

# Main Factors Affecting the Balance of Investments in Serbia and New Trends of Investment

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The importance of investment for the development of some country is undeniable. In today's economic conditions, it is necessary to observe all the influencing factors and examine their impact on the investments in the economy of some country. The goal of each country is to create a favorable climate (conditions) for the investments, because they stimulate the growth and development of the country. The aim of this paper is to point of the current situation (the past few years) of the foreign investments in Serbia's economy and to highlight the main factors that influenced this situation. In a past few years, there is another trend of unexploited resource of investment seen in Serbia, which is more and more attractive in the region, but unfortunately unjustly neglected in Serbia. These sources are venture capital and private equity funds. Some of the influencing factors that must be emphasized are the country's general economic situation, political risks, taxation, the financing of the investments, the government's incentives (subsidies), support from some specialized institutions, etc..

*Keywords:* foreign investments, influencing factors, venture capital and private equity funds.

## Introduction

After the fall of the socialist system of economy, transition economies have opened their markets for the entry of foreign investment. Looked from the side of the investitures, these countries, including Serbia, represented a new market potential for them. From the point of developing countries, this investment represented the possibility of external growth and development.

It was only in the early 21st century when Serbia was affected directly by investments although its socialist system collapsed in the 1990s. The reason for this lies in unregulated legislation and high political risk of the country (Milenković, Ikonić, & Milošević, 2011).

In January 2001, Serbia's new government launched an ambitious program aimed at a rapid transition to a market economy, the normalization of relations with foreign creditors and integration with regional, European Union (EU) and world markets. The government's economic program rested on three pillars: (1) more prudent macroeconomic policies; (2) market-oriented structural reforms; and (3) the mobilization of significant financial and technical support from donors (Government of Republic of Serbia, 2010; 2011a).

Serbia has enacted specific legislation outlining guarantees and safeguards for foreign investors. The

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current Law on Foreign Investments establishes the framework for investment in Serbia (Government of Republic of Serbia, 2003). The law eliminates previous investment restrictions; extends national treatment to foreign investors; allows the transfer/repatriation of profits and dividends; provides guarantees against expropriation; and allows customs duty waivers for equipment imported as capital-in-kind. In order to attract foreign direct investment (FDI), Serbia developed a range of incentives for investors in 2006, including cash grants to investors that create significant new jobs, as well as tax incentives in the form of credits, cuts in payroll contributions and reduced corporate tax rates (Dimireva, 2010).

Serbian government has created Serbia Investment and Export Promotion Agency (SIEPA) with the mandate to promote Serbia as favorable location for FDI. This agency provides direct assistance to investors. SIEPA has successfully attracted some headline strategic investors (Dimitrijević, 2000).

Thanks to all measures and development programs that the government has taken to improve investment in Serbia in the past decade, there was an increase in foreign investment noted. This growth has been stunted under the influence of the global economic crisis that affected the economic system of Serbia.

### Research Questions and Research Methods

The aim of this review paper is to present the situation of FDI in Serbia and to draw attention to the new trends of investment. So, the main question that arises is what are the factors that have significant influence on the volume and dynamics of foreign investment? Is there a mechanism (institutions, development strategy with clearly defined goals, etc.) that initiates and encourages foreign investors to invest in our country?

To obtain answers to these questions in this article, it will use the following methodology. Using available resources it will be determine the balance of investments in Serbia in the past period. Then by analyzing the documents issued by state institutions it will be determined if there is support that encourages foreign investment in Serbia. Document analysis and interview based facts lead to conclusions about the important factors that may be set aside as incentive to attract foreign investment. In conclusion, there is an analysis given that point of unused opportunities to attract foreign investment in the form of venture capital and private equity funds.

### Analysis

#### Overview of Investments in the Last Decade

In the period after the 1990s of the 20th century, Serbia opened up to foreign investment. The growth of investments is credited to a series of measures taken to establish a favorable climate for investment. A significant increase in investments is recorded in the past decade. According to the Serbian Chamber of Commerce in the period 2002-2011, the movement of FDI was as follows (see Figure 1).

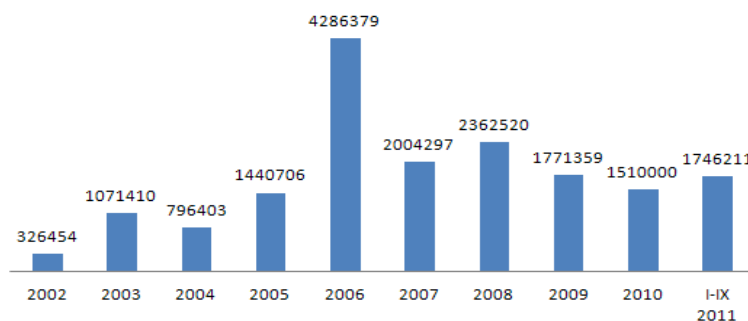


Figure 1. The movement of FDI in the period 2002-2011. Source: Serbian Chamber of Commerce, 2012.

As it can be seen based on Figure 1, in 2006 there was a sharply increase in the volume of foreign investments. The reason for such a large increase is the restructuring of large state-owned companies by FDI. In the period after 2006, the amount of FDI is continuously moving nearly two million U.S. dollars.

Economic development in the last decade is characterized by inadequate investment in production. The inflow of foreign funds in Serbia after 2000 was characterized by predominantly investing in infrastructure and energy, while very little is spent directly in production. Only in 2006 has taken steps to encourage green field investments, and also tenders were called for some concessions. In the aim of faster economic development, it is necessary in addition to encouraging investment in the form of loans from international and regional financial organizations, government measures etc.. It is necessary to take into account the sectoral direction of the investment, they must be directed in production capacity, which must be export oriented. Investing in production from domestic and foreign sources, primarily also from FDI, will enable Serbia to join the process of faster development (Nikolić, 2011; Quaterly Monitor of Economic Trends and Policies, 2011).

If a comparative analysis is made with other post-socialist countries in 2009 and 2010, as it can be seen from Figure 2, the extent of Serbian FDI is in the sixth place among developing countries.

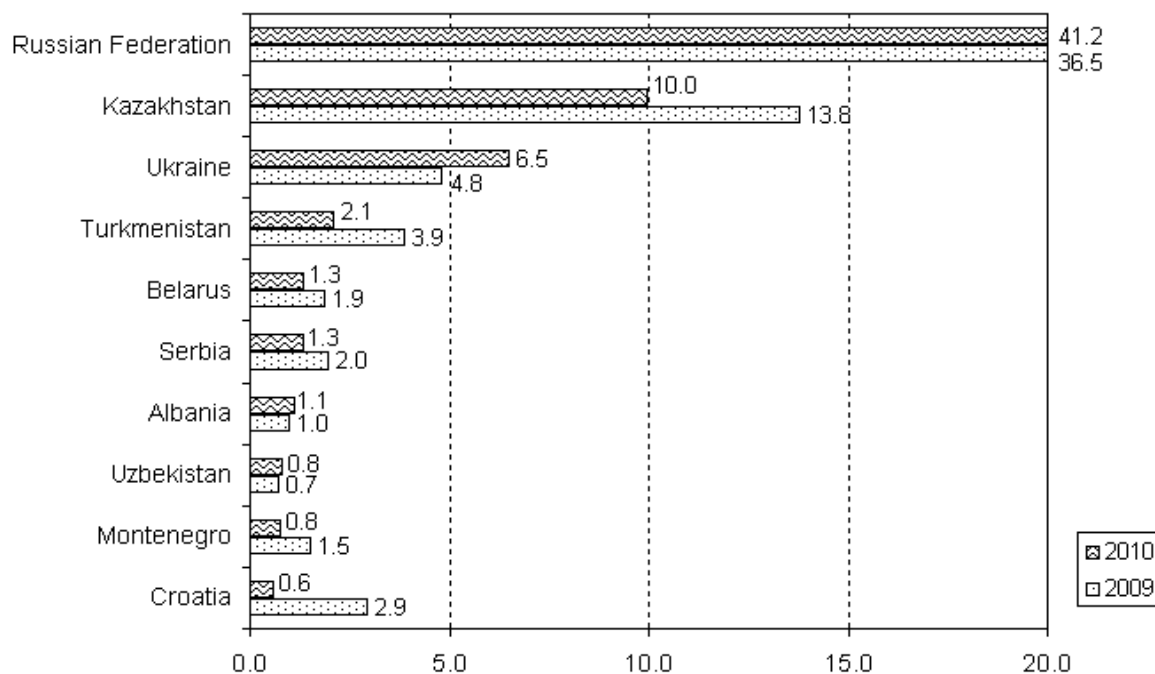


Figure 2. Transition economies: Top 10 recipients of FDI inflows, 2009, 2010 (billion of dollars). Source: UNCTAD, World Investment Report 2011.

Based on Figure 2, it can be seen that the inflow of FDI into the Russian Federation was the largest, with most investments in infrastructure and manufacturing, on the second place Russia is followed by Kazakhstan, which is attractive for FDI because of the great natural wealth that is insufficiently exploited. If you look at Serbia, it can be concluded that the lead among the neighboring countries (Montenegro, Croatia, and Albania), although in 2010 compared to 2009, the volume of FDI has declined. This decrease in value was due to effects of the financial crisis which affected the monetary sector of Serbia and therefore reduced the investors' interest in investing in Serbia.

### FDI in Serbia in 2011

Based on the report of the National Bank of Serbia in 2011, the level of investment has increased compared to the year 2010. The total amount of FDI in 2011 from January to November was amounted to 1,026.8 million of dollars, while in 2010 the relevant period amounted to 2,142.5 million dollars. The structure of this investment is given in Figure 3.

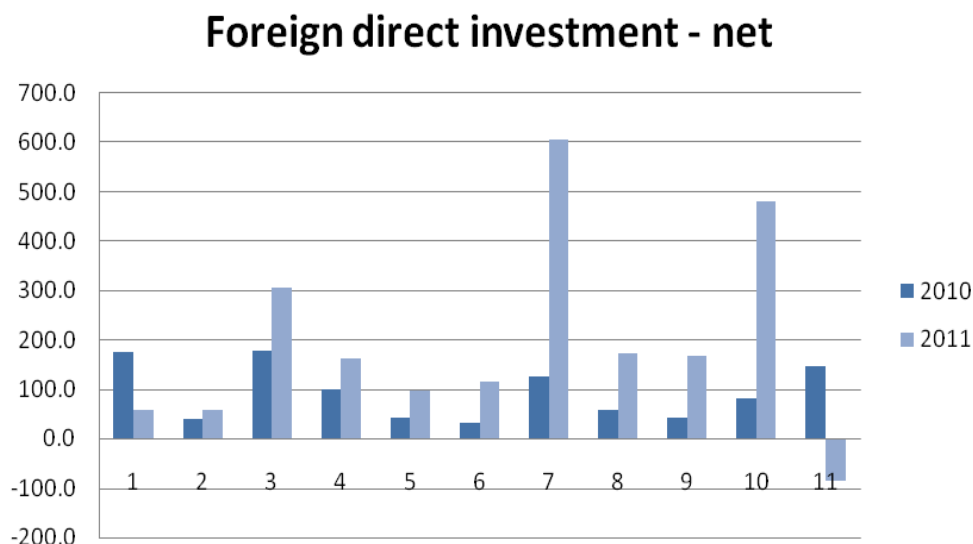


Figure 3. Amount of FDI in 2010 and 2011. Source: Authors calculation based on the report of the National Bank of Serbia.

The inflow of investments in the first three quarters in 2011, according to the National Bank of Serbia, was most intense in the retail sector with 39.5% of total inflow, followed by manufacturing with 21.1%, and financial and insurance activities with 11.1%. The investments in the manufacturing sector are so low that they do not reach 10% of total inflows, and as such can be considered as insignificant. From the standpoint of economic development in Serbia this is very important and gives an indication that in the future should be taken measures to encourage investment in productive activities in order to increase the growth of the gross domestic product based on the productivity and directed the country towards to export orientation.

### Important Factors That Implicate the Balance of Investments in Serbia

It is not enough to understand the crucial importance of FDI in the economic system of the country, it is necessary to take concrete measures to attract them, because there are very competitive countries in the environment.

Experts claim that Serbia lacks the political will to be instantaneous and very quickly overcome much of an obstacle for investors. David Lyngtoe from the company Baines Babic (Halifax Consulting) said a few basic things that Serbia needs to be more desirable for business:

- Stability—whether the economy is stable, if there are unforeseen developments in inflation rate;
- The justice system must be much more efficient;
- Regulations are still unclear and not transparent to the uninformed investors;
- Flexibility of administration, for what was cited as an example of procedures for hiring and firing workers, which complicate the hiring of workers for short periods (one, two, or three years) to execute a

particular project (he reminds that this is the simplest in Denmark, which has one of the lowest rates unemployment in the world);

- Education staff is working out of date, and the education system in Serbia has long been building staff that learn to memorize, but not to develop skills.

The Development Strategy and Policy of the Republic of Serbia from 2011 to 2020 (Government of Republic of Serbia, 2011b) analysis states that the most important factor is creating market environment in order to attract foreign investors. This influence of economic environment is given in Table 1.

Table 1

*The Influence of Economic Environment on the Competitiveness of the Economy*

	Pull motives (pull)
Political influence	A stable political situation, liberal legislation, dominant business-oriented culture, the growth of credit, regulated market
Economic influence	The good economy, high potential of growth, low operating costs, market development, opportunities for real estate investment, large market, a favourable exchange rate, depressed stock prices
Social influence	Positive social environment, positive demographic trends, population growth, reduction of social benefits
Cultural influence	Well-known reference points in the cultural milieu, attractive composition of cultural values, innovative business culture, fostering corporate culture, homogeneous cultural environment (friendly segments)
Competitive structure	Market niches, ownership of capacities, the possibility of expansion through copying, favourable operational conditions

The creation of a favorable climate for investment, both foreign and domestic, is a major challenge for all countries as increased globalization and competitive business pressures provide the framework and need for continuous improvement in both the overall enabling environment for business and company performance. Governments have a key role at the macro level in providing stability and in improving the overall environment for business while competitive market pressures are demanding continuous improvement in efficiencies, increased flexibility, and effectiveness by company management.

### **New Trends of Investment in Serbia**

Most of the countries in Southeast Europe have underdeveloped financial markets funds as well as investment funds as an alternative source of capital raises. In some countries, the importance of the investment funds is realized earlier while in Serbia the trend of intense stimulation of these funds is relatively new and is related to the last few years. Among the countries in region that have so far proved greater amount of investment by venture capital funds, it can be highlighted Poland, Hungary, Romania, Slovakia, Ukraine, Croatia, and Slovenia.

In order to stimulate the development of venture investment in the territory of south-eastern Balkans, SEAF (fund to assist small businesses) opened a representative office SEAF South Balkan Fund (SBF) in October 2005 in order to place private equity investment in Serbia, Macedonia, and Montenegro. Subsequently, in 2010 was the Serbian Association of private equity formed (SPEA—Serbian Private Equity Association) to promote and attract foreign investors, private equity, and venture capital.

In Serbia the SEAF South Balkan Fund is conducting the business as a foreign company's office and it is not registered as an investment fund. According to the available information, there are several procedural problems to be solved for the registration of venture capital funds (VCFs). Firstly, private equity and venture capital investment funds are not recognized by the investment funds law. Secondly, during the investment process it is hard to explain to the authorities the role of a venture or private equity investment fund as a new

partner in the company, its rights and obligations. These are some reasons causing the low level of attractiveness to venture capital investment funds (Makojević, 2009).

According to a survey conducted by Alexander Groh, Heinrich Liechtenstein, and Karsten Lieser, Serbia is at place 89 of attractiveness to attract venture capital and private equity funds. Countries in the region that have gone through a similar transformation of socio-economic environment of business have a much better rank in relation to Serbia. For example comparing to Poland which is on 28 place, the Czech Republic and Slovakia which are on 35 and 44 place; Hungary, Slovenia, and Croatia which are on 42, 45, and 65 place respectively, Serbia is much more behind them and has to do more on the attractiveness of its own. The first and fundamental prerequisite for attracting venture capital and private equity funds is to create a healthy business and economic environment.

It is evident that in Serbia there is not enough capital but there are some prospective sectors to attract venture investors, but the state must make several steps to make Serbian market more attractive for foreign investors. The first changes should be done in the legal framework concerning investing through investment funds. Some other issues are the taxes. Investors are looking for the country where they can earn but also pay low or no taxes. Venture capital and private equity investment funds are interested in small and medium companies with growing opportunities, so one of the suggestions is to make tax free for the investment in start-up small and medium companies. In that way is the state taking risk (sharing the risk with the investors) by not collecting taxes immediately, hoping that the deferment will promote higher tax collection in future. The state can also support these investment opportunities through venture capital and private equity funds by creating a state investment fund which should be considered as a partner to the venture and private equity investors.

### **Conclusions**

The attraction and retention of foreign investment is a key objective in many countries as it is well recognized that foreign investment has the important potential to create incremental and sustainable jobs, they increase exports, transfer technology, and business knowledge, enhance competitiveness, boost overall productivity, and ultimately reduce poverty through overall economic growth and development. All developing countries should focus on creating a favorable climate for attracting foreign investment in form of FDI or in form of more and more increasingly widespread VC/PE funds in order to take all the advantages of the capital inflow. The most important factors are related to macroeconomic and political stability, but a major role of attractiveness play also institutions (in first line state owed institutions) which encourage the inflow of investments.

In recent years, Serbia has undertaken and implemented a large number of measures to stabilize economic conditions and in this way to attract foreign investment. A major contribution was given by the government's agency for investment promotion and export opportunities, which provides assistance to investors in the pre-investment, investment, and post-investment phase. SIEPA facilitate foreign investors in many ways to invest in Serbia, because it provides advisory services related to legislation, agreements, and exemptions (Siepa, 2012). It also releases funds to investors, pointing to favorable sources of financing.

Therefore, Serbia has fulfilled a large number of conditions for attracting foreign investment, which can be observed according to the statistics of growth inflows from FDI. To further encourage foreign investment, but in first hand to encourage the development and activity of VC/PE funds and in that way to stimulate the SME

business sector, Serbia should focus on the stability of monetary and fiscal system. Also, it should not forget the influence of the political risk which has always been strong in the region. In favor of stabilization of conditions is getting the nominations for membership of the EU, which in future can contribute to a greater inflow of foreign investment in Serbia.

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