in seaside and mountain property developments have slowed in the face of their own credit fears, though behind them are Russians and Scandinavians in increasing force.

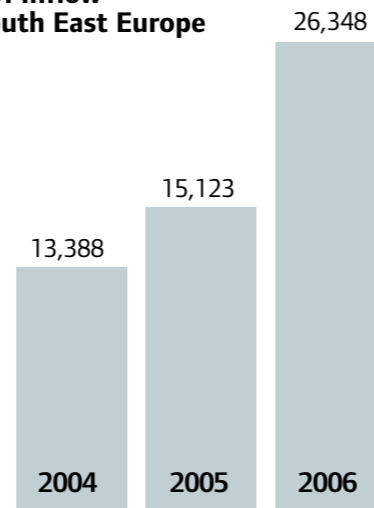
The expectations that come with EU membership also act to turn away some investors, especially those who prefer lower starting points in emerging markets. The appeal of Moldova as an investment destination has grown dramatically over the past two to three years as those investors who have been successful in Romania see a common culture and strong trading history with Russia and CIS states as good stepping off points. The Moldovan economy has moved steadily up-

### Gross Domestic Product Percentage Growth

	2006	2007*	2008*
Albania	5	6	6
Bosnia and Herzegovina	6	5.8	6.5
Bulgaria	6.1	6	5.9
Croatia	4.8	5.6	4.7
Macedonia (FYROM)	3	5	5
Moldova	4	5	5
Montenegro <sup>1</sup>	5.5	6	7
Romania	7.7	6.3	6
Serbia	5.7	6	5
Slovenia	5.7	5.4	3.8
EU	3.2	3.0	2.5
World	5.4	5.2	4.8

Source: International Monetary Fund, World Economic Outlook Database, October 2007, \* IMF predictions  
<sup>1</sup>Montenegro Source: UN, Montenegrin Government

### FDI Inflow South East Europe



Source UN Conference on Trade and Development, billions of US dollars



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ward; the World Bank has reported 4 percent growth in 2006, 6 percent in 2007 and predictions of 6.8 percent growth in 2008 rising to 7 percent in 2009. Similar growth numbers are being reported in Albania, which enters 2008 having signed a €900 million deal to vastly improve its energy system through the construction of new power plants, possibly to be online by mid-2009. As well, announcements of the discovery of a large oil and natural gas field in the country's north, estimated between 1.4 and 3 billion barrels of oil and 3 and 15 trillion cubic feet of natural gas, might just cause a wildcatting rush to a region of Albania already well-served by production facilities. Growth in Albania was reported to be in the range of 6 percent, though last summer's energy crisis may have hindered that by as much as 1 percent. And with a long-stretch of undeveloped Adriatic coastline and tourist numbers rising 10 percent yearly, increased exposure of Albania will no doubt add to its attractiveness.

Slovenia's ascension to the rotating presidency of the EU at the beginning of 2008 is evidence of the ground that has been covered by the leading economy in the transition of the former Yugoslavia. Now with the power to set the agenda in Brussels, Slovenia's unique perspective on the region will benefit South East Europe in the first half of 2008. At home,

Slovenia's growth has been more slow and steady than the rest of the region (though still topping 5 percent in 2006, nearly double the European average); its small size and powerful domestic companies have deterred some investors, while those who have placed their money there, mostly Austrian, may be more susceptible to adjustments in the world credit market.

Croatia has one of the highest per capita GDPs in the region, a robust tourist industry that pumps over €6 billion (and growing) into the economy each year and an infrastructure that was boosted to receive the large number of visiting foreigners. Ahead of the pack, there is less room for dramatic growth in the country, and the Croatian central bank recently reported accordingly, revising its ambitious 5 percent growth figures down to just 2 percent. Down the coast in Montenegro, tourism is similarly the hot topic in a country with just 700,000 people. Reports from the World Travel and Tourism Council put growth of tourist receipts in Montenegro growing at a staggering 10.2 percent annually, and predicted such growth to continue for the next decade. Relatively massive inflows of FDI (over €500 million in 2006) are following as the country sees an influx of foreign purchases of much of its prime property, though growth in real cash holdings are contributing

to a growing service sector that results from tourist hordes beating down a new path.

The situation in Serbia has confounded many for years, its growth has been pronounced and continued in the face many unresolved political questions that bring supposed investor tension. The first five months of 2007 saw a limited amount of committed investments as the government struggled to form itself, though beyond that the Serbian economy grew at a nearly 6 percent average for the year, which is expected to continue into 2008. Increasingly the potential of Serbia, many dub this country as the true Balkan tiger, is catching the attention of large transnational companies seeking the best hub for their South East Europe activities, evidenced by international package transporter DHL choosing Belgrade as its regional distribution centre and the property investment arm of Merrill Lynch doing likewise for its Western Balkan business.

Growth in Macedonia is another picture of potential, having been slow out of the gate in the early part of the decade. Several contributing factors will add to the numbers, which saw higher than expected growth at the beginning of 2007, including among them accession of its neighbour Bulgaria to the EU and the opening of cross-border opportunities associated with it, favourable tax rates

offered to foreign investors by an energetic and proactive government, CEFTA country trade increases and lastly a continued trend of growth in industrial productivity. In Bosnia and Herzegovina, GDP growth numbers of above 6 percent were reported in 2007, though its low starting point contributed to higher percentage gains. Privatisation in the country took a stronger hold in 2007, accounting for the largest influx of FDI this decade. With a decayed industrial infrastructure, Bosnia and Herzegovina's growth will be the product green-field investments, however with trade and investment restrictions loosened under CEFTA, Croatian and Serbian companies will increasingly find the market attractive for their own business expansion.

The role of international bodies working in South East Europe has been of great importance for the region's rise over the past decade, though increasingly their assistance is being transferred to an advisory role as ownership of projects is rooting. Of the international bodies operating in the region, the Organisation of Economic Cooperation and Development's (OECD) Investment Compact for South East Europe has one of the clearest mandates specific to regional economic development. The Investment Compact monitors and evaluates regional investment reform, supports the implementation of this reform, facilitates public/private dialogue through the

### 7th Euromoney Regional Finance and Investment Conference

Successful companies in South East Europe are changing rapidly to include best practices of corporate governance in their construct. Whether financing expansion of business, preparing for a merger or to be acquired, or simply meeting a higher standard in reporting to stakeholders, the need for more transparency is a necessity to modern business. In spite of this, a significant lack of awareness still exists about what good governance entails.

At the 7th Euromoney Regional Finance and Investment Conference, held in Cavtat, Croatia, the Podravka company presented a case study on its own use of corporate governance procedures. The conference draws investment professionals from throughout the world to have direct contacts with SEE companies, banks and government officials, and with over 500 high-level attendees it is often cited as the most important investment gathering in the region. While speeches, roundtables and presentations gather crowds and give the opportunity for direct questioning of senior government officials and representatives from investment institutions and companies, much of the action occurs outside the halls during coffee breaks, where face-to-face contact greatly accelerates the deal making process in SEE.

In presenting their corporate governance to the conference, leading Croatian food producer Podravka is recognising that the opening of markets



means the opening of its company. Good corporate governance at Podravka has meant establishing a clear relationship between its management, boards, shareholders and other stakeholders, and in setting up a supervisory board comprised of eight members selected at the general assembly, two put forth by the Croatian Privatisation Fund and one member appointed by the workers council, they give their managing board an extra level of monitoring. The goals include improving customer preference in doing business with Podravka, allowing for shareholder support in more difficult times, improving company value in the financial market, creating a better corporate reputation, and ultimately increasing share price, which Podravka has managed with over fourfold growth since 2000.

private sector's advisory role in its activities, and engages high-level political support towards the aim of its work.

In publishing the Investment Reform Index, which looks at eight major indices for each country in SEE, the Investment Compact uses

## 1st Southeastern Europe Private Equity Association Conference

The role of private equity is increasing yearly in South East Europe, the mid-level deals that attract lesser attention than large privatisations are the prime targets for a nimble class of investors searching for high returns in a growth market. At the first conference of the Southeastern Europe Private Equity Association, held at the end of last year in Bucharest, private equity fund managers gathered to discuss the future of their industry in the region and share experiences and statistics.

With the support of the European Private Equity and Venture Capital Association (EVCA), that association's Secretary General, Javier Echarri, explained the benefits of private equity deals on SEE: "Private equity is focused – our purpose in life is to be sure that, from investment in the company to exit from a company, we make a capital gain for our investors, for the pension funds, insurance companies, etc, and course for ourselves, because we draw money on success, not on paper. That means that you have to give the money back plus an eight percent return before you can draw anything for yourself. This makes you very focused. If our management of the companies is focused, if our investor's interest is the capital gain after working for five years with the company, I want the managers of the company to have exactly the objectives and motivations as I have and the investors have. How do we do that? I make sure that the manage-

ment of the company gets shares in the company and that he or she is going to make a substantial return when we all sell together five years down the line. It is this alignment of interests from the investor, the private equity fund manager and the managers – who all make money based on the results. This focus is extremely powerful."

Gavin Ryan, a well-known private equity manager in SEE, described the best private equity opportunities in the region: "The sectors that have proved to attract the most PE investment are those which face the emerging SEE consumer. Investing in a factory that exports all to Western Europe is not a winning strategy. The lower labour costs and other cost advantages will inevitably be eroded by other emerging markets in Asia and other parts. As the SEE middle class develops, demand for services and products will rise. Therefore breweries, telecoms, food and other consumer products, construction materials, health care financial services are some of the sectors that should see continued strong opportunities in the future. Over the last eight years I have been involved in PE investments in most of these sectors in SEE; exits have accelerated and returns have been very good. For those investments that prove successful, the chances of an interested West European company coming along and acquiring will remain high and provide the most common exit route going forwards."

data collected by its own team, supplemented by input from local consultants, the country economic team and private sector, along with direct consultation and feedback from SEE governments, to identify the key priorities in policy reform. Following up on these suggestions, working tables have been established to create 'how-to' reform guidelines and assist governments in implementing them. The study looks at investment policy, investment promotion and facilitation, tax policy, anti-corruption and business integrity, competition policy, trade policy, regulatory reform, and human capital and employment, though as well collaborating with EU bodies to investigate corporate governance and SME policy. In practice, for example, this has helped countries gauge their laws on foreign ownership of companies and property, while assisting investors in their analysis of tax and trade policy.

Unleashing capital with institutional-level security, the European Bank for Reconstruction and Development (EBRD) has been one of the most influential on-the-ground investors in South East Europe during the transformation from planned economies to those operating on market principles. Though sometimes likened to an aide agency, this comparison is ill suited as the bank's role is more compa-



EBRD funded road project in Bosnia and Herzegovina

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able to that of a private sector investor itself. In its activities, the EBRD finds foreign investors, provides loans and purchases stakes in companies in order to grow their operations. Local banks partnering with the EBRD provide access to disbursing funds for small businesses, as well as serving as a legal conduit for the relatively large flows of remittances coming from expatriates. Though the effects have been felt throughout the region, both on business and public works projects, in Bosnia and Herzegovina the bank's efforts have been especially noticed. To date the EBRD has signed 66 projects totalling €724 million, while at the same time generating an additional €744 million in partner-projects.

On the operational level, the EU has been present in the region on many levels encouraging the countries along their path towards a community built on its principles of free trade and movement of capital. The regionally-directed approach of the Stability Pact for South East Europe, a unique body that forms itself not as an international body, that is to say one with financial resources and implementing power, leads in its effort to convene representatives of SEE and the international community to work on regional cooperation in democracy, economy and security. In 1999, when the Stability Pact was formed, the idea was more urgent and focused on security issues, though with time it became more apparent to its signatory countries, which also included farther along Romania and Bulgaria,

that regional cooperation was its surest path to moving away from the past and towards economic prosperity. The Stability Pact's work in developing economic cooperation culminated in 2007's ratification of the Central European Free Trade Agreement (CEFTA), a document that had been used successfully to build trade relations between Poland, the Czech Republic, Slovakia and Hungary, and which then was updated for the South East European Countries. In effect, CEFTA brings together of a series of free-trade agreements previously negotiated by the Stability Pact, now though with a central body to resolve disputes and resist one-off changes. CEFTA has been hailed as one of the Stability Pact's greatest achievements, not only in its ability to break down borders, but as well in its effort to 'train' the countries of SEE for future membership in the EU.

As the Stability Pact's mandate comes to a close in 2008, greater ownership of its future in regional cooperation is being assigned back to the SEE countries themselves. The formation of the EU-funded Regional Co-operation Council (RCC) underscores the transformation of the Stability Pact into a regionally owned and led framework. Hido Biscevic, Croatia's former State Secretary in the Foreign Ministry, has been selected by SEE peers to lead the council as a representative who not only knows the region, but originates from it as well. The council will have its offices in Sarajevo, has firm legal status, and will address

the priority areas of economic and social development, infrastructure and energy, justice and home affairs, security cooperation and building human capital.

Massive infrastructure projects are being implemented throughout SEE, oil and gas pipeline projects bring with them jobs, money and access to cheaper energy, while road construction is carving out the corridors necessary to move product and people easily. Certainly some issues have yet to be resolved, however, perhaps more so than other emerging markets, the prospect of SEE is clearer to investors – a future for the region has been spelled out in Euro and Euro-Atlantic coalitions. Growth in Western Europe is slowing and businesses looking for higher yields are finding appeal in SEE. Taking into account just one economic aspect typical of the region, that of significantly low levels of mortgage capital yet to be released through consumers, the economic surety of growth is palpable on the minds of investors carving out market share. As the whole world sits and waits to see if a worsening US and world situation brings a recession, it should be noted that during the last downturn, between 2000-2002, though it was predicted to see a tapering off, the markets of Central and South East Europe did not fare so badly, as trans-national investors supplanted pessimism in world markets for optimism in Europe's emerging markets.



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Secretary General of Regional Co-operation Council Hido Biscevic and Stability Pact Special Coordinator Erhard Busek