

Private Equity Market Study

Southeast Europe Albania Region

Lower Mid-Cap Private Equity Fund

Market Review and Feasibility Study for the creation of a fund
focussed on SMEs in Albania, Kosovo and North Macedonia

By

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Abbreviations

AAEF	Albanian American Enterprise Fund
CEE	Central and Eastern Europe
DFC	Development Finance Corporation
DFI	Developmental Financial Institution
EBRD	European Bank for Reconstruction and Development
EIB	The European Investment Bank
ENEF	Enterprise Expansion Fund
FITD	Fund for innovation, technology and development
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
HNWI	High net worth individual
IC	Investment committee
IESE	Instituto de Estudios Superiores de la Empresa
IPO	Initial public offering
IRR	Internal rate of return
LP	Limited Partner
OPIC	Overseas Private Investment Corporation (now DFC)
PE	Private equity
The Region	The area consisting of Albania, Kosovo and North Macedonia
SEAF	Small Enterprise Assistance Funds
SEE	Southeastern Europe
SEEF	Southeast Europe Equity Fund
SME	Small and medium sized enterprise
UCITS	Undertaking for Investment in Transferable Securities
VAA	Value attribution analysis
VC	Venture Capital

Profile of the Authors



Gavin Ryan worked for 15 years (1999 to 2015) as a mid-cap private equity fund manager in Emerging Europe. Funds managed include a CEE renewable energy asset manager with €2.5bn under management, a Soros fund Management \$200m SEE private equity fund (SEEF I), and an Advent International \$30m Croatia country fund.

Since 2015 Gavin works as an Advisor to Developmental Financial Institutions, PE funds and Limited Partners. He also acts as a Non-Executive Director and has served on the Boards of several companies, banks and PE investment committees. He was the EBRD in-house trainer for private equity as well as a member of their Nominee Directors programme.

Gavin is involved in conducting PE market studies and helping to launch new fund manager firms based upon an anchor investment. He has completed feasibility studies on the PE markets of Albania, Armenia, Egypt, Georgia, Jamaica, Moldova, and North Macedonia. In the last 5 years, he helped to launch three new fund manager firms in the Caribbean and in CEE.

He designed the World Bank online course on private equity in the Western Balkans, <https://olc.worldbank.org/content/private-equity-western-balkans>.

His professional experience pre 1999 includes ten years as an investment banker in the City of London with HSBC Investment Bank and Nomura International. He has also worked for the British Foreign Office and Price Waterhouse. He has MA in Engineering from Cambridge University and an MBA from McGill University. He is based in Vienna.



Pranvera Guxho is a financing and business development consultant, with a financial background and expertise in growth strategy, startup funding, innovation, and financial technology. She works across the Westerns Balkans and Austria, promoting financial inclusivity, expansion, and access to finance for startups and SMEs.

Pranvera manages USAID funded regional access to finance projects working with financial institutions and SMEs to develop alternative financing products and implements fintech solutions to empower SMEs in the region. She is an expert for “Youth in Business Western Balkan” Project with a committed support of €100 million from EBRD, where she strategizes and assists in implementation of tailored financial and non-financial products and training programs for young entrepreneurs.

She holds a B.S. in Finance from Empire State College, a Masters in Finance and Accounting and is a CFA Level III Candidate.



Ivana Stankovic is a financial expert with 14 years of experience in the private and the government sector. Currently engaged as an Investment Facilitator at the Swiss Entrepreneurship Program, she supports activities in investment readiness, alternative investment and Government supported financing initiatives in North Macedonia and the wider Balkan region.

She previously held the position of adviser at the Fund for Innovations and Technology in North Macedonia, where she had been instrumental in developing the new portfolio of products, including the Corporate Innovation Program, the National Startup Council, the National Strategy for Artificial Intelligence (in development), and the government's first ever Investment Fund (in development). She was also a Special Adviser at the Ministry of Finance where she provided advice and expertise on matters related to financial system and macroeconomics, international finance, and public debt management, as well as overall public finance management. From 2015-2019 she was an Investment Manager at South Central Ventures, a VC fund with 40 million EUR AUM focused on tech companies in SEE. There, she managed the day-to-day operations of the Skopje office as well as the business development for Macedonia, Kosovo, and Albania. She led 5 investment processes, ranging from 100,000 to 500,000 EUR initial investment each, from deal sourcing to closing and monitoring. One of the companies went on to raise over 80 million EUR and is one of the most successful ones in the portfolio.

She holds a Graduate degree in Financial Management from the University Ss. Cyril and Methodius in Skopje, North Macedonia and has passed Level I of the CFA Program.

Summary and Conclusions

The objective of this Report is to consider the potential for private equity investment of the Region of Albania, Kosovo, and North Macedonia. It is an underserved Region in the wider region of Southeast Europe, which is itself underserved.

The report is based upon four main pillars. Firstly, a commitment to objectivity through use of data from reputable third-party sources, transparently documented. Secondly, direct engagement with key industry players, particularly commercial fund managers in the SEE region, provides crucial insights. Thirdly, a dedication to thoroughness in our own primary research, including a survey targeting nearly 100 SME owners. Finally, demand estimates have been validated through screening due diligence on eleven companies in the Region. This report, driven by rigorous effort, aims to deliver robust, scrutinized insights to all stakeholders involved.

We estimate that there is unmet demand for around \$255m of private equity capital over the next 5 years in the Region. This estimate is based upon a comparison with comparable population CEE and other countries.

The supply of private equity capital to the Region is limited. EBRD operates its ENEF program, which is managed by staff in its network of local offices. Besides that, there is only one private equity fund with a main office in Skopje, plus a few other regional funds that cover the region from offices outside. Despite the need, there has been a collective action failure by those LP institutions mandated with catalysing private equity investment to the Region.

Family businesses represent a significant portion of the SMEs in the region, but private equity funds tend to focus on other ownership models or start-ups. Other PE markets such as Italy, show that this is not because family-owned companies are not investment worthy, but because of a shortage of the appropriate skill set by existing fund managers.

The report makes the case for the creation of several new funds in the region of sizes of €30-50m, combined with Technical Assistance programs, which could serve to kick start the industry in the Region. Central to this is a detailed consideration of the skill set of PE fund managers and how local professionals can evolve into successful fund managers.

Stage of Market Development

Economic structures and trends

The Western Balkan region has been the object of extensive study by various economic institutions, not least the developmental financial institutions present in the region. These include EBRD, EIB, The World Bank Group, national institutions, and others. We will therefore not replicate or reproduce the easily available and extensive studies which have been made concerning economic structures, economic trends, labour markets, banking systems and capital markets and other fields. We could summarise the current situation by referring to the OECD Economic Convergence Scoreboard for the Western Balkans of 2023, which is very positive of the business environment, *“this success is largely the result of the region’s high degree of trade and investment openness and integration, as well as recent improvements related to access to finance.”*

We will limit ourselves to making a few points which are most relevant to the reality of any mid-cap private equity fund.

Income level: **the countries of SEE are classified as middle-income countries**. This tends to have the effect of putting them into the so-called “middle income trap”. Many DFIs will give greater priority to the lower income countries of regions such as Africa and Asia, as these countries present more scope for their developmental mandates. There is also the added attraction of the large populations, which increases the volume of opportunities. At the same time, the domestic LP market of these countries remains underdeveloped with local investors, such as pension funds, insurance companies, HNWIs and others being not equipped or willing to act as LPs in any local funds’ initiatives. Most cases of local LPs participating have tended to be the exception and these LPs have typically represented a small part of any fund’s investor composition.

Capital markets: **the development of capital markets, especially equity capital markets (both the stock market and the M&A market), presents a strong correlation with the development of the private equity market**. Indeed, this appears to represent the main economic factor influencing the private equity market along with the general level of income per capital.

We consider two sets of countries, all with populations in the 2-5m range. We group them into the higher income/capital category averaging around \$23,500/capita; and the middle-income category averaging around \$6,700/capita¹, as follows.

¹ We have not included Kosovo in several of the tables, due to insufficient data available.

TABLE 1 - MIDDLE INCOME COUNTRIES			IESE INDICATORS						
COUNTRY	POPULATION (2023, m)	GDP/CAPITA (2020, \$bn)	2023 Ranking	Economic Activity	Depth of Capital Market	Taxation	Investor Protection and Corporate Governance	Human and Social Environment	Entrepreneurial Opportunities
Albania	2.8	6,655.4	105	54.6	6.4	99	59.7	28.3	36
North Macedonia	2.1	6,565.2	87	48.3	14.7	124.2	65.2	26.6	43.5
Georgia	3.7	6,582.0	85	57.8	10.9	113.5	87.1	34.6	45.9
Bosnia & Herzegovina	3.2	7,478.2	93	52.7	14.4	102.9	49.6	21.4	38.6
Armenia	2.8	6,433.6	99	57.9	6.4	102.4	78.8	32.1	41.5
Azerbaijan	10.2	7,818.7	88	71.7	10.6	103.3	95	27.5	39.2
Jamaica	2.8	5,380.0	77	55.9	30.4	76.2	67.6	32.1	37.2
Moldova	2.6	6,962.2	101	62.1	6.9	117.6	65.3	26.9	40.3
Averages	3.8	6,734.4	92	57.6	12.6	104.9	71.0	28.7	40.3

Source: The Venture Capital and Private Equity Country Attractiveness Index 2023, Eleventh Edition, IESE Business School

This group of middle-income countries' private equity markets level of development can be indirectly assessed by considering the number of PE firms present.

COUNTRY	Table 2: Private Mid Cap PE Growth Funds Present ¹
Albania	Albanian American Enterprise Fund
North Macedonia	SEAF, South Central Ventures
Bosnia & Herzegovina	Western Balkans Private Equity Fund (satellite office)
Georgia	Foresight Capital, Gazelle Finance, SEAF, Cerberus
Armenia	Amber Capital, Gazelle Finance
Azerbaijan	Pasha Investments
Jamaica	Actus, Mscale, other captive funds
Moldova	Angello, Horizon Capital, NCH Capital,

1: not government owned, not DFI operation, not seed VC/angel network, includes regional funds with substantial local presence. Non exhaustive list.

Typically, there are around one to five or so firms present in each of these countries, which represents a fairly early-stage market.

We compare the middle-income countries to the higher income countries.

TABLE 3 - HIGHER INCOME COUNTRIES			IESE INDICATORS						
COUNTRY	POPULATION (2023, m)	GDP/CAPITA (2020, \$bn)	2023 Ranking	Economic Activity	Depth of Capital Market	Taxation	Investor Protection and Corporate Governance	Human and Social Environment	Entrepreneurial Opportunities
Croatia	3.9	18,284.5	61	68.1	34.7	105.1	60.9	25.6	54.9
Estonia	1.3	28,532.0	32	62.9	55.7	106.4	84.3	45.1	60.1
Latvia	1.9	21,821.5	43	63.5	43.4	103.8	79.6	37.6	52.0
Lithuania	2.8	24,920.0	41	67.0	41.6	114.8	79.3	37.6	56.8
Oman	4.6	23,052.8	55	76.4	51.6	113.3	67.7	34.3	31.1
Panama	4.4	16,333.4	80	70.1	28.5	75.3	59.6	25.2	35.0
Slovenia	2.1	29,417.4	52	70.0	32.0	103.1	72.1	33.5	70.7
Slovakia	5.4	20,856.2	62	71.5	29.9	100.5	62.1	32.4	53.8
Averages	3.3	23,561.9	53	68.7	39.7	102.8	70.7	33.9	51.8

Source: The Venture Capital and Private Equity Country Attractiveness Index 2023, Eleventh Edition, IESE Business School

The number of firms in these countries is substantially higher (typically 6-12 firms), as can be seen below.

COUNTRY	Table 4: Private Mid Cap PE Growth Funds Present ¹
Croatia	Ascendant, Copernicus, Feels Good Capital, Fil Rouge Capital, Horizonte, Invera Partners, Jadran, Questus, SEAF, Inspire Investments, Prosperus Invest, Provectus Capital Partners, South Central Ventures
Estonia	Baltcap, BPM, Livonia Partners, Siena Secondary Fund, United Partners Group, Wellman
Latvia	Altum, NCH, ZGI Capital, SEB, FlyCap, Invalda, Glucksberg Investments, Expansion Capital, Baltcap, Livonia Partners
Lithuania	Baltcap, Livonia Partners, Contrarian Ventures, Pratica Capital, Capitalia, Orion Asset Management, Lit Capital, Coinvest Capital, Modus Asset Management, Invalda, Equite, DI Asset Management
Oman	Grofin, Jabreen Capital, Sharakah, Tamnia, Bank Muscat, Spain Oman Private Equity Fund, Al Hosn Investment Company, Globinvest, IDO Oman, Oman India Joint Investment Fund, Al Anwar Investments
Panama	BG Investment Co, HBM Panama, Millenia Asset Management, Geneva Asset Management, Athena Capital, Coporation Andina de Fomento, Mundial Assets Management, Mossfon Asset Management, Sagicor Panama, Kerford Investments, Joseph Wealth systems, AAY Investment Group ²
Slovenia	ALFI Private Equity Fund, ARX Partners, ECP Tactical Opportunities, Silicon Gardens, South Central Ventures
Slovak Republic	FIT, IPM Group, Narodnoy Holdingovy Fond, Neulogy Ventures, Sandberg Capital, Venture To Future Fund, Zero Gravity Capital

1: not local government owned, not DFI operation, not seed VC/angel network, includes regional funds with substantial local presence. Non exhaustive list.

2: given Panama's status as a financial centre, it proved more challenging to distinguish between funds registered and those also investing in Panama. The list should be considered as indicative rather than completely exhaustive.

We can summarise our economic conclusions as follows.

Table 5: comparative summary table of IESE indicators

	MACRO INDICATORS		IESE INDICATORS					
	POPULATION (2023, m)	GDP/CAPITA (2023, \$bn)	Economic Activity	Depth of Capital Market	Taxation	Investor Protection and Corporate Governance	Human and Social Environment	Entrepreneurial Opportunities
Higher GDP/cap countries averages	3.3	23,561.9	68.7	39.7	102.8	70.7	33.9	51.8
Albania, North Macedonia, and peers' averages	3.8	6,734.4	57.6	12.6	104.9	71.0	28.7	40.3

What is interesting to note is that other factors, such as economic activity levels, taxation, corporate governance, human and social environment, and entrepreneurial opportunities are broadly similar.

This suggests that the main short-term action that can be conducted to boost the private equity market in the Region is to continue to promote the development of capital markets, especially equity capital markets.

In order to clarify how capital markets development affects PE, the framing of PE within the overall capital market structure is important, in order to understand the impact of various parts of the capital markets on PE.

The most notable direct impact points are:

- *Fundraising:* Having investors from other asset classes willing and able to allocate part of their portfolios to PE will enhance the fundraising capability of PE funds, as well as increase the supply of funds and the development of fund managers. As seen in other jurisdictions, when PE funds rely mainly on DFI funding with no trend to diversification, the market does not develop.
- *IPO Exits:* Having a developed stock market opens an important avenue for exits for PE funds. This is even more important in small population countries where international strategic investors may be less interested in entering.

The most notable indirect impact points are:

- *Pipeline:* As capital markets develop, the demand for PE tends to become easier to reveal and to grow, as the acquisition of funding becomes an increasing source of competitive advantage between companies, and an increase in financial sophistication encourages founders to seek PE.

- *Secondary Exits:* As a country becomes more attractive for PE, larger regional PE funds become more interested and often provide an opportunity for smaller lower mid-cap funds to exit their investments.
- *Portfolio management:* As credit markets develop and finance becomes more accessible, PE funds will have greater opportunity to grow their portfolio companies, especially as all experience points towards PE backed companies being more bankable.

It is also important to point out that PE fund managers are capable of adapting their strategies to the environment, which also evolve over time as the market matures. A PE equity fund is able to adapt its fundraising and investment strategy considerably within its mandate. Financial instruments can range from pure ordinary equity to quasi-equity, to subordinated debt. Control levels can vary from a minority stake with basic supervision, to strong minority, to control stakes. Exit options can range from self-liquidating instruments (which depend upon the portfolio company having enough financial resources at exit time); to trade sales to foreign or local groups; to IPOs on the local or foreign market; to sale to another financial investor, such as a later arriving PE fund with lower country risk appetite or looking to do a regional consolidation. The range of permutations is considerable and limited only by the skill set of the manager. As the market evolves, so should the strategy of the fund managers, generating positive dynamics for further market development.

There is frequently a debate in PE about “regional” versus “country” funds, which can be better understood by defining what is meant by “regional” more carefully. The argument frequently made by investors and others is that funds in smaller countries lack the critical size to be attractive or sustainable investments. What experience shows is that many firms which had primarily a country focus, will tend to evolve into a regional footprint. For example, South Central Ventures has invested in Serbia as well as in other SEE countries, with its primary investment team based in Ljubljana and Belgrade and satellite offices in Zagreb and Skopje. A primarily single country fund will evolve into a quasi-regional fund by reacting to neighbouring investment opportunities, setting up a satellite team, following the regional expansion of a portfolio company. Such an evolution can be contrasted to an explicitly regional fund, which would need to have substantial teams in each country and make parallel unrelated investments. An explicitly regional fund will carry more operational and investment risk than a quasi-regional fund.

Typical initiatives related to PE development

Government initiatives and the presence and activities of DFIs related to SME development and the entrepreneurship ecosystem are always of interest to PE investors. In a general context, seeing evidence of government commitment to private sector development will give confidence that the environment is moving in a positive direction. The presence of DFIs promoting reforms adds to this, as well as reducing the perceived political risk from PE investors’ point of view. In a more specific context, PE investors will welcome specific initiatives directly or indirectly relevant to PE such as DFIs being willing to be LPs in funds launched, the Government having development programs for SMEs, DFIs extending credit lines to local banks to enhance availability of credit, DFIs and others funding Technical Assistance programs of various kinds which will result in increased financial knowledge in the community and generally making doing business easier. PE investors will look to see what is in place when assessing a country’s potentiality. In the case of the Region, there is a considerable number of programs in place from many different institutions. One of the issues that will often present itself is that of lack of co-ordination between actors, which can lead to sub-optimal outcomes.

One of the most notable examples in PE in the last 20 years in the region, was the Croatian Government's seeding of around five new PE firms. This initiative saw the DFIs stay away due to concerns about governance of the firms. The outcome was mixed with several of the firms exiting the market but also some successes. The main reasons for the mixed outcome appeared to be weak governance in the selection of the management teams, the government defaulting on some part of its investment commitments and some interference in investment decisions.

In the case of the Albania/Kosovo/North Macedonia Region, there have been no initiatives of any substance to promote the mid-cap PE market, since the American Enterprise Funds and the Small Enterprise Assistance Funds [SEAF]. The majority of initiatives have been in the area of startups and accelerators, in particular in North Macedonia.

Supply of Private Equity in the Region

CEE and Western Balkans PE

The trajectory of Private Equity in Central and Eastern Europe offers valuable insights for envisaging the future development of PE in the Western Balkans.² Starting from nearly non-existent investments in the early 1990s, the CEE PE market has experienced remarkable growth. In 2022, private equity investment in the CEE region decelerated to €2.77 billion, marking a 35% decline from the record-setting levels of 2021 and a 12% dip below the previous five-year average. Despite this, 590 CEE companies secured private equity investments, marking an 18% decrease from the peak observed in 2021 but surpassing the previous five-year average.

Examining sectors, the top five sectors collectively accounted for over 85% of total investments in PE in 2022, as follows: (1) ICT (Communications, computer, and electronics) with 32.1% of all investments or 307 companies (52%); (2) Energy and environment with 18.3% invested in 22 companies (3.7%); (3) Consumer goods and services with 13.5% invested in 98 companies (16.6%); (4) Business products and services with 11.8% invested in 58 companies (9.8%); and (5) Biotech and healthcare with 10.8% invested in 52 companies (8.8%). Together, the top three sectors constituted 64% of the total CEE investment value in 2022. When it comes to VC, ICT companies continued to receive the most funding and the sector accounted for 79% of the region's total venture investment by value and 61% by number of companies.

Regarding the structure of the PE market sub-asset classes, a record €821 million was invested in venture capital or almost 30% of all PE investments in 2022, reflecting a 13% year-on-year increase. Growth capital funding emerged as the most substantial sub-asset class for investment with 44.4% of total investments, amounting to €1.23 billion, although registering a 32% decrease from the previous year's peak. CEE buyout investments accounted for €688 million in 2022, witnessing a 60% year-on-year decrease and representing just about 25% of total investments.

In 2022, PE exits throughout CEE amounted to €771 million, involving the divestment of 121 companies, marking a 34% decline from the record levels witnessed in 2021. The predominant exit strategy in the CEE region for 2022 was trade sale, contributing €386 million in exited costs, representing half of the regional total. In terms of quantity, trade sale emerged as the most favoured exit route, with 52 companies exiting, accounting for 43% of the total. The second most prevalent exit route was write-offs, amounting to €234 million in exited costs, constituting 30% of the regional total and involving 13 transactions. Management/owner buy-backs secured the third position in terms of

² The countries of CEE covered by Invest Europe are Bosnia & Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Moldova, Montenegro, North Macedonia, Poland, Romania, Serbia, Slovakia, Slovenia, and Ukraine.

value, with €64 million at cost and 24 companies exiting. Following closely, the sale to another private equity house amounted to €38 million, involving the exit of 10 companies.

When it comes to the Western Balkans, the SME Policy Index: Western Balkans and Turkey 2022³ report mentions PE only in relation to the venture capital ecosystem, and states the following:

“As in previous assessments, ...while progressing, the Western Balkan economies remain in the early stages of developing VC ecosystems. Both North Macedonia and Serbia have taken steps to strengthen their legislative framework to explicitly address VC activities. Serbia adopted a new Law on Alternative Investment Funds in 2020, detailing venture capital, while following an assessment aimed at identifying legal obstacles, North Macedonia introduced amendments to the Law on Investments in 2021. In addition, a new Law on Alternative Investments is under preparation. In Albania, a new Start-up Law was adopted in March 2022 and a new Law on Collective Investments was adopted in 2020; however, legislation falls short of effectively regulating venture capital. No progress was observed in Kosovo...”

The report goes further to suggest that the path forward for the venture capital ecosystem involves creating a supportive legal framework where needed and enhancing the investment readiness of local high-growth potential enterprises. This includes introducing targeted support schemes for innovation and research and development. The strategy emphasizes both regulatory improvements and ongoing efforts to foster local enterprise growth in the venture capital landscape.

To better contextualize the CEE experience and its relevance for Albania, Kosovo, and North Macedonia, the subsequent analysis concentrates on countries with similar population sizes that fall within the category of higher-income and more developed nations. Table 6 illustrates the investment activity volume in these comparable countries, revealing an average annual investment of €199 million. Leveraging data from these analogous nations enables us to gauge the current and future potential size of the market encompassing the three target countries. This comparative approach provides valuable insights into the investment landscape, facilitating estimations of market potential based on similar economic and demographic contexts.

Table 6 Annual PE Activity in Comparable Countries to Albania, Kosovo, and North Macedonia⁴

Averages over Period 2019-2022, all PE	Annual Investment Amount, €m	Annual Investment by Number of Companies	Average Investment Size per Company	Annual Exits Amount (historic investment cost basis), €m	Annual Exits by Number of Companies
Croatia	247	28	8.8	32	4
Estonia	508	48	10.6	22	6
Latvia	26	18	1.5	15	15
Lithuania	249	35	7.2	70	10
Slovakia	34	25	1.4	14	5
Slovenia	130	8	17.3	22	2
Average	199⁵	27	7.8	29	7
Other*	3	3	1.2	3	1

*Other consists of Bosnia & Herzegovina, Moldova, Montenegro and North Macedonia.

Source: Invest Europe, 2022 Central & Eastern Europe Private Equity Statistics

³ OECD (2022), SME Policy Index: Western Balkans and Turkey 2022: Assessing the Implementation of the Small Business Act for Europe, SME Policy Index, OECD Publishing, Paris, <https://doi.org/10.1787/b47d15f0-en>.

⁴ Invest Europe does not yet collect data from Albania and Kosovo, and North Macedonia is lumped together with 3 other countries under Other due to their small footprint. Therefore, these countries cannot be added to any tables or data sourced from Invest Europe.

⁵ Compare with figure of €178m from Table 12, which is a comparable estimate.

Despite being grouped under "Other" in the table alongside three additional countries, North Macedonia's Private Equity investment is notably minuscule, bordering on insignificance. This suggests that, as of 2022, the PE sector in the country can be considered practically non-existent. The most noteworthy performance occurred in 2020, with a total of €8 million invested in two companies across the four countries mentioned. Even considering the lowest performing countries in the group of comparable countries, the level of annual investments per country should be in the range of €50 million (see page 22).

PE in Albania, Kosovo, and North Macedonia

The current Private Equity landscape in the three observed countries exhibits notable differences despite their geographical proximity and similarities, primarily due to significant variations in their stages of development. In Albania, the first PE activities were closely tied to the establishment of the Albanian-American Enterprise Fund (AAEF) set up by the US Government in 1995 with a primary goal to catalyze private sector development and contribute to the development of economic development policy. North Macedonia saw its initial PE investments in the late 1990s with the establishment of SEAF through the SEAF Macedonia Fund again with US Government support through USAID. A major pan-SEE fund, SEEF I was launched in 2002, followed by a successor fund SEEF II in 2005. The funds' LPs were George Soros and OPIC.⁶

Moreover, North Macedonia has experienced heightened activity concerning the development and promotion of venture capital. The region now boasts several incubators offering comprehensive support to early-stage teams, including co-working spaces, shared assets, utilities, mentoring, and other professional assistance. Additionally, six accelerator programs are in operation, with three, namely Seavus Accelerator, UKIM Accelerator, and X Factor Accelerator, supported by the Government-sponsored Fund for Innovation and Technology Development (FITD), having successfully implemented their programs and utilized all funds. The remaining three, backed by the GIZ EU4Growth project, are in the process of executing their programs and are yet to disburse funds to pre-seed stage startups. Notable entities like the CEED business angel club established in 2005 and the recently formed Zephyr Angels contribute to the entrepreneurial ecosystem.

While South Central Ventures stands out as the sole early-stage investment fund with a local presence, several regional venture capital funds, such as Fil Rouge Capital, Eleven Ventures, Launchub Ventures, Purposetech, Presto Ventures, Vitosha Venture Partners, and others, are targeting the country and the broader Balkan region. Despite a substantial influx of funding into Macedonian startups, the ecosystem is eagerly anticipating its inaugural significant exit.

There are two fund managers currently operating a PE fund out of North Macedonia (SEAF and SPMG), only one in Albania (AAEF) and one in Kosovo (OXA Capital – although not a fully fledged fund). The teams of SEAF and SPMG are overlapping, and currently SPMG is the only one active with their Micro Investment Fund, investing small tickets in established SMEs with already tried models of MBOs for exit strategy. In addition, there are a few larger PE funds that have occasionally shown interest but haven't made any investments in the countries, like the Bulgarian-based BlackPeak Capital, or the Serbian-based Western Balkan PE Fund. There are also outliers like the KKCG Group from the Czech Republic, that is not an active investor in the region, but has made the largest acquisition in the tech sector through its Aricoma Group subsidiary, acquiring one of the biggest IT companies in North Macedonia, Seavus in 2020 and starting a run of strategic investments in the IT sector aimed at building a strong European IT group. The main characteristics of the funds are summarized in Table 7 and further discussed below.

⁶ Co-incidentally, the Author served as Managing Director of SEEF I.

Table 7 List of PE and Other Relevant Funds in Albania, North Macedonia & Kosovo

Fund	Year Est.	Manager	Size (\$)	Status	Main investors	Ticket (\$)	Focus	Office in Country
AAEF	1995	AAEF	30M	Fully invested	USAID	N/A	Large development projects in critical sectors like banking, telecom, energy, infrastructure etc.	Albania
AADF	2009	AAEF	180M	Ongoing	AAEF	N/A	Development projects	Albania
Greenview Alternative Investment Fund	2021	N/A	N/A	Registered	Presumably fundraising	N/A	Private Equity	Albania
SEAF Macedonia	1998	SEAF	10M	Fully invested	SEAF, EBRD, DEG, IFC	50k - 500k	Generalist: Mature companies, all sectors	Macedonia
SEAF South Balkan Fund	2005	SEAF	13M	Fully invested	SEAF, SECO, FMO, FINNFUND	0.3-1.5M	Generalist: SMEs in Serbia, Montenegro, and North Macedonia; sector agnostic	Macedonia
Sea Land Alternative Investment Fund	2020	Credins Invest (76% owned by Credins Bank)	N/A	Registered	Presumably fundraising	N/A	Private equity and Real Estate	Albania
SIF	2007	SPMG	0.8M	Fully invested; fully exited	Private	50-150k	Generalist: emerging SMEs in early stages of development; sector agnostic	Macedonia
MIF	2012	SPMG	N/A	Rolling	USAID	up to 100k	Generalist: Micro and small companies with potential for rapid growth; sector agnostic	Macedonia
SEAF Macedonia II	2014	SEAF	3.65M	Post-investment	SEAF, diaspora investors	0.5-1.5M	Generalist: growth-oriented SMEs; sectors include agribusiness, light manufacturing, consumer goods, ICT, and clean and efficient energy tech.	Macedonia
ENEF	2014	EBRD	70M	Fully invested	EC, EBRD, KfW, EIF, OeEB	1-7M	Generalist: well established SMEs with high growth potential; WB region; sector agnostic	Albania, Kosovo, Macedonia
ENEF II	2024	EBRD	71M	Investing	EBRD, EIF, CDP, KfW, Banca Intesa	0.5-10M; 4-5M AVG	Generalist: growing local SMEs and mid-caps; WB region; sector agnostic	Albania, Kosovo, Macedonia
EBRD	N/A	EBRD	N/A	Ongoing	Public	0.5-10M	Generalist: Mature companies; WB geographies; sector agnostic; co-financing with ENEF	Albania, Kosovo, Macedonia
PE FUNDS WITH PRESENCE IN THE REGION								
SEEF II	2007	Bedminster Capital Mgmt	320M	Fully invested	Soros, OPIC	N/A	Communications, healthcare, consumer and financial service industries in SEE and Turkey	
BlackPeak Fund I	2014	Blackpeak Capital	40M	Fully invested	IER, EBRF, IFC	1-8M	Generalist: high growth SMEs in SEE	Bulgaria

Fund	Year Est.	Manager	Size (\$)	Status	Main investors	Ticket (\$)	Focus	Office in Country
WBPEF-I	2021	WBPE Fund	80M	Investing	USAID	3-9M	WB geography; sectors include medical, manufacturing, fintech, IT, gaming, food	Serbia, Italy
SEE Growth Equity Fund	2022	Blackpeak Capital	132M	Final close; Investing	EIF, EBRD, IFC, Erste Asset Mgmt	5-15M	Generalist: promising SMEs in SEE; strong preference for software, niche manufacturing, FMCG, business services, healthcare.	Bulgaria

Source: Desktop research and interviews with AAEF, SEAF Macedonia, SPMG, EBRD, BlackPeak Capital, Feb. 2022 to Feb. 2023.

It is worth noting that there are several active regional VC funds with investments in North Macedonia and Kosovo but are not analyzed in more detail as they're out of the scope of the report.

It should also be noted that it has occurred in various CEE countries, that upon passing of a new funds law (as is the case in Albania with the Law n.56/2020), that various hopeful groups will incorporate a new fund without any actual investors. This may or may not lead to a real operation. This appears the case with Greenview and Sea Land in Table 7.

Unlike regular Private Equity (PE) funds, the Albanian-American Enterprise Fund (AAEF) operates as a non-political, non-profit organization. Established in 1995 with \$30 million initial capital in the form of grant from the USAID, AAEF operates independently and focuses on promoting private sector development in Albania. It invests in various enterprises, offers business expertise, proposes policy changes, and provides training to portfolio companies. Managed by professional investment managers under the guidance of its Board of Directors, AAEF, has directly invested \$109 million, creating over 7,000 jobs, and contributing \$2 billion to Albania's GDP through its portfolio companies. Profits generated from AAEF investments are reinvested in new projects in Albania, showcasing its commitment to sustainable economic development. In addition to recycling its profits for private enterprise creation and expansion, AAEF aims to demonstrate to potential investors that investments in Albania can be both successful and profitable. The Fund strives to act as a catalyst for additional private investment in the country. In 2009, it established the Albanian-American Development Foundation (AADF) to further its mission. The AADF is the largest not-for-profit entity in Albania with an endowment of over \$180 million. Some of the investments of the fund are showcased in the table below.

Table 8 AAEF Current Investment Portfolio

COMPANY	INVESTMENT DETAILS	DATE OF INVESTMENT	SECTOR	AMOUNT (\$m)
SIGAL Sh.a	AAEF acquired 13.3% of the company by financing the expansion in the region with the launch of life insurance. As of March 2007, UNIQA Group Austria is the biggest shareholder of SIGAL UNIQA with 86.9% of shares.	2003	Insurance	N/A
Tirana International	Partnership between Hochtief Airport GmbH, DEG (KfW group) and AAEF, won a 20-year BOOT concession for the building	April, 2005	Transportation	20+

Airport “Mother Teresa”	of a new modern terminal and the operations of TIA.			
ALEAT	Consortium of AAEF and Morpho (previously Sagem Securite), member of the French Safran Group won the concession for the enrollment, production and distribution of biometric ID Cards and passports for a five-year span (+5 in 2013).	2008	Digitization	N/A
Tirana East Gate (TEG) shpk	Equity financing, a joint investment with Mane TCI (part of BALFIN Group). TEG has also signed a € 24 million loan agreement with the EBRD, as the principal lender.	2008	Retail	25
Tirana Logistic Park (TLP)	Joint investment realized by cooperation with BALFIN Group and AlbStar Ltd.	2012	Logistics	43
Crimson Finance Fund Albania	Converted 50% of subordinated loan to equity in 2020.	2015	Finance	0.1 + subordinated loan 1.5M

Note: Table based upon publicly available information only. It is an incomplete list of investments made by AAEF. Dates are of initial investment, in case of investments with follow up investments.

Some more noteworthy investments from other funds operating in the Western Balkan region are summarized in Table 9.

Table 9 Other Notable Investments in Albanian companies

FUND	Type	Investee	Funding Type	Date of Investment	Funding Amount (\$)
EBRD-Italy Western Balkans Local Enterprise Facility	PE	Union Bank Albania	Equity	2008	1.6M
SEEF II	PE	Spitali Amerikan	Equity	2008	N/A
NCH Capital Inc.	PE	ABI Bank (American bank of Investments)	Equity	2015	N/A
ENEF	PE	APM	Equity	2017	1.4M
HELENOS	PE	Crimson Finance Fund Albania	Equity	2021	0.5M
SEEF II	PE sale	AbCom	Equity	2022	N/A

Note: Table based upon publicly available information only. It is an incomplete list of investments made in Albanian companies from active funds in the Balkan region.

Small Enterprise Assistance Funds (SEAF) is a good example of a pioneering fund which has lived through political and economic cycles and assumed a considerable amount of risk due to the early stage of its entry and the use of mainly equity instruments. SEAF is a Washington-based group which manages small SME funds in SEE and other regions. Its first fund in North Macedonia was a \$10 million fund in 1998 with a developmental mandate and USAID as a main investor, followed by EBRD, DEG, and IFC. Before SEAF Macedonia II, there was the Small Investment Fund (SIF) for which they were in

discussions with the Government for 4-5 million support, based on which they could approach IFIs, but the Ministry of Finance backed out and the SIF remained a very small fund. There was also the Micro Investment Fund (MIF) supported by USAID which is still running. Both SIF and MIF were and are still being managed by SPMG, a locally established PE fund management firm, monitored by SEAF. SEAF Macedonia II, established in cooperation with the Macedonian diaspora, and envisioned a bigger fund targeting \$15 million, but this fell through, and they managed to raise only a fraction of that at around \$4 million.

There was also the regional SEAF South Balkan Fund in 2005 of \$13 million, with investors that included SEAF, SECO, FMO, FINNFUND, targeting Serbia, Montenegro, and North Macedonia. This fund had a specific focus on Serbia, which had to account for at least 70% of the fund's investments. Target companies were between 10 and 250 employees, locally owned, and demonstrated strong growth prospects as well as export potential. SEAF obtained significant minority positions of 20%-49% stakes in investee companies through a variety of equity, quasi-equity, and debt instruments. The investment results of this fund: €6,3 million committed to six companies (Adore Chocolate, Finera Factoring, A2B Express, Logo Holding, PC Centar, Gomex).

Currently, SEAF has a team of three people and has been in the process of raising a new fund without substantial success and facing a lot of challenges, whereas the SPMG team is the same three people managing SEAF plus one. We can conclude that only one team has been the result of the long investment history of SEAF in North Macedonia. Table 10 shows a selection of SEAF's and SPMG's past investments.

Table 10 SEAF/SPMG Investments

FUND	Type	Investee	Funding Type	Date of Investment	Funding Amount (\$)
ENEF	PE	Makprogress	Equity	2020	600K
SPMG MIF	PE	Paket mk	Equity + Debt	2019	up to 85k
SPMG MIF	PE	Akron Staklo	Equity + Debt	2018	up to 85k
SPMG MIF	PE	Publikum Art	Equity + Debt	2016	up to 85k
SEAF Macedonia II	PE	Aronija	Equity + Debt	2014	15k + 185k
SPMG MIF	PE	Geonet	Equity + Debt	2014	up to 85k
SPMG MIF	PE	Extra Funghi	Equity + Debt	2014	up to 85k
SPMG MIF	PE	Eko Plast Tehnika	Equity + Debt	2014	up to 85k
SPMG MIF	PE	Certiadria	Equity + Debt	2014	up to 85k
SPMG MIF	PE	Aronija	Equity	2013	up to 85k
SPMG SIF	PE	Urban Invest	Equity + Debt	2009	50-150k
SPMG SIF	PE	Inet	Equity	2008	150k
SPMG SIF	PE	Oktober	Equity + Debt	2007	50-150k

SEAF Macedonia	PE	14 companies (Login Systems, Fonko, Mako Market, Gica, Tinex, Krug, OnNet, Pilko, DataPons, Medium Export, Nasto, Magnolia, Ivoprom and Planet Express)	Equity + Debt	1998-2004	6.3M
SEAF Macedonia	PE	OnNet	Equity	2000	190k

NOTE: Table based upon publicly available information only. It is an incomplete list of investments made in companies from SEAF/SPMG. Funding dates reflect the initial investment date, whereas funding amount is total over fund life

With no fund managers operating out of Kosovo, the only notable investments thus far have been made by the EBRD managed Enterprise Expansion Fund. The investments are summarized in Table 11 below.

Table 11 ENEF Investments in Kosovo

FUND	Type	Investee	Funding Type	Date of Investment	Funding Amount (\$)
ENEF	PE	Viva Fresh	Equity	2015	5.9M
ENEF	PE	Santefarm	Equity	2017	750k
ENEF	PE	Meridian	Equity	2018	1M

NOTE: Table based upon publicly available information only. It is an incomplete list of investments made in Kosovo.

PE growth funds are often generalist funds. This is almost always the case in emerging markets. There will tend to be a gravitation towards a few sectors due to sector investment activity and/or familiarity of the PE management team with a sector they have already invested in. In smaller mid-cap funds, the fund manager will bring in sector experts on a project-by-project basis, as needed. Specialist sector funds with dedicated teams are in general based in developed markets and are of larger size.

Demand for Private Equity in the Region

Understanding potential investee companies and ownership dynamics, in addition to the overall structure of the corporate sector, is critical to assessing demand for growth capital. A fund manager assesses demand in a market through a process of originating and screening investments. The first key step in screening is to understand the forces driving both the company and owner's interest in PE investment. Both of these to be aligned in order to have a deal. If a company is well managed, growing, and generating cash, it may well not see the need to open up its ownership to PE. There needs to be a problem that PE can solve, such as providing capital for further growth, paying off excessive debts of an otherwise sound business, or replacing a negative owner like an uninterested mother company. PE can help a partner support the next phase of growth by taking some of the burden off the founders' shoulders, or taking over from owners who want to slow down or who have no children to take over the business; or resolving a conflict among different owners by buying one out. Because of the role of the PE investors is not only to provide financing but also to work as a partner to address key issues hindering the growth and value creation of the investee companies (reaping returns only when such

effort succeeds), comparison of the relative cost of PE compared to the cost of debt is misleading, although sometimes attempted.⁷

There are some common obstacles to PE investment, but they are not insurmountable. One obstacle is in valuation when the seller has unrealistically high expectations. Differences in opinion can be resolved by using a ratchet mechanism or preference shares with a return enhancing coupon. Another obstacle is the founders' reluctance to give up control. PE investors' expertise lies in sharing control, rather than taking over control. This is therefore a very nuanced issue and is solved by board seats, veto rights, and reporting rights. Another obstacle can be a question of image rather than substance; that the other side does not want to be seen to be losing face. This is quite a cultural specific question, for which the PE investor needs to develop sensitivity and awareness. For example, for the founder it may be important to present the PE investor as a partner rather than as an owner. Another obstacle may be regarding exit with other shareholders wishing to remain. The last obstacle may be complication in the deal structure with the other side having difficulty understanding all the aspects or being suspicious of the investor's motives.

The demand for PE has to be revealed. Another key point is that demand is potentially always there, but it will be up to the fund manager's skills to identify the different situations which can lead to an actual transaction. For the founder or manager of any private company, the decision to open its share capital to an outside investor is a major decision, which is taken lightly nor widely advertised. It is often a decision which is arrived at over time, after a long process of thought and consultation. One thing that may accelerate this decision is seeing other companies or a competitor enter into a PE transaction. For this reason, demand for PE tends to be underestimated, especially the demand for PE by SMEs.

Developing a PE pipeline is a key skillset of fund managers. The ability to reveal demand will lead a fund manager to develop a quality pipeline of investment opportunities. Skilled fund managers pride themselves on having developed a proprietary pipeline – opportunities of which they have exclusive knowledge or access. It is also important to understand the difference between this and a so-called indicative pipeline, which is an exercise performed by fundraising fund managers to hypothetically identify opportunities, despite not having confirmed capital to deploy at the time of the exercise. The indicative pipeline is a speculative exercise which often does not succeed, given that the pipeline will not be put to the test and that company founders will be reluctant to cooperate on a hypothesis.

From a quantitative point of view, **there are abundant statistics available regarding the number of SMEs in the region**, along with their key indicators. In an in-depth study recently performed by the Author in a middle-income country with population around 4m, after applying some relevant criteria to the companies in the SME sector, it was found that there were over 3,000 companies which were potentially eligible for PE investment. The criteria applied included the degree of leverage of the company, its profit margins, and its size.

⁷ Senior debt may have a cost of 6-8 percent, mezzanine of 15-18 percent, and the target IRR of PE equity funds may be 25-30 percent. Making a percentage comparison between these debt and equity percentage figures is misleading, because the equity return only materializes when the value of the company increases. Private equity is therefore cheaper than debt if the company fails and more expensive if it succeeds. Another factor making such a comparison misleading is that the PE investor takes on the role of a partner in decision making rather than being an external financier.

An analysis of comparable CEE countries may also provide insight as to the potential level of PE investment to expect from the Region once sufficient fund manager capacities are put in place. The table shows annual PE investments expressed as a percentage of country GDP.

Table 12: PE Investments as Percent of GDP in Comparable Countries

PE investments as % of GDP in 2022	
Croatia	0.650%
Estonia	1.270%
Latvia	0.112%
Lithuania	0.356%
Slovakia	0.024%
Slovenia	0.120%
Average	0.422%
All CEE	0.131%
Europe	0.638%
Albania/Kosovo/NM combined GDP 2022 (WB/IMF), \$m	42,113
Implied total PE annual investment, \$m	178

Source: Invest Europe, 2022 Central & Eastern Europe Private Equity statistics

From the previous tables, the relative ratio of the Region’s GDP per capita to that of its higher-income peer group countries is $6,734.4 / 23,561.9 = 0.29$. This factor is used to adjust the above result of US\$178⁸ million to obtain a value of around US\$51 million for potential annual growth PE investment in the Region. This value should be considered a baseline value, which will grow with time as demand is further stimulated and the number of fund managers increases. Assuming an investment period of five years for a typical growth PE fund, an annual investment of \$51 million implies an aggregate total funds size of $\$51 \text{ million} \times 5 = \255 million .

Validation of Demand

In order to complement the “top down” approach to establishing the potential demand for PE in the Region, a **validation exercise was also conducted at the granular level**. Following a pre-selection of around twenty-five companies based upon desk work, eleven companies were selected for a more thorough screening. The exercise was conducted in late 2020.

The screening process followed a standard approach used by private equity funds, consisting of a site visit, discussions with ownership and management, collection of financial information and a certain amount of general research and business due diligence. The total man-days dedicated for the screening of each company averaged 4-5 man-days, for a total dedicated effort of around 50 man-days.

The table below summarises some details of the companies reviewed. The names and excessive detail are not disclosed for confidentiality reasons.

⁸ This is consistent with the value of €199m estimated in Table 6; we have opted for lower figure for analysis

Table 13: Companies screened as potential PE investments

SECTOR	SALES (€m)	EBITDA (€m)	NAV	EMPLOYEES	INVESTMENT NEEDED (€m)	STATUS
Agribusiness	0.1	0.013	0.13	20	2	Further review
IT	1.2	0.25	0.4	70	2.5	Further Review
Food distribution	6.2	0.2	2.4	35	1.7	Further Review
Plastic products	2.3	0.27	0.97	40	1	Further Review
Dairy	2.9	0.27	1.6	70	3	Further Review
Dairy	1.1	0.025	0.3	30	0.8	Rejected
Fuel storage	start up				1.6	Rejected
Animal waste products	1.1	0.16	0.5	120	2.8	Viable
Furniture	1.6	0.53	1.3	200	2	Viable
Leasing & Factoring			0.3	10		Viable
Animal feed production	5.5	0.33	0.6	70	1.5	Viable

Source: Companies' management; figures are from 2019

Of the total of eleven companies screened, it was decided to reject two as unsuitable, further review five with potential and earmark four as viable investments.

The Centrality of Fund Managers

The beneficial impact of PE can be seen in Central Europe. Between 2010 and 2019, Euro 28 billion was invested in 5,500 CEE companies⁹. In 2022, there were over 326,000 people employed by PE backed companies¹⁰. This investment was carried out by over 150 fund managers operating in the region.ⁱ

In PE the fund manager is central, and investors rely heavily upon the fund manager, much more so than a manager of quoted equities, because of the specific characteristics of the PE asset class:

- The investment strategy and portfolio can be opaque.
- Assessing performance is a complex exercise.
- Understanding the sources of value creation can be challenging.
- Governance and management of PE funds needs to be understood.

⁹ Source: Invest Europe, Central & Eastern Europe Private Equity Statistics – June 2023

¹⁰ Source: Invest Europe, Private Equity at Work - Employment & job creation across Europe - April 2023

- There is heavy dependence on the skill set of the fund manager due to the heavy burden of duties involved in the hands-on management of PE investments.

These important points are discussed in more detail below.

PE is an exciting but complex asset class given the opaque nature of its operations and complexity in assessing its performance. The PE asset class is notoriously opaque when it comes to divulging information about the performance of investments and funds. The companies held are unlisted companies so there is no market reference price for the value of their equity, making it difficult to estimate the value of a PE portfolio. At the end of the day, only the fund manager knows the value of the portfolio and this value is only confirmed at the time of exit.

The assessment of financial returns of PE against benchmarks has been inconclusive. Despite the importance of establishing the performance of PE as an asset class to justify its existence by producing acceptable returns for its risk level, academic studies have shown mixed results. Studies have compared the performance of PE to listed shares (this is known as the Public Market Equivalent method or PME), which are an obvious comparison metric, even though the profiles of the companies may not be the same. In 2005, academics Kaplan and Schoar analyzed a basket of 746 funds and found that PE performance was 4 percent to 26 percent below the stock market equivalent, depending on the statistical method usedⁱⁱ. In 2008, the Boston Consulting Group together with business school IESE found that their sample of PE investments returned 13 percent compared to 10 percent of their quoted benchmarkⁱⁱⁱ. In 2009, academics Phalippou and Gottschalg found that their PE sample underperformed their reference index by 3 percent to 6 percent^{iv}. In 2011, academics Robinson and Sensoy found that their sample did better than the index by 15 percent^v. In 2020, academic Phalippou found that the PE net of fund manager fees performed comparable to the index^{vi}. The evidence to date points towards PE performance on average being comparable to the stock market.

Another approach to analyzing PE performance is Value Attribution Analysis (VAA), which considers various component value drivers.^{vii} In order to get better insight into a portfolio, VAA looks at an individual investment and tries to break down how the value has been created. Value can be created by deal skill – buying the company at a low price and reselling it higher. Value can be created by taking the company and helping it to grow and develop. Value can be created for equity holders by leveraging the company and funding its growth through debt instead of putting up more equity. Most investments' value creation is a combination of all these factors and VAA allows analysts to see how these different factors weigh in creating overall value in the investment.

The skills of the management team must also be considered. Is the fund manager a skilful dealmaker or a company builder? That's often asked when considering the skills, a PE fund manager needs. In the case of emerging markets mid-cap PE, the operational skills of managing a portfolio will be relatively more important because of the more limited opportunity to create value by flipping the company (a well-timed buy and resale taking advantage of favorable capital markets), compared to enhancing governance and working with management to improve operations across the board. VAA can help profile the right manager for the environment. In the case of this Region's mid-cap PE, this means less investment banker and more company operator.

Reviewing experiences and existing studies, the following observations can be made. First, PE as an asset class has on average generated a return somewhere between nine percent and twelve percent. Second, emerging markets PE returns have been more or less the same as developed market returns. Third, there is a very wide divergence, twenty percent or more, of performance between the top and

bottom quartile of fund managers. And fourth, VAA can be used to get an idea of how value is created in PE investments.

While several features of a PE fund are relevant to its operations, governance and management teams are critical. The governance of a PE fund will be driven by the general partner, which is the fund manager and by the creation of two institutional bodies, the advisory board, and the investment committee. The advisory board is the forum in which the LPs are represented. It provides oversight and has the power to remove the GP. It will typically meet four times a year. The investment committee (IC) is the forum in which investments and divestments are decided. The proper composition of the IC and its rules of procedure is a major contributing factor to the success of a PE operation. A good IC will provide support, an independent second opinion, and wisdom.

Operational independence of a qualified fund management team has proved critical to the success of fund operations. There are three basic models of structure for the fund manager.

Table 14: Models of fund manager structure and governance

	Independent Model	Sponsor-driven Model	Captive Fund Model
Operations	Management team runs their own operation	One of the LPs has a major role. This can result in concerns by other LPs who may see a potential conflict of interest.	PE unit is part of a larger group, such as a sovereign wealth fund, an insurance company, or a bank. Occasionally, the group may decide to get out of the PE business, and the PE team may spin off to an independent GP.
Ownership & Control of the GP	Shared among several senior members of the team		
LPs Role	Fund customers		
Investments	The product that the GP delivers to the LPs		
Success Rate	By far, the most frequent and most successful	Decision making may not be clear or may change over time between the sponsor and the management team.	Potential benefit from the support of the wider group with careful management.

A credible fund manager plays a central role in making a successful PE fund operation with a given supply and demand potential in a certain market. It has been estimated that there are about 6,700 PE firms worldwide.^{viii} A few PE firms are larger organizations, but the typical PE firm will consist of a group of ten or twenty professionals managing a hundred to five hundred million Euros. One study showed that as of 2014, there were only six thousand experienced fund managers in the world.^{ix} Extrapolating that figure to 2022, there are now probably around ten thousand experienced fund managers. Successful fund managing is a valuable and sought-after skill. Team members typically become fund managers after some professional experience. A PE fund manager is a second profession in that the fund manager developed skills and experience in a previous role such as banker, company executive, entrepreneur, lawyer, accountant, etc.

Given the high failure rate of attempts to launch a PE fund, investors attach a high importance to the experience of the management team. A study showed that in year 2000, 25 percent of all new funds raised were from first-time fund managers. By 2014, this percentage had fallen to 4 percent.^{xx} The exception to this is in emerging markets, where market underdevelopment will lead LPs to be more accepting of first-time teams. Given the attraction of a career as a commercial PE fund manager, numerous people may attempt to launch a PE fund. The failure rate is extremely high, probably over

95 percent. Most groups fail to appreciate the difficulty of fundraising and will tend to give up in the early stages. Groups who benefit from an anchor type investor will have better odds. In general, having an anchor type investor is a result of longstanding and deep prior relations between members of the team and the anchor investor, rather than an acquaintance made at the time of the new fund initiative.

In an emerging market such as SEE, it is important to distinguish between first-time investors and a first-time team comprised of individuals with prior experience in PE investment. The latter will have a higher success rate. The market can be segmented as follows:

- (i) Groups of individuals spinning off from an existing PE firm,
- (ii) Financial institutions divesting their PE operations (often due to regulation changes) and co-operating in a management buyout of the PE operation,
- (iii) A group launching a fund on the back of a strong initial commitment from an anchor investor,
- (iv) A group launching a fund without any specific firm commitments.

The majority of initiatives in the market fall under category (iv), as well as the highest percentage of failures. In the case of the SEE Region, given the relative scarcity of PE players, (i) and (ii) are somewhat unlikely; therefore (iii) would seem the most likely way for there to be a new player on the market.

There appears to be a reasonable talent pool to support the next stage of development of the PE market in SEE. Given the centrality of a fund manager's skill level for the success of any PE ecosystem, the talent pool in the Region must be considered. Potential PE managers can come from the following segments:

- 1) Most relevantly, professionals that are already involved in PE type investments, existing growth funds, other types of funds, principal investment groups in banks or other financial institutions. These may be local professionals, as well as repatriates with relevant experience gained in a major financial center.
- 2) Related areas where professionals are involved in corporate lending, accounting, management consulting, legal, other types of asset management, investment advisory, etc.

It is important to point out the importance of the individual investment professional when assessing the talent pool. A 2018 study of buyout managers found that the "manager seems to be about as four times as important as the organization"^x. A 2015 study of VC found that human capital was 2 to 5 times more important than the firms'^{xi}. The 2018 study found that the main required skills fell into four categories of (i) industry expertise, (ii) geographic expertise, (iii) investment size expertise and (iv) general managerial expertise; with industry expertise being the most important and general managerial the least. This means that a new configuration of investment professionals drawn from existing firms is able to transfer their skills to a new management firm, which is one of the main premises upon which the recommendation in this Report is based.

Although harder to estimate the number of professionals in the second segment, it is reasonable to conclude that in SEE there is a potential talent pool of some 100+ individuals. For a growth fund of \$30-50 million, the typical team size of investment officers will be 5-10 people. Therefore to launch, two new funds in the market will require 10 to 20 people being available.

The main motivation to become an independent PE fund manager is the extreme attractiveness of the profession; combining as it does exciting work, independence, a secure and substantial income from

management fees, as well as a potentially considerable upside from carried interest. The main obstacle remains the difficulty of raising a fund and the career downside of failing to do so.

Private Equity Regulation and Fund Structuring

The question of regulation in Emerging Markets Private Equity is typically driven by the composition of LPs in an Emerging Markets fund, namely the breakdown between international LPs and domestic LPs.

Typically, international LPs will feel more comfortable investing through a vehicle in a jurisdiction where they are more familiar, where the legal system is more developed, where there is better knowledge of private equity and where there is more experience and jurisprudence on the topic. Investing in Emerging Europe, this in practise means jurisdictions such as Luxembourg, the Netherlands, Ireland which are recognised centres for setting up private equity funds, along with less regulated centres such as Cyprus or Malta, as well as centres geographically further afield, such as Delaware, Ontario or the Cayman Islands. It is important to note that setting up in these centres has a certain cost; which means in practise a fund with AUM below some €20m may struggle to cover these with the lower level of management fees it will have.

A notable exception to the above can be a DFI which is concerned with providing a demonstration effect and wishes to support local regulatory efforts; and therefore, invests deliberately into a local vehicle. It should be noted that most DFIs, unless engaged in such a mission, will prefer to invest through a recognised jurisdiction just like a “regular” international LP. In this case the local regulations which such an LP will be concerned about will be those protecting foreign investment, rather than local funds regulation.

Those local LPs which may invest in private equity may well have a preference for a locally incorporated fund, although that is not always the case. A typical example would be a local pension fund which is prevented by local regulation from investing abroad and therefore needs a local vehicle.

The other case where local incorporation predominates will be in the case of very small funds that simply cannot afford to set up internationally. These would typically be private equity funds with AUM below €10 and the very small VC funds linked to the accelerator/start up ecosystem. Often local PE regulations are developed by Emerging Market countries with this segment of private equity in mind, rather than the growth equity segment, which involves funds with AUM sizes over €20m.

The conclusion the above considerations point to, is that developing local regulations will have a limited effect on attracting new LPs as long as international LPs prefer recognised jurisdictions and as long as local LPs constitute a small minority (10-20%) of an Emerging Market fund’s AUM.

In many cases, it is not uncommon for a fund manager to set up two parallel funds which operate as a single unit; with an international fund for foreign LPS and a local vehicle for local LPs.

The main challenge with respect to local funds regulations, is that these are often imperfectly drafted. The usual causes for this include the legislator simply applying regulations designed for UCITS funds with minimal adaptations or a general lack of expertise in drafting such new regulations. Table 15 shows the main items which need to be addressed for any PE regulation to be comprehensive. This table highlights the key building blocks necessary for any effective regulation relating to private equity. Ideally, any legislation (and associated regulations) should cover these elements.

Legislation Item	Features
Regulator	Is the regulation parallel and separate from UCITS (Undertaking for Collective Investment in Transferable Securities) regulation/Is regulation of systemic issues and manager separate (“Twin Peaks”)/Any regulatory “Sandbox” to encourage innovation.
Alternative Investment Fund	Is the identity of an AIF clearly defined and identified.
Reporting	Periodicity of reporting: annual, quarterly, monthly/Link with external auditors/Templates specified by Regulator.
Registration	Full versus light registration/Registration only or registration requiring approval-licensing/Fund and Manager required to register.
Manager Qualifications	Specificity of manager criteria/approval required/criteria for board members versus operating management.
Investment Policy Guidelines	Specification that investee companies must be below certain size/permitted maximum shareholding in company/diversification requirements by sector and company.
Valuation of Portfolio	Valuation criteria set by regulator or obligation by manager to communicate to Regulator/Role of external auditor/Obligation of independent 3 rd party valuation and valuer’s liability/Manager primary responsibility for valuation or other, eg. Custodian.
Depository/Custodian	Necessity for custodian/Responsibilities (safekeeping, verify assets, record keeping)/Credit institution or investment firm/Level of legal liability.
Corporate Structures	Permitted corporate structures for Fund and Manager/Partnership, LLC, PLC, other/Partnerships with or without legal substance.
Qualified Investor	Definition of QI/Institution or HNWI/Qualification for individual QIs, eg. Salary, net worth ex residence/Distinction between HNWIs with and without investment experience
Marketing	Restriction on marketing to public/Treatment of reverse solicitation and “pre-marketing”.
Private Placement	Registration and reporting criteria/maximum number of investors/criteria for eligible investors, e.g. QIs only.
Leverage	Restrictions on leverage level of the Fund/Regulation of the security that can be given, e.g. LP commitments, portfolio company holdings/Treatment of subscription lines.
Remuneration of Manager	Fixed, discretionary and non discretionary variable/Reporting of remuneration/Guidelines on permitted remuneration.
3rd Party Manager	Permissions to use 3 rd party manager/Provisions to ensure arrangement not merely cosmetic, e.g. substance tests.
Diversity	Any diversity criteria such as gender or other/Mandated quotas or other criteria/At board level or also manager level.

It should be noted that several countries in Emerging Europe engage in drafting local PE legislation. It is quite common that the model they chose to base themselves upon is the European Union 2011 Alternative Fund Managers Directive and subsequent legislation. Frequently these counties will obtain technical assistance funding from DFIs in order to engage in such exercises. The results of these can be mixed, especially if some local interests result in modifications to the planned regulations which may not always make sense from a PE perspective. We include, for information purposes, in Appendix 3, a summary description of the 2011 EU Directive as well as the US 2010 Frank-Dodd Title IV regulations.

Albanian Funds Law 2020

Albania promulgated a Law on Collective Investment Undertakings in 2020 (Law n.56/2020). It is explicitly specified that the law is aligned with the EU 2011 AIFM Directive and subsequent amendments and regulations. Indeed the structure of the law is quite recognisable. The law, as might be expected, is quite thorough and provides a good framework for local funds and fund managers. The main downside of the regulations is their thoroughness which could deter smaller operators. It should be pointed out, as well, that the minimum capital allowed for a fund manager is €152K up to total AUM of €305m. These values could well act as a deterrent for operators trying to set up a small SME fund of €5-10m as well as for example, accelerators trying to set up a micro VC fund of some €1-2m, as is common. On the other hand, the law allows for registered managers to delegate substantially all their front office functions, so there may be an opportunity for someone to offer 3rd party manager services, as is the case in Luxembourg, for example.

Kosovo Legal Framework

Kosovo has no legislation regarding Alternative Investment Funds. Related legislation is the 10/2014 Law on Licensing of Pension Fund Managers and the Law no.04/220 on Foreign Investment,

North Macedonia Legal Framework

Private funds in the Republic of North Macedonia are regulated by the Law on Investment Funds. In general, the existing legislation appears more focused on UCITS funds, which are regulated to some detail; with the private funds covered much less and with key aspects omitted. Appendix 5 provides more details.

Under the current legislation, a private investment fund must have minimum AUM of €0.5m, minimum investor commitment of €50K per investor, and a term of at least 5 years. The sponsor of the Fund must draw up a Prospectus for approval by the Regulator. The Fund Manager must have minimum capital of €50K, plus further €25K for each further fund managed. The Funds must be registered in the official Register of Funds and there is an annual audit requirement.

With technical assistance from the World Bank, a new Law on Alternative Investment Funds Managers has been drafted and is currently being reviewed by the legislature. The new law is aligned with the EU 2011 Directive on Alternative Investment Fund Managers. It is expected to strengthen the rules and procedures for the operation of private investment funds and fill some of the current gaps. It will regulate the licensing process for managers of private investment funds and assign supervisory authority to the Securities and Exchange Commission.

Survey of Regional SMEs Conducted

As part of this report, a survey was conducted of SME owners in the region of Albania, Kosovo and North Macedonia. The survey involved the distribution of online questionnaires to more than 150 companies, resulting in 90 responses. While acknowledging the relatively modest sample size, it proved sufficiently relevant for validating the demand for Private Equity (PE) in the targeted region.

All surveyed companies actively responded to all the 7 questions encompassed in the questionnaire, structured across three sections. The initial section focused on delineating the company's (respondent's) profile, the second section delved into the profiles of the owners and their family

involvement and succession plans, while the third section aimed at gauging their overall familiarity and utilization of PE instruments.

The primary objective of the survey was to furnish insights into the participants' status regarding succession planning, their acquaintance with and exposure to PE within their respective countries, and their satisfaction levels with any previous experiences, if applicable. The secondary objective was to assess to what extent private equity could play a role in the handing over of control to the next generation.

Appendix 1 provides the survey questions in full detail.

We summarise the results of the survey.

The Initial Section of the questionnaire focused on the overall profile of the respondent company. The answers of the actual respondents are illustrated in Figures 1 through 4 below.

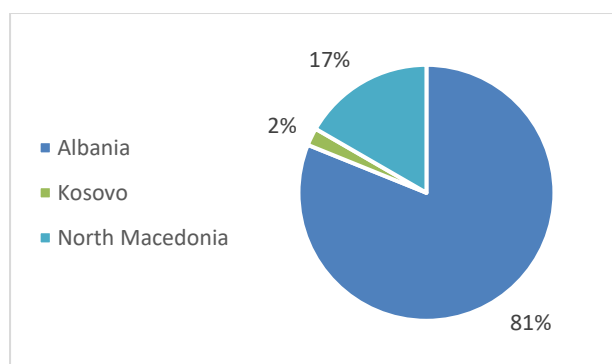


Figure 1 Where is your company located? (Q1)

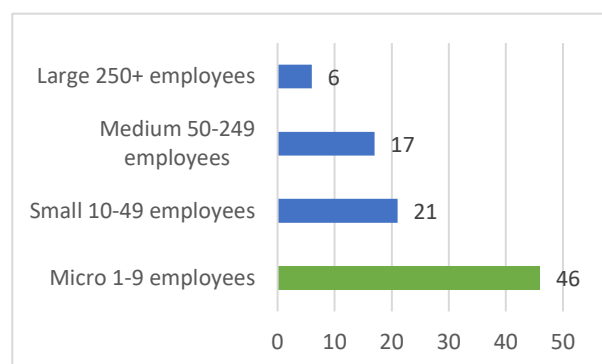


Figure 2 What is the size of your company? (Q2)

As evident from the data, our respondents' geographical distribution (refer to Figure 1) notably skews towards over-representing Albanian companies, comprising 81% of our sample. Therefore, we will refrain from scrutinizing each country's sample individually and, instead, concentrate on the overall sample as a representative snapshot of the targeted region. Regarding company size, as indicated by the number of employees (see Figure 2), most surveyed companies fall into the category of micro-enterprises (51%), followed by small enterprises (23%), medium-sized enterprises (19%), and large enterprises (7%). It's worth noting that even micro-sized companies may be eligible for PE funding, considering the availability of smaller ticket sizes and overall fund flexibility.

85% are Majority Shareholders: a significant portion of respondents possess a majority stake in their companies (refer to Figure 3). Meanwhile, the age distribution of founders reveals that 31% are under 35 years old, 34% fall within the 35-45 age bracket, 31% are between 46 and 60 years old, and only 3% are aged 60 or above (see Figure 4). Despite the potential ease for companies with single majority ownership to decide on involving a financial investor, if we consider targeting companies ready for succession, the age demographic suggests that only a third of the sample could be considered potential targets for PE deals, as two thirds are under 45 years old.

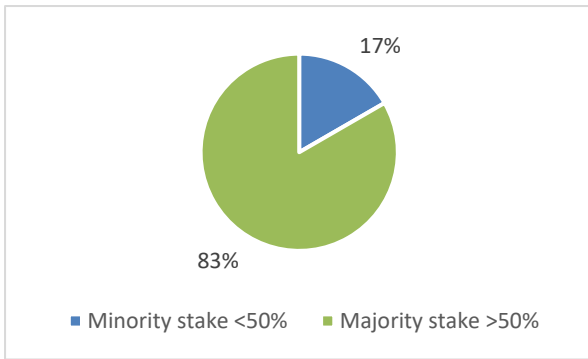


Figure 3 What is your ownership stake? (Q3)

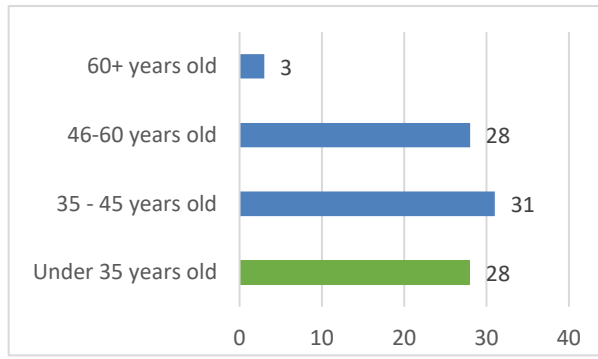
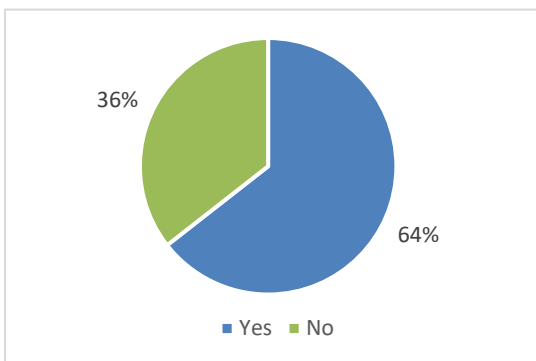


Figure 4 What is your age? (Q4)

The Second Section of the questionnaire delved into the profiles of the owners and their family involvement and succession plans. The answers of the actual respondents are illustrated in Figures 5 through 8 bellow.

Figure 5 Do you have, or do you expect to have your children (or other next generation family members) part of managing the company in next 5 years? (Q5)



64% Expect Family Involvement: A significant majority of businesses anticipate involving their children or the next generation in managing the company within the next 5 years. (see Figure 5).

This indicates that even the members of the age group of 35-45 years old are considering involving children or other family members in the management of the business and the strong inclination of keeping the business within the family.

- **55% Anticipate Imminent Readiness:** Among those expecting family involvement (see Figure 6), 55% believe that their children are either fully ready to take over in the next 5 years or expect they will be in 10 years or less, a confidence in their successors' preparedness or a proactive approach toward grooming them for leadership roles.

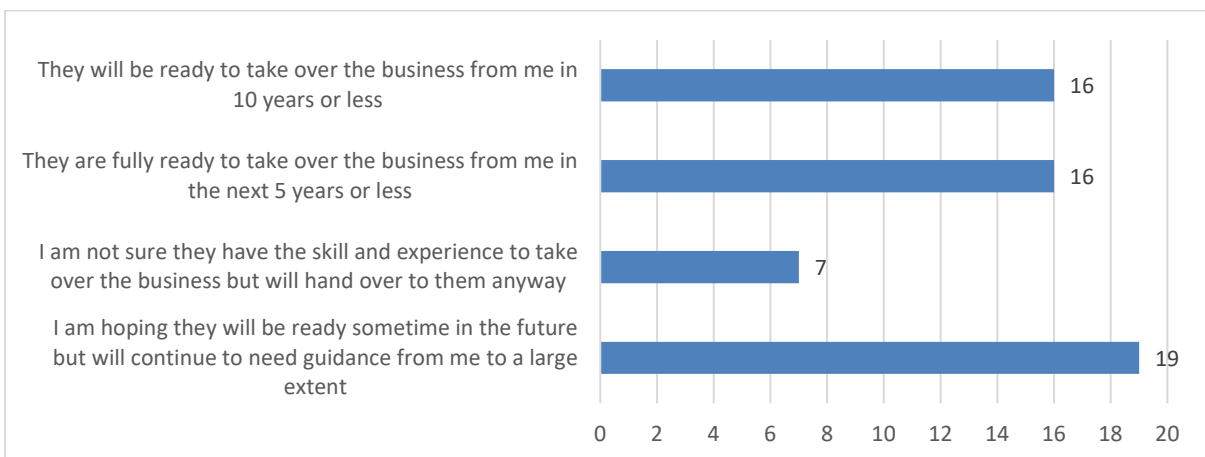


Figure 6 Which statement best describes your expectation of their future role? (Q5a)

- **Expectation of Guidance:** the remaining 45% of this group expresses uncertainty, believing that the next generation will require guidance before assuming leadership roles. This cautious approach highlights an awareness of the need for mentorship or transitional support.

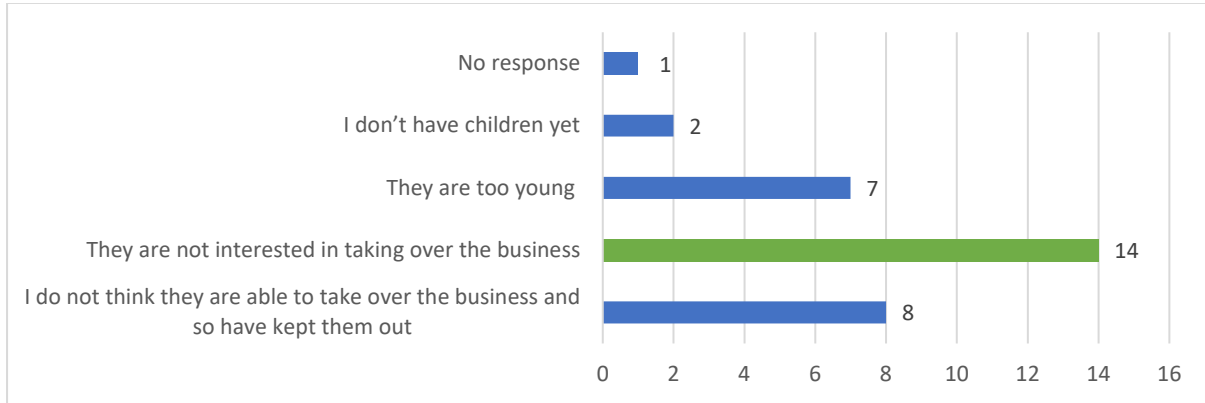


Figure 7 Which statement best describes your situation? (Q5b)

36% Do NOT Expect Family Involvement:

- Of those businesses not anticipating the involvement of their children or the next generation in managing the company, 44% list the lack of interest of their successors in taking over the business and exhibiting interests in other industries with another 25% expressing disbelief in their children's ability to take over the business, thus keeping them deliberately out of it (see Figure 7 above). This indicates that this group of business owners may end up facing significant succession and/or exit challenges and might benefit from buyout or M&A.
- 41% are not sure about the future management of their business, whereas 56% are open to the idea of selling the business in its entirety or bringing in a minority/majority financial partner and gradually transition to a non-executive role, indicating a significant potential for PE involvement.

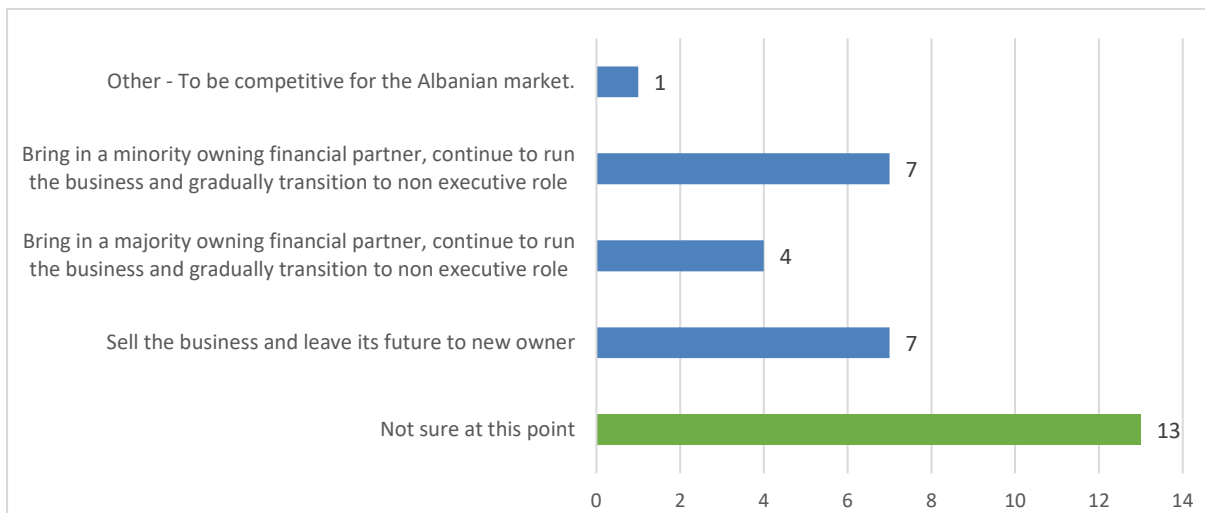
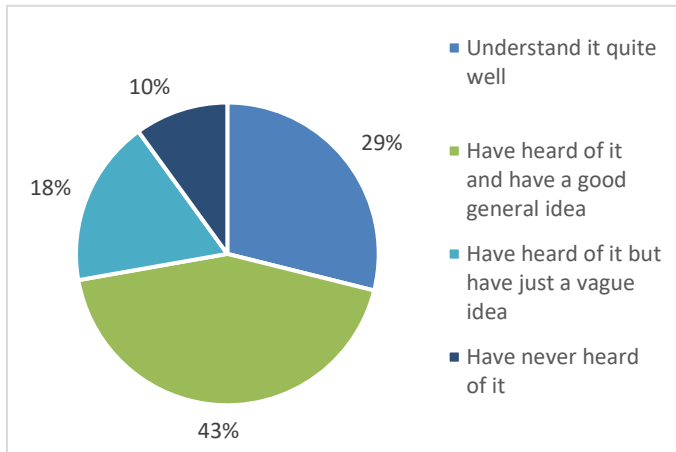


Figure 8 What is your idea for the future management of the business? (Q5c)

The Third Section of the questionnaire aimed at gauging the businesses' overall familiarity, utilization, and satisfaction with PE instruments. The answers of the actual respondents are illustrated in Figures 9 through 12 bellow.



90% Have Heard of PE: almost three quarters of the respondents claim to have heard of PE with various degrees of understanding, ranging from understanding it quite well (29%), to having a vague idea about what it is (18%).

10% never heard of PE: only a small number of respondents never heard of PE, indicating relatively developed markets and experience with PE either direct or indirect (refer to Figure 9).

Figure 9 What is your knowledge about private equity? (Q6)

26% Previous Contact: This relatively smaller segment has had prior exposure to PE and the bullets bellow summarize their experience with PE (see Figures 10 and 11).

- **40% Valuable Knowledge + Capital:** A subset of this group (40%) perceived the involvement of PE as beneficial, providing not just capital but also valuable knowledge. This suggests that a portion of companies that engaged with PE found the partnership to be enriching beyond just financial support.
- **40% Solely Capital:** Another 40% mentioned receiving capital without active involvement from the PE fund. This indicates a neutral or passive engagement where the PE fund did not interfere in day-to-day operations.
- **20% Perceived Control Intentions:** A notable 20% expressed concerns about PE's intent to take control of the company or felt that there was no added value beyond a desire for control. This suggests a degree of discomfort or a negative experience with the PE involvement, possibly due to perceived overreach or conflicts of interest.

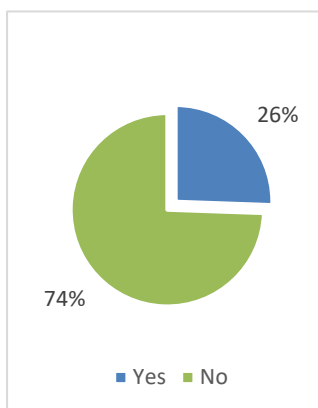


Figure 10 Have you had any contact with PE Funds? (Q7)

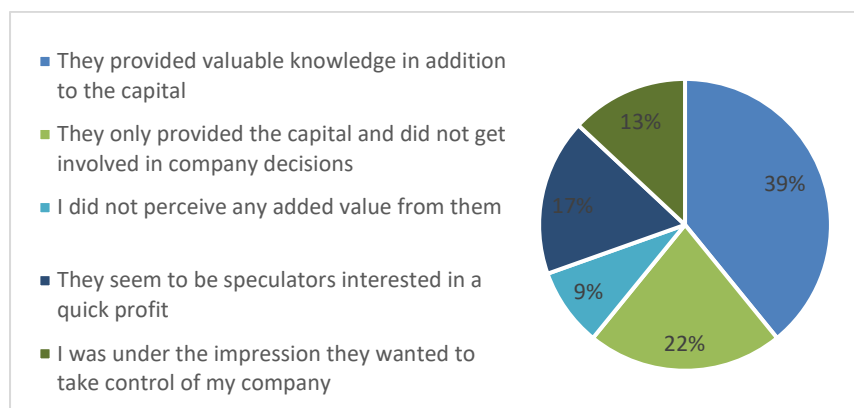


Figure 11 Which best describes your experience with PE Funds? (Q7a)

PE Funds? (Q7a)

74% No Prior Contact: A larger majority has no prior experience working directly with PE and the bullets below summarize their perception of PE as they believe it to be (see Figure 12).

- **28% Perceive Value:** A notable portion (28%) from this group still perceive PE as valuable without direct engagement, possibly based on external observations or industry knowledge.
- **34% Interested with Limits:** Another segment (34%) finds PE interesting but prefers limited involvement, indicating a preference for retaining autonomy in day-to-day operations while benefiting from PE resources.
- **30% Uncertain:** A substantial portion (30%) seems uncertain, possibly due to a lack of first-hand experience or exposure to PE practices, leading to a neutral stance.
- **7% Not Interested:** A smaller subset (7%) outright expresses disinterest, indicating a clear aversion to engaging with PE for various reasons.

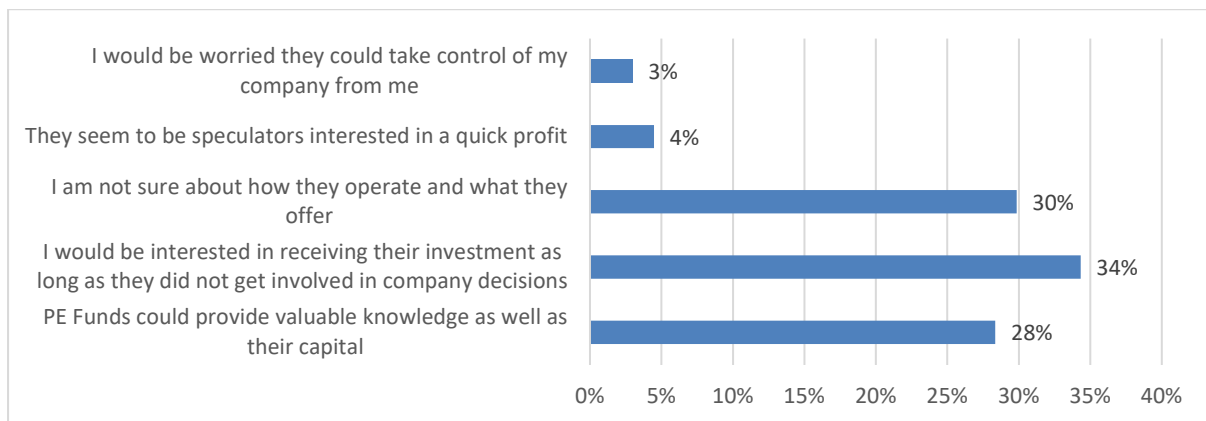


Figure 12 Which best describes your perception of PE Funds? (7b)

Potential Reasons:

- **Positive Experience Matters:** Companies that received valuable knowledge alongside capital from PE are more likely to view the interaction positively. This suggests that the nature of engagement plays a significant role in shaping perceptions.
- **Control Concerns Impact Perception:** The 20% that perceived PE as wanting control or not adding value might represent instances where PE's intentions or actions clashed with the company's vision or autonomy, leading to a negative perception.
- **Limited Understanding Affects Interest:** A considerable number of companies without direct PE experience either express uncertainty or limit their interest due to concerns about PE involvement in daily operations. This indicates a cautious approach stemming from a lack of comprehensive understanding or fear of losing control.

Relationship Between Succession and Perception of PE

- **Positive Outlook Linked to Succession Plans:** Among those who anticipate their children's readiness for leadership within 5-10 years, a significant 66% hold a positive outlook toward engaging with PE.

Potential Inferences:

- **Succession as a Catalyst:** The inclination toward family succession may influence the openness to PE engagement. The belief in the preparedness of the next generation seems to positively correlate with a favourable view of PE, potentially seeing it as a support mechanism for the incoming leadership.
- **Uncertainty and Guidance Needs:** The recognition of guidance needs for the next generation suggests a possible area where PE could play a role. Businesses acknowledging the need for transitional support might perceive PE involvement as a resource for providing strategic guidance or professional expertise during succession transitions.

Implications for PE Engagement:

- **Alignment with Successors' Vision:** PE firms aligning their strategies to complement the aspirations and vision of the incoming leadership might find greater acceptance among family-run businesses undergoing succession transitions.
- **Guidance and Transitional Support:** Offering guidance and transitional support services could be an attractive proposition for PE firms seeking to engage with businesses where the next generation requires mentorship or strategic direction.

Absence of Family Involvement and Perception of PE:

- **56% with a Positive PE Outlook:** Among those not anticipating involvement of children in the family business, a significant 56% still hold a positive view of PE. This suggests that the absence of family succession doesn't necessarily equate to resistance or scepticism toward PE involvement.

Potential Interpretations:

- **Alternative Growth Strategies:** Businesses not considering family succession might be more open to alternative strategies for growth and development, including engagement with PE firms. This segment might view PE as a viable avenue for expansion or evolution without family involvement.
- **Objective Business Assessment:** These businesses could prioritize objective assessments and growth beyond familial connections. The positive outlook toward PE might signify an openness to external expertise, capital injection, or strategic guidance that PE can offer.

Implications for PE Engagement:

- **Opportunity in Non-Family Run Entities:** PE firms might find potential opportunities in businesses not planning familial succession. These entities could be more receptive to PE propositions aimed at enhancing growth, operational efficiency, or market expansion.
- **Focus on Objective Value Addition:** Highlighting how PE can bring objective, strategic value to businesses irrespective of family involvement might resonate well with this segment. Emphasizing the benefits of professional expertise and financial support could align with their growth aspirations.

The general conclusion that can be derived from the survey, is that of the potential for private equity to play a role in the generational succession of family companies where the founders fall into the category of being receptive to the idea. There will be a need to continue to educate the market as to the benefits of responsible private equity participation.

Impact of Private Equity on family companies

There is always some discussion about the challenges of introducing private equity into the ownership of family companies. We refer to a 2021 Italian study of 300 private family-owned companies that received a private equity investment in the period 2002 to 2017^{xii}.

The study found evidence of an increase in innovation after a period of 2 to 4 years after the investment was made. The level of innovation was measured using the number of new patent requests as a marker. The average number of patents grew 30% in the four years following the private equity investment. This was more pronounced in companies where PE had acquired majority control.

The study concluded that PE investment had an overall positive effect on the companies' levels of innovation and corporate governance.

The Italian model is an interesting one to refer to because of the numerous family companies which make up the backbone of the Italian economy and into which many private equity investments are made, thus providing useful lessons in the area of the interaction between private equity and family companies. The lessons of the Italian private equity market tend to often be overlooked compared to Anglo-American PE examples; but may provide better insights for the Region object of this report.

Survey of regional banks conducted

As part of the production of this Report, a survey was conducted of several of the major banks operating in the region. The questionnaire used is shown in Appendix 6.

The banks SME clients was in the majority of the cases between 75% and 90% of their loan portfolio. 60% of the respondents said they had a good general knowledge of private equity, but only 40% had any experience of co-operating with a private equity fund. Few of their clients had received private equity investment (to their best knowledge).

All the banks felt they had clients that could benefit from private equity investment and all the banks thought that PE backed companies would be more bankable clients. The banks also all felt that PE investment would benefit the local economy by increasing access to capital for businesses.

60% of the banks perceived PE investors as offering management expertise along with capital. 83% of the respondents thought that more PE activity would spur them to become more innovative in the financial products they would offer.

Interviews held with regional fund managers

As part of the research for the preparation of this report, **in depth interviews were conducted with several fund managers active in the Southeast European region**, as well as with some local professional association representatives. The funds all have previous experience of making investments in the region and several have offices there.

Some of the key points that emerged from the conversations were:

- There is room in the market for several lower mid cap funds with size of €25-50m, provided that they have a local on the ground team and have access to a sidecar Technical Assistance grant fund to finance portfolio company improvements.
- There was disappointment with the approach of several of the traditional PE fund investing DFIs, which they felt were sometimes superficial in their view of the market and too dismissive of valid initiatives.
- Mobilising local capital in any substantial way beyond small angel investments did not seem very likely in the medium term.
- Even for funds based in SEE, there is a knowledge gap regarding the Albania/Kosovo/North Macedonia region. Ex Yugo funds tend to invest within ex-Yugoslavia and Bulgarian funds tend to focus their outside investments on North Macedonia and Serbia.
- There has been a gradual increase in the supply of more experienced fund managers with local knowledge and presence, with the notable exception of autochthonous Albanian teams.

Suggestions for the Design of an SME Fund

There is evidence that the Region has enough PE eligible companies to justify the entrance of new lower mid-cap PE funds. Any issues with company owners, such as a weak financial and governance culture, a lack of familiarity with PE, a reluctance to give up ownership in their companies, a “one man band” management style are the typical issues a lower mid-cap PE investor faces in all emerging markets and in many developed markets. In general, however, the issues are more pronounced when the company is smaller. This is something that a skilled fund manager needs to be able to work with. It is intrinsically the job of the lower mid-cap fund manager to take such companies from an underdeveloped state to a bigger and better one, which can lead to a good valuation.

While the development of the entrepreneurship ecosystem has seen significant progress in the past few years, with various support programs by the government and DFIs, continued effort in capacity building will be essential. PE market development would require capacity building for government support entities, which are exploring equity investments in addition to existing credit and grant instruments, for investment professionals including first-time fund managers, and for enterprises to improve their investment readiness.

For a PE firm, being effective in the finding investments will depend upon (i) being able to attract a consistent and sufficient amount of initial leads and given the impracticality and excessive resource cost of doing a full due diligence on every potential lead, (ii) having the skill set to screen investments in an efficient manner with even a sometimes limited amount of information and time engagement (*“What is also required is the experience of the senior executives of a GP to add value... by critically evaluating the information collected by applying their depth of business and investment experience”¹¹*).

The main reservation we find in the market is centered upon “soft factors”, such as (i) unfamiliarity with private equity, (ii) reluctance of founders to cede any degree of control, (iii) challenges achieving exits and other issues. These typical arguments are found in almost any Emerging Market and are absolutely not specific to the Region.

This will simply have the effect of increasing the cost of business of PE. Typically, in the earlier stages of a market some costs can be mitigated by the creation of a sidecar technical assistance fund, which

¹¹ Investment Decision (section 3.3.3, page 28), Professional Standards Handbook, Invest Europe, 2018

will be structured as a grant and whose funds can be applied towards upgrading the portfolio companies and also partially supporting the fund manager costs. For a fund size of €30-50m, it would be typical to have a sidecar TA fund of €0.5-1m.

Given that:

- i. There are quite a good number of initiatives in the Region relating to startups and accelerators, often DFI and Government sponsored or supported;
- ii. That many non-Tech SMEs are single founder or family-owned companies, as is typical.

We suggest the creation of a Fund with the following characteristics:

- a) A geographical focus on Albania, Kosovo and North Macedonia
- b) An investment team with main office in Tirana and the possibility of eventual satellite offices in Pristina and Skopje
- c) An investment team majority of Albanian speakers
- d) An investment strategy focusing on family-owned companies, that have made the decision to transition to a more professional type of management, or where there is a passage to the second generation with a commitment to upgrade the corporate governance of the company.
- e) Investment structures consisting mainly of minority stakes and/or quasi equity self-liquidating instruments.
- f) A portfolio management strategy centered upon supporting the development of the second generation of family members or the transition to a professional management.

It is important to clarify point d). The strategy would be that the fund would welcome dialogue with family companies where **the decision to upgrade or pass the company to the next generation has already been substantially taken or committed to.**

Within this overall strategy, we can envisage two types of specific fund strategies.

The first would be based upon a smaller fund (around €30m) which would make use of debt or quasi-equity financial instruments that would be self-liquidating, such as mezzanine loans, redeemable preferred equity, revenue-based venture type loans. They would make a larger number of smaller investments of around €1m to achieve a portfolio of around 30 companies. The management team would be less active in the company decision making and may not necessarily have board seats.

The second would be an equity fund of a larger size (€50m) which would make 7-12 investments of an average size of €5m, with a strong exit strategy based upon trade sales, IPOs or secondary sales (to another fund or financial sponsor). The management would be much more active in the company decision making and may also employ a buy and build strategy of regional consolidation.

Appendix 1 – SME Survey Questions

a. Where is your company located?

Albania
North Macedonia
Kosovo

b. What is the size of your company?

Micro 1-9 employees
Small 10-49 employees
Medium 50-249 employees
Large 250+ employees

c. What is your ownership stake?

Majority (>50%)
Minority (<50%)

d. What is your age?

Under 35 years old
35 - 45 years old
46-60 years old
60+ years old

e. Do you have or do you expect to have children (or other next generation family members) part of managing the company in next 5 years?

YES	<input type="checkbox"/>
NO	<input type="checkbox"/>

f. If yes (if no, jump to question 7):

Which statement best describes your expectation of their future role?

They are fully ready to take over the business from me in the next 5 years or less	<input type="checkbox"/>
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They will be ready to take over the business from me in 10 years or less	
I am hoping they will be ready sometime in the future but will continue to need guidance from me to a large extent	
I am not sure they have the skill and experience to take over the business but will hand over to them anyway	
I am not sure they have the skill and experience to take over and am not sure of the future at this point	
Other	

If you have answered “other”, please give short explanation:

7) If no (if yes, do not answer):

Which statement best describes your situation?

I do not think they are able to take over the business and so have kept them out	
They are not interested in taking over the business	
Other	

If you have answered “other”, please give short explanation:

8) If no (if yes, do not answer), what is your idea for the future management of the business?

Not sure at this point	
Sell the business and leave its future to new owner	
Bring in a minority owning financial partner, continue to run the business and gradually transition to non executive role	
Bring in a majority owning financial partner, continue to run the business and gradually transition to non executive role	
Other	

If you have answered “other”, please give short explanation:

9) What is your knowledge about private equity?

Understand it quite well	
Have heard of it and have a good general idea	
Have heard of it but have just a vague idea	
Have never heard of it	

10) If you have had contact/discussions with a private equity or venture capital fund, which of the below best describes your experience or opinion?

They could provide valuable knowledge as well as their capital	
I would be interested in receiving their investment as long as they did not get involved in company decisions	
They seem to be speculators interested in a quick profit	
I am worried they will take control of my company from me	
I am not sure about how they operate and what they offer	

11) Which of the below best describes your perception of Private Equity Funds? (if you have not had any previous contacts/discussion with a fund before)

I would be interested in receiving their investment as long as they did not get involved in company decisions
I am not sure about how they operate and what they offer
PE Funds could provide valuable knowledge as well as their capital
They seem to be speculators interested in a quick profit
I would be worried they could take control of my company from me

Appendix 2 – Fund Managers Interviewed in Region

Institution	Person(s) Interviewed	Date
Albanian-American Enterprise Fund (AAEF)	Martin Mata; Aleksander Sarapuli	9/2/2023
Accession Capital	Marko Mitrovic	22/11/2022
London Angel Group ¹²	Ajay Hoxha	9/2/2021
ARX Equity	Brian Wardrop	17/1/2023
Blackpeak	Kiril Ivanov	27/2/2023
Bulgarian VC Association & Vitosha Venture Partners	Max Gurvitz	8/12/2022
Croatian VC Association	Mirna Marovic	16/12/2022
Enterprise Expansion Fund (ENEF)	Fabio Serri	22/11/2022
Invenio Partners	Elvin Guri	29/3/2023
SEAF North Macedonia	Dejan Kalinikov	15/11/2022
South Central Ventures	Jan Kobler	18/1/2023

¹² Informal group of angel investors based upon a group of Albanian origin City of London based investment bankers

Appendix 3- Comparison of EU PE regulation with US.

FEATURE	AIFM	FRANK-DODD TITLE IV
Date of issue	Drafted in 2011; came into effect 2014. Implemented at different speeds in EU member states. Related Directives MiFiD I (2007) and MiFiD II (2018).	Promulgated in 2010. Federal Law; aspects are delegated to State Regulators, depending on the level of development of their regulations.
Cause & Objective	Triggered by 2009 financial crises. Objective to (i) respond to crisis and (ii) harmonise EU member state regulations	Triggered by 2009 financial crisis. Objective to respond to crisis.
Object of Regulation	Alternative Investment Funds and Fund Managers: private equity funds, hedge funds, real estate funds, infrastructure funds. Regulation applies to all EU managers managing an AIF (wherever domiciled) or marketing an AIF in EU; and to non-EU managers managing an EU AIF or marketing an AIF in EU.	Hedge funds, private equity funds and venture capital funds. Distinction between US and Foreign fund managers. Volcker rule restricts banks to invest in or sponsor PE funds.
Subsequent Regulation	MiFiD II, with focus on marketing across EU member states. Introduces option for managers to be MiFiD II approved firms or AIFM firms with MiFiD II “top up”.	Revisions in 2023. Tightening up of certain aspects, especially relating to fees charged by manager.
Regulator	European Securities Market Authority (ESMA); and national regulators.	Securities and Exchange Commission (SEC); and State regulators.
Regulation Characteristics	Regulations relate more to managers than funds. Requires registration and reporting. Sets criteria for leverage, remuneration, qualifications, valuation, depositary, 3 rd party managers, private placement, reverse solicitation and marketing and diversity. Makes exemptions based upon fund/fund manager jurisdiction size and leverage level. Distinction between “internal” and “external” fund manager.	Requires registration and reporting. Makes exemptions based upon fund manager fund jurisdiction, size and leverage level.
Registration	Registration with local national regulator unless unregulated or using 3 rd party manager.	Registration with State regulator if AUM <\$150m, unless state has no regulation, then register with SEC. Exemptions on registration for foreign and smaller fund managers. If AUM <\$25m, no registration with either SEC or State.
Reporting	Submit annual, semi annual and quarterly reports.	Submit reports depending on level of regulations. Exemptions on reporting for foreign fund

		managers. Extra reporting for AUM >\$2bn.
Leverage	Report leverage level	Report leverage level
Assets Under Management	Report	Report
Remuneration	Criteria for management remunerations-variable pay at least 50% in units of AIF, with 40-60% deferred 3-5 years.	Report structure of incentive-based compensation; exemption for AUM <\$1bn.
Qualifications	Submit CVs of managers.	Submit CVs of managers.
Valuation	Must be conducted by fund manager according to recognised criteria.	Report valuation policy.
Depositary	Criteria for depositary; must be credit institution or investment firm. Duties include safekeeping of instruments, record keeping, verifying assets, cash flow monitoring. Lighter regime for non-EU AIF.	
3rd Party Manager	Envisages delegation to 3 rd party AIFM; controls over excessive delegation back to original manager.	
Qualified Investor	Definition of qualified investor left to national regulators.	Qualified investor defined as either Net Worth less main residence >\$1m, or Income >\$200K for last 2 years.
Private Placement	Non-EU managers marketing non-EU AIFs will operate under national private placement regimes ; others covered by passporting.	
Marketing/Reverse Solicitation	Broad definition of marketing which includes placement agents and ongoing investor relations. "Reverse solicitation" exemption.	
Diversity	ESMA has issues some broad diversity criteria.	
Other	Must have conflict of interest policies Annual audits and reporting	Report counterparty exposure Report trading positions Report side letters Report type of assets
Exemptions	Exemptions for managers with either <€100m or <€500m without leverage and 5-year lockup: register (no authorisation needed) only plus annual reporting but cannot market in other EU member states other than the one where registered unless fully regulated.	Exemptions for: (i) foreign manager, if <15 clients, no place of business in US, AUM in US <\$25m, not sold to public. (ii) mid-sized manager if private funds only and AUM <\$150m (iii) VC managers if VC investment strategy, <20% in non-qualifying investments, no leverage, no redemption rights
Capital Requirements	AIFM must have capital of €300K, with sliding scale as assets go over €250m	

	(0.02% of AUM over 250m, to ceiling of €10m)	
Centres of Incorporation and structures	Any one of EU27 countries. Joint Stock, LLC or Partnership structure.	Any US State. Joint Stock, LLC or Partnership structure.

Appendix 4 – Albanian Funds Law 2020

We summarise the essential features of the Albanian Law n.56/2020 on Collective Investment Undertakings.

Legislation Item	Features	
Regulator	Is the regulation parallel and separate from UCITS (Undertaking for Collective Investment in Transferable Securities) regulation/Is regulation of systemic issues and manager separate (“Twin Peaks”)/Any regulatory “Sandbox” to encourage innovation.	Sole regulator is the Financial Supervisory Authority of Albania. Covers both UCITS and Alternative Investments.
Alternative Investment Fund	Is the identity of an AIF clearly defined and identified.	Defined as anything that is not a UCITS.
Reporting	Periodicity of reporting: annual, quarterly, monthly/Link with external auditors/Templates specified by Regulator.	Obligation of external auditor. Obligation to report materials changes and changes in manager shareholding according to thresholds of 20%, 30% and 50%.
Registration	Full versus light registration/Registration only or registration requiring approval-licensing/Fund and Manager required to register.	Funds and Managers must register into Register of Collective Investment Undertakings, Operators and Depositaries. May operate once registered.
Manager Qualifications	Specificity of manager criteria/approval required/criteria for board members versus operating management.	Foreign EU managers recognised. Local managers require minimum capital of €152K up to €305m AUM. For AUM over, increased capital by 0.02% of excess AUM to maximum of €12.5m. Professional criteria and integrity criteria specified for manager senior officials.
Investment Policy Guidelines	Specification that investee companies must be below certain size/permitted maximum shareholding in company/diversification requirements by sector and company.	None.
Valuation of Portfolio	Valuation criteria set by regulator or obligation by manager to communicate to Regulator/Role of external	External valuer or internal provided team is separate. Auditor obligation to conduct spot checks. Criteria supplied by regulator. Valuation annual unless regulator requires more frequent.

	auditor/Obligation of independent 3 rd party valuation and valuer's liability/Manager primary responsibility for valuation or other, eg. Custodian.	
Depository/Custodian	Necessity for custodian/Responsibilities (safekeeping, verify assets, record keeping)/Credit institution or investment firm/Level of legal liability.	Depository required. Must be credit institution or investment company.
Corporate Structures	Permitted corporate structures for Fund and Manager/Partnership, LLC, PLC, other/Partnerships with or without legal substance.	Funds can be investment funds, joint stock companies or limited partnerships. Managers must be joint stock companies.
Qualified Investor	Definition of QI/Institution or HNWI/Qualification for individual QIs, e.g. Salary, net worth ex residence/Distinction between HNWIs with and without investment experience	Institutions considered QI. Individuals "Qualified Client" must meet two of following three criteria: (i) carried out substantial investment transactions in past, (ii) net worth at least €650K, (iii) works or has worked in senior position in financial sector.
Marketing	Restriction on marketing to public/Treatment of reverse solicitation and "pre-marketing".	No public marketing for Alternative Funds. Reverse solicitation not covered.
Private Placement	Registration and reporting criteria/maximum number of investors/criteria for eligible investors, e.g. QIs only.	Not covered.
Leverage	Restrictions on leverage level of the Fund/Regulation of the security that can be given, e.g. LP commitments, portfolio company holdings/Treatment of subscription lines.	Guidelines on leverage management.
Remuneration of Manager	Fixed, discretionary and non-discretionary variable/Reporting of remuneration/Guidelines on permitted remuneration.	General guidelines of principle.

3rd Party Manager	Permissions to use 3 rd party manager/Provisions to ensure arrangement not merely cosmetic, e.g. substance tests.	Allows for delegation of substantially all front office functions to third party.
Diversity	Any diversity criteria such as gender or other/Mandated quotas or other criteria/At board level or also manager level.	None.

Appendix 5 – North Macedonian Funds Law

This table summarises existing legislation on Funds, without considering the current draft law being considered at the time of writing.

The table refers to the laws from the Official Gazette of the Republic of Macedonia no. 12/09, 67/10, 24/11, 188/13, 145/15 and 23/16 and Official Gazette of the Republic of North Macedonia no. 31/20, 150/21 and 288/21).

Private Funds Management Company: The law defines the company for managing private investment funds as...*a limited liability or joint-stock company whose sole purpose is the establishment and management of private funds in its name and on behalf of the owners of share documents in the fund.*

Initial capital: The company for managing private funds requires an initial capital of 50,000 EUR if the company manages one private fund. If the company is established to manage multiple private funds, the initial capital is increased by an additional 25,000 EUR for each subsequent fund.

Managing Funds: A single company for managing private funds may manage multiple private funds.

Additional Terms: The company for managing private funds is obliged to provide the Security and Exchange Commission with a summary of the prospectus of the private fund. The company for managing private funds may be the owner of share documents in any private fund it manages.

Private Fund: A private investment fund represents special assets, without the characteristics of a legal entity, formed with the purpose of collecting funds through a private offer for the sale of share documents in the fund. These funds are invested in accordance with the investment objectives outlined in the prospectus of the private fund. Owners of the share documents have the right, in addition to the profit-sharing right in the private fund, to request the redemption of their share and thus withdraw from the fund, in a manner and under conditions specified in the fund's prospectus. The private fund is registered in the Register of Funds in the Republic of North Macedonia.

Regarding the foundation and operation of private funds, the following rules apply:

- A private fund is established for a specific period, which cannot be less than five years.
- The size of the private fund amounts to at least 500,000 EUR in denar equivalent. The size of the fund implies the registered maximum obligation for payments to all investors on all bases for the entire duration of the fund.
- The minimum undertaken commitment for investment by each individual investor in the private fund cannot be less than 50,000 EUR in denar equivalent. This commitment must be realized at the call of the company for managing private funds in accordance with the provisions of the prospectus.
- A private fund is established and managed by a company for managing private funds.
- For the establishment of a private fund, the company for managing private funds adopts the statute and prospectus of the fund.
- The private fund can incur debt without restrictions.

Legislation Item	Features	
Regulator	Is the regulation parallel and separate from UCITS (Undertaking for Collective Investment in Transferable Securities) regulation/Is regulation of systemic issues and manager separate (“Twin Peaks”)/Any regulatory “Sandbox” to encourage innovation.	Securities and Exchange Commission
Private Investment Fund	Is the identity of a PIF clearly defined and identified.	Defined as “Special Assets”, with no further clarification.
Reporting	Periodicity of reporting: annual, quarterly, monthly/Link with external auditors/Templates specified by Regulator.	Investment Prospectus must be given to Commission. Restriction on costs charged by Manager to fund. Obligation of annual audited reports for each fund under management.
Registration	Full versus light registration/Registration only or registration requiring approval-licensing/Fund and Manager required to register.	Funds must be entered into the Register of Investment Funds prior to operating. Manager must have €50K of capital, increasing by €25K for each further fund managed. Minimum size of each registered fund is €500K.
Manager Qualifications	Specificity of manager criteria/approval required/criteria for board members versus operating management.	No specifications.
Investment Policy Guidelines	Specification that investee companies must be below certain size/permitted maximum shareholding in company/diversification requirements by sector and company.	Specifies statute of Fund must specify “purposes” of Fund.
Valuation of Portfolio	Valuation criteria set by regulator or obligation by manager to communicate to Regulator/Role of external auditor/Obligation of independent 3 rd party valuation and valuer’s liability/Manager primary responsibility for valuation or other, e.g. Custodian.	Not specified.

Depository/Custodian	Necessity for custodian/Responsibilities (safekeeping, verify assets, record keeping)/Credit institution or investment firm/Level of legal liability.	No requirement.
Corporate Structures	Permitted corporate structures for Fund and Manager/Partnership, LLC, PLC, other/Partnerships with or without legal substance.	Fund must be a Private Investment Fund, with minimum term of 5 years. Manager can be an LLC or joint stock company.
Qualified Investor	Definition of QI/Institution or HNWI/Qualification for individual QIs, e.g. Salary, net worth ex residence/Distinction between HNWIs with and without investment experience	No QI definition. Specifies that private fund investors must invest at least €50K per investor.
Marketing	Restriction on marketing to public/Treatment of reverse solicitation and “pre-marketing”.	Advertising funds is open to mass media or in any other manner, but content must be submitted to the Commission prior to publishing it.
Private Placement	Registration and reporting criteria/maximum number of investors/criteria for eligible investors, e.g. QIs only.	Not covered.
Leverage	Restrictions on leverage level of the Fund/Regulation of the security that can be given, e.g. LP commitments, portfolio company holdings/Treatment of subscription lines.	Allowed unlimited.
Remuneration of Manager	Fixed, discretionary and non-discretionary variable/Reporting of remuneration/Guidelines on permitted remuneration.	Should be defined in prospectus.
3rd Party Manager	Permissions to use 3 rd party manager/Provisions to ensure arrangement not merely cosmetic, e.g. substance tests.	Not covered.

Diversity	Any diversity criteria such as gender or other/Mandated quotas or other criteria/At board level or also manager level.	Not covered.
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Appendix 6 – Bank Survey Questions

1) How many SME clients do you have?

2) How does your bank classify a company as an SME (fill in all that apply)

Total Assets < Euro

Total Revenues <Euro

Total Employees <

(if your bank has several sub classifications, please indicate below)

3) How many of your SME clients have had a private equity investment?

3) In your estimation, based upon your knowledge of private equity, how many of your clients could benefit from a private equity investment?

4) Which statement below best describes your knowledge of private equity?

I have first hand experience of working on a private equity transaction	
I have a good general knowledge of private equity	
I have some general knowledge about private equity	
I have a little knowledge about private equity	
I know nothing about private equity	

5) In your opinion, would a private equity backed company be a more attractive banking client?

Yes	
No	
Not sure	

6) Has your bank locally (if part of international group) had experience of co-operating with private equity funds?

Not sure	
Yes	
No	
Mother company does (if relevant)	

7) Has your bank locally made any equity investments in companies?

Yes	
No	
Mother company has (if relevant)	
Not sure	

8) Has your bank, either locally or at parent level (if part of international group), invested into a private equity fund?

Yes	
No	
Not sure	

9) Would you be interested in becoming more informed about private equity and its benefits to companies?

Yes	
No	
Maybe	

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