Investing in Bulgaria

Tuesday November 29 2016

www.ft.com/reports | @ftreports

Vacuum at the top threatens to hinder progress

The new president's first move will be to call a general election, explains *Kerin Hope*

Bulgaria's reputation for political stability compared with some of its neighbours has come under threat after this month's election of Rumen Radev, a former national air force chief with no previous political experience, as president, by an unexpectedly large margin.

Mr Radev, an independent candidate backed by the pro-Russian Socialist party, appealed to many voters as a patriot without connections to the country's mistrusted political class. His popularity soared when he piloted a MiG-29 fighter jet in an aerobatics display at an aviation show outside Sofia two years ago. The performance attracted more than 1m YouTube views.

Even before the election result was confirmed, Boyko Borisov, the prime minister, announced his resignation as head of a coalition government led by his centre-right Gerb party. The vote was seen as a personal defeat for Mr Borisov as Tsetska Tsacheva, Gerb's presidential candidate and the speaker of parliament, had been his own choice.

While the Bulgarian presidency is not a US or French-style executive position, it carries some meaningful powers, such as the right to reject legislation and the task of brokering the formation of a new government at times of political disarray. Mr Borisov's resignation leaves the country without effective leadership and with no chance of holding an election before next April at the earliest.

According to the constitution, outgoing head of state Rosen Plevneliev cannot call another election so close to the end of his term. Also Mr Radev can only fix an election date after he takes office on January 22 and it must be set for two months later.

The country faces the awkward prospect of being run by two successive caretaker administrations. Following the elected prime minister's resignation, Mr Plevneliev is responsible for putting together a caretaker leadership until Mr Radev takes over, after which Mr Radev will have to do the same. In an effort to avoid this, Mr Plevneliev has called for "consultations" with a cross-party group of senior politicians, including Mr Radev, in what would be the first test of the president-elect's political independence from his Socialist backers.

Rumen Radev: 'Pro-European does not mean being anti-Russian' — Darko Vojinovic/AP

To some observers in Sofia, Mr Radev represents the latest example of Moscow's influence in a country that was the Soviet Union's closest satellite in the communist period and remains largely dependent on Russian natural gas. Opinion polls show that more than two-thirds of Bulgarians have positive feelings towards Russia, which is credited with liberating the country from Ottoman rule in the late 19th century.

Mr Radev, who speaks fluent English, German and Russian and studied in the US at the Air War College in Alabama, pledged that as president he would work to end EU sanctions against Moscow for its annexation of Crimea and intervention in eastern Ukraine. He also stressed Bulgaria's commitment to the western system, saying its membership of the EU and Nato is not negotiable. He added: "But to be pro-European doesn't necessarily mean being anti-Russian."

Despite widespread dissatisfaction with both main parties, Gerb is likely to beat the Socialists at a general election but would not be able to win an outright majority, says Ognian Shentov, chairman of the Center for the Study of Democracy, a Sofia think-tank. "Borisov will come back with a strong counter-attack [following the presidential defeat]," he says. "Gerb also has an edge outside Sofia and other cities."

Gerb controls three-quarters of municipalities and local government officials have ensured that EU largesse is spread as widely as possible, especially in regions of high unemployment.

Few observers predict that Gerb would be able to capture more than a 25-27 per cent share of the vote. That would leave Mr Borisov struggling to form another coalition government under the pressure of a looming deadline: Bulgaria is due to take over the EU's six-month rotating presidency in January 2018 and will need time to prepare for its European responsibilities.

Most of Gerb's half dozen possible coalition partners seem unappealing. Echoing Europe's rising populist trend, three so-called "patriotic parties" representing rightwingers of different stripes have gained ground, even though only one, the ultranationalist IMRO, is likely to capture a significant share of the vote.

The fractious Reformist Bloc, Gerb's natural ally as the other main pro-European party, may not meet the 4 per cent of the vote threshold for entering parliament. Otherwise, there is the Movement for Rights and Freedoms, representing

Continued on page 2

Inside

Foreign investors must look beyond enduring problems

Business environment

The government has made efforts to encourage foreign companies, but the travails of one UK-based property company illustrate potential difficulties, says *Kerin Hope*

Bulgaria remains less appealing to international companies than its larger neighbour Romania across the Danube, yet investment flows steadily into a variety of sectors, from automotive components and IT to logistics and food processing.

Foreign direct investment stock, a measure of the total amount of foreign investment in a country at a given time, has risen from $23bn in 2006, before Bulgaria joined the EU, to $42bn in 2015, although it is down from its 2013 peak of $51bn, according to Unctad, the UN body overseeing trade and development. The fall in investment was largely due to the collapse of a private Bulgarian bank which had several foreign shareholders and the shrinking of operations by subsidiaries of an Athens-based bank hit hard by the Greek crisis, according to an independent consultant in Sofia.

On the other hand, new investment in manufacturing and services has shown a modest increase rising from €1.2bn in 2010 to €1.6bn in 2015, according to data collected by InvestBulgaria, the government agency for promoting foreign investment.

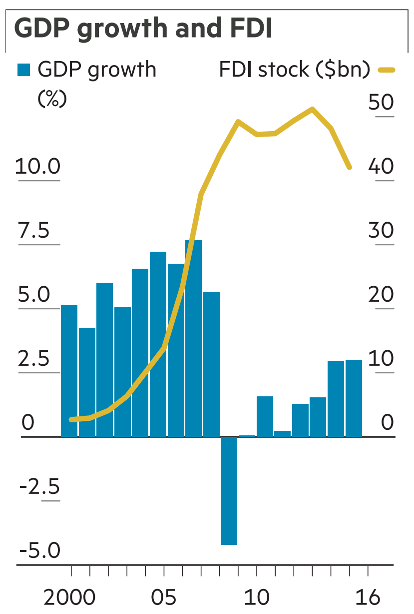
Investors will be taking advantage of low wage costs and a flat tax rate of 10 per cent on corporate profits and personal income, the lowest in the EU.

"We're a natural bridge between east and west . . . Companies can invest in Bulgaria and expand across Europe," says Stamen Yanev, executive director of InvestBulgaria. He gestures towards a map of Bulgaria depicting a swath of special economic zones across the country where investors are allowed to buy land below market prices.

In regions of high unemployment, investors also enjoy tax breaks on reinvested profits and subsidies on social insurance payments, he says.

Efforts are under way to accelerate procedures for issuing of permits and licences to investors in manufacturing and services, long a source of friction with foreign companies preparing to enter the Bulgarian market.

GDP growth and FDI



FT graphic Sources: IMF; Unctad

The situation is already markedly different in the fast-growing technology sector: start-ups, outsourcing companies and software developers are all exempt from most licensing requirements.

"The IT sector in particular is getting serious investment partly because of the skilled workforce available but also because these companies don't have to go through a permitting regime," says Alex Nestor, vice-president of the American Chamber of Commerce in Sofia.

However, despite making progress with governance since EU accession in 2007, there is still much to be done.

"It's well known that Bulgaria has problems with high-level corruption in politics and the justice system, we are publicly castigated by the EU in this respect. But successive governments have been reluctant to address this problem," says a Sofia-based lawyer speaking on condition of anonymity.

> Investors benefit from low wage costs and a flat tax rate of 10% — the lowest in the EU

Bulgaria is ranked 50th overall out of 138 countries in the World Economic Forum's latest competitiveness report. But WEF ranks it at only 110th and 115th when it comes to independence of the judiciary and security of property rights.

Sofia-based lawyers advise their foreign clients preparing to sign a contract with a local partner to insist on a clause permitting arbitration outside Bulgaria in the case of a dispute. To reduce risk further, they also suggest setting up an investment partnership abroad, so that only the operating company is based in Bulgaria.

"When it comes to property rights outside the special economic zones our advice is to make sure that title deeds are translated and that a history of title transactions is compiled," one lawyer says.

The travails of East Balkan Properties, a UK-based property company, underscore the risks associated with investing in a poorly regulated property market where there are doubts about judicial independence.

Until February, Glorient Investment Bulgaria, a local affiliate of East Balkan that specialises in building retail premises, was receiving rent regularly from 22 outlets of Technomarket, a Bulgarian electrical goods retailer from whom it bought the properties 10 years ago.

But now Glorient says NSN Investment, a company that acquired Technomarket early this year, is suing Glorient claiming its deals with the retailer are invalid and the properties still belong to Technomarket. Rents on the outlets have not been paid since the dispute began, according to Glorient's lawyer.

"We're extremely worried about this breach of property rights in an EU member state," says Michael Uhler, East Balkan managing director. Glorient is contesting NSN's claims in court in Bulgaria.

NSN could not be reached for comment about the dispute.

Despite the UK property owner's current predicament, Sofia-based observers say the majority of partnerships between Bulgarian and international businesses now operate more smoothly than previously.

It helps that international chambers of commerce, sectoral business associations and western diplomats lobby actively on behalf of investors facing problems.

Russian gas dependency almost over

Energy

Bulgaria and its EU partners have made progress on cross-border pipeline routes and other projects, writes *Tony Barber*

Nothing better illustrates Bulgaria's fast-changing energy prospects than the confidence with which government ministers and industry specialists predict the end of their nation's almost complete dependence on Russian natural gas.

In January 2009, Bulgarian citizens shivered and industry shuddered to a halt when a Russian-Ukrainian dispute abruptly cut off Russian gas piped through Ukraine to central and eastern Europe. For the EU, it was a shock to see how vulnerable new member states, liberated in 1989 from Soviet political control, were to a Russian gas embargo.

According to Temenujka Petkova, the outgoing energy minister, Bulgaria and its EU partners have absorbed the lesson of the 2009 crisis. "We've worked in a focused way to avert a similar situation by going for diversification of routes and sources of supply. Our actions are within an overall EU energy policy framework. There's no way we'll reach a 2009-type situation again," says Ms Petkova.

Gazprom of Russia, which is the sole exporter of gas to Bulgaria, supplies more than 90 per cent of the Balkan nation's annual gas consumption. Overall, Bulgaria depends on Russian imports for three-quarters of its primary energy resources — coal, gas, nuclear fuel and oil.

However, with EU and US support, the outgoing centre-right government has made progress on reducing Bulgaria's reliance on Russian energy.

The most ambitious plans involve the opening of cross-border pipeline routes with four neighbours — Greece, Romania, Serbia and Turkey — and a joint Bulgarian-Greek project to build an offshore liquefied natural gas terminal in the northern Greek port of Alexandroupolis.

"Gazprom is in absolutely no position to play the gas card any more, threatening anyone," says Ilian Vassilev, an energy analyst who served as Bulgaria's ambassador to Russia from 2000 to 2006. Mr Vassilev says Bulgaria's annual gas consumption could rise to 4bn cubic metres in 2020 from roughly 3bn cubic metres today, partly because of growing demand from chemical and fertiliser companies. Yet by 2020 Gazprom will probably supply only about half of Bulgaria's gas, he estimates.

The first operational cross-border pipeline connects Bulgaria with Romania. In terms of volumes of gas delivered, however, the most important will be the Interconnector Greece-Bulgaria (ICGB), a €220m project on which Ms Petkova says construction will start next year, with completion due by late 2018 or early 2019.

"The ICGB is our highest priority," the minister says. "It will create real diversification of supply. The source of the gas will be the Caspian Sea."

With this in mind, Bulgaria has signed a contract with Azerbaijan for the annual delivery of 1bn cubic metres of gas from the Shah Deniz 2 field in the Caspian. Socar, the Azerbaijani state oil company, plans to start piping gas to Bulgaria in 2020.

Domestic oil exploration adds another dimension to Bulgaria's quest for energy independence. A consortium led by Total of France, and including Austria's OMV and Repsol of Spain, disclosed in October that it had found oil off Bulgaria's Black Sea shelf.

Ms Petkova says she has high hopes not only for this part of the Black Sea, but also for a neighbouring deepwater block where Shell, the Anglo-Dutch company, was awarded a five-year permit in February to drill for oil.

The outlook for Bulgaria's nuclear power sector is more mixed. On the positive side, a recent inspection of the Kozloduy plant, 120km north of Sofia on the Danube river, showed that the life of the plant's Unit 5 reactor can be safely extended for 30 years. Ms Petkova says she expects similar approval for Unit 6, the plant's other reactor.

If inspectors give the green light, the two reactors, which produce about a third of Bulgaria's electricity, will be operational until the late 2040s.

> 'Gazprom is in no position to play the gas card any more, threatening anyone'

Less encouraging is the state of play with the Belene nuclear power plant, east of Kozloduy, cancelled primarily due to spiralling costs. An international arbitration court ruled in June that Bulgaria must pay Atomstroyexport, Russia's nuclear equipment company, €620m in compensation for cancelling the project. Ms Petkova says the government hopes for a private sector investor to salvage the project and manage the plant on free-market principles. However, the government is unwilling to offer sovereign guarantees for completing construction or to commit itself to buying electricity from the plant at a fixed long-term price, she says.

Given the very high costs of nuclear projects, these conditions may be unrealistic. "Any nuclear project these days needs government involvement," says Alexander Bebov, managing partner at Balkan Advisory Company, which specialises in the energy market.

Yet the option of abandoning the project and selling off Belene's equipment is not straightforward, either. "Who would buy it?" says Mr Bebov.

Vacuum at top threatens to hinder progress

Continued from page 1

the country's ethnic Turkish minority and a powerful group of local businessmen with interests in construction, banking and energy, which are controlled through opaque networks of companies. In several past governments the MRF has held the balance of power.

While still the EU's poorest country, held back by corrupt practices and weak institutions, Bulgaria has made progress under Mr Borisov, a former bodyguard who got his start in politics as mayor of Sofia and entered parliament in 2009.

Though the economy shrank by 5.5 per cent that year in the global recession, Bulgaria avoided an international bailout, unlike Romania, Serbia and Greece. It has since achieved annual output growth of 1-2 per cent; this year's growth projection has been revised upwards to 3 per cent, driven by rising confidence and consumption. A currency board set up 20 years ago, which pegs the lev to the euro, remains an economic anchor.

The unemployment rate, at 7 per cent in the third quarter, is at a seven-year low, while in fast-growing regions such as the capital Sofia and Plovdiv, a manufacturing and high-tech centre in the south, it stands at 4.5 per cent, according to private sector economists.

Bojidar Lukarski, the outgoing economy minister, is confident Bulgaria is on the way to achieving sustained higher growth rates through increased investment. "We've put a lot of effort into providing a sustainable business environment and attracting foreign investors," he says, "[and] we've significantly reduced the administrative burden."

Buoyed by the success of an EU-backed programme to fund small and medium-sized enterprises and start-ups, a second round of financing for such businesses is included in Bulgaria's current €10bn package of European financing for the 2014-20 period.

"We have an ambitious programme to achieve an economic shift towards innovative production," Mr Lukarski says. Bulgaria's emerging role as a technology hub is enabling it to retain skilled IT workers and bring back highly-qualified Bulgarians working abroad, he says.

Yet further structural reforms are needed for the country to have a chance of catching up with higher-income states in central Europe. One priority is to address high-level corruption, which permeates politics and the judiciary according to the European Commission. The outgoing government countered criticism by stressing progress made in cracking down on tax evasion and smuggling. A critical task for the next administration will be to boost the effectiveness of a newly established independent agency set up to fight corruption.

Regardless of planned reform efforts, however, the next few months are likely to be frustrating for investors.

"It's quite clear . . . private projects under development will face delays because of the political situation and new ones will get postponed," says Georgi Ganev, an economist at the Centre for Liberal Strategies, a Sofia-based think-tank. "This is going to have an impact on the growth forecast for next year."

Start-up capitalises on burst of activity in climbing gyms

Profile

Walltopia's founders expect this year's profits to exceed €10m as interest in the sport booms, writes *Kerin Hope*

Ivaylo Penchev learned rock-climbing on the vertiginous cliffs of his home town, Veliko Tarnovo in central Bulgaria, but never imagined that his weekend pursuit would become a global business.

Walltopia, founded 18 years ago by Mr Penchev and his school friend Metin Musov, has become the world's leading manufacturer and assembler of prefabricated climbing walls for gyms, malls and adventure parks, with more than 1,300 completed projects in over 50 countries.

Mr Penchev claims to have revolutionised a fragmented business that catered to a niche sport for diehard enthusiasts but now holds a much broader appeal, as specialist climbing gyms and "fun walls" for beginners proliferate across Europe and the US.

"We're seeing explosive growth in climbing gyms and most of the momentum is coming from the US," he says. "Climbing has become a mainstream sport in the last five years."

Walltopia has diversified from producing artificial walls to providing indoor training facilities to devotees. Now brightly coloured fun walls with padded floors are designed to look like medieval castles or beanstalks. Bouldering products, which simulate rock-climbing at lower heights, without the use of ropes and harnesses, are also increasingly popular.

Mr Penchev says he and Mr Musov, both from impoverished families, became entrepreneurs out of necessity. "I was a theoretical physics student at Sofia University but I was always broke. My first business with Metin was selling plastic bags on the street in the early 1990s."

Mr Penchev dropped out of university to start Walltopia. He and Mr Musov built their first two climbing walls in a Sofia garage, financed with 10,000 levs (€5,000) of earnings from their plastic bag company.

Walltopia still does all its manufacturing in Bulgaria, employing more than 200 workers at three factories around the village of Letnitsa in the Danube valley. Its tailor-made products, which can be dismantled and reused, are shipped by container and erected on-site by a specialised team of Walltopia workers dispatched from Bulgaria.

Climbing walls and bouldering "courses" come in 16 colours, including vibrant tones of orange, turquoise and violet. "Colour can make all the difference to customer footfall in a climbing gym," Mr Penchev says.

Walltopia has developed a special coating for its walls to repel black marks left by the sticky rubber-soled shoes worn by climbers to give them traction. It has acquired a majority stake in Composite-X, a Bulgarian company which makes the handholds used by climbers to grip walls. Its own gym in Sofia tests and showcases new products.

Mr Penchev says profits will exceed €10m this year on revenues of more than €60m. "We're growing at more than 30 per cent a year in terms of climbing wall surface."

Scaling heights: the company is adding 30 per cent more wall surface each year

Last year the two partners sold a minority stake in Walltopia to BlackPeak Capital, a Bulgarian private equity fund, and CEE Equity Partners, investment adviser to China Central and Eastern Europe Investment Co-operation Fund. The fund, which is backed by China's Eximbank, invests in infrastructure and specialised manufacturing in central and eastern Europe. Walltopia is its first investment in Bulgaria.

"We're seen as a company with good growth prospects," Mr Penchev says. "We're moving into developing and managing adventure and entertainment parks. And the Pacific Rim is going to be a huge market in a few years' time."

Surprise poll result throws future politics up in the air

Elections As PM resigns, a German-style 'grand coalition' begins to look unlikely, says *Tony Barber*

A period of political uncertainty is looming in Bulgaria after the presidential election victory on November 13 of Rumen Radev, a former commander of the nation's air force, who was supported by the opposition Socialist party. Mr Radev's triumph prompted the resignation of the centre-right government, which had held power for two years, and opened the door to early parliamentary elections, probably to be held in spring 2017.

These elections will be the third since May 2013. Like the previous two, they appear likely to produce a fragmented legislature. Opinion polls indicate that no party will come close to achieving an outright majority in the 240-seat chamber. Delicate and possibly lengthy negotiations to form a coalition government may follow.

Although such a scenario is less than ideal for Bulgaria's investment climate, benign economic conditions offer some protection. The outgoing government of prime minister Boyko Borisov had a respectable record of steady economic growth, rising exports, low inflation, prudently managed public finances, more efficient tax collection and currency stability.

Mainstream politicians need no reminding, however, that the next government must be built to last. Bulgaria will take over the EU's six-month rotating presidency in January 2018. It would not be the best advertisement for the nation, which joined the EU in 2007, if the government were to fall in the middle of carrying out its duties on the European stage.

In everyone's mind is the long spell of instability that plagued Bulgaria in 2013, when street protests erupted over high electricity prices and controversy surrounded the appointment of a new head of the state security agency.

Opposition: supporters of the Socialists march in Sofia — Hristo Vladev/NurPhoto/Getty Images

"People have vivid memories of the mass demonstrations and political chaos of 2013," says Kancho Stoychev of the pollsters Gallup International.

"It is true that the present situation has few parallels with 2013, but, still, we need to be careful," says Daniel Smilov of the Centre for Liberal Strategies, a Sofia think-tank. "A new cycle of parliamentary elections creates a lot of noise in the whole system."

For this reason, some political commentators say the most desirable outcome of the elections would be a German-style "grand coalition" between the main centre-right and centre-left parties. These are Gerb (Citizens for the European Development of Bulgaria), the party led by Mr Borisov, who submitted his resignation after Mr Radev's victory, and the Socialist party.

Some investors are hopeful that a grand coalition would deliver positive surprises, for instance a deal to sort out the future of the problematic Belene nuclear plant project in northern Bulgaria. "We'll see what happens with Belene after we get clarity on the politics. I wouldn't exclude the two main parties reaching some agreement," says Alexander Bebov, managing partner at Balkan Advisory Company, which specialises in the energy market.

However, the path to a grand coalition may be rocky. In the first place, the margin by which Mr Radev crushed Tsetska Tsacheva, his centre-right opponent, was so emphatic — he won by 59.4 per cent to 36.2 per cent — that the result was a clear personal defeat for Mr Borisov. Ms Tsacheva, the speaker of parliament, was Mr Borisov's handpicked candidate. There is a sense in Sofia that the curtains are falling on Bulgaria's Borisov era, which dates back a decade.

Second, Bulgaria has little experience of grand coalitions. Gerb and the Socialists are avowed rivals. Since the end of communism and the first democratic multi-party elections in 1990, there has been only one grand coalition, formed in 2005 to smooth Bulgaria's entry into the EU.

Last, there is no guarantee that Gerb and the Socialists will win enough seats to form a coalition with a solid parliamentary majority. Gerb won 84 of parliament's 240 seats in 2014, but this was down from 97 in 2013. Mr Stoychev says the party will struggle to pick up more than 70 to 75 seats in the forthcoming elections. As for the Socialists, who are descended from Bulgaria's former Soviet-backed communist party, they may win only 50 to 55 seats, Mr Stoychev says. While this would be an improvement on the 39 seats that a Socialist-led leftist electoral alliance won in 2014, it would hardly represent a thundering endorsement.

An additional risk is that, as in other European countries, a power-sharing arrangement between the centre-right and centre-left would strengthen support for anti-establishment populist movements.

> 'New parliamentary elections create a lot of noise in the whole system'

In Bulgaria's case, the main anti-establishment threat comes from the ultranationalist right, which has also attracted support by whipping up public unease over irregular migration from Muslim countries. A radical rightist candidate came third in the presidential contest's first round, with 15 per cent of the vote. An alliance of ultranationalists is expected to perform similarly well in the parliamentary elections.

Vibrant start-up scene attracts increasing interest

Funding

More private financing is critical to prevent Bulgaria's new companies moving abroad, writes *Kerin Hope*

Elvin Guri sealed his reputation as a successful entrepreneur almost a decade ago, when BNP Paribas acquired JetFinance, the consumer finance lender he co-founded to help small borrowers in the Balkans buy new household appliances.

Now the Albanian-born former auditor runs Empower Capital, one of a handful of Sofia-based venture capital and private equity funds that are driving investment both in medium-sized Bulgarian companies in manufacturing and services and the country's flourishing start-up sector.

"The small size of the [Bulgarian] market doesn't reflect the level of companies' competence and sophistication," Mr Guri says.

Daniel Tomov, founder of Eleven, a €12m start-up accelerator and seed venture fund backed by the EU's Jeremie programme for start-ups, argues that with more early stage companies emerging, private funding is becoming more diversified.

"Bulgaria has been chronically underfinanced in the past but the environment is changing. We have more angel businesspeople and more investors willing to help early stage companies," Mr Tomov says.

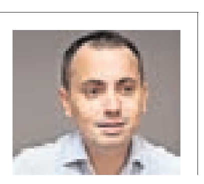
The EU's Jeremie programme, co-financed by the Bulgarian government and managed by the European Investment Fund (EIF) and local accelerator funds, which aid new businesses, has helped make the country a thriving hub for technological innovation. Some €120m has been invested since 2013 in companies backed by the programme, one Bulgarian official says.

But successful start-ups, mostly based in the capital Sofia and around Plovdiv, a software and manufacturing centre in the south of the country, face a challenge raising sufficient funds to maintain high rates of growth.

Private equity and venture capital investment into central Europe reached €1.6bn last year, a 25 per cent increase compared to 2014, according to Invest Europe, an association of investment funds. But Bulgaria ranked sixth in the region, with €46m of investment in 2015, behind its two Balkan neighbours Serbia and Romania. This amount falls far below the country's potential, according to members of the newly created Bulgarian Private Equity and Venture Capital Association.

Empower Capital's Mr Guri puts the potential for private equity investment across south-east Europe at €5.6bn.

Sofia-based funds are poised to participate in a second EIF funding round to be launched in January, again with co-financing from the government. Fund managers in the association forecast another €100m-€150m will be invested in the next two years both in start-ups and early stage companies seeking to finance growth.



Elvin Guri: the companies are more competent than the small market size indicates

However, increased amounts of private financing will be critical to making such businesses sustainable in the longer term. Otherwise, they will head for the UK, Germany or the US, where venture capital and private equity funding are readily available, warns Evgeny Angelov, outgoing economic adviser to the Bulgarian president and chairman of the new association. "We want our companies to stay here, do research and development for US companies and be plugged into the global innovation network," Mr Angelov says.

"We've become gatekeepers to the Bulgarian market . . . Increasingly we're seeing foreign funds come and knock on our doors," says Lyuben Belov, founder of Launchub Ventures, a €20m fund that will follow on from his existing Jeremie-backed accelerator fund.

Rossen Ivanov, managing partner at BlackPeak Capital, a private equity growth fund, says international investors entering the Bulgarian market are looking for export-oriented ventures with high growth rates or companies that occupy a specific niche.

BlackPeak's €31m portfolio includes Walltopia, a world leader in the making of climbing wall; Software Group, a global vendor of microfinance, banking and telecoms software; and International Power Supply (IPS), an award-winning producer of off-grid power management systems.

Mark Crandall, a US energy specialist based in Belgrade and founder of Post-Scriptum Ventures, a venture capital group that specialises in start-ups and niche investments mainly in the energy sector, has co-invested with BlackPeak in IPS and Software Group.

"These are companies that have developed world-beating technologies. They have tremendous possibilities," Mr Crandall says.

The local funds have also teamed up to co-invest in innovative companies with potential to become global players. "We see companies growing every year by two or three times," says Zlatolina Mukova, managing partner at Neveq 2, a €15m venture capital fund.

Country faces drastic shortage of people with the right IT skills

Technology

Government initiatives and industry partnerships are helping, write *Theodor Troev* and *Angel Petrov*

Up to speed: the education minister (far right) visits a vocational high school

As a country that hopes to position itself as an information technology leader in southern Europe, Bulgaria is finding it difficult to keep up with the accelerating pace of demand for skilled workers.

The government has pledged to create 30,000 IT graduates in less than a decade, but the country is already facing a drastic shortage of people with the right skills and experience.

Telecommunications and the output of hardware and software accounted for around 3 per cent of Bulgaria's economy last year. The software industry alone is estimated to have reached 1.8 per cent of GDP in 2015, a fivefold increase compared to 10 years earlier, says Stamen Kotchkov, who chairs Basscom, the industry association of leading software development companies.

Industry figures say education should be targeted to address particular skills gaps. IT companies employ 40,000 software engineers, but are struggling to find thousands more.

Though some 2,000 university graduates of IT and computer science programmes enter the labour market every year, few of them have the particular skills that businesses need.

"Education reform begins in kindergarten," says Meglena Kuneva, outgoing deputy prime minister and minister of education. "We passed legislation to change approaches to teaching from pre-school to universities and to permeate education with technology."

As part of its strategy, the ministry is working to widen access to IT training courses, so that students will no longer be required to study IT courses at a vocational trade college.

"An important component missing in the education system is teamwork with business," says Emiliyan Kadiyski, a part-time IT tutor in Vratsa in Bulgaria's poorest north-western region.

When he is not teaching, he divides his time between working for an IT company and the Vratsa Software community, an organisation he founded that provides IT courses.

Other training initiatives are also under way. Last year, HP, the US tech conglomerate, opened a high-tech lab in Sofia that offers training facilities for nearby universities and colleges.

Sibiz, a high-tech company with operations in the US and eastern Europe, is building the Sibiz Technology Center, which will combine business and educational functions.

"The success of Bulgaria's high-tech industry will depend on our ability to generate the necessary capacity of relevantly educated engineers," says Roddy Dervishev, chief executive of Sibiz.

Ms Kuneva is a founder of the Educational-Industry Board (EIB), a Plovdiv think-tank encouraging schools and employers to work together. The concept is developing a model involving IT and manufacturing companies in the nearby Trakia Economic Zone (TEZ), one of the most successful such enterprises in Bulgaria.

"There is a gap between employers' plans and the output of vocational high schools," says Georgi Stoeff, a Plovdiv-based economist and EIB co-founder. "TEZ gives successful models of integration between employers and schools, such as an employer adopting a class in a vocational school and providing resources and know-how for education in a particular profession."

One programme at a Plovdiv high school is run in co-operation with ABB, the Swedish-Swiss engineering company, which produces components for low and medium-voltage equipment in its TEZ unit.

Industry group Basscom is also involved in a vocational training project to turn out applied programmers.

"If we are not able to build sufficient engineering capacity, this may lead to stagnation, withdrawal of investments and Bulgaria will not establish itself as a high-tech destination," Mr Dervishev says.

Auto parts industry powers up

Automotive
The number of component makers has doubled, but there is still no assembly plant, write *Theodor Troev* and *Angel Petrov*

The automotive parts industry has become one of the engines for Bulgaria's national output, yet despite strong growth in the components industry, the government is still waiting for a major overseas car manufacturer to set up a vehicle-assembly plant.

Nearly 100 enterprises in the auto parts sector employ over 33,000 people, producing components for over 20 marques such as Peugeot, BMW and Mercedes, according to Automotive Cluster Bulgaria, a non-profit organisation that represents companies in the industry.

The number of auto parts manufacturers has doubled since 2012 as overseas companies have been drawn by Bulgaria's low tax environment, cheap labour and currency stability — the lev is pegged to the euro.

"Automotive manufacturing is one of the priority high-technology sectors for attracting foreign investments here," Bojidar Lukarski, Bulgaria's outgoing minister for the economy, told the FT. "The legal framework gives administrative and financial incentives to attract investors."

Employing just 1 per cent of Bulgaria's workforce, last year the automotive parts industry generated €1.55bn in sales, according to the ACB — over 3 per cent of gross domestic product.

"The productivity of our automotive industry is four times the country's average," says Lubomir Stanislavov, chief executive of ACB.

Although recent research produced by the ACB in conjunction with Colliers International and EY, the property and consultancy companies, shows Bulgaria is a popular location for component producers, its auto industry still lags behind neighbouring Romania and Serbia, for example. There the automotive sector generates a higher proportion of GDP and major car manufacturers have already set up assembly plants.

Testing times: Sensata is making use of high-skilled workers at its plant in Plovdiv's Trakia Economic Zone
Sensata Technologies

Bulgaria did have one factory that was assembling vehicles for China's Great Wall Motors, but production halted in January.

The factory's owner, Litex Motors, announced that lines were being adjusted to produce new models. However, the plant did not reopen in mid-2016 as originally indicated.

Poor infrastructure is also a hurdle facing all manufacturers. Some of Bulgaria's auto parts makers are located in the north-west region of the country, which is closest to western Europe and the capital Sofia but which is also the EU's poorest region. Infrastructure needs to improve if more investment is to be attracted.

There is another concentration of companies around Plovdiv, Bulgaria's second-largest city, towards the south of the country. Plovdiv offers access to skilled graduates of its universities and technical schools, and an industrial hub with investment incentives.

> 'Our success in the UK now creates interest in Germany, Turkey and in our native Bulgaria'

Plovdiv's Trakia Economic Zone has attracted €1.2bn in greenfield investment, of which about €500m has been devoted to auto parts manufacturing, according to Plamen Panchev, TEZ chairman.

UK-based springs and wire-forms manufacturer William Hughes was an early entrant to the automotive parts industry in Bulgaria with the establishment of a facility near Plovdiv in 2004. Other companies have followed, such as Swedish-Swiss ABB, US-based Sensata Technologies and Canada's Magna Powertrain, whose customers include BMW and General Motors.

"Over the past 12 months alone, five auto parts makers opened plants in TEZ," Plovdiv deputy mayor Stefan Stoyanov says. "We expect this trend to continue and to welcome a European carmaker."

In April, Sensata, which already had a plant employing over 2,000 people near Botevgrad near Sofia, opened another one in the TEZ, turning Bulgaria into its third-largest production base after Mexico and China. "Plovdiv has started to transform into a high-tech manufacturing hub and this should be an example for the rest of the country," says Tommy Ver Elst, general manager for Bulgaria for Sensata Technologies, a supplier of sensors and controls designed for leading automotive manufacturers.

Recent moves have been attracting more investors to Bulgaria's manufacturing capacity in the automotive industry, but at least one Bulgarian company has decided to set up abroad.

Water Fuel Engineering is now a UK-based company that is using Bulgarian engineering know-how to develop and supply clean technologies.

The company, which lists Bulgarian and UK partners on its website, says its HydroGen 4.0 can be used on vehicles to reduce emissions by as much as 80 per cent.

Angel Nenov, WFE's managing director, says: "The decision to move to the UK was integral to our growth plans," adding: "Our success in the UK now creates interest in Germany, Turkey . . . and in our native Bulgaria."

Contributors

Tony Barber
Europe editor

Kerin Hope
Greece and south Balkans correspondent

Theodor Troev
FT contributor

Angel Petrov
Freelance journalist

Emma Boyde
Commissioning editor

Steven Bird
Designer

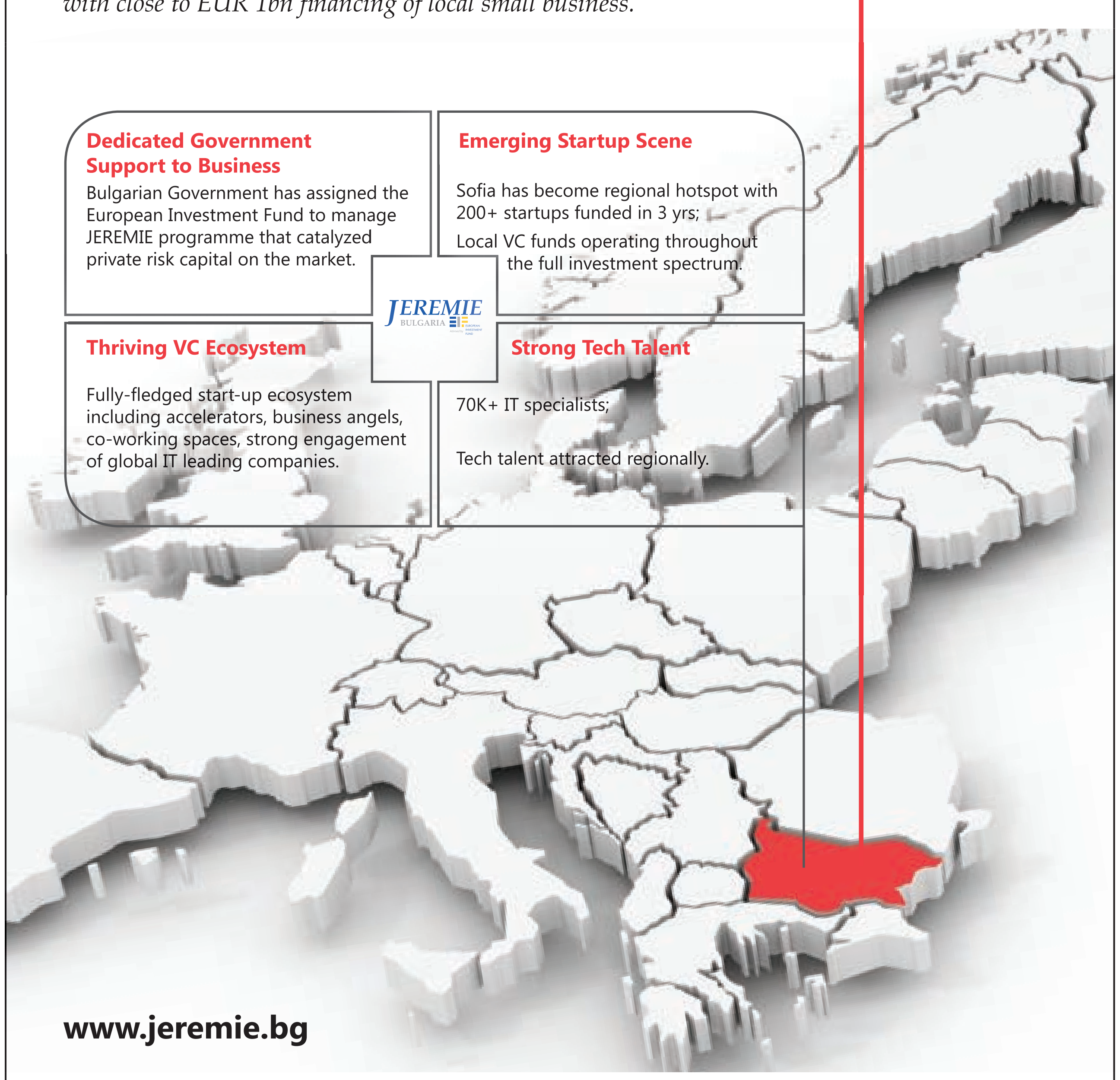
Alan Knox
Picture editor

For advertising details, contact: **Elka Koleva**, + 359 2981 0900 and ft@press.bg, or your usual FT representative.

All editorial content in this report is produced by the FT. Our advertisers have no influence over or prior sight of the articles.

All FT Reports are available at: ft.com/reports

Follow us on Twitter @ftreports



Ivan Todorov - Managing Partner of Georgiev, Todorov & Co.