

Conference Paper

Does a Venture Capital Market Exist in the Countries of Former Yugoslavia?

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Abstract

Venture capital investments spread all over the world during the last few decades. Until then, they were considered only as an American phenomenon. Countries worldwide are interested in attracting venture capital investments because of their undisputable effects on the economy. The effects of the investments are visible through the impact on innovation, creation of new companies, jobs, economic growth, corporate governance and etc.

Venture capital is a subset of Private equity focused on start-up companies and companies having difficulties in attracting necessary capital. It represents an equity investment made for the launch, early development, or expansion of a business.

The countries of former Yugoslavia (Croatia, Bosnia and Herzegovina, Former Yugoslav Republic of Macedonia - FYROM, Montenegro, Slovenia and Serbia) are part of the Central and Eastern Europe countries and represent relatively a new market for venture capitalists. They moved from the planned economies to a free market system in the 90s of 20 century. As well as other countries in the World, these countries are also interested in attracting venture capital because of the proven impact on economic growth. Despite the presence of Venture capital and Private equity funds in this region for more than twenty years, the venture capital and private equity market in the countries of former Yugoslavia is underdeveloped compared to other countries of CEE. Indeed, the venture capital investments are so small for some countries of former Yugoslavia that the data about venture capital investment are published jointly.

The objective of this paper is to examine and analyze the development of Venture Capital market in countries of former Yugoslavia. The research is both qualitative and quantitative, and involves an identification, analysis and comparison of PE/VC investments data for selected countries. The time frame for this research is between 2007 and 2014. The total volume of venture capital investments per year, the number of companies invested and the ratio of PE investments to the gross domestic product (GDP) will be used to demonstrate the existence of the venture capital market in countries of former Yugoslavia. The data necessary for the current research were taken from the yearbook of EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y. "PEREP Analytics" is a centralized, non-commercial pan-European private equity database. The "PEREP Analytics" statistics platform monitors the development of private equity and venture capital in 25 European countries.

Keywords: Venture capital investments, Former Yugoslavia, CEE, Venture capital market, economic growth

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1. Introduction

Private equity (PE there-after) and Venture Capital (VC there-after) as we know today, so-called modern PE and VC, started its development in the 1940s [3]. Till the 1980s the PE industry where concentrated in the USA. After that, VC investments spread all over the world and the PE investment activity increased its significance in European countries during the last few years [1].

According to the European Private Equity and Venture Capital Association (EVCA, 2015) PE is defined as a form of equity investment into private companies not listed on the stock exchange, while VC is a type of PE focused on start-up companies. In the focus of VC are private companies with the potential of high growth [11]. According to [22] "Venture capital represents a very interesting solution for the new and existing small and medium sized enterprises which have interesting and attractive ideas and projects, but are short of finances".

Countries worldwide are interested in attracting venture capital investments because of their undisputable effects on the economy. In a modern economy a well developed PE market fosters innovation, employment and growth [2, 11]. VC is a subset of PE focused on start-up companies, and companies having difficulties in attracting necessary capital. It represents an equity investment made for the launch, early development, or expansion of a business.

The countries of former Yugoslavia (Croatia, Bosnia and Herzegovina, FYROM, Montenegro, Slovenia and Serbia) are part of the Central and Eastern Europe (CEE) countries and represent relatively a new market for venture capitalists. They moved from the planned economies to a free market system in the 90s of 20 century. As well as other countries in the World, these countries are also interested in attracting VC because of the proven impact on economic growth. Despite the presence of VC and PE funds in this region for more than twenty years, the VC and PE market in the countries of former Yugoslavia is underdeveloped compared to other countries of CEE. According to [1] the PE market of the United Kingdom dominates in the activity, including fundraising and investing, in relation to other countries in Europe. This PE market is followed by the France and German PE market. According to EVCA (2015) 41.5 billion euros of all private equity were invested in Europe in 2014, while in the Central Eastern Europe (CEE) were invested 1,3 billion euros. In the countries of Ex-Y in the same period were invested just 381.7 million euros.

The objective of this paper is to examine and analyze the development of VC market in countries of former Yugoslavia. The research is both qualitative and quantitative, and involves an identification, analysis and comparison of PE/VC investments data for selected countries. The time frame for this research is between 2007 and 2014. The total volume of VC investments per year, the number of companies invested and the ratio of PE investments to the gross domestic product (GDP) will be used to demonstrate the existence of the VC market. The data necessary for the current research were taken from the yearbook of EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y. "PEREP Analytics" is a centralized, non-commercial pan-European private

equity database. The "PEREP Analytics" statistics platform monitors the development of private equity and venture capital in 25 European countries.

2. Impact of Private Equity and Venture Capital on European Economy

In the study of Frontier economics (2013) the focus is placed on the effects of the PE industry on key components of economic growth: innovation, productivity and competitiveness in Europe. According to them positive effects of PE activities on innovation can be visible through:

1. In some sectors, €1 of PE finance can be up to nine times more effective in patent production than €1 of non-private equity finance on patent production.
2. The patents granted to private equity-backed firms over five years to 2011 are worth up to €350bn, or twice the total amount of private equity investment during the same period.
3. That private equity-backed enterprises account for up to 12% (ca. 116,000) of total patents across 12 European countries. And it is estimated that the average economic value of a patent is €3m.

The importance of PE on productivity is summarized through the following:

1. Nearly €250bn in investments in companies in the twelve countries explored in this study in six years to 2012.
2. Private equity contributes to the creation of up to 5,600 new businesses in Europe each year, which directly leads to new job creation.
3. It is estimated that private equity participation leads to improved productivity (as measured by EBITDA per employee) of 6.9%, on average, in private equity funded companies.

The positive impact of PE activities on productivity of the investee companies results also in increased competitiveness. Table 1 summarizes results of other studies about the effects of PE activity on economic growth [9].

Gatawua and Mwithiga (2014) and Strömberg (2009) express the doubt if PE activity contributes on economic growth or if "economic growth contributes to increased PE activity" because results of conducted different studies are divergent. Strömberg (2009) in his study provides an overview of the relationship between VC and innovation (Table 2).

To determine the effects of PE and VC investments on the economy first it is necessary to identify the existence of the PE and VC markets in the country.

Authors	Coverage	Findings
Popov and Roosenboom, 2009	European private equity investments and patents 1991-2004	A 1% increase in private equity investment increases USPTO patents by between 0.04%-0.05%. Private equity accounts for 8% of aggregate industrial spending, and 12% of industrial innovation. Private equity financing can be up to nine times more effective than non-private equity financing in delivering innovations.
Gambardella et al., 2008	The value of European patents	The estimated mean-value of European patents is about €3m. Based on a survey of 9,000 patents. These are patents with priority date 1993-1997, granted by the European Patent Office, and such that the address of the first inventor listed in the patent is in Denmark, France, Germany, Hungary, Italy, the Netherlands, Spain or the UK.
Lerner et al., 2011	495 LBOs worldwide, 1980-2005	Patents applied for by firms in private equity transactions are more cited (a proxy for economic importance), show no significant shifts in the fundamental nature of the research, and are more concentrated in the most important and prominent areas of companies' innovative portfolios.
Ernst & Young, 2012	European exits in seven years to 2011	Examines exited investments and finds that private equity participation improves productivity by 6.9% (as measured by EBITDA per employee).
Bank for International Settlements, 2008	650 private equity-backed companies worldwide, 1981-2007	Default rate for private equity-backed companies is 5% lower than for matched public companies.
Kaplan and Strömberg, 2009	17,171 private equity-backed companies worldwide, 1970-2007	Private equity-backed companies have 25% lower default rates than non-private equity-backed companies.
Samila and Sorenson, 2011	US, 1993-2002	Private equity positively affects firm starts, with up to 10 further companies being created directly as a result of the creation of a new private equity-backed company.

TABLE 1: Private equity activity and economic growth. Source: Frontier economics (2013).

3. State of Venture Capital in Former Yugoslavia – Theoretical Approach

For more than 20 years PE/VC markets exist in countries of CEE whose part are also countries of former Yugoslavia. The importance of PE/VC markets is different among mentioned countries and primarily depends on the economic development (growth

Author	Country	Findings
Kortum and Lerner, 2000	US	Venture capital investment has a positive impact on patent counts and this impact is larger than that of industrial research and development expenditure.
Hirukawa and Ueda, 2006	US	Venture capital investment causes an increase in patent filings but without a corresponding increase in total factor productivity.
Mollica and Zingales, 2007	US	Venture capital investment has a positive impact on innovation and the creation of new companies (controlling for various reverse causality explanations).
Engel and Keilbach, 2007	Germany	Venture-capital-backed companies register more patents than comparable non-venture-capital-backed companies before they receive venture capital investments, but this is not the case after the investment.
Caselli, Gatti and Perrini, 2008	Italy	Venture-capital-backed companies register more patents than comparable non-venture-capital-backed companies before receiving venture capital investments, whereas this tendency disappears after the investment is made.
Popov and Roosenboom, 2008	Europe	Private equity investment causes a significant increase in patent filings.

TABLE 2: Overview of relationship between Venture capital (VC) and innovation. Source: Strömberg (2009).

of the GDP), depth and liquidity of the stock market (IPO), tax regimes, corporate governance legislation and legal system of the countries [15, 26].

According to Lazarevski et al. (2012) the PE/VC development in FYROM is legally regulated from 2007 through the amendment of the Law on Investment funds. Furthermore, in 2007 the government started an initiative of establishment three venture capital funds in co-operation with the private sector, but it ended unsuccessfully [22]. With the aim of further stimulation of the PE/VC, pension funds were enabled to invest into PE/VC from 2011 by the amended of Law for pension funds. All this returned no results, because in FYROM exist several private investments funds which are just focused on security investments rather than PE/VC investments. The reasons of the underdeveloped of the PE/VC industry in FYROM are the result of [16, 22]:

1. Underdevelopment of the IPO market as well as the existence of a shallow and illiquid secondary market;
2. Not being a member of the European Union (EU) and North Atlantic Treaty Organization (NATO);
3. Relatively high bills' rate of the Treasury and Central bank;

4. Deficiency of quality entrepreneurial projects, knowledge and skills;
5. Poor investment climate;
6. Corruption;
7. Bureaucratic and administrative barriers.

The VC market in Serbia is also underdeveloped [17]. Serbia is ranked at the 79th place in the world according to the VC/PE attractiveness index in 2014, while Slovenia is at the 50th and Croatia at the 64 place [17]. Reasons because of the poor VC market in Serbia are [17, 18]:

1. Lack of an appropriate law which is going to recognize VC investors as economic units;
2. Inadequate tax policy (it is necessary to make differences between greenfield and brownfield investments);
3. Underdevelopment of the IPO market;
4. Absence of state investment funds;
5. Poor investor protection and corporate governance;
6. Lack of knowledge about the role of VC investment funds in the company;
7. Determining of company value is not understood.

In Croatia the development of VC market started at the end of the nineties with the appearance of foreign PE/VC funds. These funds, SEAF Croatia, Horizonte Venture Management, Copernicus Capital, Vienna Capital Partners, were organized as local consulting companies of foreign PE/VC management companies [4, 20]. In 2003 the first Croatian PE/VC management company were established under the name Quaestus Private Equity Ltd. which manages the fund Quaestus Private Equity Kapital (Šimic, 2015). Today in Croatia exist four PE/VC management companies and five PE/VC funds. Despite the presence of VC in Croatia for more than 20 years, VC does not yet play a significant role as in some developed countries. Some of the reasons are:

1. VC market is far more shallow and underdeveloped;
2. Frequent changes in tax rates;
3. Poor entrepreneurial culture and business opportunities;
4. Entrepreneurs are not familiar with the entire investment process of venture capital;
5. Entrepreneurs are not ready for attracting of this form of capital;
6. Entrepreneurs are not sure what are the advantages and disadvantages of this form of capital;

7. Entrepreneurs do not know what this capital is offering, and what this capital demands;
8. Entrepreneurs are not willing to renounce ownership.

The VC market in Slovenia is also underdeveloped [12, 13, 19] as in other countries of former Yugoslavia due to the absence of VC investment tradition. Till the end of 2011 seven VC companies were supported, but still some uncertainties in the tax, administrative and legal spheres exist. Furthermore, the reasons of the underdevelopment for the equity financing are: [10, 13]:

1. Lack of institutional investors;
2. Insufficient development of VC companies due to the financial crisis;
3. Lack of experience in managing PVCCs (private VC companies);
4. Lack of exit possibilities;
5. Low cooperation between the public and private sectors because of lack of knowledge on venture capital on the public side, and extensive reporting;
6. Expectation of positive effects in the short term;
7. The lack of entrepreneurship culture and know-how, the lack of "role models";
8. Limited size of the Slovenian economy with few dynamic SMEs and a fairly closed capital market.

According to Kozarevic & Kozarevic Jukan (2014) VC investments in Montenegro do not exist yet.

4. Methodology

The research is both qualitative and quantitative and involves an identification, analysis and comparison of VC investments data for countries of former Yugoslavia in the period from 2007 to 2014. The goal is to show if the VC market exists in mentioned countries. Figures are used to visualize the time series and trends in observed variables. The data necessary for the current research were taken from the yearbook of EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y., EVCA special paper – Central and Eastern Europe Statistics 2014. "PEREP Analytics" is a centralized, non-commercial pan-European private equity database. The "PEREP Analytics" statistics platform monitors the development of private equity and venture capital in 25 European countries. The investments data provide by the EVCA/PEREP Analytics are aggregated via two methods:

1. Market statistics and
2. Industry statistics.

According to EVCA (2015) market statistics represent an “aggregation of figures according to the location of the portfolio company. At European level, this relates to investments in European companies regardless of the location of the private equity firm”. Respectively, market statistics is a sum of:

1. Domestic investments in European countries;
2. Cross-border investments within Europe;
3. Non-European private equity firms investing in portfolio companies in Europe.

Industry statistics represents an aggregation of figures according to the country in which the PE firm making a particular investment is based, and not related to the country in which the investee company is based. At European level, this relates to investments made by European PE firms regardless of the location of the target company. Industry statistics is a sum of:

1. Domestic investments in European countries;
2. Cross-border investments within Europe;
3. European private equity firms investing in portfolio companies outside Europe.

In this study data were collected by the method of market statistics and the data were processed using descriptive statistics.

5. Results

5.1. Descriptive Statistics for Vc Investments in Countries of Former Yugoslavia from 2007 till 2014

During the period between 2007 and 2014, Croatia attracted the most of total VC investments in this region followed by FYROM, Slovenia, Bosnia and Herzegovina, Serbia and Montenegro. The value of investments in the observed period for Croatia were 26.895.000 €, followed by Slovenia with 16.367.000 €, FYROM with 14.981.000 €, Bosnia and Herzegovina with 1.668.000 €, Serbia 1.360.000 €, while in Montenegro no VC investments were recorded (Figure 1).

Except the total amount of VC investments in the observed period it is necessary to show the investments per year. According to the data in Table 3 only Slovenia had VC investments in all observed years, followed by Croatia which had no VC investments just in 2009. Bosnia and Herzegovina and Serbia had VC investments only in two years, 2007 and 2008, FYROM in one year, 2007, and Montenegro had no VC investments.

According to the EVCA (Yearbook, 2015) the stage of investment of Venture Capital can be:

1. Seed (“Financing provided to research, assess and develop an initial concept before a business has reached the start-up phase”),

	2007	2008	2009	2010	2011	2012	2013	2014
BOSNIA AND HERZEGOVINA	456	1.212	0	0	0	0	0	0
CROATIA	7150	4000	0	300	5625	3000	6520	300
FYROM	14.981	0	0	0	0	0	0	0
MONTENEGRO	0	0	0	0	0	0	0	0
SERBIA	60	1.300	0	0	0	0	0	0
SLOVENIA	481	2.853	1.826	1.129	2.302	1.300	3.976	2.500

TABLE 3: Total VC investments in countries of former Yugoslavia per year (in 000 €). Source: author's own calculation based on the EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y and EVCA (2015b).

2. Start-up ("Financing provided to companies for product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short time, but have not sold their product commercially")
3. Later stage venture ("Financing provided for the expansion of an operating company, which may or may not be breaking even or trading profitably. Late stage venture tends to be financing into companies already backed by VCs, therefore they would be C or D rounds of financing").

In countries of former Yugoslavia investments in the later stage venture dominate, while investments in the seed and start-up phases, the phases of research and product development, are rare (Table 4). The reason for this stems from the high information asymmetry between the companies and the VC fund. Avoiding investments in the earlier phases of development VC funds avoid the higher risk and the associated loss.

5.2. Descriptive statistics for the number of companies invested in countries of former Yugoslavia from 2007 till 2014

During the eight-year period only 49 companies have attracted VC investments in the region of former Yugoslavia. The largest numbers of companies were placed in Slovenia (22) and Croatia (13) (Figure 2).

Figure 3 is showing the number of companies invested in the observed period per country. Like before, the only country which records investments in companies every year is Slovenia, followed by Croatia. After 2008, in Bosnia and Herzegovina and Serbia no company did attract VC, while the same situation in FYROM started in 2007. In Montenegro companies with VC investments do not exist.

5.3. The Ratio of PE Investments to the Gross Domestic Product (GDP)

The PE activity, i.e. the growth level of a country's market, on the national levels, is calculated as the ratio of PE investments to the gross domestic product (GDP) [2, 23]. For calculating this indicator PE investments are taken into account and not VC

		2007	2008	2009	2010	2011	2012	2013	2014
BOSNIA AND HERZEGOVINA	<i>Seed</i>	377	302	0	0	0	0	0	0
	<i>Start-up</i>	79	252	0	0	0	0	0	0
	<i>Later stage venture</i>	0	658	0	0	0	0	0	0
CROATIA	<i>Seed</i>	0	0	0	0	0	0	0	0
	<i>Start-up</i>	4800	0	0	300	5625	0	6220	0
	<i>Later stage venture</i>	2350	4000	0	0	0	3000	300	300
FYROM	<i>Seed</i>	0	0	0	0	0	0	0	0
	<i>Start-up</i>	1.481	0	0	0	0	0	0	0
	<i>Later stage venture</i>	13.500	0	0	0	0	0	0	0
MONTENEGRO	<i>Seed</i>	0	0	0	0	0	0	0	0
	<i>Start-up</i>	0	0	0	0	0	0	0	0
	<i>Later stage venture</i>	0	0	0	0	0	0	0	0
SERBIA	<i>Seed</i>	60	0	0	0	0	0	0	0
	<i>Start-up</i>	0	0	0	0	0	0	0	0
	<i>Later stage venture</i>	0	1.300	0	0	0	0	0	0
SLOVENIA	<i>Seed</i>	377	0	0	0	0	0	0	1.050
	<i>Start-up</i>	104	500	1.050	0	1.802	1.300	707	1.250
	<i>Later stage venture</i>	0	2.353	776	1.129	500	0	3.269	200

TABLE 4: VC investments by stage for countries of former Yugoslavia (in 000 €). Source: author's own calculation based on the EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y and EVCA (2015b).

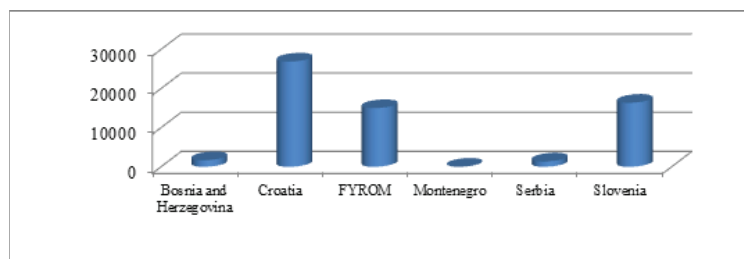


Figure 1: Total VC investments in countries of former Yugoslavia in the period 2007-2014 (in 000 €). Source: author's own calculation based on the EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y and EVCA (2015b).

investments due to the lack of necessary data. Because of this way of calculating, results of the market activity will differ than hitherto.

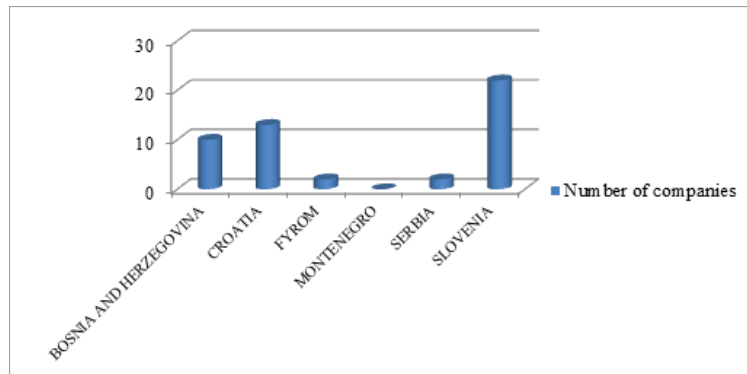


Figure 2: Number of companies invested in the period 2007-2014. Source: author’s own calculation based on the EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y and EVCA (2015b).

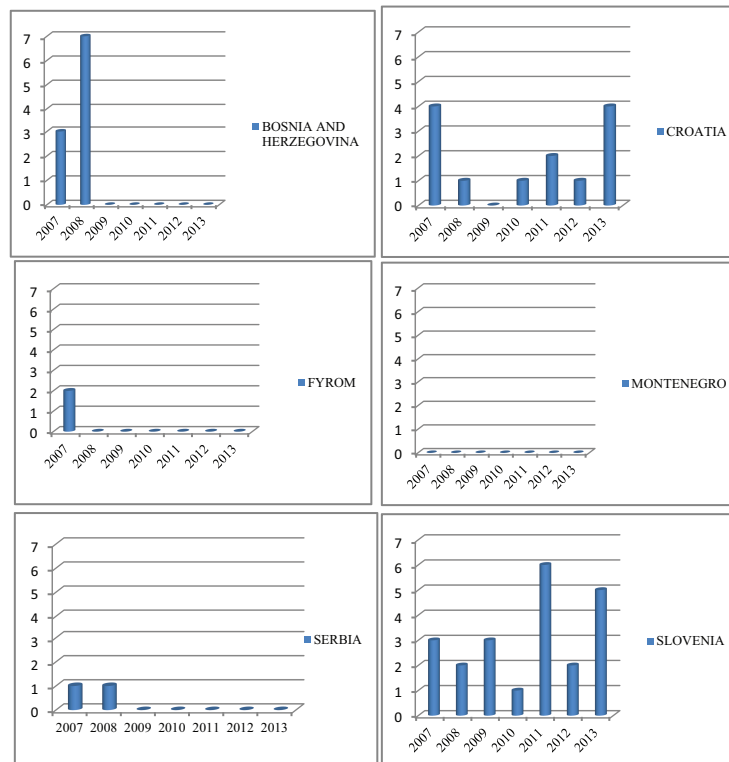


Figure 3: Number of companies invested in the period 2007-2013 per country (Data for 2014 were not available). Source: author’s own calculation based on the EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y.

According to the Figure 4, on average, only Serbia has a higher ratio of PE investment to GDP in relation to the CEE average. This is the result of an extreme buyout transaction, while all other countries of former Yugoslavia are far below the average. These results also show the lag and the underdevelopment of the analyzed market.

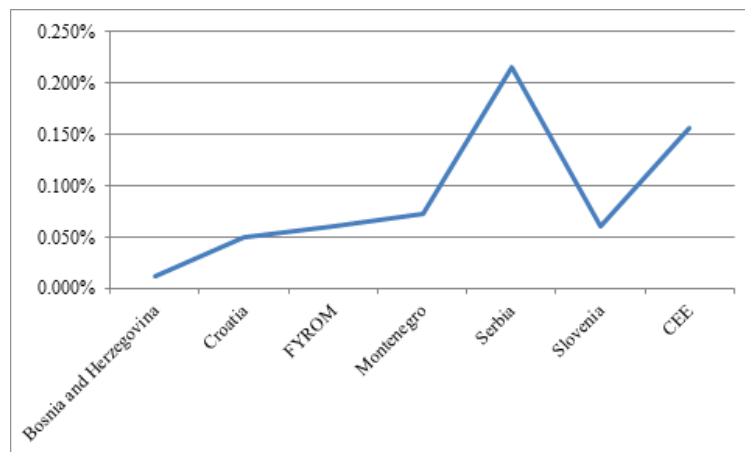


Figure 4: Average value of the ratio of PE investments to GDP for 7 years (2007-2014). Source: author's own calculation based on Šimić (2015) and EVCA (2015b).

6. Conclusion

The aim of this paper was to examine and analyze the development of VC markets in countries of former Yugoslavia. Furthermore, the goal was to answer the question about the existence of the VC market in those countries.

The presence of VC in the economy leads to innovation, economic growth, creation of new companies, jobs, corporate governance and etc. These are the most common reasons for fostering the VC investments in countries. Despite the 20 year presence of VC investments in the countries of former Yugoslavia, the VC markets are still invisible and underdeveloped. For all six countries the reasons of the underdevelopment of the market are quite similar. They are related to the underdevelopment of the IPO market as well as the existence of a shallow and illiquid secondary market, deficiency of quality entrepreneurial projects, knowledge and skills, poor investment climate, poor investor protection and corporate governance, lack of exit possibilities, inadequate tax policy and lack of entrepreneurs knowledge about VC.

Furthermore, during the eight year period only 61.3 million € of VC were invested in the countries of former Yugoslavia while in Europe just in 2014 were invested 41.5 billion € and in CEE 1.3 billion €. In addition, only Slovenia records constant investments during the analyzed period while Montenegro did not record any investments. The situation is nothing better taking into account the number of companies which attracted VC (only 49 companies). The reason can be found in the high information asymmetry between the companies and the VC fund in the early phases of development. Avoiding investments in the earlier phases of development VC funds avoid the higher risk and the associated losses. According to the ratio of PE investments to GDP, considering the average value, only Serbia is above the average of CEE, while all other analyzed countries are far below.

According to all above mentioned it can be concluded that in Bosnia and Herzegovina, FYROM, Montenegro and Serbia VC market do not exist. The VC market in Croatia and Slovenia is present, but still insufficiently developed.

As future work I see the research of PE investments, especially investments in the later stages, as well as the expansion of research on CEE countries and European countries in order to find the way of developing the PE/VC markets in countries of former Yugoslavia.

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