Unlocking the World for Central and Eastern European Champions

By JOHANNES P. HUTH
Member & Head of KKR EMEA

MARTIN RAJČAN
Investment Executive - Central and Eastern Europe; Energy & Infrastructure

and TOMÁŠ KUBICA
Investment Executive - Central and Eastern Europe; Technology & Communications
About the report

Twenty five years after the fall of the Berlin Wall, the broader Central and Eastern Europe (CEE region) is once again a flashpoint of global geopolitics. With heightened tensions surrounding Ukraine and Russia, the risk perception of CEE has increased in the eyes of many international observers and investors alike.

That perspective ignores the tremendous progress CEE countries have achieved in their governance, economies, and institutions over the past quarter century. We believe that investors would be well-served to adopt a more constructive view in looking at CEE: as a region that has achieved notable albeit uneven gains over the last 25 years, is largely converging with the rest of Europe, and could serve as an incubator to thriving, competitive companies.

Where the CEE region is still underdeveloped, however, is in its ability to develop true CEE ‘champions’ – firms that succeed both at the national or regional levels and in the international marketplace.

In this KKR Global Institute paper, we discuss why we are optimistic about the prospects for the CEE countries and how companies in this region can overcome some of the common obstacles they face. Our observations are based on extensive dialogue with CEE entrepreneurs and companies to understand their aspirations and concerns. In our view, this dialogue has made clear that there is real potential for CEE to be on the global map as an attractive, highly investable region and that global investors can positively contribute to the internationalization of local champions by providing growth capital, experience, and networks.
1. Introduction: A Compelling Region

Central and Eastern Europe (CEE) is home to world-renowned talent even though the world does not always recognize its origin. Insulin, modern contact lenses, parachutes, the Rubik’s Cube, Skype, and several of the world’s leading computer anti-virus companies all originated in Central and Eastern Europe.

Those significant achievements illustrate the potential for CEE to make valuable contributions to the global marketplace and also highlight the need for companies and investors to pay close attention to the region. While historically often overlooked or considered too risky by many investors, the region has come a long way since the fall of communism. A majority of CEE countries have become members of the European Union (EU), the North Atlantic Treaty Organization (NATO), and the Organization for Economic Cooperation and Development (OECD), and the general political, economic, and business environment has improved significantly.

CEE is not uniform; there is significant variation and fragmentation within the region. Population sizes range from Estonia, with only 1.3 million inhabitants, to Poland, a country of nearly 40 million people. Eleven countries are members of the EU, all having joined in the past decade; six are candidates at varying stages of accession and displaying varying degrees of determination. CEE countries also differ in overall governance, institutional strength, and business climates. Understanding these differences is critical for investment and business success in the region.

Notwithstanding intra-regional variations, from an investor perspective, the CEE region offers an attractive set of fundamentals:

- The CEE region has significant scale. Its combined population exceeds 100 million, and last year’s gross domestic product (GDP) of about $1.4 trillion was larger than that of the Nordic...
The CEE economies have performed relatively strongly by most measures. CEE real GDP growth rates over the last 15 years have outperformed those of the Eurozone, with an average annual growth rate of 3.1% between 1999 and 2013, compared to 1.1% in the Eurozone. Going forward, as shown in the chart below, the IMF forecasts real GDP at purchasing power parity (PPP) to grow in CEE on average by 1.4 percentage points higher than that in the Eurozone. The government debt is at approximately 50% of GDP in CEE, compared to around 100% in the Eurozone area and the U.S.  

CEE countries’ existing (and for some, forthcoming) memberships in the EU, OECD, and NATO have created a more stable and integrated economic market. While there is still work to do to integrate markets and regulations, most visibly in the energy sector, the countries are converging with Western Europe. Slovakia, Slovenia and Estonia have already adopted the euro as the single currency, with other CEE countries expected to join the Eurozone in the next decade. The political environment has been largely constructive with the embrace of pluralistic, multi-party democracy following the collapse of communism – a historic achievement – although, notably, in a few countries in CEE, these gains are coming under pressure from corruption, populism, and backsliding on judicial independence, rights protection, and free press. Broadly, however, legal, regulatory, and business conditions have advanced and standardized considerably across CEE, which has been shaped by the common EU acquis adopted as part of EU accession for some in CEE.  

The CEE, because of its location, is ideally situated for building trade links between Western Europe, the Middle East, and Asia. The region has access to the Adriatic, Baltic, Black, and Mediterranean Seas and has significantly improved road and rail infrastructure in recent years and has become deeply integrated with pan-European transport corridors;  

The region benefits from a well-educated and inexpensive workforce with particular strengths in technology and engineering. From 2001 to 2012, the percentage of the CEE labor force with tertiary qualifications increased by ~11 percentage points to 24%, versus an increase of ~7 percentage points to 29% in the Eurozone. The average wage in CEE is less than one third of that in developed Europe; and  

CEE also enjoys increasingly supportive tax regimes with favorable corporate tax rates ranging from 10% in Bulgaria to 22% in Slovakia, compared with ~30% in Germany and an OECD average of more than 24%.  

While the region exhibits several positive characteristics and some notable achievements, the global success of CEE companies lags on average behind those in other European and international markets. For comparison, Israel and Sweden, two countries with relatively small populations (both less than 10 million), have each produced more global companies than the entire CEE region combined. To  

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2 The Nordic region consists of Denmark, Finland, Iceland, Norway, and Sweden.  
4 Measured at purchasing power parity to remove price and currency effects. Excludes Estonia due to data comparability issues.  
6 The European Union’s acquis is the body of common obligations and rights that is binding on all member states. EU candidate countries are required to accept the acquis prior to membership.  
7 Albania, Bosnia & Herzegovina, Macedonia, and Montenegro are excluded due to data availability issues.  
illustrate, there are just 11 CEE-based companies listed on NASDAQ compared with 62 from Israel. In the Global Forbes 2000 list, there are ten companies from all of CEE (seven from Poland, two from Hungary, and one from the Czech Republic), compared to 26 from Sweden alone.

With such attractive market fundamentals, why does the CEE region have so few global champions? What are some of the lessons from other countries that could be applied to CEE? And, what can we learn from some of the true CEE success stories, which, despite the odds, have managed to flourish internationally?

In order to attempt to answer these questions, we have drawn upon our institutional knowledge of having evaluated investment opportunities in the CEE region and across Europe, as well as extensive dialogue with entrepreneurs and CEOs of the region’s leading companies, regional experts, and other government officials. In this paper, we review the key challenges CEE companies face in penetrating the global markets. We then offer a set of considerations for the public sector and aspiring CEE companies, identifying potential ways to tackle those challenges. We aim to draw lessons from CEE champions as well as pan-European KKR portfolio companies that have succeeded internationally.

We have not attempted to cover either the region’s macro-economic or geopolitical situation in depth; our aim is to provide a ‘battlefield’ business perspective based on our experience. We neither have nor offer all the answers, but we hope our observations can contribute to the debate among private and public stakeholders in CEE on how to propel private sector champions and, thereby, accelerate growth of the region.

10 Nasdaq citing FactSet, data supplied June 16, 2014.
2. Key Challenges

There are several obstacles that CEE companies must overcome to expand successfully beyond their home markets. While some challenges are structural and difficult to change (e.g., smaller, fragmented markets), most are linked to the more nascent stage of these countries’ respective economies and free market development. Such factors include more limited financing alternatives, less mature corporate governance practices, brain drain, low entrepreneurship recognition, and a lack of global outlook. As countries in CEE develop further, globalization continues, and generations turn over, we believe those difficulties can be largely overcome or mitigated and conditions for local entrepreneurs thereby improved.

As countries in CEE develop further, globalization continues, and generations turn over, we believe many of these difficulties can be overcome and conditions for local entrepreneurs thereby improved.

a. Fragmented Markets

CEE companies face significant challenges in reaching a large number of customers. While the large size of the U.S. enables growth companies to scale up fast in a single-language market, the fragmented nature of the markets across CEE means rolling out a cross-border business, even through consolidation, often remains a slow and challenging process.

EU members benefit from a largely harmonized legal framework, but certain barriers continue to hinder international growth: uneven sector developments in different EU markets, small populations, different currencies (outside of the Eurozone), and multiple languages, cultures, and customer tastes. Dealing with disparate tax regimes is also cumbersome.

Such a broad range of differences across CEE highlights the importance of having an adaptable business model that can be tailored to the specific needs of each country. For instance, certain products, particularly those aimed at consumers (rather than business to business, or B2B), may only sell well in a handful of countries. Creating a large, international business which relies on meeting the needs of different countries can be difficult, time consuming, and costly.

b. More Limited Availability and Acceptance of Financing Alternatives

The relatively short private sector history in CEE also means a less developed understanding and utilization of different financing sources by companies there. Banks have been the traditional funding alternative for CEE companies, but bank loans are often inaccessible, and sometimes not advantageous, for earlier-stage companies that need them most. Non-bank financial institutions emerged in the 1990s, but given their poorer risk management and more aggressive practices, many ended in bankruptcy. Public markets are generally under-developed in CEE (with Poland being a notable exception), with the total market capitalization of the region at ~$340 billion, or only ~23% of GDP, compared to 63% of GDP in the Euro zone.12

Private equity and growth capital is generally available in CEE, but it is less widespread compared to Western European markets. The CEE region represents only 2% of total European private equity activity, compared to 8% of GDP.13 CEE entrepreneurs are often resistant to raising equity from third party investors, often due to wariness of losing some autonomy, even if the new capital and fresh ideas would help the company accelerate its growth. Consequently, international investors, especially those focusing on providing growth capital, are less present, discovering the region only gradually. Venture capital and seed financing, from local venture capital funds, angel investors, or accelerator platforms, are relatively more advanced, as young entrepreneurs have a more open approach to raising external financing and accelerating growth.

Improved access to and familiarity with different financing sources would allow companies to grow faster and consequently attract even more capital to the region — reinforcing a positive virtuous cycle.

c. Less Mature Corporate Governance Practices

Entrepreneurs in CEE have typically not been accustomed to fully-developed corporate governance best practices. Many family businesses have only recently started professionalizing their management teams and few companies have invited non-executive members to bring fresh perspectives to their boards. In time, efforts by the EU to raise governance standards across the continent should benefit the CEE ecosystem through enhanced transparency and more effective board representation. Greater diversity and higher corporate governance standards are also likely over time to lead to more innovative, better-run, and more transparent businesses.

12 Market capitalization data as of September 8, 2014, from Bloomberg; 2013 GDP sourced from the IMF World Economic Outlook. A total of the 3,000 largest listed companies in each region used as a proxy for the total market capitalization.

d. Brain Drain

CEE is renowned for its technology expertise, due largely to the popularity of studying engineering – an educational background shared by many of the world’s most successful entrepreneurs and businesspeople. However ‘brain drain’ is a concern, whereby, many of the most talented engineers leave the region to pursue advanced studies or higher-paid, more entrepreneurial opportunities abroad. Only a small proportion of this talent finds its way back home.

This trend, in turn, has contributed to a lack of well-known entrepreneurial role models in the region to inspire the next generation. In addition, the founders of large and successful companies in CEE do not tend to seek public profiles, despite the success they achieved. Many of the most talented students or entrepreneurs thus think about moving abroad and succeeding away from home, rather than developing international businesses from their own countries.

e. Low Interest in and Recognition for Entrepreneurship

A long tradition of engineering and technical expertise means CEE ought to have a wealth of innovative entrepreneurs. However, unlike in other regions where entrepreneurs are highly regarded, many young professionals in CEE do not set up their own businesses. A positive exception is the Baltic region, where entrepreneurship has gained significant traction in recent years. In our view, slow progress in other countries may be explained by several reasons:

- First, as previously mentioned, the current generation did not grow up with local entrepreneurial role models. Indeed, before the end of communism in 1989, there were hardly any private companies whatsoever;

- Second, the public reputation of entrepreneurship is rather mixed in CEE, where post-communist privatization processes often rewarded politically connected insiders. Entrepreneurship often has a negative association with corruption and achieving success in a relatively short period of time is often viewed with suspicion. Negative public perceptions of entrepreneurship also seem to be an issue across numerous EU countries, not only CEE. According to a recent European Commission survey, more than half of respondents in the EU believe that entrepreneurs ‘think only about their own pockets’ and ‘take advantage of other people’s work,’ compared with less than one third in the U.S., and

- Third, entrepreneurs in CEE are concerned about not succeeding and subsequently suffering from a public stigma of failure. By contrast, in the United States, failure is often considered a badge of honor. An entrepreneur who saw his startup collapse and moved on to succeed with a new venture or in a more traditional corporate career is seen as more experienced, more driven, and resilient. This fear of failure is a Europe-wide issue; according to

the same European Commission survey, 50% of respondents in the EU said the risk of failure would deter them from starting their own businesses, compared with only 28% in the U.S.

As a result, the best students in CEE are often attracted to corporate, banking, or consulting career, rather than setting up their own businesses. Attracting high caliber employees to startups is even more challenging since the experience and reward is perceived as too low and the risk too high.

f. Lack of Global Perspective

Entrepreneurs in CEE often see themselves and their businesses as part of CEE or perhaps Europe more broadly but rarely as part of the global business system. CEE companies tend to benchmark themselves more to local or regional peers than to best practice global competitors. That said, the younger generation is increasingly connected to the international markets (by often studying or working abroad), has more international connections, and is able to speak fluent English, while older generations often lag behind in those respects.

Also, CEE companies often need to fight negative perceptions or misconceptions from potential Western customers or business partners. Regional companies are perceived as less experienced in dealing with international clients, and products with CEE origin are often seen as of lower quality compared to Western equivalents (this is more applicable to consumer goods and less so for technology products). Some CEE companies have adopted international names or branding and started selling to international markets from foreign subsidiaries to circumvent this problem.


15 Albania, Bosnia & Herzegovina, Macedonia, and Montenegro are excluded due to data availability issues.
3. CEE Champions

There are many CEE companies which started small, dreamt big, and succeeded over time. There is no single path to follow – each company succeeded in its own way; however, there are some common traits and lessons to be learned from their successes. CEE champions used their comparative advantage (often a technology/engineering edge or a low cost manufacturing position) and the founders’ passion and dedication to carve out a strong position in the global marketplace. We have included here a small selection of such companies.

Czech Republic

Linet, a Czech Republic based manufacturer of high-end hospital and nursing beds, was founded in 1990. Shortly after Linet’s inception, the company established a close working relationship with a German hospital beds company Wissner-Bosserhoff, which complemented Linet’s offering and used its position as a Western player to export Linet’s products outside of Central Europe. The partnership created one of the largest European specialists in beds for medical and residential care. Linet Group produces approximately 120,000 beds a year and exports them to more than 100 countries.¹

Inglot Cosmetics, which makes long-lasting makeup, has succeeded in exporting its products globally in an industry in which brands, reputation, and origin are under particular scrutiny from consumers. The company was founded in Poland more than 30 years ago and began its international expansion in 2006 with a franchise store in Montreal, Canada. Since then, Inglot has become available in 57 countries on six continents and can be bought at more than 450 locations. Inglot succeeded through employing the latest technology, using high-quality ingredients, offering a wide range of products to suit different customers’ preferences (a variety of more than 1,500 colors), and charging fair prices (enabled by lower manufacturing costs compared to Western peers). In addition, the company cooperates with world-renowned makeup, and color artists to bring the latest color, texture and form trends and developments to the market.

Polish bus and tram supplier Solaris Bus & Coach has built its success around CEE’s engineering talent, industrial heritage, and lower cost of production. The business was founded and is still owned by a couple, Solange Olszewski and Krzysztof Olszewski, a mechanical engineering graduate. Solaris initially employed a staff of 36 and since production began in a village in Western Poland in 1996, the company has supplied more than 10,000 vehicles, which continue to run in 28 countries all over the world. The company now employs more than 2,000 people in its own region as well as more than 300 in its foreign subsidiaries.

One of the most successful and well-known global CEE champions, security software provider AVG is listed on NYSE with a market cap of around $1 billion and serves about 182 million active users. AVG, founded in 1991 by Jan Gritzbach and Tomáš Hofer in the Czech Republic, played on CEE’s technology and engineering expertise a key competitive advantage in the region, in our view. While still operating under the brand GRISOFT, AVG launched its first anti-virus product in 1992 to its local market and in the late 1990s was already selling worldwide using an international distributor network. Since 2001, AVG has partnered with private equity firms, which provided necessary capital and know-how for international expansion. In 2012, the company completed its initial public offering on NYSE. The company has offices in the U.S., including one close to Silicon Valley, Canada, Australia and across Europe, and is managed by an international management team.

Michal Stencl, the co-founder and CEO of GPS navigation systems provider Sygic in Slovakia, began programming at the age of seven. In 2004, he launched Sygic to supply GPS navigation for smart phones. In 2009, Sygic Mobile Maps became the world’s first navigation for the iPhone available on Apple’s App Store and fast became the top grossing application on the App Store in ten countries. The following year, Sygic Aura became the world’s first 3D navigation system. Today, more than 50 million users in 115 countries use the Sygic GPS navigation applications on a daily basis.

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4. Unlocking the Global Marketplace

Notwithstanding significant obstacles, we believe that the CEE region has the necessary fundamentals to develop into a thriving region that can produce successful global players across sectors. There are a number of initiatives and focus areas for the public sector and for companies that could help develop a more constructive environment for nurturing CEE champions; we include some of those as suggestions below.

a. Priorities for the Public Sector

While the success or failure of an enterprise should be determined by the forces of the free market, government policies and actions can also have a strong impact on the general entrepreneurship, business, and investment climate of a country. As articulated in the EBRD’s Transition Report 2013, many CEE countries are at risk of getting “stuck in transition” due to slow progress on strengthening economic institutions, driving structural reforms, investing in education and human capital, and promoting economic inclusion. In addition, regrettably, several countries in the CEE region fall toward the bottom of rankings for corruption and ease of doing business. These national considerations can easily deter potential international business partners and also hinder the effective formation and functioning of the domestic market, and therefore should be a subject of broader and much-needed government attention.

The public sector can play a unique role in creating conditions to enable CEE companies to grow beyond their region, to go above and beyond the critical political and macroeconomic considerations necessary for local market development. Experience from other countries points to several practical government-led initiatives that can help propel global CEE champions:

I. CREATING A BUSINESS- AND ENTREPRENEURSHIP-FRIENDLY ENVIRONMENT

Governments can meaningfully improve the business environment by establishing a business-friendly legal, financial, and tax framework. The ease of doing business differs radically across CEE – while the Baltic countries are ranked among the top 25 countries in the world (ranks 17-24, which represent top ~13% out of 189 ranked countries), most of the CEE countries are ranked 45-75 (top 25-40%), with Bosnia and Herzegovina closing the CEE list at 131. The most often cited complications include setting up a business, dealing with construction permits, paying taxes, and protecting investors.

Corruption is another complication that makes it difficult for young businesses to succeed against more established players, which may at times ‘bend’ the rules of the game. As mentioned by some local entrepreneurs, in certain sectors, for example construction and healthcare, the high degree of perceived corruption may deter new entrants who wish to play fair from even entering and competing. Transparency International ranks CEE countries roughly in the middle of the pack in its corruption perceptions analysis. Estonia is ranked #28, indicating lowest corruption in the CEE, followed by Poland at #38, Czech Republic at #57, and lastly Albania at #116. According to a Eurobarometer survey carried out in 2013, corruption is perceived as a widespread issue across most CEE countries, with all, except for Estonia, being worse than the EU average.

Entrepreneurship in CEE does not always carry the best reputation. Historical corruption and privatization issues have resulted in suspicion, often combined with jealousy, about entrepreneurial success stories. Students and young professionals do not generally yearn to start their own businesses. The perception is changing, as evidenced by the Czechs voting into power last year a new party led by a high profile entrepreneur and more recently the Slovaks electing an entrepreneur-turned-philanthropist as their president, but the progress appears slow and uneven to many. Governments could more proactively drive the improvement in the public perception of the entrepreneurial career path through deliberate advocacy and targeted education initiatives.

Estonia provides an example of how countries can propel improved governance and entrepreneurship with the use of modern technology. The Estonian government bet on technology and digitization when upgrading its infrastructure in the early 1990s and thus leapfrogged the paper era. Today, 98% of bank transfers in Estonia are done online, 25% of people vote over the Internet, and health records are stored in the cloud. It takes on average 15 minutes to register a company and five minutes to file an annual tax return online, enabled by digital signatures and online background checks. This investment in technology also helped to drive down corruption in Estonia and encouraged a culture of entrepreneurship. Estonia benefits from the highest number of startups per capita in the world, and high-tech industries account for about 15% of GDP.

II. PROVIDING TARGETED FINANCIAL SUPPORT

There are mixed views on the benefits of governments providing direct financial support to the private sector. National governments across CEE support local startups through direct investment, often in the form of low-interest loans or free grants, frequently subsidized by EU funds. While those funds provide capital to the often needy startup

community, they also can push out the initially more expensive but also more value-adding VC funding, which in addition to capital for growth, can also provide advice and coaching to new entrepreneurs.

Proven areas suitable for government funding include university research, education projects (as further described below), and projects aimed at strengthening physical and digital infrastructure. Investments in national and international highways, fast broadband, and mobile networks all benefit the private sector, as well as society at large, making it more efficient and competitive in an international setting.

In Israel, the government launched the Technological Incubators Program, which oversees technology ideas before they are ready for private investment. The Israeli government has also partnered with the U.S. government to set up the BIRD (Bi-national Industrial Research and Development) Foundation, which seeks to partner Israeli technology companies with U.S. corporates with sales and distribution networks, to create mutually beneficial joint ventures. CEE governments could consider establishing similar programs to help prepare early-stage companies for private funding as well as establish links with foreign governments and the international business community.

III. ESTABLISHING REGIONAL TECHNOLOGY CLUSTERS

According to the cluster theory first laid out by an economist Alfred Marshall in 1890 and later popularized by Michael Porter in 1990, companies and whole industries can develop faster if they are concentrated in the same area, facilitating the exchange of information, experience, innovation, and talent. The most famous clusters are Silicon Valley (technology), London and New York (finance), and multiple Chinese provinces (low-cost manufacturing).

Due to its low-cost labor advantage, stable investment environment, and central geographic location, the Czech Republic and Slovakia have developed an automotive cluster with many international automotive manufacturers, suppliers, and service providers setting up their local operations. Low-cost manufacturing is not an attractive and sustainable business niche, however. Its focus on low value-add production (with engineering, research and development often located abroad), and low labor cost advantage provides only a temporary edge, which is gradually being eliminated by higher economic growth and convergence.

We believe that one of the CEE’s competitive advantages is a large pool of high quality technical and information technology (IT) talent, and many of the current CEE global champions have succeeded thanks to tapping into this. The region’s governments could thus facilitate the creation of national technology hubs, connecting their universities, research centers, corporations, startup incubators, and local investors. Governments could support the hub with initial funding and mobilizing state-owned universities and publicly-funded research institutions, which would subsequently attract the private sector. National technology hubs could then be linked across the region to create a CEE technology network, forging relationships across the region. An internationally recognized CEE technology hub would in turn attract more international investors and also help prevent the outflow of the most talented entrepreneurs and engineers abroad.

Well-connected and integrated venture hubs and technology clusters have played an important role in creating thriving entrepreneurial ecosystems in Israel, the Nordic countries, and in other areas of Europe. There are 20 accelerators in Israel, out of which 18 are technology focused. In addition, the country has lured many global corporates including Google, which in 2013 unveiled Campus Tel Aviv, a hub for developers and entrepreneurs, and Microsoft, which in 2006 launched the Israel Research & Development Center as an expansion of the technology activities the company had run in Israel since 1991. The Swedish venture landscape is equally buzzing. SUP46, a meeting place for startups and investors launched in 2013 and whose partners include the Swedish government, is on a mission to make Stockholm the world’s number one startup city. STHLM Tech Meetup, a regular event for the Stockholm technology community, has more than 2,000 members and Sting, which describes itself as an ecosystem for startups in Stockholm, provides business development support including a business incubator, an accelerator program, and an international network of investors. Europe boasts several other notable technology hubs, including London, Berlin, Paris, Amsterdam, Barcelona, and Helsinki, which are often connected through personal, business, or investment relationships.

IV. CREATING CONDITIONS FOR THE RETURN OF THE LOST TALENT

To address the brain drain of many of its most talented citizens, governments can support international opportunities for its citizens while also making it more attractive for people to return home. Many young Scandinavian professionals leave their countries to spend the early part of their careers abroad but return home to settle down, attracted by the favorable social system and work-life balance, bringing back with them their valuable international experience.

Many of the initiatives already mentioned – strengthening the business environment or creating leading regional technology hubs – can help in reducing the outflow of local talent abroad as well as luring talent back. However, more can be done to send a positive signal to diaspora members that they are welcome to return. Estonia launched a targeted campaign, “Talents, come home,” in 2010 to appeal to young professionals who had left the country. It offers practical information for the return back home, and it collects and advertises attractive job positions for people with international experience.

Developing a corrective brain drain strategy is not only about convincing talented citizens to return home; equally important and beneficial for the countries is fostering strong relationships with and among their citizens when they are abroad. Emigrants can support their home countries by establishing business links or cooperation opportunities in the fields of culture, arts, or research and development. Tomáš Červenka, a Cambridge-educated Chief Technology Officer at London-based technology company VisualDNA, has recently set up an IT development center in his native Slovakia to leverage the local IT talent and have an opportunity to spend more time in his home country. There are many formal and less formal events being organized for expatriates to strengthen their links to their home countries and establish relationships among themselves.

22 The Technological Incubators Program.
23 STHLM Tech Meetup.
V. INCREASING EDUCATION QUALITY

The quality of education in CEE is generally considered good, yet with significant variations across countries. While Estonia, Poland, Slovenia, and the Czech Republic rank above the OECD average in secondary level math and science, Albania, Bulgaria, Montenegro, Romania, and Serbia fall well below the average. At the tertiary level, technical faculties focused on IT, engineering, and mathematics have a strong reputation internationally. In 2013, 16 out of the 24 finalists of Google’s annual Code Jam programming competition were from CEE. In 2014, computer science students from three CEE universities (University of Warsaw in Poland, University of Zagreb in Croatia, and the Comenius University in Slovakia) won silver and bronze medals at the ACM International Collegiate Programming Contest, a prestigious international programming competition with ~2,300 participating universities from 94 countries.

There are two areas where CEE education systems lag behind international best practices. First, while students are generally well equipped with hard skills, there is limited focus on soft skills development. CEE teaching methods are generally based on listening to the teacher and memorizing facts, rather than students working in teams to come up with their own solutions, presenting them in class, and thus building important social and communication skills and self-confidence. Second, although improving, basic entrepreneurship education and training is largely non-existent at primary and secondary level. It is also very limited at university level, being largely restricted to business faculties only and often completely missing from technical schools. Junior Achievement, a U.S. non-profit organization which focuses on ‘turning kids of today into entrepreneurs of tomorrow,’ has made great progress in this regard across multiple CEE countries, but the rollout is still limited.

There is no doubt that CEE students can be competitive at the international level. To sustain and further improve this position, universities, which are generally publicly funded and do not charge tuition fees, need to receive adequate financial support to invest in research and development and equally important, to attract and retain quality professors who often prefer more lucrative careers in the private sector at home or abroad. Well-funded and resourced universities are more likely to attract the highest caliber professors, generate research breakthroughs for commercialization, and encourage the best students, who are often lured out of the country by generous scholarships to foreign universities and research centers. In addition to government money, universities can explore research partnerships with the private sector, which could provide additional sources of funding while offering students relevant work experience. Finally, with technology advancement, there are numerous online and technology-enabled educational methods, including distance learning and massive open online courses (MOOCs), which can bring quality content and instruction to students irrespective of their location.

d. Priorities for Companies

The public sector can contribute to creating a favorable business environment, but it is the private sector that will successfully drive international growth. We have summarized below a few lessons observed among other CEE champions as well as from our experience.

I. BUILDING ON COMPETITIVE ADVANTAGES

Successful global companies often rely on building a business around the strong competitive advantages of their respective regions. For example, U.K.-based school operators have expanded internationally into Europe, Southeast Asia, and Latin America, leveraging the strong reputation and brand of U.K. education. Many Africa based companies have integrated themselves into the global agricultural and horticultural supply chain, leveraging the region’s unique climate, labor costs, and demographic dividend.

Swedish companies have recognized that succeeding with mainstream products outside of their domestic markets is more difficult. By the time they develop a tailored product, international markets are saturated. The most successful companies have thus focused on niche sectors, in line with their competitive advantage, where they can differentiate from lower-cost players. For example, Sweden’s Sandvik has focused on high-end engineering machine tools, while Volvo Trucks specialized in high-quality heavy trucks. Both are successful companies that benefitted from Sweden’s engineering tradition and which have been able to carve out strong global positions.

CEE countries also have competitive advantages. For CEE as a region, notwithstanding country-to-country variations, the main differentiating factors include a large pool of high quality technical and IT talent, engineering, and industrial heritage, strategic location between major consumer markets, lower labor costs, and in some cases (Poland and Serbia, for example) arable land. Many local companies have leveraged these advantages to build truly global players; good examples are CEE antivirus companies, which benefit from the large availability and high quality of IT talent.

II. THINKING GLOBALLY

The target market for many CEE companies should not end at national, regional, or European borders; the entire world is their potential marketplace. From our experience, in many industry sectors, especially technology, it is easier to think globally from the very start, rather than focus on the local market first and then try to expand. Successful technology leaders from the CEE region – AVG, Eset, Sygic, and Telerik – started developing their products with a global perspective. Similarly, when it comes to business, Israeli and Swedish entrepreneurs, cognizant of their small home countries, target the U.K., Germany, and the U.S. as their priority markets from the beginning.

For Israel or Scandinavia, global citizenship is part of their cultures. Extensive travel, study or work abroad programs, and English language fluency all contribute to fostering a global outlook and perspective. Similarly, when it comes to business, Israeli and Swedish entrepreneurs, cognizant of their small home countries, target the U.K., Germany, and the U.S. as their priority markets from the beginning.

Thinking globally does not mean spending time and resources on international expansion before the business model is established but rather by adjusting the company’s mindset, internal and external
communication, and business strategy with a global marketplace in mind. This is where market fragmentation within CEE and Europe more generally may be an advantage: local entrepreneurs in CEE gain experience by dealing with different countries, cultures, and languages early on, in contrast to their U.S. peers. Some specific suggestions for adopting a more global approach include:

- **Developing an internationalization strategy**: CEE companies may want to identify priority international markets, based on expected product and service demand, competition, and market size, and develop a go-to-market approach for each priority market. Targeting B2B customers or finding distribution partners may be an easier way to break into new markets to establish a presence, rather than focusing on a direct greenfield business to consumer (B2C) strategy;

- **Catering products to the customer base**: Different countries have different preferences. Slovenian multi-channel retailer Studio Moderna, backed by a group of growth equity firms, found that an important component to its international success has been its strategy to tailor products and marketing to the specific needs of each local market. The business now operates in 21 countries across Europe;

- **Adapting positioning, marketing, and communication**: CEE companies may wish to think about international, easy-to-pronounce product brand names, develop a company website and marketing materials in multiple languages, avoid culturally-biased or sensitive advertising, and make cultural adjustments where appropriate. Showing the international customer case studies can establish higher comfort in the company’s ability to serve them globally, regardless of location or origin. Marking products ‘Made in the EU’ can – for some CEE countries – be a potentially strong advantage versus other non-EU low-cost competitors;

- **Opening offices in the global centers**: We see many CEE companies opening small representative offices in major global cities to be closer to their customers and add to their global image. Relationships with international customers, media, or investors develop faster with face-to-face meetings; being in the same time zone as important contacts also makes the interaction easier. It is important to avoid incurring high fixed costs; one or two salespersons and a local address may suffice. As an example, a Czech social analytics company, Sociabakers, opened a small London office with a public relations person and a small sales team, allowing it to gain greater customer, media, and investor visibility, while the large majority of the staff remained in the Czech Republic; and

- **Hiring staff, especially in sales, with international background and experience**: CEE companies should think about looking for people with study and work experience abroad, or expatriates living in the country, building a global outlook, international cultural awareness, and language capabilities early on.

### III. PURSUING INORGANIC GROWTH OPTIONS

Many entrepreneurs focus exclusively on organic growth to scale their business. We agree that growing customers in a cost- and capital-effective way should be the priority, but we also believe that there can be significant benefits from pursuing inorganic growth opportunities. Completing targeted acquisitions can bring access to new international markets and customers, improvements in technology, extensions to existing product portfolio, and the addition of new management talent. From our experience, smaller acquisitions often result in higher synergies, lower execution risk, and easier integration, compared with large transformational mergers.

Another avenue to consider is establishing partnerships with selected international distribution or manufacturing partners, who can bring the required knowledge and experience to enter the international markets. This would involve giving up some economic benefits, but it may allow the companies to scale more quickly and at a lower risk.

It is important that inorganic growth options complement the overall business strategy. For example, KKR previously invested in BMG Rights Management, a music rights business, in a 50/50 joint venture with Bertelsmann, a leading German media conglomerate. KKR and Bertelsmann supported the business through its industry knowledge, contacts, and experience. During the four-year ownership, BMG had completed seven acquisitions, which was a major contributor to its overall growth.

The target market for many CEE companies should not end at national, regional, or European borders; the entire world is their potential marketplace.

### IV. STRENGTHENING CORPORATE GOVERNANCE AND MANAGEMENT

The CEE business environment and corporate governance best practices are less developed compared to Western markets. Many successful CEE businesses are still led by their founders, who are approaching retirement age and have often not adequately prepared their companies for eventual succession. Bringing the founder’s children to the business is often the most obvious and frequent way for ensuring continuity in the business, but that may not always be a viable or preferred option.

Retaining and empowering professional management can solve succession issues, as well as bring new perspectives and ideas to the business. Bringing in new management or developing internal candidates well ahead of the founder’s eventual retirement to provide sufficient time for training, hand-over, as well as assessment of
the new hires, is typically a good way of de-risking management transition.

Even if there are no succession issues, significant benefits can be accrued from bringing new talent to the executive management ranks or to the boardroom as non-executive directors. For example, SBB/Telemach Group, a leading provider of pay television and broadband services in the countries of former Yugoslavia in which KKR recently invested, added to its advisory board Boris Nemšić, a Bosnian/Croatian/Austrian national and a former CEO of Telekom Austria and VimpelCom, who is an expert on the Balkan region and telecommunication industry. Well-selected additions can benefit a business by sharing best practices from their prior experience, contributing their industry contacts, and providing a more independent sounding board for new ideas and initiatives. Well-designed incentive schemes with equity upsides are often necessary to attract high caliber candidates and retain them for the long term.

V. EXPLORING DIFFERENT CAPITAL ALTERNATIVES

In order to fund international growth, execute on potential acquisitions, or bring in new talent, companies may need to re-examine their funding sources. Reliance on savings or self-generated profits is a suitable option in many situations, which may result in lower risk and full equity retention by the original founders. However, in faster changing sectors, more significant investments may be required to be able to differentiate oneself from the competition. With increasing globalization, CEE companies are no longer only competing against each other but also need to keep pace with the international developments.

Finding a strong financial partner, which can support the company by injecting capital and also through its know-how and international contacts, can lead to a potential “win-win” situation. A well-selected financial sponsor can help the founder and management team to professionalize the organization, enter new markets, bring industry and regional expertise from other investments, and open up its network of contacts for potential customer, supplier, or partnership opportunities. Private equity backing has stood behind many of the CEE international successes, including AVG, a leading antivirus provider from the Czech Republic or HTL-Strefa, the world’s leading producer of personal lancets and pen needles for people with diabetes from Poland.

In addition to considering partnering with a financial sponsor, companies may also wish to explore other financing alternatives to fund their growth and potential acquisitions. In today’s environment, debt financing (both bank loans and public bonds) is relatively cheap and can provide companies with sufficient capital for international growth as well as acquisitions. In some cases, and despite their somewhat mixed reputation, EU’s structural funds, aimed at reducing regional disparities between EU regions, can be an attractive alternative for funding expansion projects, especially for developing new infrastructure or employing more people. Funding from a development bank, such as EBRD, can be another attractive alternative, especially in the less developed countries of the CEE region.
5. Conclusion

Over the past 25 years, the CEE region has experienced strong albeit uneven economic growth, democratization, and political development. Most CEE countries have integrated into the Euro-Atlantic security and governance architecture or are in the midst of doing so; capitalism has broadly taken root in the region; and citizens’ disposable incomes have increased although there is need for continued growth. The region’s strategic location and educated, low-cost labor force, have attracted significant foreign direct investment. The convergence process has successfully started, and the gap between Western Europe and CEE has narrowed significantly.

During this time, while foreign investors have moved into the region, private CEE companies have started branching out internationally. Their starting position has been challenging, characterized by a lack of entrepreneurship experience, limited international know-how, an immature business environment, and constraints on access to capital. Yet success stories – truly global companies with a CEE origin – have emerged, underscoring the region’s potential and comparative advantages.

Companies, governments, and investors have roles to play in overcoming the remaining obstacles to propel more CEE companies to the global stage. Many companies in CEE stand to benefit from adopting a more global outlook and adapting their business models to the international marketplace, while taking advantage of their unique comparative advantages. Governments can do more to support the private sector by strengthening their business climates and legal systems, combating corruption, and investing in education and infrastructure, while avoiding interference in otherwise well-functioning market processes and resisting the siren songs of populism and democratic backsliding. Rather than being deterred by headline risk or stereotypes, investors should pay greater attention to CEE, seeking out opportunities to be long-term partners for the next generation of entrepreneurs and sharing their experience and knowledge, rather than just providing short-term capital.

The bottom line is clear: a quarter century after the fall of the Berlin Wall and the demise of communism in CEE, we are optimistic about the region’s prospects. We believe that the next 25 years for CEE can be marked by further convergence with Western Europe and the emergence of global champions, bringing valuable innovation to the global marketplace. The people of CEE inspired the world in 1989 by peacefully standing up for their dreams; we are confident that, over the next quarter century, they can harness their talents to realize their region’s enormous economic potential too.

Tale of Two Salesmen

Tomáš Baťa, the founder of Baťa, a leading shoe company founded in the Czech Republic in 1894, was fond of telling the story of how he sent two salesmen to explore market potential in Africa.

One sent home the following message: “No one here wears shoes. No potential.”

The second salesman responded: “Everyone here is barefoot. Infinite potential.”

Baťa was known for his optimism, courage, and hard work to make his dreams a reality.

Bata Shoes today serves a million customers a day through 5,000 locations in 60 countries globally.
About the Authors

JOHANNES P. HUTH
KKR, London
Member & Head of KKR EMEA

Johannes Huth joined KKR in 1999 and is a Member of KKR and Individual Partner of Kohlberg Kravis Roberts & Co Partners LLP. Mr. Huth is responsible for KKR’s operations in Europe, the Middle East, and Africa. He has participated in investments including Wincor Nixdorf, Zumtobel, Demag Holdings, MTU Aero Engines, DSD, Selenia, Kion Group, NXP Semiconductors, Pro7 Sat1, BMG, Wild, and Württembergische Metallwarenfabrik AG (WMF). He is currently a member of the supervisory board of Kion. He serves as vice chairman of the Supervisory Board of NXP BV. He is a member of the Advisory Board of Wild Flavors GmbH, Chairman of the Supervisory Board of WMF, and member of the Board of Hertha KG auf Aktien. Prior to joining KKR, Mr. Huth was a member of Investcorp’s management committee and was also responsible for the firm’s operations in Europe. Previously, he was with Salomon Brothers, where he was a vice president in the mergers and acquisitions departments in London and New York. Mr. Huth holds a B.Sc. with highest honors from the London School of Economics and an MBA from the University of Chicago. He is Chairman of the Trustees of the Private Equity Foundation, Vice-Chair of the Board of Trustees of the Design Museum, trustee of the Staedel Museum in Frankfurt, and a governor of the London School of Economics.

MARTIN RAJČAN
KKR, London
Investment Executive - Central and Eastern Europe; Energy & Infrastructure

Martin Rajčan joined KKR in 2009 and is responsible for regional coverage of the Central and Eastern European markets and is also a member of the Energy & Infrastructure industry team. While at KKR, he participated in investments including Acteon, Avincis, Consorcio Shushufindi, FlowStream Commodities, OEG Group, and U.N. Ro-Ro. Prior to joining KKR, Mr. Rajčan worked in the investment banking division of Morgan Stanley in New York, Singapore, and Hong Kong. He is a trustee of NESsT, a charity focused on increasing labor participation of marginalized groups in middle income countries. A native of Slovakia, he holds a B.A. with valedictorian honors from Middlebury College, Vermont.

TOMÁŠ KUBICA
KKR, London
Investment Executive - Central and Eastern Europe; Technology & Communications

Tomáš Kubica joined KKR in 2012 and is a member of the Central and Eastern European and Technology & Communications teams. Mr. Kubica, a Slovak by origin, has been involved with KKR’s investments in the SBB/Telemach Group (KKR’s first direct investment in the CEE region), Arago, Acteon, Avincis, and TDC. Before joining KKR, he was with Goldman Sachs International in London and McKinsey & Co in Prague, where he worked on numerous projects and transactions across Central Europe. Mr. Kubica received his degrees from INSEAD and State University of New York Empire State College / University of New York in Prague, both with valedictorian honors.
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