Private Equity in Poland and in Other Countries of Central and Eastern Europe – the Present State – and Perspectives – for the Future

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The author analyses the Private Equity investments in Poland and compares them with Private Equity market in other Central and Eastern Europe countries in 2002 – 2006. It is concluded that this kind of investment as a percentage of Gross Domestic Product is generally low for Central and Eastern Europe countries. What's more, for Poland it is even lower than the average for the rest of analysed European countries.

Besides, it is shown that Poland is the largest market of Private Equity exits in the region. However, it should be emphasised that exits are a normal part of this kind of investment and should be interpreted no other than having achieved a goal defined as completing a project.

Generally, data depicted in the paper do not seem optimistic, which requires that the countries make some encourages to attract Private Equity investors, both foreign and most of all domestic ones. Otherwise PE sector in these countries will become marginal, which will not have a good influence on the economy.

Introduction

The aim of the paper is to show the amount of venture capital/private equity investments and divestments in Poland versus Central and Eastern Europe countries. This is done by the analysis of fundraising, annual investment volume and divestments in these countries. Investments are also presented as a percentage of Gross Domestic Product. The analysis is conducted in 2002 – 2006 in order to comprise both period of not being EU members by some of these countries and the period after the 1st of May 2004. This is due to the fact that the EU membership had a great impact on the scale of private equity investments. The overall conclusion is that private equity in all CEE countries is not well developed in comparison to other countries of Europe, however it graduates and has good prospects for the future if these countries pay more attention to attracting capital to this kind of investments.

Examinations are mainly made on the basis of recent literature, as well as data gathered by European Private Equity & Venture Capital Association.

Private equity vs. venture capital

Private equity means investments on a private capital market that are linked with managing the company, leading towards generating mid and long term profits. They are a source of financing all development stages of a company.

Venture capital is one kind of private equity and means investments made in early stages of firm's development that are aimed at starting up a company or its further expansion.

Some authors name also business angels as a kind of private equity investments, however they are not included in the statistics presented beneath.

According to A. Metrick, a venture capital has five main characteristics:

1. A venture capital is a financial intermediary, meaning that it takes the investors' capital and invests it directly in portfolio companies.

2. A venture capital invests only in private companies. This means that once the investments are made, the companies cannot be immediately traded on a public exchange.

3. A venture capital takes an active role in monitoring and helping the companies in its portfolio.

4. A venture capital's primary goal is to maximize its financial return by exiting investments through a sale or an initial public offering (IPO).

5. A venture capital invests to found the internal growth of companies.[1]

It is worth emphasising that in many publications these two names (i.e. venture capital and private equity) are applied as substitutes. The author also uses this terminology.

Studies have shown that private equity is good for economies in the medium-term. In particular, this is attributed to the strong alignment of interests between Private equity General Partners and portfolio company managements. Private equity General Partners recognise that appropriate financial engineering does not in isolation provide longer term value creation.[2] Some authors proved that there is a positive correlation between venture capital and profits generated by companies,

[1] A. Metrick, Venture Capital and the Finance of Innovation, John Wiley & Sons, New York 2007, p. 3.
[2] Private Equity Going Public, Global Private Equity Report 2006, PriceWaterhouseCoopers, p.9.

their innovation, as well as good effects for the whole economy.[1] Besides, there are many publications that prove that venture capital influences knowledge creation in companies. Thus, taking all above mentioned factors into consideration, one can conclude that that venture capital indisputably has many good sides to companies and to the economy itself. This is why such countries as Poland or other Central and Eastern Europe Countries should attract private equity, which will definitely help them to build strong enterprises and economy.

Private equity investments volume

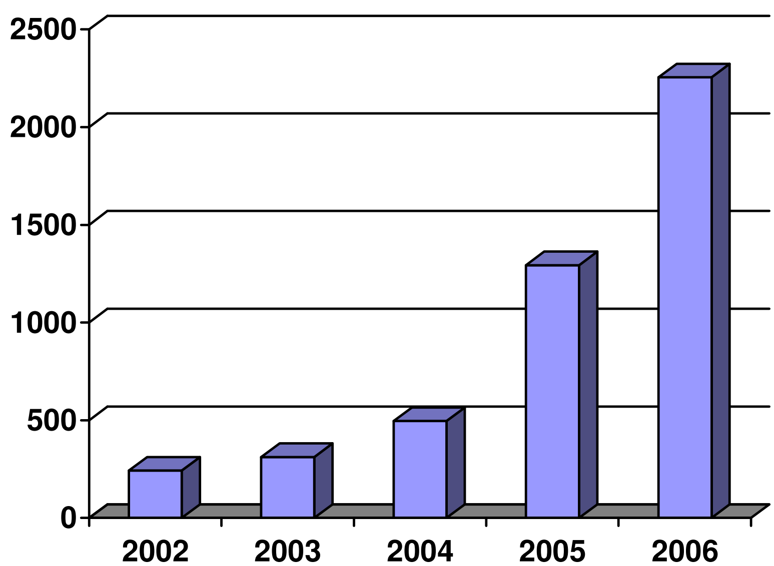
Private equity has a positive effect on companies that take advantage of it, thus countries should care about the development of this sector. The data presented beneath prove that Central and Eastern European countries started to attract private equity, however they still need some stimulations in this matter.

As it is shown in Figure 1, fundraising for Countries of Central and Eastern Europe private equity has risen gradually for the whole examined period. In 2002 it was 245 million EUR, whereas in 2003 it increased by 28% to 312 million EUR. In 2003 - 2006 the growing trend was still continued reaching in 2004 - 496 million EUR, which means a 59% growth and in 2005 achieving 1293 million EUR, which was a

[1] See f.ex. A. Brav, P. Gompers, Myth or Reality? The Long-Run Underperformance of Initial Public Offerings: Evidence from Venture and Non-Venture Capital-Backed Companies, Journal of Finance 52(5), 1997, p. 1791 – 1821; D. Engel, The Impact of Venture Capital on Firm Growth: An Empirical Investigation, ZEW Discussion Paper 02 – 02, 2002; D. Engel, M. Keilbach, Firm Level Implications of Early Stage VC Investments: An Empirical Investigation, ZEW Discussion Paper 02 – 82, 2002; R. Fehn, T. Fuchs, Capital Market Institutions and Venture Capital: Do They Affect Unemployment and Labour Demand?Applied Economics Quarterly 50(4), 2004, p. 393 – 422.; T.Hellmann, M. Puri, The Interaction between Product Market and Financing Strategy: The Role of Venture Capital, Review of Financial Studies 13(4),2000, p. 959 – 984; S. Kortum, J. Lerner, Assessing the Contribution of Venture Capital to Innovation, Rand Journal of Economics 31(4), 2000, p. 674 – 692; J. Lerner, Boom and Bust in the Venture Capital Industry and the Impact on Innovation, Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter 2002b; W.L. Megginson, K.A. Weiss, Venture Capitalist Certification in Initial Public Offerings, Journal of Finance 46(3), 1991, p. 879 – 903.

record number equal to 260%. In 2006 there was still a dramatic increase to 2254 million EUR, which accounted for 74%. The highest investments growth in 2005 can be explained by some of these countries joining the European Union, which stimulated their economies development and made it easier to attract foreign capital. It is worth noticing that this is not only in 2005, that is directly after joining the European Union, but also in 2006 when private equity investments grow. This trend gives optimistic views for the future development of this sector in the analysed countries.

Figure 1. Fundraising for Countries of Central and Eastern Europe (CEE) private equity in 2002 – 2006 [million EUR].



Source: Central and Eastern Europe Statistics 2006, An EVCA Special Paper, European Private Equity & Venture Capital Association, October 2007, p. 3

Data gathered in Table 1 prove that Poland is generally in the first three countries in 2002 – 2004 and in 2006 as far as the private equity investment volume is concerned. It is positive, however the amount of investments fluctuates and is not stable.

In 2002 Poland's investment volume was equal to 137,2 million EUR, whereas the second best country was Hungary accounting for 75,7 million EUR, however its investment volume was not much more than a half of Poland's. The third country with the biggest investment volume was Czech Republic but its investments are only about one third of these of Hungary that is 27,4 million EUR.

In 2003 it was also Poland to have been the leader with investment volume of 177,2 million EUR, which was about 19% of Poland's result at the same year. The third best country was Romania whose private equity investment volume suddenly increased more than four times in comparison to the previous year.

In 2004 Bulgaria was the first with its volume of 216 million EUR, which was 60% more than in Poland accounting for 134,4 million EUR at the same period. The third place went to Hungary which reached only 11% less than Poland, i.e. 121,6 million EUR. It is worth emphasising that Romania's growing trend in 2002 – 2003 was not continued in 2004. Its investment volume dramatically fell by more than a half, however a positive side was that in 2004 it was still about 80% higher than two years earlier.

In 2005 Hungary was the country with the biggest investment volume of 147,2 million EUR. The analysed data show that in 2002 – 2006 there was a steady growing trend there. It should be stressed as a positive side of its economy development. There is no other country in Central and Eastern Europe whose private equity investments develop so dynamically and without any fluctuations down. The second country in 2005 was Lithuania, which was rather surprising as it had extremely low investment volume both in the previous years and in the following one. There must have been some huge investment there at one time and the country does not seem to have a reasonable politics towards private equity. The third one in 2005 was Czech Republic with 109 million EUR. This country, except from 2004, had a growing trend in private equity investments in the examined years, which deserves a flattering word.

In 2006 the country with the biggest investment volume was Hungary which reached a record level for all countries of Central and Eastern Europe in all examined years, that is 734,4 million EUR, which is about five times higher than this country's result in the previous year. The second country was Czech Republic with 354,2 million EUR, however it was about half less than for Hungary. Poland was the third one with the result of 303,6 million EUR, which was only about 11% lower than in Czech Republic.

To sum up, in the analysed years, the leader in private equity investment volume was Hungary. The second best country was Czech Republic and the third price goes to Poland, although in Poland it is hard to notice a stable growing trend in private equity. In the following years probably it will be Hungary and Czech Republic to be still the leaders because these countries seen to have stable growing trends in private equity investments, which lets assume that they have some politics towards this sectors. As far as Poland is concerned, it seems to develop private equity but not as dynamically as Hungary and Czech Republic, so in the following years it may not be the third best country in Central and Eastern Europe. There may appear a new leader which is at the moment hard to predict because none of the rest of the countries seems to be definitely the best. However, if some of these countries decide to stimulate private equity investments, they may catch up with Poland and later take its position. However, there is a chance that Poland's government will also care about attracting private equity for this country, both from domestic companies and from foreign ones, and will create economic conditions to do so. Then, Poland, as a country of relatively stronger and stronger economy and of good perspectives for the future has chances to develop this sector steadily and dynamically.

Venture capital is influenced by macroeconomic factors. This problem was examined by Paul A. Gomper and Josh Lerner on the basis of the United States in 1972 – 1994.[1] The authors conclude that the most important factors are those that influence demand. Decreasing rate of income tax resulted in the increased amount of capital possessed by venture capital funds. The interesting matter was the fact that this rule applied both to institutions paying taxes and to those which are tax-free like pension funds or foundations. Demand for venture capital is created thanks to the development of the whole economy. It helps to create new companies which then use venture capital. Supply depends for example on risk free interest rate. If interest rates are rather high, venture capital investors are not eager to risk more than that. This may be one of the reasons for poor development of domestic venture capital in Central and Eastern Europe Countries. However, it is positive that interest rates in these countries have generally been decreasing recently, which gives rather optimistic forecasts for the future.

Table 1. Annual investment volume in Countries of Central and Eastern Europe private equity in 2002 – 2006 [million EUR]

Country	**2002**	**2003**	**2004**	**2005**	**2006**
Czech Republic	27,4	39,4	16,0	109,0	354,2
Hungary	75,7	110,7	121,6	147,2	734,4
Poland	137,2	177,2	134,4	107,8	303,6
Romania	18,0	82,0	32,5	70,0	110,0
Slovak Re-	4,7	4,5	7,0	19,5	19,3

[1] P.A. Gompers, J. Lerner, What Drives Venture Capital Fundraising?, NBER Working Paper No. 6906, 1999.

<table>
<tr><td>public</td><td></td><td></td><td></td><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td>Latvia</td><td rowspan="3">2,9</td><td rowspan="3">10,0</td><td rowspan="3">14,8</td><td>8,7</td><td rowspan="3">165,4</td><td>0,0</td><td rowspan="3">22,1</td></tr>
<tr><td>Lithuania</td><td>144</td><td>18,1</td></tr>
<tr><td>Estonia</td><td>12,7</td><td>4,0</td></tr>
<tr><td>Bulgaria</td><td>N/A</td><td>18,0</td><td>216,0</td><td colspan="2">0,0</td><td colspan="2">35,8</td></tr>
<tr><td>Other[1]</td><td>7,7</td><td>5,9</td><td>4,4</td><td colspan="2">19,1</td><td colspan="2">87,6</td></tr>
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Source: based on: Central and Eastern Europe Success Stories, Special Paper, Edited by the EVCA Central and Eastern Europe Task Force, Private Equity & Venture Capital Association, October 2004, p. 6 and Central and Eastern Europe Statistics 2004, An EVCA Special Paper, European Private Equity & Venture Capital Association, October 2005, p. 3 and Central and Eastern Europe Statistics 2006, An EVCA Special Paper, European Private Equity & Venture Capital Association, October 2007, p. 3

Private equity as a percentage of Gross Domestic Product

Private equity investments measured as a share in Gross Domestic Product can also be a good measure of this sector importance for the economy of any country. Data presented in the tables presented beneath confirm that private equity did not play the important role in the examined countries in the analysed years.

[1] For 2002 other means Bulgaria, Croatia and Slovenia, for 2003 – 2004 other means Croatia and Slovenia whereas for 2005 – 2006 other means Croatia, Slovenia, Bosnia and Herzegovina, Serbia and Montenegro.

Table 2. Investments as a percentage of Gross Domestic Product in Central and Eastern Europe Countries in 2002 – 2006

Country	**2002**	**2003**	**2004**	**2005**	**2006**
Bosnia and Herzegovina	N/A	N/A	N/A	0,123%	0,055%
Bulgaria	0,016%	0,101%	1,110%	0,000%	0,143%
Croatia	0,014%	0,011%	0,015%	0,002%	0,035%
Czech Republic	0,037%	0,052%	0,019%	0,112%	0,315%
Estonia	0,010%	0,022%	0,004%	0,120%	0,031%
Hungary	0,110%	0,154%	0,150%	0,167%	0,883%
Latvia	0,011%	0,031%	0,120%	0,068%	0,000%
Lithuania	0,008%	0,036%	0,007%	0,070%	0,076%
Poland	0,069%	0,098%	0,069%	0,045%	0,118%
Romania	0,037%	0,159%	0,055%	0,088%	0,115%
Serbia and Montenegro	N/A	N/A	N/A	0,030%	0,150%
Slovak Republic	0,018%	0,016%	0,021%	0,052%	0,045%
Slovenia	0,007%	0,015%	0,000%	0,007%	0,130%
TOTAL	0,054%	0,088%	0,096%	0,073%	0,218%

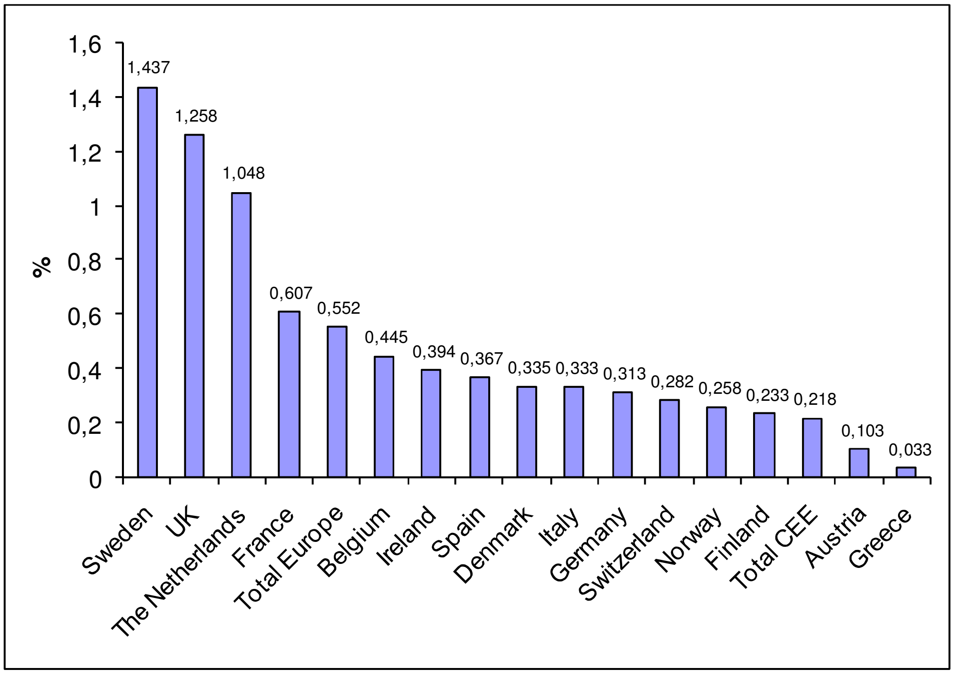
Source: based on: Central and Eastern Europe Success Stories, Special Paper, Edited by the EVCA Central and Eastern Europe Task Force, Private Equity & Venture Capital Association, October 2004, p. 6 and Central and Eastern Europe Statistics 2004, Special Paper, Edited by the EVCA Central and Eastern Europe Task Force, European Private

Equity & Venture Capital Association, October 2005, p.3 and Central and Eastern Europe Statistics 2006, An EVCA Special Paper, European Private Equity & Venture Capital Association, October 2007, p. 3

As far as private equity investments as a percentage of Gross Domestic Capital are concerned (see Figure 2), in 2006 the average for total Europe is 0,552%, whereas the average for Central and Eastern Europe countries is 0,218%, which is more than a half lower. It is not surprising because Central and Eastern Europe countries are generally less developed than the rest of Europe. Their economies were transformed from central to market not so long ago, thus it is obvious that they need some time to catch up with others. Table 2 leads to similar conclusions as Table 1. To be exact, Hungary's private equity investments have grown steadily, which was discussed above, and also their share in Gross Domestic Product was higher and higher every year reaching 0,883% in 2006, which was even more than the average for total Europe. The second country with a big share of private equity in Gross Domestic Product in the examined period was Czech Republic which in 2006 reached 0,315% of Gross Domestic Product. The rest of countries had much smaller shares of private equity in Gross Domestic Product and are not worth attention in this context.

The concluding remark is that Central and Eastern Europe countries have generally lower amounts of private equity investments as a percentage of Gross Domestic Product that the rest of Europe and thus need some stimulations in their economies to attract domestic and foreign capital to this sector because private equity influences companies and economies in a positive way. It is then worth consideration.

Figure 2. Private equity investments as a percentage of Gross Domestic Product for Europe in 2006



Source: based on EVCA data

Private equity divestments

Exits are a part of the private equity investment and they can be interpreted as completing the task, which usually means realising some earlier assumed project. They are strictly connected with the investment value that is countries which are leaders in investments are generally leaders in divestments, although there may appear some small differences.

As data depicted in Table 3 show, Poland was the biggest market of private equity divestments in Central and Eastern Europe in 2002 - 2006.

In 2002 divestments at cost in Poland were equal to 79 million EUR, which was 59% of the total divestment value in the region. The second country of biggest investments was Czech Republic with 20,6 million EUR, which accounts for only 26% of Poland's result from the same period. The third one was Hungary with the value of 13,3 million EUR being 65% of Czech Republic's.

In 2003 Poland was still the leader as stated earlier, with 108,2 million EUR, that is about half of the total for Central and Eastern Europe countries. The second price goes to Hungary with the amount of divestments equal to 41,6 million EUR, which was only 38% of Poland's results. The third one was Romania that reached the amount of 26,2 million EUR, i.e. 63% of Hungary's divestment value. It is worth emphasising here that Baltic States had a little bit higher divestments (27 million EUR) than Romania, however this category stands for three countries that is Latvia, Lithuania and Estonia, and it is hardly probable that any of them had bigger divestments on its own than Romania, especially when one looks into the following years when their divestments values were not impressive at all.

In 2004, after Poland accounting for 85,9 million EUR (that is 70% of the total divestment value in the region), there came Czech Republic with 18,4 million EUR, which is almost five times lower amount than the one for Poland. The third best was Romania with 10,8 million EUR, accounting for only less than 9% of the total divestment value in the region.

In 2005 Poland's divestments increased by 24% to 106,9 million EUR, which enabled to retain the leader's position for the fourth year. The second country of the highest divestments was Romania with 87,5 million EUR, which was a dramatic increase for this country by more than eight times in comparison to 2004. The third best one was Czech Republic with the amount of 69,9 million EUR that is 25% less than Romania but still 17% of the total value for Central and Eastern Europe countries.

In 2006 Poland's divestments rose by 29% to 137,6 million EUR compared with the previous year. The second country was Czech Republic accounting for 115 million EUR that is 84% of Poland's result from the same period. Czech Republic's result in 2006 is worth emphasising because it is almost twice as big as one year earlier and a few times higher than in the previous years. The third one was Romania with its 63,2 million EUR, which was 28% less than in 2005.

To sum up, although Poland's divestment value is all the time the highest in Central and Eastern European countries, its share in the total divestment value of these countries decreased in 2002 – 2006, which means that other countries develop their private equity sector quicker and in the future Poland's role may be diminished. Its most important competitors in the private equity sector are Hungary and Czech Republic. It is proved both by investments and divestments values in Central and Eastern Europe, which is obvious because divestments are generally correlated with investments which should come first.

Table 3. Divestments at cost by Central and Eastern Europe Countries in 2002 – 2006 [million EUR]

Country	**2002**	**2003**	**2004**	**2005**	**2006**
Czech Republic	20,6	13,7	18,4	60,7	115,0
Hungary	13,3	41,6	0,9	36,8	31,7
Poland	79,5	108,2	85,9	106,9	137,6
Romania	12,9	26,2	10,8	87,5	63,2
Slovak Republic	1,0	13,2	1,7	69,9	8,2
Bulgaria	N/A	N/A	N/A	22,4	58,9

Baltic States	7,3	27,0	3,5	16,4	20,0
Other[1]	0,0	6,0	1,5	21,2	7,1
TOTAL CEE	134,7	235,9	122,6	421,7	441,6

Source: based on EVCA data

Final findings

Private equity investments in Central and Eastern European countries are not as high as in the rest of Europe. However, if one takes into consideration that these countries' economies are at lower stages of development at the moment, it is not so surprising. Although the existing data are not so positive, a big advantage is the fact that they care about private equity sector, which may bring some good results in the future. The best developed private equity sectors are in Hungary and in Czech Republic. Then come Poland and Romania. These countries generally had the highest amounts of both investments and divestments of all Central and Eastern Europe countries. What's more, Hungary had a bigger share of private equity in the Gross Domestic Product than the average for the rest of Europe.

The future shape of the private equity market in Central and Eastern Europe will be directly influenced by macroeconomic factors as well as by governments' efforts to attract both foreign and domestic capital to this sector. If their economies are stronger and stronger, private equity will have big chances to develop rapidly. The present economic indicators are rather positive, interest rates have been decreasing, so one can expect that private equity will develop further in these countries and that in a few years at least some of Central and Eastern Eu-

[1] For 2003 – 2004 other means Croatia and Slovenia whereas for 2005 – 2006 other means Croatia, Slovenia, Bosnia and Herzegovina, Serbia and Montenegro.

rope countries will achieve the level of other, well-developed countries of Europe.

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