
INVESTMENT FUNDS AND PRIVATIZATION PROCESS IN SERBIA

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Abstract: Both existence and efficient functioning of economic systems, which enable a greater, cheaper and quality production of material goods and services, rely, as a rule, on a relatively free market and private property as two inseparable assumptions of their efficient functioning. The construction of such systems can not end with ownership transformation and liberalization of internal and external economic flows. It is an important precondition for the functioning of such systems, but at the same time, just the beginning of their construction. The decisive role in raising efficient capital allocation at all levels has the construction of a sophisticated, open and competitive market which should be adjusted to the country's financial system. This implies the construction of a whole series of new financial institutions and fundamental reconstruction of the existing ones, the introduction of a large number of new financial instruments, especially in the form of securities, a thorough personnel reconstruction and innovation of educational institutions, but also the change of awareness of the broad social layers on the assumptions and modes of efficient operation. In that respect, investment funds play an important role.

Key words: *privatization, investment funds, regulation, financial instruments, capital*

The privatization process itself was followed by a series of legal and institutional constraints. Laws in this field did not have the adequate support of the necessary legal solutions in the sphere of financial and judicial regulation. The beginning of privatization took place under the following limitations: a lack of institutional framework for the implementation of laws from this field, a lack of corporate governance in companies, a lack of shareholder culture and tradition,

a high level of security illiteracy, unreliable financial and business information of companies, a lack of legal sanctions for the non-signing of the small stockholders free stock trade management prospect, a low level of knowledge and professionalism of broker-dealer and investment consultants, a lack of effective practice in resolving financial disputes, etc. That is why the role of the Stock Fund in attracting foreign investors, especially the financial ones, was incomparably more difficult, since it has a key role in the investment decision of a potential investor for each capital market in the emergence of liquidity. The appearance of the Stock Fund in the stock trading on the Belgrade Stock Exchange also meant a lot of reactivation of the stock exchange and the creation of capital markets. That was a parallel process of privatization and capital market development. Namely, as a single largest stockholder in privatized companies under the previous regulations and with *the legal provision on time deposit* (from 2008), the Stock Fund started stock trading as one of the methods in the privatization process and it contributed to increasing the volume of turnover on the stock market with its permanent presence from month to month.

Share trading from the privatization process on the Belgrade Stock Exchange thus gave way to the development of the capital market.

The basic role of the development of the stock exchange business and the capital market is for the companies to appear on the official stock exchange listing where the liquidity of trading in stocks would be established and the financing of companies would be enabled through the collection of free capital on the market, which is in direct correlation with the principles of the Stock Fund in the privatization process (*inflow of investments, development of the financial market - capital markets, maximization of privatization revenues*). The stock market has been established through the sale of stocks from the Stock Fund portfolio, which improves the depth and breadth of the market in an adequate way and contributes to the development of gradual liquidity.

Also, in accordance with the accompanying developments on the stock market in the phase of capital market formation, the Stock Fund, in cooperation with the Belgrade Stock Exchange, participated in adapting the stock trading methodologies from the privatization process with the goal of overcoming the observed anomalies and practical experiences in the realization of the stock sale and the development of the capital market. In that sense, certain stock trading methodologies have been complemented in the way of enabling the prevailing price method, in addition to the method of Stock Fund minimum price, which allowed the increase in the volume of turnover by selling smaller quantities of stocks in several transactions, on the one hand, and the prevention of the trend of reducing the number of listed companies on the Stock Exchange.

In addition to the organized market at the Stock Exchange, with the application of the Law on the Market of Securities and Other Financial Instruments in the beginning of 2004, it became possible to trade with an off-exchange method, ie, take over, as an integral part of the developed

financial markets. Furthermore, the Law on Business Companies, the Law on Investment Funds and the Law on Pension Funds additionally accelerated the qualitative and quantitative development of the capital market.

In accordance with the goals of the privatization process acceleration and further development of the capital market, amendments to the Law on the Stock Fund and the Law on Privatization (2005) have been implemented, *which, in a preventive manner, achieve the following goals:*

- achieving a higher level of publicity in the businesses of the companies in which the Stock Fund has stocks, which is in the function of the privatization process acceleration; namely, in order to increase the protection of state capital, accelerate the privatization process and develop the capital market, the Stock Fund has acquired stockholder rights which is important for the preservation of the property or the value of the shares;
- ex ante, but not the ex post operation of the Stock Fund in the implementation of the protection of the state property value, and indirectly protection of the assets of minority stockholders,
- acceleration of the privatization process in several ways (amendments to the law predict several methods of selling stocks),
- the obligation to submit "the Prospect" for stock trading at the Stock Exchange.

The effects of privatization are manifested through a change in the stock market structure, increased liquidity, broadcasting and sale of the stocks, starting the process of corporate governance, improvement of the overall investment climate, so that these effects are just as important as direct effects (increase in investment, production, export of employment ...) to the privatized company. A successful realization of privatization and achievement of a higher level of capital market development represent one of the foundations on which the future growth of the Serbian economy is based, and at the same time, with parallel processes of privatization and capital market development the maintenance of the internal and external macroeconomic stability will be enabled.

The parallel process of privatization and capital market development in our country started in 2002 with the first sale of stocks of the companies from the Stock Fund portfolio in the privatization process on the Belgrade Stock Exchange, as before the stocks were traded sporadically and with the stocks of a small number of companies on the Stock Exchange. Since then, a large number of domestic companies have been included in the stock market, which, in that period, managed to significantly increase the level of corporate governance, business and financial performance and to meet the strictest international accounting standards for stock listing. Also, the privatization of public companies in the coming period will make Serbia's capital market respectable and send a message to potential investors for making long-term investment decisions and their presence on it.

In particular, the A listing of the Belgrade Stock Exchange should be noted, because it is a listing whose conditions for the stock listing are in line with those that are valid in the developed markets and which are the strictest in the region, so listing A is a kind of business prestige for

every company that decides to offer their stocks there. Companies that choose to list their stocks in this official capital market are becoming interesting for attracting powerful institutional, portfolio investors that are prevented by regulations from investing in unofficial markets.

Investment funds represent one of the most important types of financial institutions in the world. They will certainly play a key role in the creation, development and affirmation of the portfolio management functions as the basis for efficient capital allocation in our country. In order to achieve this, there is a need for quality financial assets, primarily the emergence of a number of different ones, primarily long-term government and corporate securities in the financial market.

Considering the fact that according to the basic rules of the portfolio theory, a portfolio consisting of twenty stocks through diversification provides protection from a so-called unsystematic risk, investors in such portfolio, which matches the investment fund portfolio that invests in stocks (property growth fund), enjoy the same protection against risk.

If an active portfolio management, or an active investment strategy, is conducted, it would imply that, on the basis of the performed analyzes, periodic corrections are made, i.e. purchase and sale of stocks, and in this way the structure of the portfolio is changed.

Hemofarm from Vrsac is a very illustrative example of the growth in the stock price of certain companies in the privatization period in our country. Namely, the stocks of this company first appeared on the Belgrade Stock Exchange in early February 2002, when the price for one stock was 450RSD, while on July 18, 2006 one stock was worth 12,000RSD.

The example of Hemofarm is not lonely in the privatization process in our country; on the contrary, there were a number of successful domestic companies from all economic sectors, from production to service ones, whose owners became foreign investment funds, or foreign companies, as well as domestic companies with capital of unknown origin. The privatization process often took place in a non-transparent manner, and the participants in it, especially small stockholders, did not know enough about the regulations in this field, so the change in ownership in companies was very often carried out at book values that were far below the market ones.

All these facts point to one question: why were the laws in this field late, especially the Law on Investment Funds and the Law on Voluntary Pension Funds?

Strategy of foreign investment funds in Serbia

Since the beginning of the privatization period in our country, the first foreign investment funds, which started buying in our capital market, appeared. Their business philosophy is mainly as follows: *buy, restructure, sell at a higher price and make a profit from the difference in price.*

Illustrative example of their business strategy is the one of the investment fund Salford, which came to Serbia in 2001 and since the following year has had an open office. The fund bought five dairy companies (Imlek, Impaz, Zemun, Subotica and Novosadskaya) in Serbia through the recapitalization process, except for Zemun, which was purchased on the stock exchange, and two confectionery industries (Bambi and Banat), as well as a significant participation in the ownership of Knjaz Miloš. Total investment of Salford in Serbia is approximately \$300 million, and in 2008, they started with sales, expecting

to achieve a total price of \$ 750 million for all the companies.

Salford and other investment funds are coming to transition countries to earn money. Earnings in the West are about 10 to 12 percent per year. By arriving at risky markets, funds may lose but they can also earn much more than in the west; Salford accounts for an annual profit of between 20 and 25 percent in our market. This fund invested significant funds in the restructuring of purchased companies with the aim to bring the quality of raw materials and finished products closer to the ones of the European Union.

And while the results in the production and marketing of milk can be somewhat challenged by the monopoly position of this fund, the results achieved in the confectionery industry are in favor of the proper orientation of this fund. Namely, by merging Bambi and Banat and reconstructing them, a growth of 40% was achieved in 2007. Before the fund took over, the total income of both companies was 32 million Euros, and in two years it reached 70 million Euros.

The business strategy of this fund in our country was defined the moment they entered our market, and it foresees the exit period during 2008 and 2009, i.e. the sale of most of the purchased companies. The plan is to keep the minority share in some of the companies, to increase it and to sell it in the next three years. In the long-term plans of this fund, there is an intention to reinvest part of the money in Serbia. The achieved results in this business are the best reference for the arrival of new investors in our country.

It is obvious that foreign investment funds have great experience and knowledge in the field of investment and performance in new markets that are much more risky but also bear a possibility of high growth in the value of the fund.

Investment rules can be best studied on the example of Warren Buffett, who was named the best investor of the 20th century.

Buffett set himself a difficult goal: to surpass the Dow Jones Index by ten percent a year. That is what he achieved, even more than that. In the period from 1956 to 1969, Buffet achieved an average annual profit by 22% higher than Dow Jones. At that time, he took control of the small textile company Berkshire Hathaway and in a 35-year period he raised the book value from \$ 19 to \$ 37,987 per stock, which represents a growth rate of 24% per year.

V. Buffett believes that, basically, there is no difference between a purchase of a business as a whole (the company) and a purchase of securities of that business (company). In both cases, the same strategy is applied: businesses that are understood are chosen - companies with long-term prospects, which are managed by honest and professional people and which are available at attractive prices.

***Business (company) buying guide
– Buffett's 12 Golden Rules:***

Business rules

- 1- Is the business simple and understandable?
- 2- Does the business have a stable history?
- 3- Does the business have good prospects in the long run?

Management rules

- 1- Does management make rational decisions?
- 2- Is the management honest with its stockholders?
- 3- Does the management resist the institutional imperative?

Financial rules

- 1- Focus on the stock capital income, not on earnings per stock.
- 2- Calculate the "owner's earnings".
- 3- Look for a company with a high profit margin.
- 4- Make sure that the company makes at least one dollar of market value for each retained dollar.

Market rules

- 1- What is the value of the business?
- 2- Can you buy a business at a lower price than its real value?

Buffett rules for managing a portfolio of securities:

- 1- Manage a focused portfolio with low turnover volume.
- 2- The key thing is to choose the right moment to deliver a blow
- 3- The best way to achieve extraordinary results: don't swing at everything, wait for the best pitch
- 4- The best way to outsmart the market: do not rely on everything the market offers; wait patiently for the right opportunity.
- 5- You should use index funds to calculate the average value of your purchases. It's a simple technique; however, the index investors have actually surpassed most professional investors.
- 6- Do not measure the success of a company on the basis of the price change of its securities in a short term. Instead, analyze the economics of the business.

- 7- Imagine yourself in the role of the portfolio owner of a specific business, not of a securities portfolio.
- 8- Learn to distinguish between investments and speculations and make sure you never exceed the thin line that separates the two.

Buffett's investment strategy rules:

- 1- Analyze securities as a real business behind them.
- 2- Require a security threshold for each purchase.
- 3- Manage a focused securities portfolio of small number of clients.
- 4- Protect yourself from the speculative and emotional forces of the market.

Conclusion

The strategic determination of investment fund management companies in Serbia is to contribute to the further development of the investment environment in Serbia and more profitable exploitation of all its potentials through their innovativeness and experience of their teams. The establishment, organization and management of investment funds represent a response to the growing need of both domestic and foreign investors to meet their

investment needs through appropriate placements.

The joint intention of the investment fund management companies is to form and manage a number of different investment funds on the investment market of Serbia in the coming period, and thus profile and adjust their services to the needs of their clients in the best possible way. In addition, the absolute respect of the highest professional standards and the ensurance of lasting satisfaction of all the members of the funds that the companies manage, have been and will remain the backbone of the entire future business.

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