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## Analysis of the global market and commercial banks' trends: on the opportunities for PPP financing in Serbia

### Abstract

Opportunities given by the legal framework for public-private partnerships (PPP) are rather novel in Serbia. Although being very active in preparing the environment, and launching PPP project proposals, public sector is still on the way to accomplish the first PPP while private sector, including banks operating in Serbia, is still aside. Banks, which act globally in the field of PPP most frequently provide advisory services, and partially or fully participate in the process of financing. This paper aims to analyze if domestic banks can benefit from the impact of the commercial banks' activities and trends at the global PPP market in light of recently launched opportunities for PPP financing. Analysis is aimed to explore several aspects of potential benefits that could trigger, improve or diversify the activities of banks in Serbia related to PPP financing: (a) roles of bank; (b) some specifics of the procedure for PPP financing in the banks; (c) trends in participation of banks as lead arrangers on the global PPP market; and (d) presence of international banks in existing PPP projects in the Western Balkan. Contrasting the results of the analysis with the structure of banking sector in Serbia, research will identify areas of possible direct and indirect benefits of the global PPP market and commercial banks on the opportunities for PPP financing in Serbia. The objective of the paper is to provide valuable insight to banks as potential financiers of PPP projects in Serbia, both domestic and internationally active one, as well as to regulators in the financial services sector.

**Keywords:** bank, financial advisor, lead manager, project finance, public-private partnership.

**JEL Classification:** E44, G21, H54, F34.

### Introduction

**Background.** Serbia is a country in transition to market-based economy. Among other macroeconomic and social challenges, development of infrastructure may be considered as a precondition and generator of a wider economic development. In that respect, during last decade (from 2000), Government was relying on the financial sources from the international financial institutions such as EIB, EBRD, World Bank, donor community, EU program and funds, etc. World economic crisis reflected on the economy of Serbia, too. Therefore, the existing policy of infrastructure financing became subject to a change. Introduction of new methods such as public-private partnerships (PPP) came in place with the Law on Public-Private Partnerships and Concessions in November 2011, as well as with a new Law on Public Procurement (2012). However, there are no projects that reached financial close yet. Infrastructure needs are still huge.

Yescombe (2010) argued that financing PPP projects by one or several banks operating in the same country in which the project is located is a rather favorable form of finding capital to meet the needs for it. The most significant potential benefits that would be realized in case of financing PPP projects by domestic banks are:

- ◆ Complete avoidance of FX risk.
- ◆ Synergy in the activities of PPP projects' implementation due to the fact that domestic banks are most familiar with the business conditions in the local environment.

Although PPP financing is international transaction, and country can benefit from PPP itself and from international participants in PPP deal, countries in transition often have problem that they cannot achieve this mentioned advantage. Serbia could face such potential problem, too. Future and PPP projects in pipeline should be particularly important for domestic banking system that is liquid and seeking for opportunities. However, is that connection certain? Therefore, motivation for research is rooted in the following questions:

- ◆ Are the banks operating in Serbia the one to be able to meet the need of PPP projects proposals in Serbia?
- ◆ Can they benefit directly or indirectly from the impact of the global PPP market and banks' participation in the light of PPP financing in Serbia?
- ◆ What are possible forms of benefits for domestic banks?
- ◆ Could characteristics of global trends (measured by structure and presence of international banks) be reflected to the Serbian PPP and banking market?
- ◆ Eventually, can policy makers in public sector and business community expect funding from the local market, i.e. the same market where PPP project is coming from?

### 1. Literature review

Using private capital in financing public needs was popularized having led to a successful concept, in literature and practice known as the public-private partnership (PPP). Many authors agree that the cooperation between public and private sector is not a new phenomenon, but they have different views on

how deep are the roots of PPP concept itself. Wettenhall (2010) finds that PPPs have been developed from the earliest civilizations onwards, which can be a little bit misleading. The PPP acronym itself became known and popular in early eighties, and gained a significant keyword status in the nineties with the rise of the importance of the Public Finance Initiative for social and economic environment renewal under surveillance of the public expenditures (Bovaird, 2010).

Several attempts have been made to establish definition of a PPP (e.g. Wettenhall, 2010; Hodge and Greve, 2007; Van Ham and Koppenjan, 2001), but no single approach has been launched. That might be due to the wide range of features that a PPP contract can adopt, as stated by Yang and Yang (2010): “several contract types are possible, such as build-own-operate-transfer, joint ventures, sale-and-lease-back, design-build-maintain, etc.” Besides, national and/or local frameworks may provoke different interpretations of the concept. For the purpose of this research, all individual attempts of definitions will be out of further focus, and the research will rely on the determinants of PPP projects given by the European Commission in the Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions: *“the term refers to forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service”* (European Commission, 2004).

As being the subject of the empirical and academic research, PPP concept has already disclosed and demystified determinants for its successful implementation. However, De Clerck, Demeulemeester and Herroelen (2012) claims that *“contract negotiation phase is the critical stage in the PPP process, often causing delays and overruns of the advisory and bidding costs of approximately 25% to 200%.”* The role of financiers (banks) in contract negotiations is crucial for the financial closure success. As the result of contract negotiations, conditions of financing (terms of the loan contract), depend not only on the political risk but also on the legal and institutional environment as well (Hainz and Kleimeier, 2012) that includes the banks as important contributors to that overall macroeconomic and institutional framework. Banks interested to finance certain PPP project determine possibilities for PPP financing and conditions of the loan contract, too. Therefore, the presence of banks, their specific products and expertise is of utmost importance for a successful implementation of PPP projects.

## 2. Methodology, analysis and expected results

Methodology is based on interviews and desk research, using the review of library and online literature, databases, reports and documentation. Analysis is aimed to explore several aspects (forms) of potential benefits that could trigger, improve or diversify the activities of banks in Serbia related to PPP financing. Research is done by analyzing: (a) role of bank in PPP (as advisor, lead arranger and financier); (b) some specifics of the procedure for PPP financing in the banks; (c) trends in participation of EU and non-EU banks on the global PPP market (over 10 year period); and (d) presence of international banks in existing PPP projects in the countries of Western Balkan. Eventually, analysis of banks operating in Serbia (ownerships structure and share) will identify in which extent and forms they can benefit from the global trends and banks in PPP financing.

Expected results are to disclose in more details benefit from the impact of the commercial banks' activities and trends at the global PPP market on domestic banks in order to support and improve their capacities in light of recently launched opportunities for PPP financing in Serbia.

## 3. Roles of bank in PPP projects

### 3.1. Bank as a financial advisor in PPP projects.

A private partner (sponsor) selected in a public bidding (tender) procedure by the public partner is in charge of negotiating all contractual arrangements concerning the project, signing the contract and closing the financial structure. With a view to enabling the project to reach the financial closure, the sponsors without relevant expertise and experience always hire financial advisors. Financial advisory services are provided to sponsors by the major banks in the world; by some other banks with specialized knowledge about a certain market; by investment banks (banks which only arrange the finance, but do not provide lending to the project); by leading international accounting or consulting companies, specialized project finance companies, or individual financial advisors. The responsibility of a bank as a financial advisor is covering several segments:

- ◆ Tender preparation.
- ◆ Feasibility study of the project.
- ◆ Risk analysis.
- ◆ Optimizing economic, legal and tax structure.
- ◆ Legal structure.
- ◆ Optimal financial structure of the project: sources of debt and favorable financial terms.
- ◆ Preparation of the financial model.

- ◆ Project presentation in the capital markets: preparation of the informative memorandum presenting the project at the financial market; assessment of financial offers.
- ◆ Participation in the negotiations with the financial institutions.

In addition to high costs, hiring a financial advisor entails a high level of risk; namely, regardless of his top qualifications, the advisor's expert assessment that a project is bankable in some cases does not get confirmed at the financial market, and the financial structure never gets finalized.

**3.2. Bank as a lead manager in PPP projects.** The typical approach in arranging loans in PPP projects is to assign one or several banks the role of lead manager, which would be the underwriter of debt, placing it on the financial market. The lead manager is often referred to as arranger or lead arranger. One of the crucial moments is when the private partner determines at which point to involve the lead manager in the transaction. In this respect, there are several possibilities:

1. From the perspective of achieving maximum competition among banks in terms of financial conditions, the best moment to invite a certain number of banks to take part in a tender (and choose the lead manager as underwriter and lender) is only after finalizing all elements of the PPP project contract.
2. A considerably different approach is when the private partner selects one or several banks as his financial advisor(s) and lead manager(s) at the very beginning of the project's development process. The advantage of this approach lies in the fact that it reduces the costs of financial services and underwriting fees, and provides certainty that given financial advice is based on the banks' readiness to conduct the transaction, which, at the same time, increases the probability of the financial structure finalization.
3. The private partner also has the possibility to use his right to test the final financial package (prepared by the financial advisor and lead manager) at the market, by comparing it with the offers of other banks on a previously invited tender: if it turns out that the lead manager did not give the best offer, the financing is entrusted to another bank.

When several banks act as lead manager, they share the responsibilities for various aspects of the transaction, which enables them to exploit their capacities more efficiently. In this case, the division of responsibilities among banks is conducted in respect of the following activities:

- ◆ Preparing the documentation, in cooperation with the banks' attorneys.
- ◆ Engineering, in cooperation with the lender's engineer.
- ◆ Financial modeling.
- ◆ Insurance, in cooperation with the insurance advisor.
- ◆ Assessment of turnover revenues, in cooperation with the bank's market or revenues advisors.
- ◆ Preparation of an informative memorandum.
- ◆ Syndication.

Cooperation among banks in respect of these operations may take various forms and implies different perceptions of prestige. If it is impossible for banks to reach a mutual agreement, an intervention by the sponsor is required, which thereby assumes the role of the decision-maker (Lewis and Davis, 1987). However, such situations are rather unusual for the project finance market, because banks are used to working in teams which are more cooperative than some other forms of formal organization. Therefore, banks should always be cooperative, in order to avoid giving the sponsor a reason to intervene and make the decision himself.

Nevertheless, it is extremely important for both the financial advisor and lead manager to have an active role in negotiating all contracts concerning the project to ensure that all financial implications of all contracts have been duly noted and taken into account. All amendments to the project's contracts which are beneficial for the private partner (sponsor) are usually beneficial for banks as well, so that the private partner often bids to banks for the purpose of strengthening their commercial position during the negotiations.

**3.3. Bank as a financier.** Examining the global scene of loans for projects financed by project finance techniques (including PPP projects), one may observe the buoyancy of the market and high worldwide presence of these loans. Despite the fact that the effects of the global economic crisis continue to pose a huge disturbance, in 2011 this market recorded a total amount of extended loans of USD 213,487.00 billion, through 615 projects with a financial closure, in 54 countries in the world. According to the Project Finance International (2013), among a dozen leading countries in the world when it comes to the amounts of project finance loans, in 2011 the Indian market dominated the global scene as the most attractive, followed by the Australian, US, Russian and Brazilian markets. These were immediately followed by the markets of the EU countries, such as: France, Spain, Great Britain, and Italy. The observed activity of the EU countries is the evidence of their traditional share in granting loans for financing infrastructure projects.

Although the contemporary financial markets are abundant with various financial products to be used in the financing of PPP projects, the typical ways to finance PPP projects are as follows: (a) through financial intermediaries – lending to Special Purpose Vehicles (SPVs); and (b) through direct access to the capital market – issuing of bonds by a project company or an SPV.

- ◆ Lending as a method of financing PPP projects is provided by *banks as financial intermediaries*. Commercial banks, as the most important financiers of PPP projects, provide lending to an SPV, given that they are able to offer really high amounts of long-term capital. Within a credit transaction, a bank establishes operational activities with the private partner, and a direct financial relationship with the SPV as a project company. The loan granted by the bank to the PPP project is extended under the conditions that are typically applied to other long-term and capital-intensive projects, taking into account the projection of the future cash flow of the PPP project. At the same time, the conditions of lending largely depend on the current circumstances at the global market, and on the position in a given country/sector (political risk, etc). Thus, for instance, the price of a loan usually gets determined based on two inputs: the existing costs of borrowing on the part of the financier (expressed in the form of an interest rate), and the fixed component (margin) expressed in percentage points, used to cover the default risk and other costs (operational costs, profit). The nature of interest rates on these loans is variable: typically applied are EURIBOR interest rates and LIBOR interest rate. Quite the opposite, the SPV's revenues are not directly related to the changes in interest rates. Therefore, in order for banks as financiers and SPVs to protect themselves, they frequently implement strategies and activities of protection against the risk of price changes, FX risk, inflation risk, etc, through adequate, modern financial instruments – bank products.

The role of banks in lending as a direct form of financing PPP projects is extremely important and extremely complex. Main fields of activities of the bank in this respect are: Financial Underwriting, Funding in the Capital Markets, other financial facilities (bridge, possibility of equity investments), risk management.

- ◆ When it comes to financing PPP projects by means of a direct approach at the capital market, *bonds are issued* by SPVs. Investors in

these bonds are mostly institutional investors, such as pension funds or insurance companies, which have a natural interest in long-term investments. Financing PPP projects by issuing SPV bonds is relatively feasible in developed market economies (though not in all of them, and not as a rule: for instance, not in Spain), whereas this is not the case in transition countries due to their insufficiently developed financial markets and market principles in general. Apart from issuing bonds, another non-banking source of finance can be securitization<sup>1</sup>.

#### 4. Some specificities of the bank's PPP/project financing procedure

**4.1. Letter of intent.** At the outset of project development, banks usually send a letter of intent to the private partner. A letter of intent is brief (one or two pages), and its purpose is for a bank to confirm that it is basically interested in participating in the project. If private partners receive letters of intent from several different banks, it would indicate that the financial market is certainly interested in the future project. However, from the bank's perspective, writing and sending a letter of intent does not imply any commitment on the bank's part at that stage.

**4.2. Lenders and public bid.** It often happens that the tender for selecting the private partner for the PPP project gets separated from the financing tender: the public bid for financing actually commences after a partner wins the tender and project contracts have been accordingly negotiated. Thus, the full amount and structure of the costs of participating in the financing tender are known and covered by the project contract.

Although the financial closure (with the bank) comes after the selection of private partner, banks as financiers may participate in the public bidding (tender) procedure for the purpose of private partner selection and project contract negotiation. Financial advisors and lead managers are usually involved in this process: when the bid is placed, the tender participants may provide evidence that the financial is feasible, such as, for instance, a letter of intent whereby the bank supports the tender participant by promising to provide project financing (without getting obliged to do so at this stage).

Nevertheless, in order for banks to step forward even with a non-obliging letter of intent, they have to perform the entire due diligence procedure, arrange the draft financial structure, complete the internal procedure for fund provisioning, sometimes

<sup>1</sup> The process of aggregating credit rights of concessioners (most typically rights to charge road-tolls, for instance), revenues from commercial operations and administrative payments into a protection instrument that can further be traded with.

even to harmonize their financial documentation with the tender participant, all with a view to demonstrating that they are able to provide the required funds and that the project may commence without any delay.

**4.3. Financial model.** During the due diligence procedure, financial advisor or lead manager, in cooperation with the private partner, develops the financial model for the project. It is far better to develop just one model for the project, so that all stakeholders could work on the same foundations.

**4.4. Term sheet, underwriting.** As the financial structure develops, the list of financial conditions (i.e. term sheet) is compiled. The final term sheet provides the foundation for lead managers to complete their internal lending proposal and obtain all required permissions so that they could formulate the official lending offer. This means that banks must have excellent cooperation between the project finance team and the lending department, especially if the bank plays the role of the lead arranger.

Upon receiving the approval of the lending proposal, whereby it gets adopted, the lead manager underwrites the debt based on the previously negotiated term sheet. The term sheet also sets the date by which the documentation should be signed, bearing in mind that banks usually need to repeat the internal approval procedure if the loan contract does not get signed within the prescribed deadline. The signature on the term sheet, however, still represents a mere expression of intent, because the bank's formal commitment commences only after further detailed analysis of project documentation from the financial, technical and insurance perspective. Nevertheless, the signed term sheet is treated rather seriously, and banks withdraw from underwriting only in the case of essentially changed circumstances concerning the project, the country in which it is located, or the market in general.

**4.5. Negotiations on financial documentation.** If negotiations on financial documentation are successful, financial documentation is signed by the private partner – this signifies that he finally secured the promised financing of the project. In the ideal circumstances, i.e. if the project is presented to the lead manager as a complete set including all project contracts it takes three months at best for the lead manager to sign the financial documentation<sup>1</sup>. This is why financing is the most critical segment of the project, and why banks usually require over a year to arrange the financial side of the project.

**4.6. Informative memorandum and syndication.** Lead managers usually tend to reduce their expo-

sure by placing a section of finance together with other banks in the market, thereby entering the process of syndication. In order to facilitate this process, the lead manager prepares a package of information in the form of an informative memorandum, with the private partner and SPV actively participating in its preparation.

The final informative memorandum, of about 100 pages, provides a detailed review of the project's structure, flow of the analysis, with the objective of accelerating the credit analysis of banks – potential participants in the syndication:

- ◆ Summary of the project.
- ◆ SPV structure and organization.
- ◆ Financial information about the sponsors and other participants in the project.
- ◆ Market analysis.
- ◆ Technical description of the project.
- ◆ Review of project contracts.
- ◆ Risk analysis.
- ◆ Financial analysis, including the financial model of the basic case and a sensitivity study.
- ◆ Detailed list of financial conditions (term sheet).

The financial memorandum is formally presented to other potential participants in the syndication by the lead manager, sponsor and other relevant project stakeholders. The potential participants in the syndication are often given three to four weeks to analyze the presented financial memorandum and state their final decision concerning their participation in the financing.

**4.7. Agency-related activities.** After the financial documentation has been signed, one of the banks – lead managers acts as agent on behalf of the banks' syndicate as a whole: the agent bank represents a channel of communication between the SPV and all syndicate banks. The agent bank collects the funds from the syndicate upon registration and forwards them to the SPV; takes care about the project's insurance, on behalf of the lender; receives payments from the SPV and forwards them individually to each syndicate bank; monitors the compliance of the SPV with the requirements of the signed financial documentation.

## 5. Global trends in participation of banks as lead arrangers on the global PPP market

This section aims to analyze the participation of EU and non-EU banks that were active as lead arrangers on the global PPP market during the last decade.

<sup>1</sup> See more in: Brealey, R. and Myers, S. (2003). *Principles of Corporate Finance*, 7<sup>th</sup> edition, Irwin McGraw-Hill, Boston.

Table 1. Top 20 banks – lead arrangers in the world in 2001

	Lead arrangers	Country	Amount in USD million	Number of loans	Average loan amount in USD million
1	Citigroup	USA	15 512	54	287
2	West LB	Germany	8 235	27	305
3	BNP Paribas	France	6 429	29	222
4	Societe General	France	5 301	17	312
5	Credit Suisse First Boston	Switzerland	4 742	8	593
6	JP Morgan	USA	4 333	18	241
7	Dresdner Kleinwort Wasserstein	Germany	4 038	17	238
8	ABN Amro	Netherland	4 019	19	212
9	Deutsche Bank	Germany	3 623	14	259
10	Barclays Bank	Great Britain	3 612	18	201
11	Mizuho Financial Group	Japan	3 187	20	159
12	Intesa BCI	Italy	2 621	5	524
13	Bank of America	USA	2 282	13	176
14	Credit Lyonnais	France	2 019	12	168
15	Royal Bank of Scotland	Great Britain	1 911	16	119
16	SEB	Sweden	1 582	2	791
17	Bank of Tokyo-Mitsubishi	Japan	1 573	18	87
18	ANZ Bank	Australia	1 532	12	128
19	Santander Central Hispano	Spain	1 465	10	147
20	Credit Agricole Indosuez	France	1 366	10	137

Source: Yescombe, E.R. (2000). *Project Financing*, Yescombe Consulting Ltd., London, p. 25.

In 2001, project finance lenders, commercial banks recorded a share of 82% in the private debt market. As shown in Table 1, banks were rather active in project finance, especially banks in the USA and Western Europe (in top 10), followed by banks from other continents (Japan, Australia), with the European banks dominating in overall activities. Nevertheless, in the late 2000s, the global economic crisis caused some extremely significant changes at the global level in banks specialized to conduct lead arranger's opera-

tions, which had a particularly prominent impact on the participation of the European banks. Comparison of main indicators on this market from the early 2000 (Table 1) with the situation as it is ten years later (Table 2) is chosen for the reason that this period integrates the significant changes occurred during the time of world economic crisis. Table 2 illustrates a considerably altered composition of top 20 banks, with the increased number of closed deals: from 17 (2001) to 44 (2011).

Table 2. Top 20 banks – lead arrangers in the world in 2011 (global initial mandated lead arrangers)

	Mandated arrangers	Country of origin	USD (m)	%	No. of deals
1	State Bank of India	India	21.631.6	10.1	52
2	Mitsubishi UFJ	Japan	9.486.1	4.4	88
3	SMBC	Japan	8.188.1	3.8	71
4	Credit Agricole	France	6.506.4	3.1	60
5	Mizuho Financial	Japan	5.797.5	2.7	55
6	Societe Generale	France	5.760.5	2.7	55
7	BNP Paribas	France	5.390.8	2.5	55
8	Axis Bank	India	5.216.9	2.4	18
9	IDBI Bank	India	5.162.3	2.4	10
10	ING	Netherland	4.916.1	2.3	49
11	BBVA	Spain	4.810.7	2.3	52
12	ANZ	Australia / New Zealand	4.703.6	2.2	33
13	Santander	Spain	4.661.3	2.2	62
14	RBS	UK	4.207.3	2.0	36
15	HSBC	UK	4.090.8	1.9	32
16	KDB	n.a.	4.032.1	1.9	17
17	CBA	Australia	3.941.2	1.9	29
18	UniCredit	Italia	3.801.0	1.8	45

Table 2. Top 20 banks – lead arrangers in the world in 2011 (global initial mandated lead arrangers)

	Mandated arrangers	Country of origin	USD (m)	%	No. of deals
19	Natixis	France	3.643.2	1.7	35
20	NAB	Australia	3.428.4	1.6	33

Source: Project Finance International (September 2013). *League Tables*, Project Finance International (<http://www.pfie.com/Attachments/PFIe/PFILeagueTables2011.pdf>).

Looking at the changes over a ten-year time horizon (2001-2011), we have observed that they caused movement in the participation of EU versus non-EU banks: the top 10 banks are predominantly those from outside Europe (Japan, India), the European banks being represented only by the French banks. In total amount, banks from the EU market are somewhat less present than at the beginning of the observed period, whereas the presence of banks – lead managers from Japan, India and Australia has noticeably increased. According to the Infrastruc-

ture Journal (2014), EU banks are the one to be predominant in 2013 again.

## 6. Potential impact of the trends from the global PPP market on banks operating in Serbia

Before we focus on structure of Serbian banking market, analysis of participation of banks (financial advisor, ex.) in the regional context will be conducted. Some PPP projects implemented in the Western Balkan are chosen in the sample, according to the available relevant data on their synopses.

Table 3. Banks' participation in selected PPP projects in the Western Balkan Region

1. Mother Teresa Airport Terminal (Tirana) – Albania				
Financial advisor	Country of origin	Financial advisor role	Project legal advisor	Project lawyer role
Deloitte & Touche	Multinational company	Financial advisor to state		
2. Sofiska voda - water utility in Sofia – Bulgaria				
Financial advisor	Country of origin	Financial advisor role	Project legal advisor	Project lawyer role
Price Waterhouse	Multinational company	Financial advisor to state	CMS Cameron McKenna	Legal advisor to state
ING Barings	Netherland	Financial advisor to project	Legacom	Legal advisor to state
3. Zagreb to Macelj Toll Motorway – Croatia				
Financial advisor	Country of origin	Financial advisor role	Project legal advisor	Project lawyer role
Fortis	France	Financial advisor to project	Freshfields Bruckhaus Deringer	Legal advisor to project
Bankgesellschaft Berlin AG	Germany	Financial advisor to project	Allen & Overy	Legal advisor to project
4. Korinthos Tripoli Kalamata and Lefktro Sparti Motorway – Greece				
Financial advisor	Country of origin	Financial advisor role	Project legal advisor	Project lawyer role
Bank of America International	USA	Financial advisor to state	/	/
HypoVereinsbank AG	Germany	Financial advisor to project	/	/
Banco Espirito Santo	Portugal	Financial advisor to bidder	/	/
BBVA	Spain	Financial advisor to bidder	/	/
Babcock & Brown Inc	Australia	Financial advisor to project	/	/
5. Maribor Wastewater Plant – Slovenia				
Financial advisor	Country of origin	Financial advisor role	Project legal advisor	Project lawyer role
Charterhouse Bank Ltd	UK	Financial advisor to concession awardee	Dewey Ballantine	Legal advisor to state

Source: Dialogic.

Table 3 shows that beside international companies, financial advisors of the PPP projects in the region are<sup>1</sup> EU banks from Germany, the UK, Portugal, France. We can assess that the link between territories where PPP project is located and is financed exists and it is direct: EU banks have

natural capacity and motivation to be part of the PPP deals in its territory (see, Sredojevic, 2010).

When it comes to the possible position and role of banks in PPP financing in the Republic of Serbia, here it is important to analyze two aspects: (a) ownership structure of the banking sector; and (b) opportunities for PPP projects financing in Serbia.

Ownership structure of the banking sector of Serbia is analyzed through following determinants: domestic versus foreign owned, public versus private owned, shareholders' origin.

<sup>1</sup> In some cases, due to the closure or merger & acquisitions of some banks.

Table 4. Structure of ownership of the banking sector of the Republic of Serbia

	Number of banks	Assets (billion RSD)	Share %	Capital (billion RSD)	Share %	Employees (number)	Share %
<b>Domestically owned banks</b>	<b>11</b>	<b>726</b>	<b>25.4%</b>	<b>154</b>	<b>25.4%</b>	<b>8.036</b>	<b>28.4%</b>
State capital	8	528	18.5%	92	15.2%	6.964	24.6%
Private capital	3	199	7.0%	62	10.2%	1.072	3.8%
<b>Foreign owned banks</b>	<b>21</b>	<b>2.129</b>	<b>74.6%</b>	<b>452</b>	<b>74.6%</b>	<b>20.243</b>	<b>71.6%</b>
Italy	2	647	22.7%	140	23.2%	4.050	14.3%
Austria	3	447	15.6%	105	17.3%	3.664	13.0%
Greece	4	426	14.9%	90	14.9%	5.255	18.6%
France	3	277	9.7%	46	7.7%	2.709	9.6%
Other	9	331	11.6%	70	11.5%	4.565	16.1%
<b>Total banking sector</b>	<b>32</b>	<b>2.855</b>	<b>100%</b>	<b>606</b>	<b>100%</b>	<b>28.279</b>	<b>100%</b>

Source: Banking sector in Serbia, Report for the first half 2013, National Bank of Serbia.

Domestic banks with foreign capital still have major share with participation by 75% of total assets, as well as of total capital of the banking sector. Banks originating from EU countries dominate with 70.7% (69.2% from Eurozone-Italy, Austria, Greece, France), while banks from Russia and the USA have 3.6% and 0.3% respectively. Some of EU globally active banks that are operating in Serbia are Societe General, Credit Agricole, Intesa, Erste Bank, etc.

Recent changes decreased number of banks (to 30) operating in Serbia and they are all universal type: AIK banka a.d. Niš, ALPHA Bank Srbija a.d. Beograd, Banca Intesa a.d. Beograd, Banka Poštanska štedionica a.d. Beograd, Crédit Agricole banka Srbija a.d. Novi Sad, Čačanska banka a.d. Čačak, Dunav banka a.d. Beograd, Erste bank a.d. Novi Sad, Eurobank a.d. Beograd, Findomestic banka a.d. Beograd, Hypo Alpe-Adria-Bank a.d. Beograd, JUBMES banka a.d. Beograd, Jugobanka Jugbanka a.d. Kosovska Mitrovica, KBC Banka a.d. Beograd, KBM Banka a.d. Kragujevac, Komercijalna banka a.d. Beograd, Marfin Bank a.d. Beograd, NLB Banka a.d. Beograd, Opportunity banka a.d. Novi Sad, OTP banka Srbija a.d. Novi Sad, Piraeus Bank a.d. Beograd, ProCredit Bank a.d. Beograd, Raiffeisen banka a.d. Beograd, Sberbank Srbija a.d. Beograd, Société Générale banka Srbija a.d. Beograd, Srpska banka a.d. Beograd, Unicredit Bank Srbija a.d. Beograd, Vojvodanska banka a.d. Novi Sad, VTB banka a.d. Beograd. They do not have the same level of interest and/or capacity for PPP financing. However, banks that are traditionally present in infrastructure financing in Serbia could be more prepared for this kind of arrangement.

The Law on Public-Private Partnership and Concessions<sup>1</sup> allows the public sector to hire an advisor in all stages of a PPP project cycle as: “one or several

*legal entities or natural persons possessing specialist knowledge required for the preparation, negotiation and realization of a public-private partnership project*”. The Law itself recognizes the importance of the financiers’ role, too, and indicates that a public contract can be financed by a private partner through a combination of direct capital investments or through lending, including unlimited structured or project finance, etc. provided by international financial institutions, banks, or third parties (financiers). With the prior consent of the public partner, the private partner will be authorized to assign, mortgage, or pledge any right or obligation from the public contract, or any other underlying asset of the project, to the financier’s benefit, in order to secure the payment of any current or future receivables in respect of the construction and financing or refinancing of the PPP project.

At the request of the financier and private partner, the public partner may accept to provide certain reasonable collaterals, and to assume certain responsibilities necessary to the private partner in respect of any obligation from the public contract.

Such collateral may also refer to the signing of a special direct contract between the public partner, private partner and financier, according to which, among other things, the public partner may agree to the following: financiers will be authorized to – temporarily, instead of the private partner – implement all rights from the public contract, and correct any oversights of the private partner, and the public partner will recognize the above actions as if they were conducted by the private partner.

This legal framework gives explicit possibility for banks to take the role of advisors and financiers of PPP projects in Serbia.

## Conclusion

The activities of the EU banks on the project finance market have shown that their strategic dedi-

<sup>1</sup> Official Gazette of the Republic of Serbia, No. 88/2011.

cation to financing PPP projects has not diminished even in the challenging times of the global economic crisis. Although the global economic crisis did cause some serious turmoil on the global market of financing PPP projects and project finance in general, the trends at the global and European level indicate that the markets are dynamic, that all regions in the world are well represented, and that the demand for finance has been omnipresent and adequately satisfied.

The possibilities that are open in the Republic of Serbia in terms of financing PPP projects, along with the level of banking sector's development, provide rather positive prospects for a more intensive presence of PPP projects on this market. The research results are important for banks in Serbia in two ways:

1. Serbian banks with major share of foreign capital can use various forms of benefits via: (a) Direct impact (via connection with mother-bank) through know-how, same policy and procedures, experience sharing, expertise, easier insight into the country/region specific, culture familiarity; (b) Indirect impact (via non-EU banks), due to their

know-how, syndication, diversity of services, competition. In both cases, benefits are also in risk sharing, political risk mitigation (mostly through participation of IFIs or public bank), hedging, regardless the origin of the bank advisor/financier.

2. In parallel, existence both of capable domestic banks and future PPP projects, is important for current banking system, too, for the fact that currently it is (over) liquid and seeking for investment opportunities in order to achieve its optimum.

Although PPP financing is international deal and country could benefit it, there are advantages if PPP projects were to be financed by one or several banks operating in the same country in which the project is located related to complete avoidance of FX risk and the fact that domestic banks are most familiar with the business conditions in the local environment. Therefore, measures and regulation by the government and by the Central Bank could be issued in a way to stimulate its competitive advantage which will be recognized by the international participants and particularly by the banks operating in Serbia.

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