Financing and investment opportunities in Southeastern Europe, before and after crisis

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Abstract

Southeastern Europe is now in a moment of change and provocation generated by the new European context. In this new context, this region is a challenge for investors, and also an opportunity. We will primarily present, discuss and analyze data related to the Southeastern Europe region - Albania, Bosnia & Herzegovina, Croatia, Serbia, Macedonia, Kosovo, Montenegro, and Bulgaria and Romania (i.e., EU member states since 2007), also known as the countries of the Western Balkan region.

The whole material used is ensured by different World Investment Reports and regional surveys about Financial Statistics made during years.

Since all of these countries are to a great extent integrated within the global economy yet struggle with economic, administrative, social and political challenges, development and implementation of reforms there largely depends on their access to

foreign capital and the overall performance of their main trading partner and primary funding contributor -the European Union , this paper strives to provide an exhaustive survey of the type, scale, target and origin of investment activity in the region.

In this respect, this paper, tries to analyze investment and financing opportunities in this region, taking into account the general economic evolution of countries.

Key words: investment, opportunities, activity, management, trade

1 The Southeastern European region

1.1 Overview of the Southeastern European region

Southeastern Europe is a relatively new geopolitical denotation for the Balkan states, a region frequently regarded by Western countries as a heterogeneous set of countries with their own cultural specifics, dynamics, and an interconnected and complex modern history. The countries that form this part of Europe are Albania, Bosnia & Herzegovina, Bulgaria, Croatia, Kosovo, FYR Macedonia, Moldova, Montenegro, Romania and Serbia. Although diverse in nature and rich with differing histories, the Southeastern European countries have one thing in common - all have expressed a desire and immense willingness to become part of the European Union and thus benefit from one democratic European market with all countries having equal rights and favorable future prospects.

However, at the present, SEE countries differ substantially in their status of EU accession.

The EU accession itself is one of the key factors that influence the investment climate in the region. Cases in point for SEE are Bulgaria and Romania, which in the process of their EU accession managed to attract record levels of FDI to their economies. In this respect, it could be argued that with the advancement of the EU accession process, the investment climate in the rest of the Balkan countries would improve significantly. An equally important challenge for the region was how to attract investment.

1.2 Sectors of interest

To no one's surprise, the real estate and construction sectors proved to be the most attractive, with strategic investors and investment funds allocating almost **one-third of their capital** in such projects, while SEE banks financed even more projects – more than **half of all loans** given to businesses were for real estate and construction projects. Another three sectors, namely financial intermediation, ICT and telecom, also proved to be highly attractive to foreign investors given the global trend toward digitalization and virtualization. Still other projects were undertaken in the manufacturing sector, transport and logistics, healthcare, energy and agriculture sectors. In the period 2004-2009, major privatization opportunities were the main driver for private capital inflows and strategic investments into the SEE region. Table 1 and Figure 1 below outline the gradual process of liberalization of Southeastern European countries' economies and the corresponding privatization revenues of the SEE countries in the period 2004-2008.

Table 8.1 — *Privatization revenues (cumulative, in per cent of GDP). Source: Transition report, 2009, EBRD.*

Country	**2004**	**2005**	**2006**	**2007**	**2008**
Albania	11,4	11,5	11,7	13,7	13,6
Bosnia and Herzegovina	2,6	n/a	n/a	n/a	n/a
Bulgaria	18,0	21,4	22,8	23,3	n/a
Croatia	14,6	14,7	15,7	15,7	17,0
Kosovo	n/a	n/a	n/a	n/a	n/a
Macedonia	13,8	14,3	20,0	20,2	20,6
Montenegro	n/a	n/a	n/a	n/a	n/a
Romanua	9,2	9,5	9,8	9,9	10,0
Serbia	7,7	10,2	17,4	20,2	21,4

Not surprisingly, the countries that proved to be the most attractive to foreign investors prior to the crisis were Romania and Bulgaria. Given their status of full EU members, their large populations (relative to the other SEE countries) and high levels of GDP per capital, these two countries attracted the bulk of investments to the region.

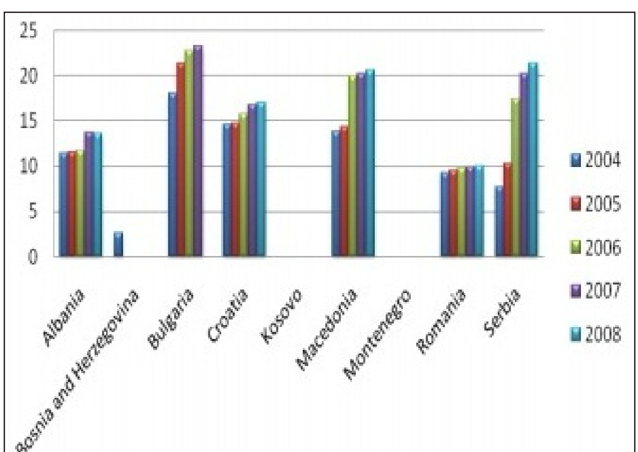

Figure 8.1 — *Privatization revenues (cumulative, in per cent of GDP). Source: Transition report, 2009, EBRD.*

Serbian and Croatia make up the second group of countries with a lower number of investments, though still above the average of the region. The rest of the SEE countries, namely Albania, Bosnia and Herzegovina, Kosovo, Macedonia and Montenegro, were not able to attract many investment projects, mainly because of their small markets, small population, low levels of GDP per capital and the fact that they have a long way to go to become EU members.

Bulgaria and Romania have already completed the necessary reforms and have become members of the EU. Macedonia, Croatia and Turkey are officially recognized as candidate countries and as such they must implement the remaining necessary reforms in order to become member states. Albania, Bosnia and Herzegovina, Kosovo, Montenegro and Serbia are identified as potential candidates and need to focus more on restructuring in order to move on. Depending on the category, there are different types of financing available to the countries to assist them in the process of implementing EU standards.

2 Origins of financing

Considering the origin of the financing in the SEE region, the majority of investment projects were financed with EU capital. Similar to the strategic investors in the region (most were EU-based), most of the capital of the investment funds was from within Europe, the same as for the Banks. The main reason is that the EU was and still is the main trading partner for the countries in the region.

2.1 Origin of financing of the strategic investors

With regards to the origin of the foreign investors who have undertaken investment projects in SEE, EU countries has the majority stake of the total strategic investments in the region (in Bosnia and Herzegovina it is around 90 percent). Austrian companies have been the major foreign investors in the most of the SEE countries. For example, over the past three to four years Austrian companies have been the biggest investors in Albania, Bosnia and Herzegovina, Kosovo, Serbia, and Romania and the second biggest investors in Bulgaria and Macedonia following foreign investors from the Netherlands. Besides Austrian and Dutch companies, other major investors to the countries in the region include companies from Norway, Germany, Italy, Greece, Slovenia, France, Luxembourg and Hungary.

Bosnia and Herzegovina, however, is an exception among the SEE countries. Although Austria tops the list of foreign investors, the other most active investors were from neighboring Serbia, Slovenia and Croatia, which is not common for the rest of the SEE countries. Another interesting fact is that US-based investors represent only a small fraction of all foreign investors. However, the actual rate of US investment is much higher given the fact that US companies invest primarily through their European affiliates.

The companies that have been most active in both Greenfield/Brownfield projects and in acquiring different types of assets in the region are some of the biggest blue-chip companies in the world, in the banking sector (i.e., insurance, financial intermediation), in the energy sector, in the telecom industry, in the retail industry, and in the consumer goods sector.

2.2 Origin of financing of the Investment funds

With regard to the origin of capital that has been used to finance investment projects in the SEE countries, we can differentiate between three groups of investment funds:

1. Multinational (i.e., the capital is from the US, Europe, Asia, etc.,),
2. European (i.e., the capital comes from individuals, corporations and institutions within Europe),
3. Southeastern European (the capital comes from the SEE region). Based on the finding of this research, the origin of the investment funds' capital is as follows:
    a. 41 funds with multinational capital – the investors were both private and public institutions form US, Europe, Asia, etc. ,
    b. 23 funds with European capital – the investors were both private and public institutions from European countries ,
    c. 14 funds with Southeastern European capital – the investors were both private and public institutions from within the SEE region ,

2.3 Origin of financing of the Banks

Almost all the commercial banks in the Southeastern European countries are privately owned, most of them belonging to banking groups based outside the region. Austrian, Italian and French banks are the biggest players in the SEE banking sector. Banking groups from Hungary and Greece also entered the region's unsaturated financial market and quickly expanded their networks in 2006 and 2007. Non-SEE banks controlled the banking sector of most SEE countries in 2008.

Given the fact that strategic investments and financial projects by investment funds comprise the bulk of foreign direct investments to a country, this report will consider the volume of FDI as representative of the volume of those two types of financing. It is worth mentioning here that FDI to a country also includes some types of credit lending and reinvested capital from business corporations. In the years prior to the crisis, the Southeastern European countries experienced a boom in their domestic economies, mainly fueled by large inflows of FDI. For instance, in 2006 in Romania inward FDI amounted to USD 11.394 billion, while in 2007 and 2008 it was USD 9.923

billion and USD 13.305 billion respectively. In 2006, Bulgaria attracted USD 5,172 million as FDI, in 2007 – USD 11.716 billion, and in 2008 – 9.205 USD billion. These figures show that FDI growth for the two countries prior to the crisis was more than 50 percent year on year, and would have been more if not for the negative effects of the crisis. Another set of countries, namely Croatia and Serbia, attracted a relatively large amount of FDI, though not as much as Bulgaria and Romania. One of the primary reasons is that those countries are still in a process of becoming EU members and thus have not become part of the large EU market.

Although the remaining countries from the region – i.e., Albania, Bosnia and Herzegovina, Macedonia and Montenegro saw a record number of investment projects by foreign investors between 2006 and 2008, they attracted the least amount of FDI of all the SEE countries. The FDI for those countries were mainly targeted at the privatization of state-owned enterprises. The foreign investment varied ranged between USD 400 million to USD 1 billion, with the exception of Bosnia and Herzegovina in 2007 – USD 2.197 billion. The years prior to the financial crisis can be characterized by rapid credit lending growth by commercial banks. In the end of 2009 in almost all SEE countries credit lending stopped, which inevitably reflected on the on the volumes of credits lent to the private sector. The only exception was Croatia with a mild credit lending growth of around 3-5 per cent in November 2009.

2.4 EU Funding

Evolving from a small core of European countries, the EU today is a dynamic political and economic union of 27 European states, based on a single market allowing for the free flow of capital, goods and people. The enlargement process requires candidate countries to implement certain political, economic and legal reforms in order to harmonize with EU standards. With the accession of Bulgaria and Romania in 2007, it has become clear that the EU will continue its enlargement with the countries of Eastern Europe.

In the light of the major changes in political regimes in the 1990s, the countries of the SEE region have seen the accession into the EU as a viable option for their future development given the much bigger market and business opportunities. The eruption of hostilities in the Western Balkans over the collapse of Yugoslavia was a major setback for the region. Depending on the political, economic, legal and social development on one hand and the level of progress of accession negotiations with the EU on the other, a few clear categories of countries could be highlighted.

Bulgaria and Romania have already completed the necessary reforms and have become members of the EU. Macedonia, Croatia and Turkey are officially recognized as candidate countries and as such they must implement the remaining necessary reforms in order to become member states. Albania, Bosnia and Herzegovina, Kosovo, Montenegro and Serbia are identified as potential candidates and need to focus more on restructuring in order to move on. Depending on the category, there are different types of financing available to the countries to assist them in the process of implementing EU standards.

2.5 EU funding – past and present financial instruments. EU funding for the Western Balkan countries

As a core factor in the EU's Enlargement Policy, the countries of the SEE region are subject to close monitoring and substantial assistance from Brussels. Although different in size, culture and economic standing, Albania, Serbia, Macedonia, Montenegro, Kosovo, Bosnia & Herzegovina and Croatia share similarities in issue areas and priorities to be addressed. Hence, these countries are regarded, by the EU, as constituents of a politically fragmented, but virtually unified economic and political landscape – namely the region of the Western Balkans. These countries qualify for structural aid and assistance from a number of EU foreign policy instruments, with the fundamental purpose of tying these countries closer to EU legislation, the European economy and values and successfully integrating them within the EU's Single Market.

3 Factors of attraction/motivators

3.1 EU membership

The status of EU accession of the SEE countries has always been considered as a competitive advantage and a positive factor, influencing the flow of foreign investments by both strategic investors and investment funds. In the beginning of 2007, Bulgaria and Romania became full members of the EU and for the past two years have benefitted the most from inward FDI. For them, EU membership means access to a much bigger market, unrestricted capital flow and no tariffs and duties for exported goods and services. All this has motivated foreign investors (i.e., mainly from the Netherlands, Austria and Belgium) to initiate big investment projects either to serve the two countries' market or simply to outsource production lines there.

At present the rest of the SEE countries are at a different stage in their EU accession. On the one hand, Croatia and Macedonia have been officially accepted as EU candidates and are expected to become full members in the beginning of 2014. As a consequence, they are now benefiting from EU financial aid to develop local infrastructure and administration. Once they are accepted into the EU, they are expected to attract more foreign investments into their economies. On the other hand, Albania, Bosnia and Herzegovina, Kosovo and Serbia still have a lot to do in order to eventually become EU members. Nevertheless, it is expected that in the future, as they move toward EU accession and membership, those countries will attract more investors and investment projects.

3.2 Market size

The market size of a country is an important factor to foreign investors when considering investment projects abroad, for the simple reason that countries with bigger markets and thus bigger market potential are able to provide more opportunities to multinational companies and foreign investors for their products and services.

Compared to the rest of the world, the SEE region represents a small fraction and thus a small share of the global market. However, looked at on the country level within the region, Romania, Bulgaria and Croatia stand out as the countries with the biggest market sizes, which was an important factor for attracting foreign investments before the crisis. Romania, with its population of over 20 million, is the most attractive to foreign investors, followed by Bulgaria with its 7.6 million population.

This indicates that like in the period prior to the crisis, when foreign investors were lured by the countries' market sizes, in the forthcoming years we can expect this trend to continue. Once the world economy has gone back to its normal path, foreign investments will first go to the countries with the biggest market size (Romania, Bulgaria and Croatia) and to a lesser extent to Bosnia and Herzegovina, Macedonia, and Albania.

3.3 Location and geographical characteristics

SEE countries are strategically situated as a connecting point between Europe and Asia, while also offering access to Russia and Africa. In the context of globalization and world markets' specialization in providing goods and services, this becomes a vital consideration for any investment initiative. The geographical features of the countries in the SEE region have proved to be an important factor of attraction to foreign investments. The SEE countries' natural resources are another factor that has acted as a magnet for foreign investments for several sectors in the region (e.g., mining, renewable energy and agriculture). The Southeastern European countries vary in terms of their mineral deposits, oil and gas reserves, water resources, forests and arable land.

Table 8.2 — *GDP per capita (USD) in the SEE countries. Source: Countries' national banks.*

Country	2008	2009
Albania	4,073	3,824
Bosnia and Herzegovina	4,625	4,278
Bulgaria	6,856	6,223
Croatia	15,628	14,242
Kosovo	n/a	n/a
Macedonia	4,656	4,482
Montenegro	6,509	n/a
Romanua	9,291	7,542
Serbia	6,781	5808

3.4 Macroeconomic stability

Macroeconomic stability as a factor is important to foreign investors when deciding whether to undertake investment projects or not. Although frequently regarded as a single figure, it is comprised of several components, namely the level of inflation in the country, the level of interest rates, the levels of GDP per capital, the amount government debt and whether the country has a surplus or a deficit. It is worth mentioning that this factor applies with equal weight to investment projects in all the sectors of a national economy.

In the period prior to the crisis, the macroeconomic stability of several of the SEE countries contributed substantially to attracting foreign investments. Since 2005, foreign investors have been willing to invest in Bulgaria, Romania and Croatia due to their stable domestic economies with rising levels of GDP per capita, affordable interest rates and relatively low inflation rates. According to their national banks, these three countries had the highest levels of GDP per capital in the region.

3.5 Taxes

Although the SEE countries varied in terms of their tax systems in the period prior to the financial crisis, they were in general more favorable to foreign investments than the rest of the countries in Europe.

Personal Taxes: With regard to personal income tax, the countries in the Southeastern European Region can be divided into two sub-groups: (i) countries with a flat income tax (Romania, Montenegro, Moldova, Macedonia, Kosovo, Bulgaria, Bosnia and Herzegovina, and Albania), and (ii) countries with variable tax (Serbia and Croatia).

Corporate Tax: Just as SEE countries can be split into two groups according to their personal income tax systems, they can also be grouped into two subgroups depending on their corporate tax rates: (i) countries with low corporate taxes , and (ii) countries with high corporate taxes.

The first group includes Montenegro with only 9%, followed by Albania, Bosnia and Herzegovina, Bulgaria, Macedonia and Serbia with a corporate tax rate of 10%, while the second group is made up of Romania with a 16% corporate tax, followed by Croatia and Kosovo with 20%.

3.6 Seaport Facilities

In terms of maritime logistics and seaport facilities, the countries of the Western Balkans, except for Serbia, Macedonia and Kosovo, have access to the Adriatic Sea and maintain an adequate water transportation infrastructure. Albania occupies an important strategic location in the Balkans along the Strait of Otranto, which links the Adriatic Sea to the Ionian and Mediterranean Seas. The country has four main seaports: Durres, Vlore, Sarande, and Shengjin, making it an important sea-hub in economic relations between the EU, Africa and Asia. Croatia's six seaports make it the most preferred country for maritime transport from Asia, Australia and Oceania through the Suez Canal to Europe. Montenegro is situated in the central Mediterranean area, on the coast of the Adriatic Sea. The country has three seaports – Bar, Kotor and Zelenika; however, only Bor has the capacity to handle industrial cargo on a larger scale.

Bosnia has the right of passage to the outer sea via its only port: Neum. The main freight port for Bosnia today is Ploče (in Croatia), which lies further north and is connected to Bosnia via a railroad. Bulgaria and Romania have access to the Black Sea and the Danube, which significantly contributes to their overall import-export potential and logistic connectivity between Asia and Europe. Bulgaria has two major cargo ports at the Black Sea – Varna and Burgas – while the major ports in Romania are Constanta (the largest Black Sea port), Mangalia and Sulina. Macedonia, Kosovo and Serbia are landlocked countries with no sea access. However, they are important to cross-regional transportation. Macedonia is especially crucial in this respect, being situated centrally on all international transport corridors.

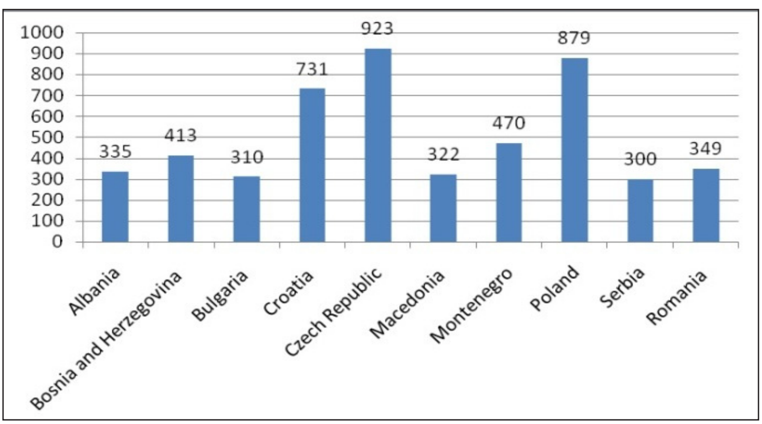

Figure 8.2 — *Gross average wage per month (in EUR). Source: Central banks publications.*

3.7 Low labor costs

The cost of labor in 2009 remained relatively inexpensive in the countries of the region, compared to labor markets in Western and Central Europe. The average monthly salary in Bulgaria and Romania, both EU member states, amounts to 310-350 euro; the figures for Serbia and Macedonia are similar. Average remuneration is slightly higher in Bosnia and Montenegro at around 450 euro, with a peak registered in Croatia at 731 EUR. By comparison, the average monthly salary in Central European countries is significantly higher – around 879 EUR in Poland and 923 EUR in the Czech Republic.

4 Why Southeastern Europe, why Albania? (The most attractive domains for investments)

4.1 Tourism

The tourism, represent one of the most attractive sector in Southeastern Europe. This domain is very attractive in:

- Bosnia and Herzegovina (geographic position, fascinating natural beauties variety of attractions);
- Greece (according to Word Tourism Organizations, Greece ranks among the top 15 tourism destination);
- Macedonia (summer and winter tourism, eco-tourism and cultural tourism),
- Moldova (rural tourism, national tour, wine path tour, business tourism—the favorable geographic location);
- Montenegro (tourism is a strategic sector for the country's economic development)
- Romania (rural tourism, variety of attractions, eco-tourism and cultural tourism);
- Serbia (the tourism industry directly employs around 8% of the active population of Serbia);
- Turkey (is one of the most popular destination in Mediterranean region and its performance in terms of tourism revenues is substantially above the world average).

4.2 Agriculture and Food proceeding

- Albania (is rich in herb and spices. About 30% of the European medicinal flora is found in Albania);
- Bosnia and Herzegovina (there are over 1.5 million hectares of agricultural land in B&H, divided between crop growing and livestock breeding);
- Macedonia (the agribusiness sector is of great significance for the economy, accounting for 15% of GDP);
- Montenegro (represents one of the territories in Europe where to a large extend nature has been preserved);
- Serbia (fruits, vegetables and organic products).

4.3 Business services sector

- Albania (the Albanian business services sector is a distinct feature in the country's economic live);
- Bulgaria (is in the list of leading outsourcing destination for technical support and shared services among countries in Eastern Europe);
- Croatia (with its highly developed telecommunication infrastructure, stable and transparent fiscal and legal environment, highly educated and multilingual workforce).

4.4 Conclusions

1. The Southeastern Europe represents an attractive zone for investment, in different activities sectors, with a great potential of development.
2. With EU countries being the main export trading partner for all of the Southeastern Europe countries (e.g., over 50% of the exports of all countries are EU related), it is expected that investment interest in the region, especially in the segment of strategic investment, will come mainly from EU based entities.
3. In this respect, it will be easier and more cost effective for European companies to expand their operations networks to countries with lower transition costs, but uniform EU administrative and legal framework. For a progress in figures in Albania will not necessarily translate into a sizeable advantage of investment conditions there, in so far levels of workforce sophistication and functioning market and rule of law institutions are still low and reforms take place slowly.
4. Sizeable and adequate assistance from international entities, such as the EU, IMF, the World Bank and other IFIs, including EBRD, EIB and CEB has also contributed to a large extend for the preservation of confidence in the region and for lowering risk perceptions.
5. As a general conclusion from all foreseen and undertaken counter crisis measures in the region, however, it is clear, that due to the relatively small size of the economies and their general dependence on outbound markets, it is not only from within that changes will come.
6. Countries as Albania, Kosovo, Bosnia & Herzegovina and Montenegro are currently subject to intensive funding by both the EU and IFIs with the general aim to enhance necessary reforms in administration, fiscal policies and labor market efficiency and pave the road for EU membership and FDI.
7. However, lacking infrastructure in energy and water supply in Albania

are a general concern for investment and general economic development, although performing well in current crisis conditions, these countries have a long way to go before being able to turn into a sound investment hotspot.

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