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EU'S NEW NEIGHBOURS: THE CASE OF UKRAINE

LAPPEENRANTA UNIVERSITY OF TECHNOLOGY

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Foreword

The Northern Dimension Research Centre (NORDI) is a research institute run by Lappeenranta University of technology (LUT). NORDI was established in the spring 2003 in order to co-ordinate research into Russia. NORDI's mission is to conduct research into Russia and issues related to Russia's relations with EU with the aim of providing up-to-date information on different fields of technology and economics. NORDI's core research areas are Russian business and economy, energy and environment, the forest cluster, the ICT sector, as well as logistics and transport infrastructure. The most outstanding characteristic of NORDI's research activities is the way in which it integrates technology and economics.

LUT has a long research tradition in making research and educating students in the field of communist and post-communist economies. From the point of view of these studies, LUT is ideally located in the Eastern part of Finland near the border between EU and Russia.

This volume "EU's New Neighbours: The Case of Ukraine" tells about Ukraine – one of the largest European countries, but surprisingly unknown for many Europeans. Authors aim to provide readers with overview of Ukrainian economy and politics and discuss investment climate in Ukraine, Ukrainian regions and investments in the different Ukrainian industries.

The authors would like to express their gratitude the EU's Interreg IIIA programme and the cities of Lappeenranta, Imatra and Joutseno and the Ministry of Education in Finland for their financial support towards NORDI. We also give our sincere thanks to our colleagues in Lappeenranta University of Technology: to Riitta Salminen for proof-reading of the book; to Professor Juha Väätänen and to NORDI's coordinator Maija Toivonen for valuable comments, editing and support; to Natalia Dobrovolskaya and Antonio Saluena from Information Technology Department for technical assistance and comments, to Daria Palitsyna for help with proof-reading and editing. We also are thankful to Ukrainian specialists Alexander Marchenko and Artem Poddubny for help with collecting materials, creative ideas, comments and editing.

Lappeenranta, March 2004

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1. Introduction

The communist system of central planning collapsed in Europe in two waves. In 1989, the former Eastern bloc countries abandoned the undemocratic form of society in a peaceful manner. Two years later, the former Soviet Union comprising 15 republics, dissolved itself. This former superpower with 288 million inhabitants was divided in 15 independent states.

Shortly after the collapse of the Soviet Union, a new edifice, the Commonwealth of Independent States (CIS), was created. Twelve former Soviet republics joined the CIS, which is a loose organisation with no supranational powers. Occasionally, CIS is called the former Soviet Union. This is not correct. Three former Soviet republics, the Baltic States (Estonia, Latvia and Lithuania) never joined the CIS.

In the Soviet era, it was usual to point out that the Union had two big republics, Russia (with over 150 million inhabitants) and Ukraine (with more than 50 million citizens). In the post-Soviet period, Ukraine has hardly been in headlines in the financial press. There are several reasons for this fact. Ukraine has not been involved in the Eastern enlargement of EU. Even if Ukraine is rather big and resourceful country in European comparison, it is not a net exporter of energy bearers, like oil and natural gas. Transitional process in Ukraine has been especially arduous, and thus, foreign companies have had only marginal interest in establishing themselves in that rather large country.

After the first wave of EU's Eastern enlargement, three EU–countries (Poland, Slovakia, and Hungary) have common border with Ukraine, whose economy has started to improve lately. Thus, it can be assumed that there will be increasing interest in Ukrainian economic development in the EU–region.

Ukraine offers a rather large internal market with an interesting bridge–head position between the enlarged EU and CIS. In many transitional economies (TEs) of Central Eastern Europe (CEE), labour costs have increased rapidly since the middle of 1990s. In TE-comparison, Ukraine can presently offer very convenient cost level. This fact may offer special attraction for those foreign investors who are active in labour-intensive branches.

It is a well known fact that cheap labour is only one factor of the investment climate. FDI flows are not necessarily determined by relative values of nominal wages. So far, Ukraine has been able to attract FDI into her territory in a very modest scale. The main aim of this research report is to shed light to Ukrainian FDI scene as it is now and how it will develop in the nearest future.

2. Ukrainian Economic Trends

2.1. Economic Growth and Stability in the Early Period of Transition

In the immediate post-communist period, all TEs without any exceptions suffered an economic decline. This slump, which was linked with high inflation rates, was more severe in the former Soviet republics, than in the former Eastern bloc countries. This difference has some obvious reasons. The Soviet economy was highly centralised for a rather long period of time, longer than in Eastern Europe. Decentralising this huge administrative system caused an enormous shock wave when Moscow's planning system ceased to exist. In this context it must be noticed that the main resource base remained in Russian territory. Thus, crucial supplies (oil, gas, etc) stopped suddenly to flow to CIS-countries according to the old system. The Soviet Union had a huge military-industrial complex which had priority in various deliveries. This mighty complex experienced as sudden disruption amid the collapse of the empire sending shock waves through the newly independent states.

In every Eastern bloc country there was a socio-political and economic statehood in communist era. That was not the case in former Soviet republics. Institutional infrastructure (parliament, government, central bank, etc) had to be created in Estonia, Ukraine, Armenia, and so on. Therefore, early transition was especially difficult in post-Soviet TEs.

In every communist country, foreign trade was a monopoly of the state. In the Soviet Union that meant that this tightly controlled monopoly was functioning in Moscow, only via so called FTOs (foreign trade organisations), which were formed according to industrial branch (Avtoexport dealing with export and import of automotive industry products, Stankoimport with machine tools, etc.). Capital cities of the Soviet republics were isolated from the foreign trade business. This handicap was not the same in Eastern Europe.

These important facts ought to be considered when comparisons between different TEs are made. A detailed analysis in this respect is not possible here. It suffice to say that the early period of transition was not a fair competition between equals.

In communist system, extensive waste took place. Many products, which were not sold to anybody, were permanently produced causing stockpiling. There are estimates that military hardware made up some one third of the Soviet production. In the transitional period cost-benefit analysis must be taken into consideration, as well as the marketability of products.

Thus, the slump of the early transition involved cutting off dead wood from the production process. It is, however, impossible to calculate how much of the economic decline in the early 1990s was rational from the restructuring point of view and how much of it was unnecessary. In the 1990s, economies in TEs started to recover, but in a very uneven manner. General trends of economic growth in the post communist period can be described by some index figures (Table 1).

Table 1. GDP Trends in TEs, 2002

	Index 1990=100	Index 1995=100
CEEC 5[1)]	128.3	127.2
Bulgaria	87.9	104.0
Romania	92.3	102.8
Russia	72.4	116.6
Ukraine	49.1	102.7
Estonia	97.4	140.5
Latvia	70.7	142.6
Lithuania	76.5	131.9

[1)] Poland, the Czech Republic, Slovakia, Slovenia, Hungary
Source: WIIW

The base year of the first index is 1990. Thus, the deep slump of the early transition is included. CEEC-group (of 5 countries) exceeded in 2002 the GDP level of 1990 by almost 30 %. These five countries were called in the 1990s “transitional tigers”. Bulgaria and Romania, which are not joining EU in the first-wave enlargement, have figures below 100. It means that their economies were in 2002 on a lower level than in 1990. The same can be observed in all former Soviet republics in the above table.

Ukraine has the lowest figure in the first comparison. Economic activity was roughly halved in the given time-frame (1990-2002). This decline was more severe than in the small national economies in the Baltic area (which are former Soviet republics as well).

The base year of the second index is 1995, with other words, the original slump of the transitional period is eliminated. All figures in that second column are over 100. In the CEECs (5) the total growth since 1995 is again about 30 %. Estonia and Latvia have even higher growth performance, over 40 %. The lowest figures can be found in Bulgaria, Romania (relegated from EU entry), as well as in Ukraine. In these three countries the overall growth between 1995 and 2002 has been only some 3-4 %.

Economic growth figures are difficult to interpret. In the communist time, there was an incentive to overestimate production figures to show plan fulfilment. In many cases, production, which did not take place at all, was recorder by communist time enterprises. Statistics are, thus, not necessarily comparable in the time of systemic change.

Inflation was a real problem in early transition, especially in the former Soviet Union. This can be illustrated with some simple figures (Table 2).

Table 2. Inflation. Consumer Price Index, 1989=100

	1997
Ukraine	14 172 537
Russia	659 723
Bulgaria	146 393
Romania	34 759
Czech Republic	327

Source: WIIW

In the communist time, almost all prices were centrally fixed. However, the system was not able to guarantee that supply and demand are in equilibrium. Thus, special phenomenon "hidden" inflation came into being: people had to wait for many items and stand in line for groceries. Everything was available in "the black market" for a high price. People had "forced savings", which meant that meager supplies caused accumulation of purchasing power: this problem was called "monetary overhang".

Transition means free market and free prices, which skyrocketed in the early period of post-Soviet time. When 1989 is taken as base year of the consumer price index (CPI), Ukraine had after 10 years (1997) an index figure over 14 million! In Russia, the equivalent figure was about 660 000, and in Bulgaria almost 150 000. In the Czech Republic, consumer prices increased in the same period only 3.3 times.

Experience in many countries shows that hyperinflation makes saving (capital formation) and investment irrational. If individuals save money, it is rational to convert saving into something more stable, for example, into foreign currency. Feasibility studies in investment are hardly possible, when there is a runaway increase in prices.

In the early period of Ukrainian and also of Russian transition there was reckless printing of money. In both cases economic recession was fought by excessive monetary supply. Amid severe shortages this uncontrolled money supply caused unpredictable inflation rates which postponed economic recovery. In the above table the Czech Republic is taken as a comparison with relative price stability in the early transition period.

Strong inflation always induces capital flight. There are plenty of evidences of this in economic history, e.g., in Latin America and in transitional Russia and Ukraine. Investment in the host country of hyperinflation is unlikely to take place.

Thus, a healthy transition calls for relative stability which is the most important single factor of healthy investment climate. In the second part of the 1990s, this very basic fact was recognized in all TEs.

2.2. Investment and Productivity

The very essence of communist economic thinking was underlining capital formation and industrialisation. Preference was given to "heavy industry", or production of input goods (metals and machines). It was said that capital formation (saving) was too important factor to be left to individuals. Central planners always set a high investment quota (the share of investment of GDP) and organized equivalent saving rates without relying on individual or enterprise savings.

This economic development model, which is called "the extensive way of economic growth", never established proper cost-benefit calculations based on relative scarcities of resources. Extensive growth meant to maximize the capital stock without paying attention to the qualitative side, that is, to technology and quality.

It is a well-known fact that various economic reform attempts took place in different communist countries before the system collapsed. The core of every reform was trying to find a path of "intensive economic growth", which underlines efficiency and productivity. In the extensive growth model, increased output is supposed to be achieved by adding factors of production (primarily capital), while in the intensive growth model the aim is to find allocative efficiency and receive the best possible benefits out of existing means of production. The system of central planning failed because it was unable to find a scheme for post-industrial information society based on intensive elements of economic development like new technology, human skill and flexibility.

In the early years of transition, there was a tendency of investment (gross fixed capital formation) to decrease in all TEs. In Poland, where a new growth path was found already in early period of transition, investment boom started in early 1990s gaining strength in the previous decade. In the two large former Soviet republics, in Russia and in Ukraine, investment activity just collapsed in the early period of transition.

The base year of the first index in Table 3 is 1990, marked with 100. Russia and Ukraine show both a figure of about 30 in 2002, which means that investment virtually collapsed in the period of post-communist stagflation. In the same period (1990-2002) investment in Poland roughly doubled, while there was a 70 % decrease in Russia and Ukraine. Bulgaria and Romania, which were unable to achieve EU-accession in 2004, are taken as comparisons. Both of them have in the first index figures over 100 hinting on investment growth.

Table 3. Gross Fixed Capital Formation, 2002

	Index 1990=100	Index 1995=100
Bulgaria	108.9	151.3
Romania	123.2	116.1
Russia	29.2	94.8
Ukraine	29.3	111.1

Source: WIIW

In the second index (1995=100), Russia is below 100 mark (about 5 %), while the other three countries exceed the base year level: Bulgaria very clearly by more than 50 %, Romania with 16 % and Ukraine by 11 %.

From the restructuring point of view it is essential to have positive development in TEs' investment trends. There is an urgent need to modernize existing capacities and build up new ones. If that trend is missing, there is an obvious danger of long-term decline of the economy.

A turning point in Ukrainian investment scene was reached in 1998, when investment in physical capital grew by 6.1 % (on the annual basis). However, in the following year (1999), there was a virtual stagnation of investment (+ 0.4 %). In 2000, the same figure was clearly positive (14.4 %) and in 2001 investment growth accelerated to 20.8 %. Investment growth in 2002 was with 6.2 % rather moderate.

Labour productivity in industry is one of key indicators in the development process of TEs. Also this sphere can be measured by using index numbers (Table 4).

Table 4. Labour Productivity in Industry, 2002

	Index 1990=100	Index 1995=100
Bulgaria	142.6	123.7
Romania	154.0	147.2
Russia	94.2	145.0
Ukraine	124.2	180.2

Source: WIIW

Productivity in Russian industry was in 2002 almost 6 % lower than in 1990. Equivalent figures in other countries were all positive, over 100: Romania had growth of 54 %, Bulgaria 42.6 % and Ukraine 24.2 %.

In all TEs, unemployment started to appear in the 1990s. In communist system by definition there was full employment everywhere. Enterprises where not interested in cost factors, but in plan fulfilment. It was an advantage to hoard all resources including labour. "Unemployment in the working place" took place in large scale: people were in the payroll, even if their input was not necessarily needed. In the transitional period labour costs must be seriously considered, and thus, open unemployment has come to the surface. This is likely to improve productivity.

In the second index (1995=100) all four countries under review have clearly positive results (over 100). Ukraine has far the best mark with a productivity level in 2002 some 80 % higher than in 1995. Bulgaria’s equivalent figure is modest, 24 % only, while Romania and Russia both show an improvement of almost 50 %.

Ukraine shows annual productivity gains starting 1996. The growth has not been even. In the turn of the century, productivity improved considerably, 9.6 % in 1999, no less than 28.3 % in 2000 and 12.5 % in 2001. Therefore, the overall results in the previous table in the second index are very positive.

2.3 Living Standard

Ukrainian living-standard has suffered a relative quantitative decline in the early period of transition. According to statistical data by WIIW, the living-standard in Ukraine was about 40 % of the level reached in EU (average of 15 countries) in 1990. In this figure GDP per capita in current purchasing power parity (PPP) in Euro (ECU) is considered.

When the same method is used in the transitional period and an equivalent figure for 1995 is taken, the result in Ukraine is less than half of the 1990 figure: only 18 % of the EU average living standard (Table 5). In 2002, the same comparative figure was 19 %. Thus, the average living-standard in EU is about five times higher than in Ukraine. Greece, the poorest EU country, is about four times better off than Ukraine.

Table 5. GDP Per Capita at Current PPPs (EUR0), 2002

	2002
Bulgaria	7 645
Romania	5 980
Russia	7 000
Ukraine	4 528
Greece	16 555
EU (15) average	23 582

Source: WIIW

As mentioned, above figures are calculated at current PPPs, Euro-based. Some clarifying remarks are needed. The most usual way of living-standard comparison is to take gross domestic product (GDP) figures per capita converted in US dollars or euros from countries under review. These figures are grossly misleading if emerging markets (like TEs) are involved. There is no perfect market in TE-region, and thus, there are many biases, for example, in exchange rates (ER). Official ERs do not reflect local price level correctly. Basically, prices in emerging markets are lower than in the rich part of the world. Thus, “original” figures – GDP per capita in Euros without PPP adjustment – give results which are misleading from the point of view of real living-standard: one dollar or one euro buys more hamburgers, tomatoes, or potatoes in TEs than in EU-region.

Currencies in TEs are all undervalued, which means that the “original” figures (GDP per capita in Euros) are lower than the PPP-adjusted ones. These two figures ought to be identical: official ER should reflect the local price level perfectly well. Unfortunately, this is not the case in emerging markets.

The biases of official ERs can be measured with a tool called exchange rate deviation index (ERDI). It is derived in every country with a simple method: PPP-adjusted GDP figure per capita (in dollars or euros) is divided by the original figure (GDP per capita in dollars or euros). The result says how much there is deviation in the official ER.

For example, if in a country (TE) ERDI value is 5, it means that price level in that country is one fifth of the price level (20 %) of dollar or euro area. In this case ER deviation is very strong.

Undervaluation of a currency is also called “exchange rate protectionism”. In very primitive terms, undervaluation of a currency can be called “devaluation in beforehand”: with high ERDI value, price competitiveness is created for exportables and importables are made expensive in the eyes of local clients (calculated in local currency). Thus, undervaluation of a currency has an important economic function. It keeps the balance of payment on current account (CA) in relative equilibrium. In simple terms, undervaluation of a currency (ERDI value over 1) helps to keep import expenditure in line with export revenue.

If there is a severe deficit in a current account (CA), which is persistent, the deficit-country must one way or the other bring export and import bookkeeping in relative equilibrium. Devaluation is a tool to achieve this aim: depreciation of a currency means that ERDI value increases. The higher is the ERDI, the higher is “the ER protectionism”.

ERDI values were relatively high in all TEs in 1995 (Table 6). With improving competitiveness (with higher quality exportable, and import-substituting local products) ERDI values are supposed to go down (undervaluation advantage erodes). ERDI values in TEs show clearly diminishing tendency in TE-region.

ERDI has declined strongly in Lithuania and Romania (more than 40 % in both). On the other side of the scale, there is the richest TE, Slovenia, with low ERDI value in 1995, and thus, little change in 1995-2002 (only - 4 %). Bulgaria had rather high ERDI in 1995 and still in 2002, and thus, a low decrease. Ukraine has far the highest ERDI value in both years under review: it was exceptionally high in 1995 (over 6), but also in 2002 Ukraine has the highest value in TE comparison (over 5). This extreme ERDI value gives really good competitiveness for Ukraine not only in East-West comparison, but also within TE-region.

Table 6. ERDI, Euro-based at Current PPPs (EURO)

	1995	2002	Growth, % (1995 - 2002)
Russia	3.49	2.75	- 21.2
Ukraine	6.06	5.08	- 26.2
Czech Republic	2.90	2.07	- 28.7
Hungary	2.44	1.92	- 22.0
Poland	2.47	1.90	- 23.1
Slovakia	2.99	2.69	- 10.0
Slovenia	1.54	1.53	- 3.8
Bulgaria	4.15	3.62	- 12.7
Romania	4.77	2.82	- 40.9
Estonia	3.09	2.07	- 33.0
Latvia	3.21	2.19	- 31.8
Lithuania	3.96	2.19	- 44.7

Source: WIIW

In living-standards comparisons wages are naturally in key position (Table 7). Nominal wages (calculated in euros) have strongly increased in TE-region between 1995 and 2002. Nominal average gross wage / month is the highest in Slovenia (over 1000 euros) in TE-region, where wage differences are striking: Ukraine has far the lowest figure in 2002 with a mere 75 euro per month. It is almost twice as much as equivalent figure in 1995.

Table 7. Average Growth Wage/Month (EURO)

	1995	2002	Growth, % (1995 - 2002)	Real Wage (nominal wage x ERDI)
Czech Republic	230	511	115	1 057
Hungary	239	502	110	966
Poland	220	591	169	1 121
Slovak Republic	187	317	70	853
Slovenia	731	1039	42	1 591
Bulgaria	87	138	59	500
Romania	107	175	64	494
Estonia	160	373	133	774
Latvia	131	292	123	638
Lithuania	93	298	220	651
Russia	90	149	66	410
Ukraine	38	75	97	381

Source: WIIW

Real wage is PPP-adjusted, that is, the nominal wage is multiplied by ERDI. Real wage differentials are smaller than in nominal pay package. Nominally, Slovenians are about 14 times better than Ukrainians. In the real wage comparison (ERDI corrected), the difference between these two countries still exists, but it is only 4.2 times.

When multinational companies make their investment decisions and compare labour costs in various locations, they pay special attention to unit labour costs (ULC), which contain productivity differentials in various countries. Unit labour costs in TEs are continuously relatively advantageous in Western comparison.

In the Table 8, Austria (a rather well-off EU-country) is marked with 100. The table tells us, how much ULCs in TEs deviate from the Austrian (EU) level.

ULCs in TEs were very low in 1995 (in Austrian comparison). However, there has been a rapid or even very rapid increase in comparative level of ULCs in TEs: the highest growth rates (1995-2002) can be found in Lithuania (122.7 %) and in Poland (110 %). ULC-level is only some 40 % cheaper in Poland than in Austria (2002). Lithuanian level (2002) is still only one third of the Austrian equivalent, even if there has been rapid increase since 1995.

Table 8. Unit Labour Costs (PPP adjusted), Austria = 100

	1995	2002	Growth, % (1995 - 2002)
Czech Republic	20.9	40.9	95.7
Hungary	21.3	38.1	78.9
Poland	27.9	58.6	110.0
Slovak Republic	18.6	25.5	37.1
Slovenia	49.7	59.9	20.5
Bulgaria	11.8	17.1	44.9
Romania	18.9	29.7	57.1
Estonia	23.7	38.7	63.3
Latvia	23.2	38.5	66.0
Lithuania	15.0	33.4	122.7
Russia	16.5	24.7	49.7
Ukraine	10.1	17.7	75.3

Source: WIIW

Ukraine and Bulgaria offer the best alternative. In both countries the marking in ULC table is less than 18 % (of the Austrian level). It means in actual fact that internationally active companies can hire about 6 Bulgarians or Ukrainians with the average pay of one Austrian. Thus, in labour intensive activities these two TEs (Ukraine and Bulgaria) offer the best alternatives in ULCs comparison.

In 2002, there were about 2.2 million unemployed persons in Ukraine. From the foreign investor's point of view, it means that cheap labour in large magnitude is available in the national economy of Ukraine.

At the same time, it is worth remarking that from the point of view of direct export (from the West to Ukraine) the country under review is far from optimal. Ukrainian import figure is amazingly low: in 2001-2002, the country imported annually only in total value of 18 billion euro. This is roughly the same figure, as in neighbouring Slovakia with over five million inhabitants. Low living-standard and extremely high ERDI value create a protective wall, which is here called "ER protectionism". Import is thus kept on a very low level.

2.4. Current Economic Trends

In the turn of the century, certain consolidation of the Ukrainian economy has taken place. GDP, which was brought to a very low level in the early period of transition, started growing in 2000 (Table 9). Very strong inflation in the 1990s seemed to become a permanent problem, but relative price stability has been achieved lately.

Table 9. Main Economic Indicators of Ukraine

	1998	1999	2000	2001	2002
Population, mn	50.1	49.7	49.3	48.4	48.0
GDP, real growth, %	-1.9	-0.2	5.9	9.2	4.8
Inflation of consumer prices, %	10.6	22.7	28.2	12.0	0.8
Unemployment rate, LFS[1] estim.	11.3	11.9	11.7	11.1	10.2
Current account, % of GDP	-3.1	5.2	4.7	3.7	5.7
Gross fixed investment (% growth)	6.1	0.4	14.4	20.8	8.9
Central government budget Deficit (-), surplus (+) % of GDP	-2.2	-1.5	0.6	-0.3	0.8
Reserves of NB[2], excluding gold USD mn	761	1 046	1 352	2 955	4 241
Export (% growth)	-10.1	-3.8	45.3	15.1	4.7
Import (% growth)	-13.2	-15.3	36.0	16.6	2.0

Source: WIIW

Obviously, the boom period of 2000-2002 contains some special factors. In that phase, oil prices were on a high level on the world market giving a boost for Russian economy, which is an extremely important export market for Ukrainian goods. In addition, agricultural years 2001-2002 were exceptionally good. Thus, GDP grew vigorously, by more than 9 % in 2001.

Inflation rate has abated from 28 % in 2000 to 12 % in 2001 and further to less than 1 % in 2002. Obviously, an important background factor in this positive development is the good shape of agriculture: two bumper harvests have increased foodstuff supply on the home

[1] LFS – Labour Force Survey
[2] NB – National Bank

market exercising pressure on the price level. Thus, no ultimate price stability can be predicted in the immediate future. Current account shows an annual surplus of 4-6 % of GDP between 1999 and 2002. This yearly results are not surprising because Ukraine has continuously a very high ERDI value of 5, which gives ample price competitiveness even in TE-market, an important destination of Ukrainian exportables.

A crucial factor from the long-term growth point of view is the development of investment. Last years' trend hints on improved investment climate, especially in the sphere of relative price stability. No dramatic increase in FDI flow has taken place. In this important field Ukraine offers alongside with Bulgaria very advantageous ULCs.

There is plenty of evidence that FDI inflow in European TEs has speeded up transitional process in those countries involved in Eastern enlargement of EU *(see T. Tiusanen: Pan-European Integration. EU's Eastern Enlargement, 2003*).

There is a huge concentration of FDIs in CEECs which may mean that a certain level of saturation has been reached (especially in the Czech Republic, Slovenia, Hungary and also in Estonia in the Baltic region). If that is really the case (for which there is no guarantee), it might be that potential investors are looking for new opportunities further East, for example, in Ukraine, whose economy is definitely in a better shape than five years ago. In the first years of the 21st century, central government budget has been in equilibrium, an essential improvement in comparison to the 1990s. Ukrainian labour market offers highly educated people with advantageous compensation.

2.5 Distribution of Incomes and Household Expenditures

According to the official statistics, the average of the household in Ukraine was 2.71 in 2002 (Table 10). The number of households with 4 people has decreased during last four years due to demographic situation in country.

Table 10. Average Household Size

	1999	2000	2001	2002
Average household size, persons	2.77	2.76	2.73	2.71
1 person, %	20.1	20.9	21.0	20.9
2 persons, %	28.2	27.6	28.1	29.2
3 persons, %	21.4	22	22.1	22.6
4 and more, %	30.3	29.5	28.8	27.3
Total population, %	100	100	100	100

Source: Goskomstat[3] of Russia

[3] Goskomstat – State Statistical Committee of Russia

The income level of households in Ukraine is much lower than in Europe. It is difficult to estimate the real incomes because of high rate of non-registered salary payments in Ukraine and other CIS countries. Table 11 represents data on the minimum wage (X) in Ukraine and Russia and distribution of employees based on the salary they receive in comparison with minimum wage (X): from 1X to 3X, from 3.1X to 6 X, etc.

Table 11. Income Distribution, %

<table>
<tr><th></th><th>Ukraine (Dec 2001)</th><th>Russia (May 2002)</th></tr>
<tr><td>Minimum wages level (local currency)</td><td>118 UAH</td><td>450 RUB</td></tr>
<tr><td>Minimum wages level (USD)</td><td>22 USD</td><td>16 USD</td></tr>
<tr><td>Less than minimum wages</td><td>11.0</td><td>1.9</td></tr>
<tr><td>1 – 3</td><td>56.1</td><td>10.6</td></tr>
<tr><td>3.1 – 6</td><td>22.2</td><td>19.0</td></tr>
<tr><td>6.1 – 10</td><td rowspan="4">10.7</td><td>22.3</td></tr>
<tr><td>10.1 – 15</td><td>17.8</td></tr>
<tr><td>15.1 – 20</td><td>10.4</td></tr>
<tr><td>More than 20</td><td>18.0</td></tr>
<tr><td>Total (%)</td><td>100</td><td>100</td></tr>
</table>

Source: Goskomstat of Russia

The minimum wage in Ukraine at the end of 2001 was 118 UAH[4] (approximately 22 USD); in 2003 it increased up to 205 UAH (approximately 38.5 USD). The minimum wage in Russia was set as 450 roubles (approximately 16 USD) in May, 2002. In 2001, 11 % of the Ukrainian employees were paid less than minimum level. The majority of working people (56.1 %) receive salary which is 1 – 3 times minimum – between 22 USD and 66 USD. 22 % of Ukrainians get salary 3 – 6 times higher than minimum (from 66 to 132 USD), and the rest 10.7 % have higher salary (6 times more than minimum or higher).

According to the Vienna Institute's data, the average wage in Ukraine has been growing from 40 Euro in 1999 up to 75 Euro in 2002 (Table 12). The PPP adjustments are made in order to get average wage closer to the reality.

Table 12. Average Monthly Wages (in 1997–2002)

	1997	1998	1999	2000	2001	2002
Euro (ER)	68	55	40	46	65	75
Euro (PPP adjusted)	257	249	231	250	317	380
ERDI (Euro based)	3.8	4.5	5.72	5.46	4.91	5.08

Source: WIIW

The structure of the household income has been changing during the last years (Table 13). As in 1999 the money incomes were only 63.8 %, in 2002 this figure increased to 80 %. After the currency meltdown of 1998, the share of non-monetary income was significant, as people tried to survive in difficult economic situation by producing their own foodstuffs. In 1999 this

[4] UAH – Ukrainian National Currency, Hryvna. The average ER during 2003 was on the level of 1USD=5.33 UAH, 1EURO=6.0 UAH

non-monetary component of income was 23 %, but decreased to only 10 % in 2002. The average monthly income per household has practically doubled since 1999, considering monetary and non-monetary income.

Table 13. Average monthly income and income structure, %

	1999	2000	2001	2002
Money Income	63.8	68.1	75.8	80.0
- salary paid	34.1	37.1	40.8	42.8
- entrepreneurship income	2.6	2.4	3.1	3.2
- agricultural products sales	3.8	5.3	5.5	5.0
- pensions, subsidies, stipends, etc	16.2	15.9	18	20.4
- other money incomes	7.1	7.4	8.4	8.6
Costs of consumed products, produced by households	23.0	17.1	13.1	10.3
Subsidies for accommodation and public utilities costs	3.7	2.9	2.5	2.0
Other Subsidies	0.9	0.9	0.7	0.7
Other incomes	8.6	11.0	7.9	7.0
Total Incomes, %	100	100	100	100
Average Monthly income per household, UAH	332.0	422.9	520.8	608.1
Average Monthly income per household, USD	62.3	79.3	97.7	114.1

Source: Goskomstat of Russia

According to the research made by a marketing research agency, 76 % of the Ukrainian population live under the poverty line (Table 14). The study classifies people, earning less than 200 USD per month as poor. 10 % of population are considered as “lower middle class” with income between 200 and 500 USD. Only about 14 % of people earn more than 500 USD.

Table 14. Distribution of Population by Income, 2002

	%	Income monthly
Poor	76 %	Less 200 USD
Lower Middle class	10 %	200 – 500 USD
Middle class	7 %	400 – 1000 USD
Rich	5 % *	More that 1000 USD
Richest	1.5 – 2 % *	More 10000 USD

*Source: Sirex Marketing Service, * of urban population,*

Official statistics show that the category with lowest income (lower than 85 USD) has decreased between 2000 and 2002 (Table 15).

Table 15. Income Distribution, 2000 – 2002, %

	UAH	USD	2000	2001	2002
Higher income	5001 +	939 +	1.4	1.3	1.5
High income	1701 - 5000	319 - 938	4.9	3.2	5.8
Higher than average	801 - 1700	150 – 318	14.0	16.9	15.3
Average	451 – 800	85 - 149	26.3	26.2	34.0
Lower than average	226 - 450	42 – 84	32.5	29.1	27.4
Low	100 – 225	20 – 41	15.4	20.1	13.6
Very low	0 - 99	0 - 19	5.4	3.2	2.4
Total			100	100	100

Source: Goskomstat data, authors’ calculations

The largest part of population (about 61 %) has income between 42 USD and 149 USD, what is considered as average and lower average level.

The average monthly expenditure of the households has grown by 54 % for the last four years (Table 16) from 80 USD up to 123.5 USD. More than 90 % of this sum represents the consumer expenditures: about 60 % goes to the food (including alcohol, tobacco, and eating out), 30 % goes to the other consumer products and less than 10 % is spend for accommodation payments and public utilities. Monthly food consumption in Ukraine (Table 17) has been stable during 1999 – 2000.

Table 16. Household Budget Expenditure (% of Total)

	1999	2000	2001	2002
Expenditures, USD, per household	80.0	101.6	113.9	123.5
Expenditures, UAH, per household	426.5	541.3	607.0	658.3
Consumer expenditures	96.6	93.3	93.7	92.8
- Food (including alcohol, tobacco, and eating out)	68.1	67.9	65.4	62.8
- Non-food products	28.5	25.4	28.3	30.0
- Accommodation payments and public utilities	8.6	6.9	9.0	9.2
-- of which deductions and subsidies	2.9	2.3	2.1	1.9
Other expenditure	3.4	6.7	6.3	7.2

Source: Goskomstat of Russia, authors' calculations

Table 17. Monthly Food Consumption per capita, average

	1999	2000	2001	2002
Meat and meat products, kg	3.7	3.3	2.8	3.3
Milk and milk products, kg	18.7	17.1	17.3	18.8
Eggs, items	19	18	16	17
Fish and fish products, kg	1.3	1.3	1.4	1.4
Sugar, kg	2.7	3.5	3.3	3.1
Vegetable oil, kg	1.5	1.8	2.0	2.0
Potatos, kg	10.2	10.4	11.1	10.3
Vegetables, kg	10	9.5	9.0	9.5
Fruits and berries, kg	2.0	2.5	2.2	2.4
Bread and wheat products, kg	9.1	10.7	10.7	10.7

Source: Goskomstat of Russia

The number of different consumer durables per 100 households (Table 18) has not changed much for the last 3 year. The number of TVs has increased compared with the level of 2000.

Table 18. Consumer Products per 100 Households

	2000	2001	2002
TV	68.6	71.2	74.2
Type recorder	43.3	42.7	41.0
Photo camera	21.8	23.2	25.1
Refrigerator	93.5	93.4	93.6
Washing machine	73.7	74.1	74.4
Vacuum cleaner	55.5	55.0	54.1
Sewing machine	47.9	46.2	43.3
Motor bicycle	6.6	6.0	5.1
Bicycle	42.8	42.6	42.2

Source: Goskomstat of Russia

3. Ukraine: History, Geography, Economy and Politics

One of the largest countries in Europe, by area 10 % bigger than France, Ukraine as independent country emerged in 20th century, after long periods of successive domination by Poland – Lithuania, Russia and the Union of Soviet Socialist Republics. The Ukrainian legislature proclaimed sovereignty in July, 1990 and then declared Ukraine's outright independence in August, 24, 1991 (*Ukraine report, 2001*).

Ukrainian national economy is based on the heavy machine building, ferrous and non – ferrous metallurgy, shipbuilding, automotive industry, manufacturing of agricultural machinery and machine tools, turbines and aircraft engines construction. But traditionally Ukraine is a country with strong agricultural sector.

In order to attract foreign investment, Ukraine has improved the legal framework. The Law of Ukraine "On State Budget for 2003" includes Article 21 "On Privatization of State Property", according to which foreign investors are allowed to buy state property. On July 9, 2003, the parliament of Ukraine passed a law which allows the sale of non-agricultural land to foreigners.

The cumulative FDI in Ukraine amounted to USD 5.6 billion or about USD 117 per capita on April 1, 2003. This figure is quite low when compared with the other countries in the region. But there is a trend towards FDIs growth.

Ukraine's business environment is complex and challenging, but it presents unprecedented opportunities to investors who can align their own needs with the necessities of the Ukrainian market, combine local expertise with the best international experience, and use a practical, hands-on approach in developing the market.

3.1. Geographic Location, Climate and Natural Resources

The territory of Ukraine is 603 700 km^2, which is 5.7 % of European territory and 0.44 % of world's territory. It occupies the South-Western part of Eastern-European Plains and a part of the Carpathian and Crimean mountains. It stretches for 893 km from North to South and for 1316 km from West to East. Ukraine has access to the Black and the Azov Seas. Due to its advantageous location in the centre of Europe, Ukraine is a transit country for passengers and cargo from many countries (Table 19).

Table 19. Map of Ukraine

Ukraine's territory is covered with dense network of large and small rivers (73 000). Ukraine has about 20 000 lakes. The biggest river systems are Dnepr, Danube, Dnestr, Southern Bug and Northern Donets. Dnepr - the largest river in Ukraine – is the third longest river in Europe.

The total length of the Ukraine's land and maritime borders is 7590 km. Ukraine verges with the Russian Federation (2063 km), the Republic of Belarus (975 km), the Republic of Poland (542.5 km), Slovak Republic (98 km), Hungary (135 km), Romania (608 km) and the Republic of Moldova (1194 km). The borders with countries of Central Europe are 2590 km. Ukraine is mostly flat: 95 % of lands are plains and 5 % are mountains.

Ukraine is located in two climatic zones: moderate and subtropical (southern shore of Crimea). Change of seasons can be clearly observed during the year. The weather and climate of Ukraine's territory positively influence economic activity, tourism and recreation.

Ukraine is rich of various minerals, including coal, iron ore, oil and gas, gravel, salt etc. Donbass is Ukraine's main coal production base; its deposits are estimated at 109 billion tns. Dnepr lignite basin contains about 6 billion tns of lignite. Oil and natural gas are located in Dnepr-Donetsk (80 %) and the Black Sea - Crimea regions. Ukraine covers 10 – 15 % of its oil consumption and 25 % of gas consumption by its own resources. Iron ore is found in Krivoy Rig (18.7 billion tns), Kremenchug (4.5 billion tns), Belozersky (2.5 billion tns) and Kerch (1.8 billion tns) basins. Nikopol basin contains the biggest deposits of manganese ore in the world. Nickel, chrome, titanium and mercury (2^{nd} place in the world) deposits are also considerable. Recently more than 15 gold deposits were discovered.

Ukrainian mineral waters are very valuable. The springs are located in Mirgorod, Svalyava, Truskavets and Feodosia. Mud from towns of Evpatoria and Saki has good healthy abilities.

The soil of the country is very rich: 2/3 of it is black earth. Experts estimate that Ukraine possesses 30 % of the world's black earth.

Ukrainian nature includes about 30 000 plants. Natural vegetative complexes are widely used as a basis for cattle-breeding, beekeeping, hunting and collection of wild medicinal herbs. Ukraine has a variety of species of animal world. About 44 800 animal species are found in Ukraine[5].

3.2. Political System and Regions

Ukraine comprises the Autonomous Republic of Crimea and 24 oblasts: Vinnitsa, Volyn, Dnepropetrovsk, Donetsk, Zhytomir, Zakarpatie, Zaporozhie, Ivano-Frankovsk, Kiev, Kirovograd, Lugansk, Lvov, Nikolaev, Odessa, Poltava, Rovno, Sumy, Ternopol, Kharkov, Kherson, Khmelnitskiy, Cherkassy, Chernigov, Chernovtsy. The cities of Kiev and Sevastopol have a special status set by the laws of Ukraine. Ukraine has 446 cities, 907 towns and 10 196 villages.

The population of Ukraine is approximately 48 million (and declining), of which 73 % is Ukrainian and 22 % Russian. The remaining population is made up of many minorities, the largest of which is Jewish (1.35 %), followed by Belorussians, Moldavians, Poles, Armenians, Greeks, Bulgarians and others. Ukrainian population is only 68 % urban. Literacy rate is extremely high in Ukraine – 99 %. All children received at least a high school education. Approximately one-third of them attend a university or other higher educational institutions.

Ukraine is a unitary state, and only the Verhovna Rada, or the Parliament, has the right to make laws. The Verhovna Rada is a one-chamber body, consisting of 450 People's Deputies elected to four-year terms. The deputies elected in 1994 were delegated on a majoritarian basis (the candidate received at least 50 % of the entire vote cast won a seat). However, in September 1997 a new law was accepted, according to which 225 deputies are elected on a majority basis and the other 225 on a proportional basis. The Verhovna Rada confirms the

[5] Materials of this sub-chapter were adapted from the www.mfa.gov.ua

appointment of a number of top government officials, including the Prime Minister and the Prosecutor General. The Rada also appoints one third of all judges to the Constitutional Court.

The President of Ukraine is elected for a five year period. The president is the head of the state, but not the head of the executive branch (this is the prime minister). The president is involved into activities in all branches of power, including signing and vetoing laws, appointing the Prime Minister (subject to confirmation by the Parliament) and dismissing him, regulating some issues of executive power by presidential decrees, and appointing a third of the judges to the Constitutional Court and judges to the general and arbitration courts. To fulfil all his tasks, the President has rather large and influential staff, the President's Administration. The President may be impeached by the Verhovna Rada. Currently the president of Ukraine is Leonid Kuchma, who was first elected in 1994 and later re-elected in 1999.

The Cabinet of Ministers is the state executive body headed by the Prime Minister. The Cabinet of Ministers is responsible for implementing laws passed by the Verhovna Rada and signed by the President. The Prime Minister and the Cabinet of Ministers together form the Government of Ukraine.

The Constitutional Court studies laws, presidential decrees, and decisions of the government and other official acts to see if they are constitutional. A system of general courts deals with criminal and civil cases, the same system of arbitrary courts submits decisions on commercial cases in which legal entities are involved[6]

There are over 100 political parties registered in Ukraine, but approximately only a dozen have significant size and influence. For example, more than 30 parties and organizations contested the March 2002 parliamentary election. From that number only a handful exceeded the 4 % threshold for the parliamentary representation. The main parties are: United Ukraine, Our Ukraine, Communist Party of Ukraine, Social Democratic Party of Ukraine-united, Yuliya Tymoshenko Bloc and Social Party of Ukraine.

The first mention of the modern national colours of Ukrainian flag dates back to the period of Hetman State and is found in the Lvov Chronicle of the 17th century. When Ukraine declared its independence in 1991, it adopted a new National Flag on January 28, 1992 - a horizontally 2-striped flag. The upper stripe, blue, is signifying the open sky and the bottom yellow stripe, symbolizing the wheat fields of Ukraine.

[6] Materials were adopted from www.usukraine.org

The Ukrainian State Anthem, “Shche ne vmerla Ukraina” (poetry by Pavlo Chubynsky, 1839-84) ("Ukraine Has Not Yet Perished" - or "Ukraine Lives On") is of quite recent origin. Mykhailo Verbytskyi (1815-70), composer of many Ukrainian songs realized the need for an anthem at the first Ukrainian concert in Western Ukraine, to honour the poet Taras Shevchenko[7]

3.3. History of Ukraine

Notwithstanding on the twelve years of independency only, history and culture of Ukraine goes deep into thousand years to the cradle of civilisation. In the 9th century AD, the name "Rus" first appeared in Kiev chronicle where it referred to the King and his men. According to Arab and Byzantine written sources, in the 12th century AD Rus was on the Taman Peninsula. Thereafter, Chervona (Red) Rus (or Halychyna), Bila (White) Rus (the territory of present-day Belarus) and Western Rus Lands (Volin) were referred to as Rus Provinces. Generally, the name "Rus" had been applied to all the lands of Kievskaya Rus since the 6th century AD.

Trypillya, Chernyakhiv, Zarubyntsi – ancient cultures had existed on the territory of Ukraine from the first millennium BC. A remarkable and mysterious civilisation of the Scythians, farmers and nomads, brave warriors and skilful craftsmen, existed in the 5th and later centuries BC in the South Ukrainian steppes and the Crimean peninsula. In Southern Ukraine many Hellenic cities were founded. This land was much trodden by the armies of ancient Persian and Parthian kings, Roman legions, hordes of Huns and Goths.

Since the 16th century, Cossack lands along the Dnepr were called Ukraine. The Cossacks' State headed by Bohdan Khmelnytski was also called Ukraine. Ukraine became popular in Western Europe after 1661 owing to publications by G.L. de Beauplan. From the beginning of 19th century, the name Ukraine was used to denote the entire territory where Ukrainians lived. Thus, all other names irrespective of their origin and length of use were removed.

The formation of Ukraine is closely connected with the history of *Kiev*, its capital. The earliest evidence of the city on the Dnepr River dates back to the 5th century AD, though, according to the results of archaeological excavation, Kiev is much older. In the 9th century, Kiev became the capital of a vast state of Eastern Slavs, whose territory spread to the Baltic Sea in the North, the Black Sea in the South, the Carpathian Mountains in the West and the Volga River in the East. In 998, when Christianity was introduced to *Kievskaya Rus,* it was already one of the most influential countries in Europe. Its political authority was widely

[7] Materials were adopted from www.ukremb.com

recognized; there were permanent diplomatic missions of leading European states. Kiev and other ancient cities of Rus became the cradle of the Slavic Orthodox culture.

In 13th century the Mongol-Tartars invaded Kievskaya Rus and the once brilliant Kiev civilisation was ruined. But even in those hard times, the old Ukrainian cultural tradition lived on. Kiev and its surrounding area came under the military and political control of the powerful and expanding Grand Principality of Lithuania, but it preserved its cultural originality. Old Ukrainian was the official language of the state. In the early 15th century, the Magdeburg Law gave the city of Kiev the status of a free city.

The strong and aggressive neighbouring states of medieval Ukraine – Rechpospalitaya exercised constant pressure upon Ukraine. In the South of Ukraine a unique Cossack republic, *Zaporizhian Sich*, appeared. It was a shelter for oppressed Ukrainians and a mighty defensive force against invading enemies, as well as a freedom-loving society with deep cultural traditions. After protracted and cruel wars in the middle of the 17th century, Ukraine became independent state headed by hetman, an elected state leader.

In 1654, Hetman Bohdan Khmelnytsky concluded an alliance with Russia, according to which Ukraine came under the aegis of the Moscow tsar. At the end of the 18th century, the greater part of Ukraine became a Russian province. The Western part of the country came under the authority of the Austrian dynasty of the Habsburgs. At the end of World War I the Russian and Austrian-Hungarian Empires collapsed. On January 22, 1918, the independence of the Ukrainian People's Republic, that united almost the whole territory of historical Ukraine, was declared. Its first president became a renowned historian and political figure, professor Mykhaylo Hrushevsky.

The Soviet Civil War of 1917-1921 was especially fierce in Ukraine with national forces fighting the Bolsheviks, Generals of the former Russian Empire's army, the anarchists' army, armed forces of Germany, Austria-Hungary, Great Britain, France, Greece, Romania and numerous bandit detachments. All of them fought for supremacy in Ukraine. Finally, in 1922, Ukraine became a republic of the USSR[8].

In the years of World War II Ukraine was one of the main battle grounds. 3 million Ukrainians were killed in action and 5 million more perished in the Nazi-occupied area. Ukraine's material losses are estimated at about 1 billion dollars[9].

[8] USSR – Union of Soviet Socialist Republics
[9] Materials of the sub-chapter were adopted from www.erevan.am/ukrembassy

The post-war Soviet period in the history of Ukraine was full of contradictions. On the one hand, Ukraine's economy and culture made vigorous progress, on the other hand, the persecutions and repressions continued. With the Soviet Union collapsing, the Ukrainian Parliament proclaimed independence on August 24, 1991. On December 1, some 90 % of the Ukrainian electorate endorsed independence and chose Leonid Kravchuk as Ukraine's first democratically elected president. Along with Russia and Belarus, Ukraine was a founding member of the Commonwealth of Independent States (CIS) in December of 1991.

3.4. Economic History and Reforms

3.4.1. Independence and USSR's Heritage

The population of Ukraine, as well as of other countries of the Former Soviet Union (FSU) bear strong traces of Communism on their mentality. In the Soviet period, everyone had to work (in order to be "working class") and everyone received a small but fair salary and social benefits: free education, free health care, subsidized living accommodations and housing services, subsidized transport, pensions, etc. There was little distinction between good workers and bad workers and many jobs existed so as to create full employment.

The ex-USSR developed primarily the "basic industries", that is input production as well as military industry. Both largely dominated in Ukraine where 2.7 million people were employed in the 1800 military-oriented enterprises making the relative importance of military production in Ukraine obvious. While the resource-oriented policy led to the notorious inefficiency in the resource utilization throughout the former USSR, Ukraine was the dishonourable leader in this respect. High-energy consumption was considered as no problem in the non-market, mostly closed economy of ex-USSR notably rich in energy resources. This led to the unfavourable terms of trade in the energy scarce Ukraine. Moreover, the inevitable terms-of-trade shock, which followed the trade liberalization, was especially painful for the resource-dependent industries, which dominate in the Ukrainian economy.

Soviet type human capital was characterized by the huge share of professionals in science, engineering and research. In 1981-1992 Ukraine had the world's highest percentage of researchers – 6761 per million people.

Thus, Ukraine under communism suffered from the resource-oriented paternalistic policy probably more than other Soviet Republics. Moreover, the structure by itself made Ukraine more vulnerable to the transition than any other country of the FSU because deindustrialization or re-industrialization meant high costs in terms of output restructuring.

In the early period of Ukraine's independence it was generally believed that the Ukrainian economy was one of the strongest of the Soviet Republics, and that it would benefit from the economic independence. In fact, the Ukrainian economy faced the worst imaginable conditions for entering into economic reforms *(von Hirschhausen, 1998):* 1) Soviet production and distribution networks, in which Ukrainian industry was tightly integrated, broke up rapidly. Transportation costs, lack of communication, legal instability, monetary uncertainty and protectionist trade policies led to major disruptions in former network relations, in particular, with Russia. 2) Most Ukrainian natural resources turned out to be of low economic value calculated in world market prices. Ukraine had to relay almost entirely (85 %) on imported energy. Only one third of its coal production was economically viable, while oil and gas reserves were depleted *(World Bank: Ukraine – The Energy Sector, 1993; Ukraine – Coal Industry Restructuring Sector Report, 1996; EU – Tacis: Business Guide to the Energy Sector of Ukraine, 1997).* Metal ores were of low metal content, located in remote areas, and thus difficult to get them to consumers at reasonable prices. 3) The so called agricultural "potential" of Ukraine turned out to be low in the post – socialist context, too, as sawing and harvesting techniques were outdated, many soils eroded, and production structures inefficient, leading to returns of only about one sixth of international standards *(von Hirschhausen, 1998).*

3.4.2. Ukrainian Economic Development in 1991-1994

Three first years of transition with inconsistent economic policies rendered the difficult situation disastrous. The reason for this has to be sought in the priority given to a peaceful institutionalization of the new Ukrainian nation, i.e. the process of Ukrainization (*von Hirschhausen, 1998).* Attempts were made via peculiar combination of Ukrainian nationalists, turnaround bureaucrats and miners. Struggles of economic concepts and individual rent seeking among these elites were permanent, making it impossible to carry out a consistent economic policy. Instead, the government bowed to all requests of each pressure group, be they miners, Branch Ministries, regions, etc.

As regards structural policies, no serious effort was made to urge the factories to restructure or close. Between the referendum of December 1991 and summer of 1994, three years passed by, during which the government tried to preserve an unviable industrial structure. The misunderstanding of the nature of the "crisis" added to the deterioration of the situation. Industrial policies were designed as if the post 1991 reforms were just another "crisis", like the ones witnessed in the 1960s and 80s. The irreversibility of the collapse of the Soviet socialist system was not understood. Instead, the new Ukrainian administration tried to emulate the institutions of the Soviet Union on the national level, including all facets of state planning.

In purely economic terms, the results of this "absence of economic policy" were disastrous. Monetary policies were loose in 1992 and 1993 *(von Hirschhausen, 1998).* The money printing press was substituted for a monetary policy, leading to inflation rates of 2,100% in 1992, 10,255% in 1993 and 801% in 1993. The introduction of an interim currency, the karbovanetz (Krb) or "Coupon", did not contribute to stability vis-à-vis the Rouble zone. Instead, the Ukrainian currency continued to devalue against the Russian rouble. Even massive interventions on the exchange market, culminating in the closure of the foreign exchange market on the 4th of November 1993, could not halt the slide of the currency.

Administrative controls were modified somewhat between early 1992 and mid-1993, just to go up again sharply by early 1994 (*Kaufmann, 1994*). Export and domestic trade restrictions remained permanently high and retail and wholesale price controls were irrational. The exchange rate was kept artificially low, leading to an increasing black market and to dollarisation.

Table 20 summarizes key economic indicators of Ukraine between 1991 and 1997. One detects clearly the deterioration of main aggregates between 1992 and 1994, in particular the output slump in 1994, as well as hyperinflation in 1992 and 1993. In fact, Ukraine featured the highest inflation ever witnessed in a non-war country.

Table 20. Macroeconomic indicators for Ukraine, 1992 - 1997

	1992	1993	1994	1995	1996	1997
Macroeconomic Development						
GDP (market prices, % change year on year (yoy)	-16.4	-14.2	-23.0	-11.8	-10.0	-3.2
Gross industrial output (% change, yoy)	-6.4	-7.6	-27.2	-11.5	-5.1	-2.0
Agricultural output (% change, yoy)	-8.3	1.5	-17.0	-3.9	-9.0	-2.0
Capital investment (% change, yoy)	-36.9	-10.3	-25.0	-35.0	-22.0	-
Inflation rate (CPI, Dec / Dec, %)	2 100	10 255	401	182	40	10
Sector Shares (in % of GDP)						
Industry	44.6	27.6	35.0	34.4	43.2	-
Construction	7.5	7.2	7.4	9.3	8.1	-
Agriculture	20.6	18.4	14.3	13.2	17.3	-
Trade	6.5	10.1	7.3	6.6	6.9	-
Services and other	20.8	36.7	36.0	36.5	24.5	-
Foreign Trade						
Exports of goods and services, bn USD	11.3	8.6	10.2	12.7	15.5	15.4
Imports of goods and services, bn USD	11.9	11.1	12.7	15.3	19.8	19.6
Of which energy imports, %	n/a	49	44	45	48	-
Budget deficit, bn USD	0.62	0.85	1.40	1.40	1.45	-
Foreign debt, bn USD	3.5	4.2	7.2	8.1	9.2	9.5

Source: MinStat Ukraine, MinEconom Ukraine, World Bank

Given the heterodox coalition between reformers (nationalists), pseudo-reformers (turnaround bureaucrats) and anti-reformers (coal industry), it was impossible to strike a coherent reform path. Ex-post, the non-policies pursued in 1992-94 may have not been as irrational as they are usually judged from outside: Ukraine is the only European Republic of the CIS that has managed a peaceful transition from a Soviet Republic to a democratic nation. In the Russian Federation, the President had to assault Parliament and burn it down in order to keep the situation under control; in Belarus, elementary human rights, such as the freedom of demonstration, were suppressed. None of that type happened in Ukraine, which is considered to be the CIS-country with the best human rights record.

3.4.3. Economic Development of Ukraine in 1994-1997

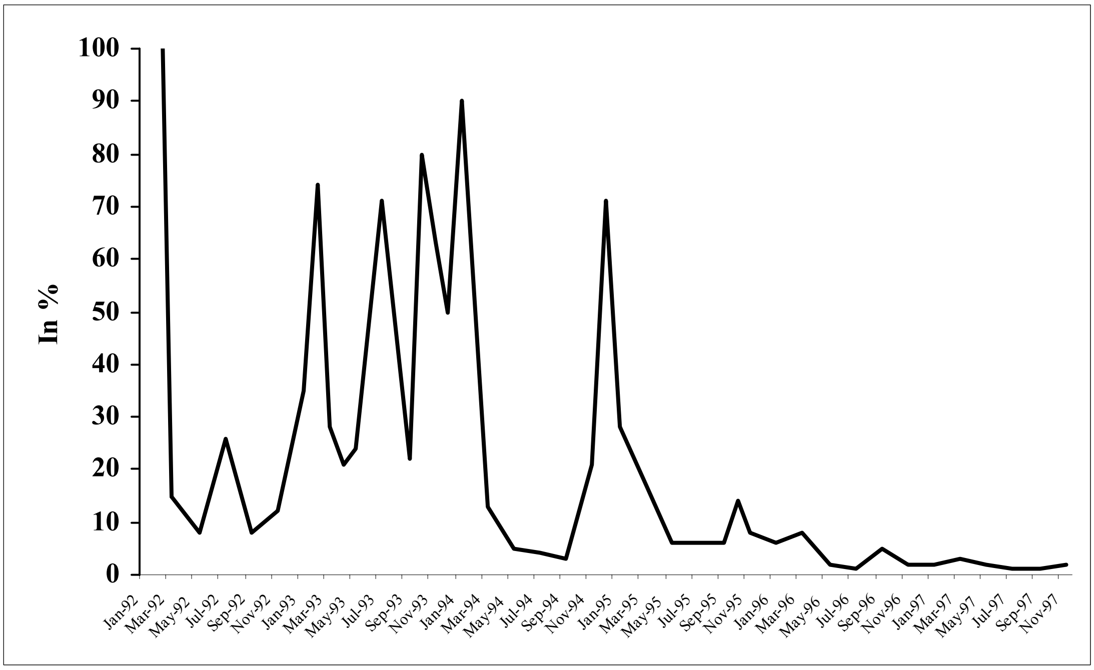
The economic situation changed with the general realization that continued inflation and economic isolation would lead to the complete loss of the country's industrial and technological base *(von Hirschhausen, 1998).* The idea, according to which national independence would have led per se to economic recovery, was rejected. The election to President of the industrialist Leonid Kuchma against the former apparatchik turned nationalist Leonid Kravchuk, in July 1994, was a sign that the population now preferred an industrial strategy suitable for post-soviet time. The so-called "reform" program of 1994 was in fact not a shift towards a Western-type market economy, but instead an attempt to create conditions under which state control on industry could be made more efficient.

The results of the October 1994 reform program are impressive, though from a macroeconomic point of view only. Domestic prices were almost fully and foreign trade largely liberalized. Administrative control of the exchange rate was abandoned, the budget deficit reduced (from 20% of GDP in the first quarter of 1994 to 9.6% in December 1994) and the Central Bank financed credits to industry reduced (*Conrad & Gummich, 1995*). Mass privatization, in the pipeline for a long time, started in January 1995 and the process of direct privatization was strengthened through a centralization of power in the State Property Fund.

Table 21 shows the development of monthly inflation rates since 1993, which has fallen to a record 0.1% in June and July 1996.

Consequently, inflation decelerated rapidly, after the November 1994 peak. In 1995, inflation was down to 180% (December/December) and continued to fall to about 50% in 1996. The real exchange rate stabilized somewhat during 1995 and even appreciated in 1996. The slump in industrial output was limited to 11% in 1995 and about 3% in 1996.

Table 21. Stabilisation of inflation in Ukraine, 1992-1997



Source: von Hirschhausen, 1998

Monetary policy remained tight, leading to high real interest rates. International financial institutions started to support the reform program. The IMF offered credits in order to assure the country's liquidity and mainly to pay the Russian energy supplies. Between 1994 and 1996, about 1.3 billion USD were channelled to Ukraine in the form of Systematic Transformation Facility and two Stand-By-Agreements. Other international credits followed. In 1996, the Ukrainian economy achieved relative stabilization.

3.4.4. The Privatization: Procedures and Results

During the time when macroeconomic decline continued, a unique phenomenon gained ground on the enterprise level, unobserved by many, including a part of the government: privatization. Public debate on the usefulness of and justification for privatization remained vivid, culminating in the interruption of privatization by Parliament in June 1994. But on-site, in the enterprises, ownership changes proceeded nonetheless.

There were two driving forces behind this process: workers' collectives and private investment funds *(von Hirschhausen, 1998*). For workers' collectives, the privatization of ”their” state enterprises, mostly leased formerly, was a cheap way of becoming real owners of the entity they already managed for some time. Over 3,000 "lease enterprises" were privatized this way between 1992 and 1995. For the newly created private investment funds, the privatization of medium and large enterprises through auctions was an efficient way to accumulate capital quickly. For this purpose, the funds used mainly external resources, i.e.

privatization vouchers entrusted to them by individuals. Though privatization had a difficult start in 1992, it came into full swing in 1993, i.e. in the midst of macroeconomic decline.

Mass privatization through the free distribution of vouchers was initially confined to the control of investment funds, which had rapidly understood how the system works. But since January 1995, after the reorganization of privatization and revaluation of vouchers, the process started to attract increasing interest of the population, as documented in the rise of the domestic demand for vouchers by individuals. Thus, only one privatization method remained without success: the strategic investor privatization. Until late 1996, neither domestic nor foreign industrial companies showed a great interest to take over Ukrainian post-socialist enterprises.

Contrary to common belief, ownership reform and privatization significantly altered the composition of industry ownership. Table 22 provides evidence on this: the number of medium and large enterprises increased from 6 850 in the end of 1992 to 8 972 in the beginning of 1996. The number of private enterprises, collectively owned or leased with a private majority of ownership, increased to 5 401 in 1996, i.e. 60 % of the total number of large and medium scale enterprises.

Table 22. Results of large-scale privatization in Ukrainian industry, 1992-1997

	1992	1993	1994	1995	1996	1997
Number of large and medium size industrial enterprises	6 850	7 963	8 826	8 931	9 051	9 710
Of which:						
State ownership	5 159	5 421	4 763	3 882	2 715	2 516
Private ownership	1 686	2 525	4 045	5 030	6 386	7 194
Share of privatised industrial enterprises:						
Number of enterprises, %	25	32	46	57	70	74
Volume of production, %	17	29	38	48	58	64

Source: Ukrainian Economic Trends

The part of private enterprises in industrial production grew significantly, too, from 17 % in 1992 to 48 % in 1996 *(von Hirschhausen, 1998*). The big bulk of small enterprises, about 90 % is today owned by private agents, either directly or in the form of collectives. Taking into account the important share of non - official production (shadow economy) which is almost exclusively generated in private enterprises, it is certain that more than 50 % of industrial production comes from private sector.

It is important to mention that privatization of non - strategic enterprises is far advanced. The corporate governance structures resulting from Ukrainian ownership reform may be less efficient than initially hoped in 1992. However, privatization has worked smoothly in a chaotic macro-environment. In particular, it means that the impact stemming from future privatization can only be limited. Yet, macroeconomic stabilization and formal privatization remain ineffective unless they are accompanied by substantial structural reform.

3.4.5. Crisis-1998 as a Turning Point for Growth

The South-East Asian crisis in the fall of 1997, affected some big emerging markets on the other continents – Brazil and Russia. The Russian state finance in 1997 was in total disarray. The heavy reliance on domestic Treasury bills (GKOs in Russian abbreviation) combined with slow structural reforms led to a financial "heart attack". In August 1998, Russia announced her defaulting on servicing T-bills.

Since late 1997 Ukraine entered into financial crisis that continued all through 1998. The prevalence of loss-making energy-intensive sectors in the industrial structure of Ukraine made the economic situation in the country after the independence quite difficult due to a high import - reliance on energy resources. While Russia accounted for 91 % of the total ex-USSR oil production, the share of Ukraine was a mere 0.9 %. That clearly made two highly industrialized economies face different perspectives after becoming independent state. At the time when Russia could take advantage of rising world prices on energy products, Ukraine became highly dependent on energy imports and was subject to large terms-of-trade shocks. About 60 % for Ukraine's demand for fuel is satisfied through imports, including, 100 % of nuclear fuel, 77 % of the natural gas, 15 % of coal and more than 85 % of oil. The main energy supplies come from Russia and Turkmenistan.

In Ukrainian context one could expect that the lack of energy resources would result in a faster restructuring of energy-intensive enterprises and introduction of the energy-saving technologies. The Ukraine experience is indeed unique: nothing of the above has happened. The government policy of energy subsidies to industrial producers conducted under the pressure of rent-seeking industrial lobby provided little incentives for enterprises to adopt energy-saving technologies. The state diverted away a large chunk of resources that could have been alternatively used for the benefit of economy. Moreover, having very limited resources to earn export income a number of businessmen supported by high-ranking government officials engaged in a dirty game of importing energy from Russia at below the world market price and selling it profitably abroad. Needless to say that as a result of such operations the state was left with huge external debts, while the declining economy was further stripped off.

The lack of structural reforms and deteriorating financial situation led to decreasing confidence of international financial institutions and investors. Actually, the friction in relations with the IMF and World Bank became clearly distinguished at the end of 1996, when the initiative known as "The package of economic growth" was not approved by the Parliament. But later, in February and March 1998, being reluctant to implement structural reforms, Ukrainian authorities surprised the world making a debut on the Eurobond market by issuing bonds at the exorbitant 16 % interest rate. In March 1998 the government deliberately violated the budget deficit benchmark by using international funds not for their primary target but for some payments of pension arrears. This caused anger by the IMF and the termination of the stand-by program in April 1998. This in turn led to a drastic increase of interest rates (T-bills climbed up to 50 % p.a.), bad international ratings, capital outflow and almost defaulting by Ukrainian Treasury.

As a result, in the fall 1998 Ukraine experienced a deep economic crisis. However, the country managed to avoid a complete financial collapse because Russia had fallen first. After that the Ukrainian conditions of T-bill restructuring "30 cents for 1 dollar" looked attractive comparing with the Russian "10 cents for 1 dollar" ones.

Under the pressure of external creditors, the ruling elite agreed to appoint a limited number of people with pro-market reputation to the top positions in the government. Ukraine entered a new phase of its economic development[10] *(Babanin et al, 2002).*

[10] Materials of this sub-chapter were adapted from "Ukraine: the last decade… and coming boom?" edited by O. Babanin, V. Dubrovsky, O. Ivaschenko, Kiev, 2002

4. Investment Climate in Ukraine

4.1. Foreign Direct Investments in Ukraine

Studying investment in Ukraine, both Ukrainian and foreign experts have noticed a paradox: being potentially attractive for investors, possessing a great amount of physical and human capital, large domestic market with 48 million people, and easy access to large markets of Russia and other FSU countries, Ukraine is not succeeding well with attracting investors.

4.1.1. FDIs to Ukraine in Comparison with Other TEs

According to Ukrainian State Statistics Committee's data of January 1, 2003, the stock of foreign direct investment (FDI) in Ukraine reached 5.34 billion USD. For the same period the Czech Republic attracted more than 30 billion USD, Poland more than 45 billion USD and Russia accumulated more than 20 billion USD of FDIs (Tables 23, 24).

Table 23. Foreign Direct Investment Inflow, USD million

	1995	1997	1998	1999	2001	2002	2003*
Czech Republic	2 562	1 300	3 718	6 324	4 916	8 000	4 000
Hungary	4 453	2 173	2 036	1 970	2 443	1 600	1 600
Poland	3 659	4 908	6 365	7 270	5 713	4 000	4 000
Slovak Republic	258	220	684	390	1 475	4 000	2 000
Slovenia	151	334	216	107	503	2 000	2 000
Total (5)	*11 083*	*8 936*	*13 018*	*16 061*	*15 051*	*19 600*	*13 600*
Bulgaria	90	505	537	819	694	400	600
Romania	419	1 215	2 031	1 041	1 157	900	1 000
Total (7)	*11 593*	*10 656*	*15 587*	*17 921*	*16 902*	*20 900*	*15 200*
Russia	2 065	4 865	2 761	3 309	2 469	2 500	2 500
Ukraine	267	623	743	496	792	500	500

*Source: WIIW; * 2003 – forecast*

FDIs per capita in Ukraine is only 111 USD, which is one of the lowest figures in TEs and only exceeds similar indicators of Belarus, Uzbekistan and Tajikistan.

Table 24. Foreign Direct Investment Stock, USD million

	1995	1997	1998	1999	2001	2002
Czech Republic	7 350	9 234	14 375	17 552	26 764	37 000
Hungary	11 926	16 086	18 517	19 299	23 562	27 000
Poland	7 843	14 587	22 479	26 075	41 031	46 000
Slovak Republic	1 297	2 083	2 890	3 188	5 582	10 000
Slovenia	1 763	2 207	2 777	2 682	3 209	5 500
Total (5)	*30 180*	*44 197*	*61 038*	*68 797*	*100 148*	*125 500*
Bulgaria	337	951	1 488	2 307	4 003	4 400
Romania	971	2 449	4 480	5 521	7 715	8 600
Total (7)	*31 488*	*47 597*	*67 007*	*76 625*	*111 866*	*138 500*
Russia	3 966	11 410	14 171	17 480	22 663	25 000
Ukraine	796	1 940	2 683	3 179	4 566	5 000

Source: WIIW

4.1.2. FDI Growth and Structure in Ukraine

FDI in Ukraine is on a low level, but increasing. The permanent growth of FDIs can be observed in the period of 1995 – 2003 (Table 25). Authoritative international institutions estimate that Ukraine's need for investment in the nearest ten years will be approximately 40 billion USD. Investment needs are urgent in telecommunication, energy producing sector, agriculture and chemical industry.

Table 25. FDI Stock in Ukraine, to the Beginning of the Year, USD million

	1995	1996	1998	1999	2000	2001	2002	2003
FDI	483.5	896.9	2 063.6	2 810.7	3 281.8	3 875	4 555.3	5 339
Growth,%	-	86.0	43.0	36.0	17.0	18.0	18.0	17

Source: GKS

The structure of FDI in Ukraine is rather production oriented: 50.4 % of FDIs are in the manufacturing sector, particularly in food processing industry (16 %), in mechanical engineering (8.8 %), in metallurgy (5.3 %) and in chemical industry (4.1) (Table 26). Wholesale and retail trade are on the second place in attracting foreign investors – 18.5 % of total of FDI. FDIs are increasing significantly in transport, communication, financial services and real estate sectors.

Table 26. Structure of FDI in Ukraine, on Jan., 1, USD million and % of total

	2001	%	2002	%	2003	%
Industry	*2 063.2*	*53.2*	*2 443.6*	*53.6*	*2 690.6*	*50.4*
- Food-processing industry	408.5	19.8	461.8	18.9	854.2	16.0
- Mechanical engineering	169.2	8.2	205.3	8.4	469.8	8.8
- Metallurgy					283.0	5.3
- Chemical industry					218.9	4.1
Wholesales / Retail trade	647.2	16.7	769.2	16.9	986.3	18.5
Financial activities	313.1	8.1	355.2	7.8	433.3	8.1
Transport and communications	245.1	6.3	308.8	6.8	382.0	7.2
Real estate activities	152.2	3.9	177.5	3.9	249.8	4.7
Health protection and public assistance	116.1	3.0	117.1	2.6	119.0	2.2
Hotels and restaurants	108.7	2.8	117.6	2.6	123.5	2.3
Building	99.7	2.6	116.7	2.6	156.7	2.9
Agriculture, hunting and forestry	73.4	1.9	86.7	1.9	113.0	2.1
Collective, public and personal services	53.4	1.4	59.0	1.3	80.9	1.5
Education	2.5	0.06	3.4	0.07	3.3	0.06
Fish industry	0.4	0.01	0.4	0.01	0.4	0.01
Public administration	-	0	-	0	0.1	0.002
Total	***3 875.0***	***100***	***4 555.3***	***100***	***5 339.0***	***100***

Source: GKS, authors' calculations

It can be concluded that FDI in the Ukrainian economy is not innovative by nature. Foreign companies invest mainly in the processing industry with high capital intensity. More than 50 % of FDIs were made in agro-business, oil processing and food industry. FDIs in the hotel business and construction have been growing during the last years.

4.1.3. Major Investors to the Ukrainian Economy

Ukraine has got FDI from 114 countries (Table 27). The USA holds the first place among countries investing in Ukraine. By 01.01.03, there were 1 186 companies registered in Ukraine with American capital participation in Ukraine, including 724 American – Ukrainian joint ventures. US investment stocks in Ukraine reached 898 million USD (Table 28).

Table 27. Main Countries Investing to Ukraine (on Jan., 1, 2003)

Country	Amount (USD mln)	% of total
The United States	898.0	16.8
Cyprus	602.6	11.3
The United Kingdom	510.5	9.6
The Netherlands	398.8	7.5
British Virgin Islands	337.0	6.3
Russia	322.6	6.0
Germany	312.1	5.8
Switzerland	272.7	5.1
Austria	210.9	3.9
Other countries	1 480.9	27.7

Source: GKS

Table 28. Distribution of US investments by Activity (on Jan., 1, 2003)

Sectors	Volume of investments	
	USD thousand	%
Wholesale trade and trade facilitation	158 318.78	17.63
Food industry and processing of agricultural products	140 232.30	15.62
Hotels and restaurants	86 677.25	9.65
Finance	55 158.92	6.14
Civil engineering	52 665.14	5.86
Metallurgy and metal processing	47 701.76	5.31
Energy, gas and water supply	46 775.32	5.21
Real estate operations and legal services	39 326.02	4.38
Other manufacturing sectors, not elsewhere specified	37 163.57	4.14
Extracting industry	30 292.71	3.37
Machine-building	28 261.15	3.15
Agriculture and hunting	27 599.06	3.07
Chemical and petrochemical industry	27 036.83	3.01
Land transportation	21 235.19	2.36
Postal services and communication	17 994.70	2.00
Trade in means of transportation and repairing service	16 880.10	1.88
Trade in consumer goods and repairing services for the same	16 858.02	1.88
Coke production, oil refinery products	9 025.10	1.01
Production of other non-ferrous mineral goods	7 658.23	0.85
Auxiliary transportation services	7 417.36	0.83
Collective, public and personal services	6 023.04	0.67
Light industry (textile, skin manufacturing)	5 189.40	0.58
Pulp and paper industry, publishing activities	4 238.94	0.47
Health protection and social services	3 644.02	0.41
Woodwork and products of wood	3 011.86	0.34
Education	740.80	0.08
Forestry	685.94	0.08
Fishery	200.00	0.02
Aviation transport	2.50	0.0003
Total	898 014.01	100.00

Source: GKS

Russia's influence is rather high in the context of FDI to Ukraine. Russian (and Ukrainian) businessmen repatriate and invest their flight capital back to their home countries through offshore companies in Cyprus, British Virgin Islands, Switzerland and other countries. Russian companies now control Ukrainian's aluminium and oil refining sectors, while their presence is increasing in the processed foods, metallurgy and machinery sectors, banking and transportation *(Ogutsu & Kinach, 2003).*

4.2. Motives and Obstacles for FDI in Ukraine

In order to identify the reasons for low FDI stock in Ukraine, Flemings/SARS Consortium performed in the year 2000 a mail survey of 65 companies with presence in Ukraine, grouping them into multinational enterprises (MNEs), multilateral financial institutions, private institutional investors and entrepreneurs. Besides requesting them to identify the major deterrents to investment and to estimate the significance of privatization for FDI, the questionnaire asked the sample investors about their motives, risk assessment and decision-making mechanism while investing in Ukraine. Inquiries were also made about the investor's assessment of priorities for their investment-enhancing policy agenda[11].

The sample included 32 enterprises: 2 multilateral financial institutions, 5 entrepreneurial firms, 3 direct equity funds and 22 MNEs. The headquarters of 19 companies are located in USA, 1 in Canada and the rest in the European countries. The response ratio was 50 %.

According to this study, Ukraine's low FDI stock was explained at least partly by its inferior investment climate (legal, economic and infrastructure aspects), as well as by deficiencies in the country's privatization approach and effort.

Implicit evidence for the inadequacy of Ukraine's privatization effort may be found in the fact that the most of the mail survey respondents (including 60 % of MNEs) reported that they had invested in Ukraine through greenfield projects of joint ventures with private companies, rather than through privatization offerings.

The mail survey respondents together have invested over USD 2 billion. They employ some 9000 people in Ukraine. The sampled firms were most frequently found in the food/beverage branch, followed by agriculture and telecommunications. Other prominent investment targets included the mechanical engineering, retail trade, fast food, banking and consumer goods sectors. Most of the respondents were medium-sized investors (USD 10-100 million). Besides the EBRD, only MNEs were able to commit amounts over USD 100 million.

[11] Materials of Chapter 4.2 were adapted from the report published on www.investgazeta.com.ua

The survey provides strong evidence that market-seeking is the most dominant motive for FDI in Ukraine, well ahead of other possible reasons (including pursuit of cheap and qualified labour) (Table 29). Most investors are attracted to Ukraine's domestic market of 48 million people. The availability of low-cost labour turned out to be insignificant for the majority of companies surveyed except entrepreneurial investors, who tend to be more sensitive to the availability of cheap inputs. Although Ukrainian wages are lower than in other Eastern-European countries, this competitive advantage is diminished by significantly lower labour productivity, the lack of capital, inferior management and regulatory burdens. Thus unit costs in Ukraine are not necessarily much cheaper than in neighbouring countries.

Table 29. Motives for Companies Investing in Ukraine

Rank	Reason	Total
1	Market size and potential for market growth	1.05
2	Access to a new regional (Central/Eastern Europe, CIS) market	1.92
3	Skill of labour force	2.15
4	Availability of low-cost inputs (e.g., cheap labour; energy; raw materials)	2.27
5	Production capacities	2.32
6	To improve competitiveness in supplying established markets (Europe)	2.53
7	Tax incentives	2.69
8	A chance to access research and technological expertise available in Ukraine	2.71

"major reason"=1; "minor reason"=2; "not a reason"=3
Source: Flemings/SARS survey

Most survey respondents reported that their investment decision-making takes typically more than 6 months. Institutional investors can usually decide on certain projects within a period of 3 to 6 months. However, they tend to have the highest number of decision makers. On the other hand, some entrepreneurial investors can commit to investing within a month after the opportunity is identified. On average, in such organizations 4 persons are involved in taking the decision on investment in Ukraine. The most complicated and lengthy decision-making process was reported by multilateral financial institutions. The survey also ranked the major deterrents to FDI in Ukraine (Table 30).

Table 30. Deterrents for Companies Investing in Ukraine

Rank	Problem	Total
1	Instability and exorbitance of regulations	1.03
2	Ambiguity of the legal system	1.21
3	Uncertainty of the economic environment	1.27
4	Corruption	1.34
5	High tax burden	1.46
6	Problems establishing clear ownership conditions	1.56
7	Depressed disposable income levels	1.69
8	Difficulty negotiating with government and privatization authorities	1.79
9	Volatility of the political environment	1.82
10	Lack of physical infrastructure	2.09
11	Problems in accessing domestic and export markets	2.16

"major reason"=1; "minor reason"=2; "not a reason"=3
Source: Flemings/SARS survey

It is noteworthy that all these impediments were recognised as causing problems. Though on the lower end of ranking, the clarity of ownership rights and the ease of negotiating with government/privatization authorities were still ranked between “major problem” and “minor problem”, i.e., they were perceived as significant FDI deterrents.

As anticipated, the status of private ownership in Ukraine was significant for the majority of survey respondents. Only 5 percent of respondents (deep-pocketed SMEs) found it unimportant in their activity. For the rest of the investors (95 percent), privatization policy appears to be a very significant factor, which affects their investment decisions. It is expected that privatization will not only create new acquisition opportunities, but also improve the overall business climate, through productivity growth and reduction of harmful government interference.

Respondents provided their views on what should be done by the Ukrainian government to improve Ukraine’s attractiveness for FDI (Table 31).

Table 31. Priorities of Government Policy

Rank	Priority	Total
1	Liberalise capital, foreign exchange and profit repatriation controls	1.12
2	Lift restriction on foreign ownership and control	1.16
3	Minimise red tape	1.17
4	Reduce tax rates and the number of taxes	1.32
5	Lift restrictions on accessing domestic and export markets	1.78
6	Enhance the contract enforcement system	1.81

from “1 – a top priority” to “3 – not a priority”
Source: Flemings/SARS survey

In brief, the suggested policy agenda may be summarised as follows: investors want to deal with fewer government officials and less frequently. Many of them believe that a comprehensive and rigorous privatization approach would lead to this end. Russian companies investing in Ukraine were not included in the survey.

In contrast to western investors, Russian companies are not very interested in the international financial institutions’ opinions, internal political instability or how Ukraine is going to be integrated into the global economy in future. Many Russian companies tie up money in Ukraine in order to enclose the technological chain broken after the dissolution of the Soviet Union. Main interests of the Russian investors lie in the metallurgical (aluminium production), chemical and mechanical engineering industries.

4.3. Ukraine in International Ratings

4.3.1. Credit Ratings

Today virtually every state in the world is included in a credit rating by at least one of the following rating agencies: Moody's, Standard & Poor's or Fitch. These agencies use financial indicators as a base for their ratings, such as liquidity and solvency *(Investment Ratings of the Ukrainian Regions, 2003)*.

Moody's Investors' Service

On May 2, 2003 Moody's agency *(www.moodys.com)* confirmed the following ratings for Ukraine: B2 for long-term governmental bonds in national and foreign currency and B3 for long-term bank securities.

Among the reasons of the rise of trust to Ukraine, Moody's pick up growth of export, hard budgetary policy, abbreviation of debts and augmentation of currency reserves of NBU[12]. Until now Ukrainian credit rating has never been higher than Caa3 "with negative perspective". Only in October 2001, there was a "break" in this direction and the index of Ukrainian credit rating grew to Caa1 (Table 31). Still, this is one of the worst indices among rated countries. Despite the economic growth in Ukraine in 2000-2001, which already found its reflection in ratings of other influential organizations, Moody's continued to hold Ukrainian rating on that level, reasoning it with lack of positive changes in political sphere.

Estimation of solvency in Moody's rating provides a country with access to international credit resources. In other words, it measures how soon a country will return borrowed money. Methodology of the rating calculation includes evaluation of indices, which can be grouped into three main branches: (1) solvency, (2) likelihood that in the case of default the moratorium on financial operations will not be brought in, (3) access conditions to international money market. The rating is conferred in letters and numbers. The highest is Aaa, further successively go: Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3, Ba1 and so on, the lowermost is Caa3 *(Investment Ratings of the Ukrainian Regions, 2003).*

The ratings of governmental bonds in foreign currency of neighbouring countries look as follows (Table 32): Russia - B2, Poland - A2, Hungary - A1, Czech Republic - A1, Slovak Republic - A3. On March 26[t], 2003 Moody's confirmed municipal credit rating of Kiev City at the B2 level *(Investment Ratings of the Ukrainian Regions, 2003).*

[12] NBU – National Bank of Ukraine

Standard & Poor's Rating Service

In May 2003 Standard & Poor's *(www.standardandpoors.com)* proved sovereign Ukrainian credit rating for long-term and short-term bonds in foreign and national currency at the B level and changed its outlook from 'negative' to 'stable' *(Investment Ratings of Ukrainian Regions, 2003).*

The agency also improved the Kiev City municipal credit rating (B) outlook to 'stable'. In a press release S&P states the main "chronic" defects of Ukrainian development: centralized mechanism of decisions' adaptation, insufficiently developed system of state agencies and legal system (including poor control over law enforcement that contributes to formation of influential criminal groups and to diffusion of corruption) *(Investment Ratings of Ukrainian Regions, 2003).*

Table 32. Some Credit Ratings for Long-term Bonds (nominated in foreign currency)

Rating	Moody's		Standard & Poor's		Fitch	
Investment Grades	Aaa	Germany	AAA	Germany	AAA	Germany
	Aa1	Bermuda Islands	AA+	Spain	AA+	Canada
	Aa2	Panama	AA	Bermuda Islands	AA	Bermuda Islands
	Aa3	Slovenia	AA-	Japan	AA-	Kuwait
	A1	Czech Republic / Hungary	A+	Slovenia	A+	Slovenia
	A2	Poland	A	Cyprus	A	Korea
	A3	Slovak Republic	A-	Czech Republic / Hungary	A-	Hungary
	Baa1	Lithuania	BBB+	Poland	BBB+	Czech Republic / Hungary
	Baa2	Mexico	BBB	Slovak Republic	BBB	Slovak Republic
	Baa3	Kazakhstan	BBB-	Croatia	BBB-	Croatia
Junk Grades	Ba1	India	BB+	Bulgaria	BB+	Russia / Kazakhstan
	Ba2	Russia	BB	Russia/Kazakhstan	BB	Bulgaria
	Ba3	Peru	BB-	Guatemala	BB-	Azerbaijan
	B1	Romania	B+	Jamaica	**B+**	**Ukraine** (since 25.06.2003)
	B2	**Ukraine** (since 02.05.2003)	**B**	**Ukraine** (since 20.05.2003)	B	Iran
	B3	Pakistan	B-	Lebanon	B-	Lebanon/Moldova
	Caa1	Cuba	CCC+	Ecuador	CCC+	Venezuela
	Caa2	Ecuador	CCC		CCC	
	Caa3		CCC-		CCC-	Turkmenistan
	Ca	Argentina	CC		CC	
	C		C		C	
Selective default			SD	Argentina	SD	
Default			D		D	Argentina

Source: Investment Ratings of the Ukrainian Regions, 2003

Fitch Ratings

On June 25, 2003 rating agency Fitch Ratings (www.fitchratings.com) assigned B+/stable rating to the 800 million USD Ukrainian eurobonds nominated in U.S. dollars (7.65 % annual yield; maturity date June 11, 2013). Fitch experts believe that despite political instability Ukraine hereafter will be able to cover its debt obligations and the economic prospects look good. According to the Fitch, Ukraine's neighbours were assigned the following ratings (Table 31): Hungary (A), Czech Republic (BBB+), Poland (BBB+), Slovak Republic (BBB), Russia (BB+) *(Investment Ratings of Ukrainian Regions, 2003).*

Methodology of credit rating calculation of Standard & Poor's and Fitch practically coincides with Moody's methodology. Designations, that are used for countries' classification are: AAA – the highest index, further go AA+, AA, AA-, A+, A, A-, BBB+ and so on.

4.3.2. Qualitative Indexes

So called qualitative indexes try to measure various aspects of an economy such as: level of competitiveness, economic freedom, and corruption. These indexes are often considered by direct investors (Table 33).

2002 Global Competitiveness Report

On November 12, 2002 World Economic Forum in Davos (WEF) (*www.weforum.org)* published the report on global competitiveness, which includes the Growth Competitiveness Ranking (GCR) and Microeconomic Competitiveness Ranking (MCR) tables.

In the GCR scoreboard Ukraine ranked 77th, leaving behind only Bolivia, Zimbabwe and Haiti. In the Microeconomic Competitiveness Ranking Ukraine resides on the 69th place near Romania, Bulgaria and Guatemala. Among former socialist countries the highest positions belong to Estonia (26th in GCR and 30th in MCR), Hungary (28th and 29th), and Lithuania (36th, 40th). The Czech Republic occupied 40th in GCR and 34th in MCR, leaving behind Slovak Republic (49th, 42nd), Poland (51st, 46th) and Russia (64th, 58th). The leaders of both ratings are USA and Finland *(Investment Ratings of Ukrainian Regions, 2003).*

The Heritage Foundation Index of Economic Freedom

Composite index of economic freedom developed by the Heritage Foundation (www.heritage.org) is used to expose the level of state regulations. Published on November 13, 2002 on the list of 156 countries Ukraine ranked 131st. Even though composite index of economic freedom in Ukraine considerably improved, it still remains in the group of countries which are "mostly not free".

Transparency International Corruption Perception Index

Since 1998 Transparency International (www.transparency.org) calculates Corruption Perception Index for Ukraine. On June 2003, Ukraine was 85th (with the index equals 2.4) out of 102 countries. Georgia and Vietnam received the same value of the index. Russia occupies 71st place with the index value of 2.7. Top country in this table is Finland. Estonia was ranked 29th, Hungary 33rd, Poland 45th. The Czech Republic and Slovak Republic are on the 52nd place, while Bangladesh is considered to be the most corrupted country *(Investment Ratings of Ukrainian Regions, 2003).*

Table 33. Qualitative Indexes of Ukraine

Organization	Rating Index	Date of publication	Place	Number of countries
Heritage Foundation	Index of economic freedom	13.11.2002	131(↑6)	156
Transparency International	Corruption Perceptions Index	28.08.2002	85(↓2)	102
World Economic Forum	Growth Competitiveness Ranking	12.11.2002	77(↓9)	80
	Microeconomic Competitiveness Ranking	12.11.2002	69(↓10)	

Source: Investment Ratings of Ukrainian Regions, 2003

4.4. The Legal Framework for FDIs

Although tangible incentives for foreign direct investments have yet to be developed in Ukraine, the government is paying increasingly close attention to the issue. A framework law on foreign investments is already in place. Foreign arbitration is available. A presidential council on foreign investments, which includes representatives of all major foreign companies operating in Ukraine, has been set up and meets regularly to discuss problems. In addition, a special committee for resolving tax disputes involving foreign companies is working at the State Tax Administration.

Top government authorities have repeatedly declared their commitment to attracting foreign investment to Ukraine, and key laws on FDI have been approved, including the law on foreign investments (passed in 1996) and the law on production sharing and concessions (approved in 1999), both of which offer foreign businesses largely equal treatment with local companies. But enforceability of legislation (not only FDI-related) at lower government levels still leaves much to be desired, which highlights the urgency of administrative and regulatory reforms. Indeed, it is Ukraine's confusing regulatory environment, that foreign investors here name among primary deterrents to their business.

Due to budgetary constraints, the government has substantially cut subsidies to the industry in recent years. However, they are still applied, especially in sectors of particular significance to the economy. Enterprises may either be granted lower tax rates, receive energy supplies at below market prices, or be allocated production inputs for free or below cost. However, the practice of subsidizing is virtually non-existent in industries, which attracted significant FDI, as these sectors are largely privatized.

In foreign trade, Ukraine employs general (full-rate) and preferential (lower-rate) tariffs. Imports from Western countries are usually granted preferential tariffs. The size of import duties usually depends on whether a similar product is made in Ukraine.

Imported goods are subject to sanitary, veterinary, radiological and ecological control. Ukraine's numerous certification bodies operate as independent entities. Many products require multiple certifications from different agencies on the federal and local levels. Product testing may sometimes require an official inspection of the company's production facilities at its expense.

The government is trying to overcome the above-mentioned hurdles by reforming foreign trade legislation according to the requirements of World Trade Organization (WTO). Ukraine hopes to get a membership in WTO in 2004. Ukraine has negotiated the required bilateral agreements with a number of WTO member countries and is gradually adapting its legislation.

The new tax draft laws envisage a lower number of taxes and smaller tax rates as well as abolish many of the existing tax privileges and exemptions. The total number of taxes is proposed to be cut to 25, or by about a dozen. Recently, amendments to the corporate income tax law were approved, cutting the tax rate from 30% to 25% as of January 1, 2004. The new VAT rate would be set at 17% and personal income tax at 10% to 20%. Reduction of payroll taxes is also being discussed in the framework of pension reform.

These radical changes underscore the cumbersome nature of Ukraine's current tax system. Among the main problems of the existing tax legislation is the lack of clarity causing conflicting interpretations. Along with 22 central government taxes there are 16 regional ones, which make proper tax accounting very difficult and time-consuming. Foreign companies located and operating in Ukraine are taxed based on their Ukrainian business, while Ukrainian companies are paying taxes on their worldwide activities.

Income earned in Ukraine by foreigners not residing in the country on a permanent basis is subject to the withholding tax. The regular withholding tax rate is 15% for interest, dividends, royalties, property rent, capital gains, income of non-incorporated joint ventures, and other types of income. A 30% rate is levied on income from interest-bearing bonds, T-bills, and some other instruments. A 6% rate is used for taxing freight services. Income from the government bonds is exempt from the withholding tax.

In several double taxation treaties, signed by Ukraine, special provisions for taxation of dividends, interest, royalties and other types of income prevail over the regular withholding legislation. Double taxation treaties have been signed with countries such as Austria, Belgium, Canada, Cyprus, the Czech Republic, Denmark, Finland, France, Germany, Hungary, Italy, the Netherlands, Norway, Poland, Russia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

Protection of investments is guaranteed by the Law on Foreign Investments (approved in 1996): Guarantees against adverse changes in the investment environment during a time period of 10 years; Guarantees against expropriation, except in case of national emergency and with proper compensation; Adequate compensation for losses due to negligence of state authorities; The right to repatriate the original investment and income earned in foreign currency.

For further protection of foreign investors, Ukraine has signed corresponding agreements with over 50 countries, including Austria, Belgian-Luxembourg Economic Union, Canada, the Czech Republic, France, Germany, Hungary, Israel, Italy, the Netherlands, Russia, Spain, Sweden, Switzerland, Turkey and the United States. Ukraine also ratified the Convention on the Procedure for the Settlement of Investment Disputes between governments and foreign entities and/or individuals. Ukraine is a member of the World Bank's Multilateral Investment Guarantee Agency (MIGA) as well. (*Dragon Capital, http://www.dragon-capital.com/)*

4.5. Special Economic Zones

Special (free) Economic Zones (SEZs) have been increasingly applied as a vehicle for attracting investments. The law of 1992 has established a framework for SEZs (Table 34), providing separate tax holidays for individual zones. Under Ukrainian Law "On Special

(Free) Economic Zones" adopted in 1997, there are three types of special economic zones in Ukraine:

- Special (free) economic zones;
- Territories with a special investment regime (TSIR);
- Territories of priority development (TPD).

Depending on the type of the zone, many privileges are extended to the subjects in their enterprise activity, including: customs regime benefits for import and export of the goods on the territory of the zones; tax benefits; clearing of land tax payment for the period of development of the real estate.

Table 34. Special Economic Zones of Ukraine

The special regime of investment activity provides the establishment of tax and customs privileges for the subjects of enterprise activity that have concluded the contract with local bodies concerning realization of the investment project in priority branches. The established privileges provide exemption for a certain period (usually 3-5 years): from taxation by the import customs duty and VAT of the equipment (except for excise goods) for realization of investment project; from profit tax of the newly established enterprises, where the size of the investment is determined for each territory separately (but not less than 200 thousands USD).

Main objectives of SEZ and TPD are: new jobs creation; foreign trade stimulation; foreign investment attraction; active exchange of knowledge and technologies; broadening of export base or import substitution.

In the beginning of 2001, 369 investment projects with total value of more than 1.5 billion USD were confirmed in SEZ (126 projects) and TPD (243 projects) (Table 35).

During the realization of investment projects in SEZ and TPD, 429.5 million USD investment were attracted (27 % of the total projects' value), including foreign investments of 211.9 million USD. 12500 new working places were created and 28900 working places were saved as a result of the SZE and TPD activities.

Table 35. Results of economic activity of SEZ as for 01.01.2001

Name of SEZ, location	**Created, period**	**Economic Results**		
		Investment projects approved (cost, USD mn)	**Investments, USD mn**	
			total	**FDIs**
SEZ "Donetsk"	60 years since 14.01.99	116 (775.1), 43% of FDI	318.1	166.4
SEZ "Azov"				
TPD Donetsk oblast	30 years since 14.01.99			
TPD Chernigov oblast	30 years since 01.01.2000	2 (4.2)	-	0.04
SEZ "Health Resorts-polis Truskavets'"	20 years since 01.01.2000	12 (26.9)	2.8	1.2
TPD Lugansk oblast	30 years since 07.08.99	16 (40.4)	63.4	1.1
TPD Autonomous Republic Crimea	30 years since 01.01.2000	20 (43.1), 44% of FDI	8.5	8.3
TSIR Kharkov	30 years since 01.01.2000	22 (68.9), 66% of FDI	34.2	2.9
SEZ "Yavoriv"	20 years since 17.02.99	45 subjects of SEZ registered	106.4	-
TPD Zhytomer oblast	30 years since 01.01.2000	15 (24.7)	2.0	-
SEZ "Slavutich"	20 years since 30.06.99	23 subjects of SEZ registered (30.5)	2.1	-
TDP Volyn oblast	30 years since 01.01.2000	5 (4.1)	0.96	-
TSIR Zakarpattie oblast	15 years since 19.01.99	49 (196.3), 80% of FDI	27.9	15.2
SEZ "Zakarpattie"	30 years since 17.12.98	4 (9.1)	1.8	-
TSIR Shostka (Sumy' oblast)	30 years since 01.01.2000	The realization of investment projects has not started by 01.01.2001		
SEZ "Mykolaev"				
SEZ "Reny"				
SEZ "Porto-Franco"	25 years since 01.01.2000			
SEZ "Interport Kovel"	20 years since 01.01.2000			
Total			***568.16***	***195.14***

Source: Authors' calculations

SEZ and TPD have become significant tax payers to all levels of budget of Ukraine. In 2000 313.9 million UAH were paid in taxes: profit tax – 27.5 million UAH, VAT – 205.9 million UAH, personal income tax – 22.2 million UAH. In 2002, about USD 909 million of investment (both domestic and foreign) was attracted to these zones and territories. Over

5000 investment projects valued at USD2.8 billion were signed in 2002 to be implemented in these zones and territories. In 2002 over 90 000 jobs were either created or preserved due to these special investment conditions.

However, different views and opinions persist as to the future fate of these zones and territories. While the IMF experts suggest curbing their activities or eliminating them altogether, so far the Ukrainian Government has taken no steps to do so because of their importance to the country's economy at the present stage. The adequate solution is being sought now based on broad international experience.

5. The Investment Rating of Ukrainian Regions

5.1. FDIs by Regions

FDI stock in Ukraine is not evenly distributed – foreign investment per capita in Kiev amounts to 705 USD, while in Chernovtsy region it is 16 USD in 2002 (Table 36).

Table 36. FDI by Regions 2002

Region	FDI inflow		FDI inflow growth		FDI per capita		FDI per capita growth		FDI outflow		FDI outflow growth		FDI outflow per capita	
	USD mln	Rank	USD mln	Rank	USD	Rank	USD	Rank	USD mln	Rank	USD mln	Rank	USD	Rank
Kiev City	1848.9	1	307.2	1	705.4	1	117.2	1	8.07	5	-0.18	19	3.08	5
Kiev	419.5	2	5.9	18	232.0	2	3.3	21	0.04	17	0.01	8	0.02	17
Donetsk	389.4	3	54.7	5	81.6	11	11.5	10	3.99	7	-0.21	20	0.84	9
Zaporozhie	362.0	4	55.0	4	189.6	3	28.8	2	2.01	9	-2.71	24	1.05	8
Dnepropetrovsk	359.4	5	64.8	2	101.8	6	18.4	5	4.13	6	4.13	1	1.17	7
Odessa	289.3	6	53.6	6	118.2	4	21.9	4	40.84	2	0.11	3	16.68	1
Lvov	220.3	7	60.6	3	84.4	10	23.2	3	0.52	12	0.06	5	0.20	13
Crimea	209.6	8	31.2	7	87.5	9	13.0	9	19.52	3	0.57	2	8.15	4
Kharkov	164.2	9	14.1	11	56.9	12	4.9	16	43.86	1	-6.04	26	15.19	2
Poltava	155.9	10	6.3	17	96.9	8	3.9	19	0.06	15	-2.32	23	0.04	15
Zakarpatie	127.7	11	19.7	10	101.9	5	15.7	7	0.00	22	-0.02	18	0.00	22
Sumy	127.6	12	0.8	25	99.8	7	0.6	25	0.01	18	0.01	6	0.01	18
Ivano-Frankovsk	70.0	13	23.7	8	49.9	16	16.9	6	0.01	20	0.00	16	0.00	20
Nikolaev	65.4	14	5.0	19	52.3	13	4.0	18	0.53	11	0.01	7	0.42	11
Chernigov	61.3	15	7.4	15	50.0	15	6.0	13	0.04	16	0.00	14	0.03	16
Zhytomir	58.2	16	20.1	9	42.4	19	14.6	8	0.10	14	0.00	15	0.08	14
Kherson	55.8	17	10.8	14	48.1	17	9.3	11	0.25	13	0.00	12	0.22	12
Volyn	53.5	18	4.6	20	50.8	14	4.4	17	0.00	22	-3.77	25	0.00	22
Lugansk	51.6	19	12.3	12	20.6	24	4.9	15	2.09	8	0.06	4	0.83	10
Cherkassy	51.6	20	-3.1	26	37.2	20	-2.2	26	0.00	22	0.00	10	0.00	22
Rovno	51.0	21	3.0	22	43.7	18	2.6	22	0.01	19	0.00	13	0.01	19
Vinnitsa	38.4	22	11.0	13	21.9	23	6.3	12	15.87	4	-0.87	22	9.05	3
Kirovograd	38.0	23	2.0	24	34.1	21	1.8	24	0.00	21	0.00	9	0.00	21
Khmelnitskiy	28.5	24	7.0	16	20.2	25	5.0	14	0.00	22	0.00	10	0.00	22
Ternopol	26.9	25	3.9	21	23.7	22	3.4	20	0.00	22	-0.02	17	0.00	22
Chernovtsy	15.0	26	2.1	23	16.3	26	2.3	23	1.92	10	-0.44	21	2.09	6

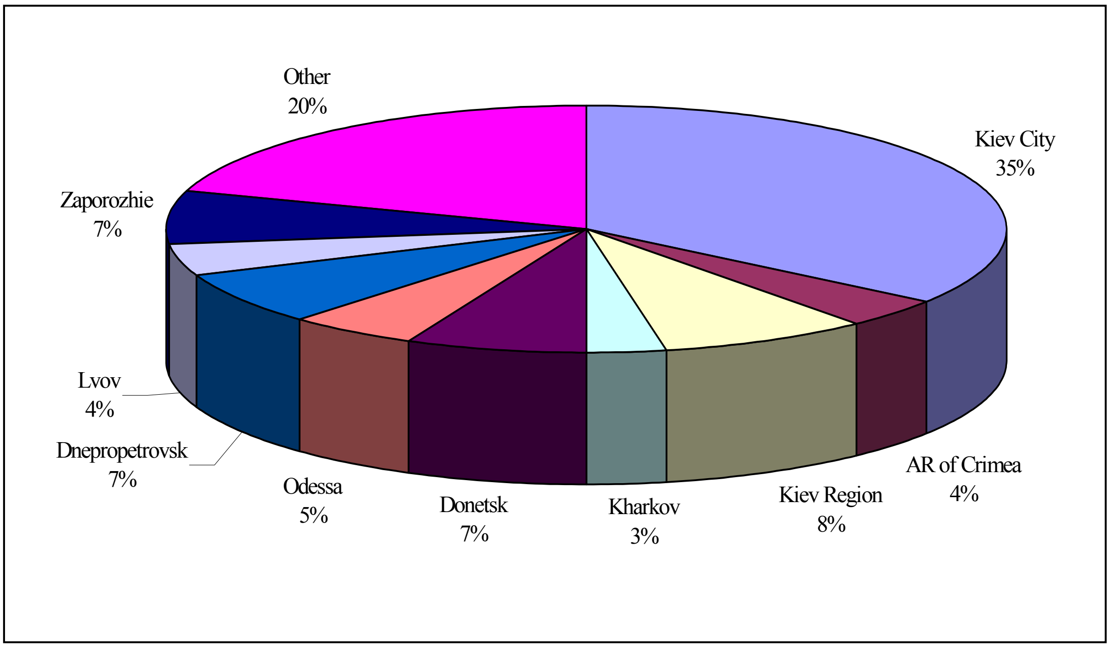
Source: www.ipa.net.ua

Concentration of foreign investment shows that investors pay attention to the infrastructure and economic development of certain regions. During 2002 net FDI increase in Kiev City totalled 307 million USD, while in Cherkassy region the equivalent figure decreased by 3.1 million USD.

Net increase in FDI higher than 30 million USD was observed only in six regions (excluding Kiev City): Odessa, Lvov, Zaporozhie, Dnepropetrovsk, Donetsk regions and Republic of Crimea.

Then uneven spread of FDI is striking: 80 % of all FDI were invested in enterprises, situated in eight regions and Kiev City (Table 37).

Table 37. FDI in Ukrainian Regions, as of January 1, 2003



Source: www.ir.org.ua

5.2. The Investment Rating of Ukrainian Regions

An investment climate study of 24 regions, Republic of Crimea and Kiev City allows to pick up the best regions. The complicated score board made by "Institute for Reforms"[13] shows that the capital city (Kiev) is far the best location.

The Institute for Reforms' experts calculated for the first time the investment rating of the Ukrainian regions in 1999. The results of 2002 are based on five categories of indexes: economic development of a region (1), market infrastructure (2), financial sector (3), human resources (4) and private enterprises and local authorities (5) (Table 38).

[13] Ukrainian non-governmental analytical centre "Institute for Reforms", www.ir.org.ua

Table 38. Components of the 2002 Investment Rating of the Ukrainian Regions

Region	Composite Rating Score Breakdown: Economic Development (25%)		Market Infrastructure (22%)		Financial Sector (25%)		Human Resources (13%)		Business and Local Authorities (15%)		Composite Rating Score	Rank
	score	rank	score	rank	score	rank	score	rank	score	rank		
Kiev City	0.728	1	0.640	1	0.921	1	0.853	1	0.696	1	0.787	1
Donetsk	0.409	2	0.574	2	0.177	7	0.473	3	0.289	8	0.395	2
Kharkov	0.401	4	0.410	3	0.216	4	0.451	7	0.426	2	0.379	3
Dnepropetrovsk	0.399	5	0.402	4	0.280	2	0.473	4	0.277	11	0.373	4
Odessa	0.374	6	0.273	6	0.184	6	0.448	8	0.388	3	0.324	5
Zaporozhie	0.408	3	0.258	8	0.198	5	0.435	11	0.249	13	0.310	6
Lvov	0.310	9	0.352	5	0.160	11	0.467	5	0.281	9	0.309	7
Poltava	0.361	7	0.233	10	0.155	12	0.390	16	0.301	5	0.283	8
Kiev region	0.355	8	0.149	21	0.161	10	0.475	2	0.302	4	0.273	9
Nikolaev	0.284	12	0.170	17	0.227	3	0.394	15	0.279	10	0.263	10
Crimea	0.269	15	0.225	11	0.165	8	0.452	6	0.300	6	0.262	11
Vinnytsa	0.256	17	0.269	7	0.108	19	0.445	9	0.243	15	0.253	12
Lugansk	0.248	18	0.255	9	0.148	13	0.348	26	0.209	16	0.240	13
Zakarpatie	0.271	14	0.204	15	0.093	25	0.429	12	0.245	14	0.235	14
Ivano-Frankovsk	0.244	19	0.222	12	0.115	16	0.423	13	0.148	21	0.222	15
Sumy	0.295	11	0.140	23	0.099	23	0.361	21	0.256	12	0.219	16
Cherkassy	0.258	16	0.143	22	0.136	14	0.390	17	0.199	17	0.215	17
Kirovograd	0.210	23	0.151	20	0.112	17	0.352	23	0.290	7	0.208	18
Chernigov	0.296	10	0.139	24	0.123	15	0.355	22	0.136	24	0.206	19
Chernovtsy	0.239	21	0.208	14	0.099	22	0.350	24	0.116	25	0.199	20
Khmelnitskiy	0.189	25	0.194	16	0.104	21	0.407	14	0.159	19	0.199	21
Volyn	0.272	13	0.161	19	0.046	26	0.439	10	0.142	23	0.198	22
Ternopol	0.183	26	0.217	13	0.110	18	0.348	25	0.145	22	0.194	23
Zhytomir	0.239	20	0.161	18	0.099	24	0.381	19	0.092	26	0.188	24
Rovno	0.232	22	0.118	25	0.108	20	0.387	18	0.153	20	0.188	25
Kherson	0.200	24	0.076	26	0.162	9	0.369	20	0.192	18	0.186	26

Source: www.ir.org.ua

5.3. Description of Ukrainian Regions[14]

5.3.1. Central Regions

Table 39. The Main Economic Indicators of Central Regions 2002

Region	Population, % of total	GDP per capita, real prices, USD	Industrial output per capita, USD	Agricultural output per 100ha arable land, USD thousand	Average monthly wage, USD	Fixed capital investments per capita, comparable prices, USD	Export per capita, USD	Import per capita, USD	Territory, % of total
Kiev City	5.5	1 267.2	742.0	-	120.6	422.8	1 077.9	1 445.9	0.1
Kiev region	3.8	661.5	500.2	45.1	71.0	171.9	183.0	261.0	4.7
Poltava	3.3	545.6	965.0	30.4	66.4	213.5	545.6	119.3	4.8
Cherkassy	2.9	445.8	397.7	40.5	51.8	78.7	147.2	99.8	3.5
Zhytomir	2.9	398.9	266.1	25.3	50.3	73.6	130.6	102.7	5.0
Chernigov	2.5	502.4	482.0	23.8	52.0	89.9	140.6	134.8	5.3
Kirovograd	2.3	332.1	244.0	27.1	52.8	85.3	72.9	27.4	4.1

Source: www.ipa.net.ua

KIEV CITY

Kiev - the capital of Ukraine - is the political, administrative, religious, cultural, historical, scientific and educational centre of Ukraine.

Kiev is one of the leading industrial centres of the country. There are 400 large manufacturing enterprises. The number of small and medium sized companies (SMEs) is growing fast in Kiev. In 2001, there were registered 130 SMEs per 10 000 of people – this is the highest result all over Ukraine. Small companies employ 8.6 % of the city's population.

Enterprises located in Kiev produce airplanes, sea and river vessels, electronic computer facilities, high tech products, radio equipment, dredges, machines and equipment for different industrial enterprises, chemical and pharmaceutical production, building materials and cable production.

[14] Chapter is written based on the information on www.ukraine.be/trade/regions

Kiev's industrial enterprises are actively cooperating with other regions of Ukraine, as well as with foreign countries. The number of companies with FDIs is the highest in the country. Kiev accumulates about 35 % of total FDI stock in Ukraine.

KIEV REGION

Kiev region is rich in natural resources like peat, charcoal, construction and building materials.

The industry of the region comprises electric power engineering, food industry, mechanical engineering, metal-working, chemistry and oil chemistry. Mechanical engineering and metalworking concentrate on equipment production for the chemical industry (factory Krasnyi Oktjabr). There are also trading companies, cattle-breeding and food-processing machines producers, dredgers producers (Borodjany Dredger Plant), electro-technical production, production of refrigerators (Vasylkiv Refrigerator Plant), air-conditioners, etc.

Chemical and oil-chemical industry of the region is represented by Bila Tserkva Tyre Plant number 2.

POLTAVA

Poltava region is important Ukrainian gas and oil producer: one fifth of the oil and one third of the gas produced in Ukraine comes from the region. The mining industry is developing in Komsomolsk due to rich iron ore deposits. Besides, there are considerable deposits of raw materials for producing bricks. Mineral water from Mirgorod is well known all over Ukraine.

Fuel industry, food industry and black metallurgy are the most important for Poltava region. Famous Ukrainian companies manufacture lorries, railway vans, electric engines, gas lamps, instruments, metal-cutting machines, equipment for light and food industry, china, consumer goods, clothes, furniture, etc.

There are 620 agricultural enterprises and 1393 farms in the Poltava region. Horses from Dibrovsky horse farm of Mirgorod district are well known in Ukraine and abroad.

CHERKASSY

Cherkassy region is rich in natural resources; especially in fuel resources like charcoal and peat. There are many construction material producers in the region. The region has deposits of clays suitable for ceramics production. A unique deposit of bentonite clays is located in Cherkassy region.

Cherkassy region is one of the leading producers of agricultural and food products in Ukraine. There are 130 food processing enterprises in the region, employing 29 thousand people. The leading dairy enterprise of the region is Yuria, producing more than 50 types of dairy products, which are popular in many regions of Ukraine. “Molochnyi Svit” and “Bilosvit” trademarks of Cherkassy milk processing factories are also well known. Cherkassy Biscuit Factory is a new enterprise with modern equipment and technologies. It produces 18 thousand tns of different confectionery annually: cookies, waffles, chocolate and waffle cakes.

For the last two years, alcohol producers have started production of 17 new brands of alcohol drinks. One of the best known companies in Ukraine is Zolotonosha Distillery. Cherkassy region is also famous for its beer brands, particularly "Kniaz", "Cherkaske Yantarne" (produced by Cherkassy Pyvo brewery), "Kazbet" and "999" (produced by brewery Bogdan).

Cherkassy Prodovolcha Compania (Food Company) is a local food company, producing about 300 types of products: meat, sausages, smoked meat, meat and combined meat-vegetables preserves, semi-finished food products, food and industrial fats, endocrine and ferment materials and medicines.

Uman Cannery, Zolotonosha enterprise Universal and Korsun-Shevchenkivsky vegetable canneries are famous for their wide range of products, which are sold in Ukrainian regions, exported to the CIS countries, Germany, Denmark, Austria and the Baltic States.

The following products of chemical industry are produced in the Cherkassy region: fertilizers, artificial fibres, varnish and dye, chemical reagents, thinners, cleaning and polishing substances for cars, polymer films and medicines. Viscose fibre manufactured by Cherkassy Himvolokno company competes successfully with well known brands in Western Europe. Azot company is a monopolist in caprolactam production in Ukraine. Azot’s products are exported to the USA, Italy, Finland, Liechtenstein, Slovakia, Latvia and Russia.

The machine-building industry is important for the economy of the Cherkassy region. It includes enterprises of machine-building production for light and food industries and agriculture; it also includes manufacturing the technological equipment and production of machine tools.

Due to the chernozem (black soil), Cherkassy region has a developed agricultural sector. Cereals and sugar beats cultivation traditionally prevails in the agricultural output of the region.

ZHYTOMIR

Zhytomir region is the leader in manufacturing of porcelain, faience, linen cloth, footwear and paper. Major branches of the production in the region are: food industry, machine-building and metal working, pulp and paper industry, light industry, construction, electric power industry and chemical industry.

Zhytomir region is rich in non-ferrous minerals. Significant amount of peat is mined on the north of the region. There are also deposits of titanium- and uranium-containing rocks.

The largest machine-building and metal processing companies are: Progress (Berdychiv), Korosten plant Chimmash, Zavod Shlyakhovykh Mashyn (road-building machines plant), Novohrad-Volynsksilmash, Prozhektor and Ovruch Pryladobudivnik. These companies work in machine-building equipment production, metal and wood processing, equipment for chemical industry manufacturing, machines and equipment for livestock breeding, road-building machines, electro-technical devices, technological equipment for processing agricultural goods, etc.

There are 120 food processing companies in the region: baking, confectionery, brewery and soft drinks, dairy and meat, sugar and flour companies. The leading companies are: Zhytomirskyi Maslozavod (butter factory), Zhytomirski Lasoshchi (confectionery factory), Berdychiv Kholod, Molochnyk (dairy), Ovruchskyi Molochno-Konservnyi Kombinat (dairy and cannery), Novohrad-Volynskiy Myasokombinat (meat-packing plant). The region produces about 6% of the butter and other dairy products and more than 3% of the confectionery in produced Ukraine.

Light industry is represented mainly by companies producing clothes, shoes, textile and leather products: company Arsania in Korosten, Berdychiv clothes factory, Novohrad-Volynskiy Lesya, Malyn clothes factory, Radomyshlyanka.

Companies of wood processing industry produce furniture, joinery products, paper, board, timber, etc. The largest companies are: Zhytomirderev, Berdychivmebli, Malynska Paperova Fabryka (paper mill).

Chemical industry manufactures chemical fibers, plastics and lacquer-paint production. The largest companies in the chemical industry are: Korosten Works Yantar and Liktravy (medicinal herbs) and Zhytomir-Polysaks.

There are almost 700 agricultural enterprises, 410 farms and 306 600 private farms in the region. The soil is very rich in the Zhytomir region: 79 % of arable land is in agricultural use.

CHERNIGOV

Chernigov region is rich in wide range of natural resources. There are deposits of sand used for glass production (Ripkinskiy district); oil and gas condensate deposits (Ichnianskiy, Prilutskiy, Varvinskiy, Talalayivskiy districts); chalk deposits (Siverskiy district); clay deposits, which are suitable for production of roof tiles, tiles, pottery and ceramics; bischofite deposit (Novopodilske, Ichnianskiy district). The central part of the region is rich in mineral water springs.

Chernigov region provides more than 80 % of the national production of wool and wallpaper; 30 % of chemical fibre and thread; 20 % of crude oil production.

Chernigov is the only region in Ukraine, producing cord, fire-fighting vehicles, protein shell, pianos, special equipment for agricultural and food processing enterprises. Food processing, fuel, machine building and metal processing, wood processing, pulp and paper, light industry are dominant industries in the regional economy structure. Power engineering, chemical and petrochemical industries also play the important role in the economy of the region.

The main producers in the region are: Chernigov Chimvolokno, producing cord and thread; company Cheksil - the main wool producer in Ukraine; Krukiv technical paper production factory, specializing in wallpaper manufacturing. Prilutsk company Pozhmashina is the only producer of fire-fighting equipment in Ukraine. Silmash is the only poultry farming equipment producer in Ukraine. Bilkozin factory in Prilutsk is the only manufacturer of protein shells for sausage production in Ukraine. Chernigovavtodetal is collaborating with car manufacturing plant in Nizhniy-Novgorod (Russia). Chernigov music instrument factory produces pianos, pinch music instruments and children music toys.

Among other enterprises should be mentioned tobacco factory British American Tobacco - Priluki, producing about 15 % of all tobacco products in Ukraine. The factory is discussed more detailed in chapter 6.9.

Chernigov region is one of the most developed agricultural regions of Ukraine. Agricultural lands occupy 21 000 km^2. Cereals, potatoes, grain, beetroots and flax are growing in the region. A cattle farming is developing: mostly milk and meat cattle farming and pig and poultry farming.

KIROVOGRAD

The position of Kirovograd region in the centre of the Ukrainian crystalline massif causes the formation of large rare metal deposits. The region has wide range deposits of ore-bearing rocks: tungsten, copper, molybdenum, apatite, uranium, gold and silver, bismuth, tin, lead, beryllium, stibium, tantalum and niobium.

The mining industry is developing intensively in the region. There are deposits of coal, iron ore, nickel ore, raw materials for atomic power engineering (uranium), non-metallic minerals.

During the last decade gold deposits were discovered in Kirovograd region. According to the geological survey information, it is possible that new deposits of platinum, diamonds, chromium and rare metals will be discovered in the region.

The main industrial branches of the Kirovograd region are: food industry, machine-building and metal-working industry, power-engineering, building materials industry, fuel industry, non-ferrous metallurgy and light industry. The region is a large-scale producer of sowing and harvesting machinery, electrical lifting cranes, brown coal briquettes, nickel, graphite, mineral wax, etc.

Agriculture is important for the economy of Kirovograd region. The machine-building industry is supporting agri-business development by producing agricultural machines and spare parts. Plant Avtoshtamp produces grain reapers and flour-milling equipment. Company Krasnaya Zvezda specializes in manufacture of various types of seeders, cultivators, hay stackers and spare parts.

Non-ferrous metallurgy is represented by company Pure Metals and Svetlovodsk Hard Alloys and Refractory Metals factory. Pure Metals specializes in production of semiconductor materials and compounds. The company exports its products to CIS and other countries.

The fuel industry in Kirovograd region is represented by state company Alexandriaugol, mining and processing brown coal used in chemicals production by Semenovsky Mineral Wax factory - the unique manufacturing unit in Ukraine.

Food processing companies of the Kirovograd region produce sugar, flour, macaroni and pastry, bread and bakery products, vegetable oil, meat and dairy products. Company Ptitsekombinat, located in the region, is the leader in the meat-processing in Ukraine. The company has launched environment friendly technology in the production of sausages and smoked products.

Agriculture is well-developed in Kirovograd region. The climate and rich soil – chernozem – have created excellent conditions for agri-business. The region produces winter wheat, barley, maize, leguminous plants, buckwheat, millet, sunflower and sugar beet. The main products of gardening are apples, pears, plums, cherries and berries.

5.3.2. Eastern Regions

Table 40. The Main Economic Indicators of Eastern Regions 2002

Region	Population, % of total	GDP per capita, real prices, USD	Industrial output per capita, USD	Agricultural output per 100ha arable land, USD thousand	Average monthly wage, USD	Fixed capital investments per capita, comparable prices, USD	Export per capita, USD	Import per capita, USD	Territory, % of total
Donetsk	9.9	752.2	1 378.2	35.2	84.7	150.3	752.2	189.6	4.4
Dnepropetrovsk	7.4	743.2	1 423.9	31.1	82.1	155.0	832.8	333.7	5.3
Kharkov	6.0	629.3	656.1	30.3	69.5	160.4	150.9	196.3	5.2
Lugansk	5.2	518.2	985.9	16.7	73.8	104.1	569.4	79.5	3.9
Zaporozhie	4.0	764.9	1 362.6	20.4	83.5	150.3	729.2	261.7	4.5
Sumy	2.7	507.5	567.4	26.9	57.5	141.7	211.3	109.9	3.9

Source: www.ipa.net.ua

DONETSK

Donetsk region is the richest in natural resources in Ukraine. 12 % of Ukrainian natural resources are concentrated in the region: coal, kaolin, cement, rock salt, mercury, gypsum, flux limestone, dolomite, potassium salt, stone building materials, fire, ceramic clays and chalk. The region is exploring deposits of iron ore, alkaline kaolins, basalt, phosphorites, ornamental lining stones, aluminium ores and rare metals. New deposits of gold, copper and lead have been discovered. Kimberlite pipes with fractions of the fine diamond crystals have been discovered on the North of Priazovsky Crystal Field.

15 gas fields with total deposits of 30 billion cubic meters are currently being explored. Coal deposits in the region contain 118 billion cubic meters of methane, which is a valuable energy source. New gas field was discovered in the Northern part of Donetsk region; its estimated deposits are about 1200 million cubic meters of gas.

20% of Ukrainian manufacturing companies are located in Donetsk region. There are 800 enterprises, 500 construction companies and 13 650 small firms.

Donetsk specializes in beer, champagne and vodka production. One of the largest former Soviet champagne factories is located in Artemovsk. Its "Artemovskoye" champagne is known world-wide.

The metallurgy sector produces half of the region's industrial output. 80 enterprises manufacture a number of metal and steel products and export to more than 50 countries. The largest plants are: world-famous Donetsk Metallurgical plant, Azovstal and Illicha plants located in Mariupol with access to world markets via the sea port.

Donetsk region is the only Ukrainian region supplying lead, mercury, solid alloys and rolled non-ferrous metals. The region's machine-building sector includes 200 enterprises, which satisfy a major part of Ukraine's need in machines and equipment.

15 chemical enterprises produce a wide range of chemical products including fertilizers, acids, soda, plastic and chemical reagents. A considerable part of these products is exported to the CIS countries, Europe and Asia.

Donetsk region’s power generating companies produce 10 GWh energy annually, which covers local need in energy, the surplus is exported to other regions or abroad. Power stations are currently being privatized and foreign investors can acquire equity through international tenders or other forms of privatization.

Donetsk region has rich, fertile soils, providing ideal conditions for agriculture. There are about 470 agricultural firms and approximately 2 300 farms in the region.

DNEPROPETROVSK

Dnepropetrovsk region is very rich in mineral resources: there are about 300 ore deposits. Potential gold deposits were discovered. There are 15 mineral water springs in the region.

There are number of non-metal ore deposits in Dnepropetrovsk region. The region has significant deposits of black and brown coal, exceeding 21 billion tns. About 10 million tns of coal are extracted annually (12% of the coal extraction in Ukraine).

Dnepropetrovsk region holds the second position in Ukraine: there are 587 industrial enterprises. Mining and metallurgical are the core industries of the region's economy. There are 24 mining enterprises and 23 ferrous metallurgy enterprises. The region produces 100 % of the Ukrainian manganese ore, 82 % of iron ore, 72 % of pipes, 36 % of rolled metal, 33 % of cast iron, 32 % of steel and 28 % of coke.

The power industry is developed in the region: there are Prydneprovsk and Krivoi Rog heating power plants with total capacity of 4 700 MW and Dneprodzerzhynsk hydroelectric power plant with capacity of 350 MW.

17 large chemical enterprises produce varnish, paint, mineral fertilizers, tires, explosives, etc. The varnish and paint production is one of the largest in Ukraine. Tires manufactured in the region are exported to 30 countries.

Machine-building and metal working industry is developed in the region. There are number of companies in metallurgy, transport, electric engineering, mining, road-building, chemical and polymeric machine building and machine-tool construction.

The light industry of the region has powerful production potential. The wide range of its products like clothes, knitwear, shoes, synthetic furs, toys, wool and cottons yarn, sewing threads, etc., is exported to France, Canada, Germany, England and other countries.

Fertile black soil covers the large part of the Dnepropetrovsk region. There are 23 000 km^2 of agricultural lands: croplands – 66 %, hayfields and pastures - 10.8 %. The major crops of the region are grain, sunflower, sugar beets and vegetables.

KHARKOV

Kharkov region is rich in natural resources: natural gas, oil, lignite, hard coal, cement, etc. Fuel and power resources are represented by 41 combustible gas reservoirs among which the most notable are Shebelinkske, Krestyshchenske and Kegychivske gas pools (the half of gas recovery in Ukraine). Deposits of sand, clay, chalk, limestone exist in the region. Brick-tile and clay, chalks are extracted throughout the territory of the region.

There are many large industrial enterprises in the region: production of power equipment, aircraft construction, machine tool construction, fuel, electronic, chemical, pharmaceutical, food processing, light industries and armament industry, etc.

The region produce bakery foods, meat products, and full-cream milk products. Confectionery, canned milk, strong drinks, oil and fat products, sugar are exported. The largest enterprises of food industry are: Brewery Rogan and tobacco factory Phillips Morris Ukraine.

In the region, Ukrainian largest enterprises producing cement, tiles, wall materials, plastic, bricks, constructional steelwork are located.

About 660 new farming companies were created in Kharkov region. There are 24 000 km^2 of agricultural lands, arable land area is 19 000 km^2. Kharkov region produces high volumes of grain, sugar beets, sunflowers seeds, vegetables and potatoes.

LUGANSK

The Lugansk region is rich in coal, gas, agrochemical raw materials and construction materials (ceramic, rock, broken brick, sand, clay, lime, chalk, gypsum). There are also deposits of gold, silver, polymetals. One of the largest mineral water springs are located in the region.

Lugansk region produces more than half of the total window glass products, a quarter of coal and electric engines; a sixth of petrochemicals, steel pipes, chemical fertilizers, synthetic ammonia in Ukraine.

The region exports steel, rolled products, ferrous metals and ferrous-metal goods, oil-processing products, chemical fertilizers, metal working machinery, batteries, dyes, organic chemical compounds; import-oil, gas, wood and consumer goods.

The agricultural sector of Lugansk region specialises in grain and oil crops cultivation, meat and milk cattle farming and poultry. The agricultural land cover almost 22 000 km^2.

ZAPOROZHIE

Zaporozhie region is rich in natural resources. There are significant deposits of iron and manganese ores, granites, pegmatite, apatite, manganese ore, secondary kaolin, iron ores, fireproof clay.

Electric power, high-quality steel, ferrous and non-ferrous metals, abrasive and cable products aluminium and other colour metals, power transformers, cars, agricultural machines, various electromechanical devices and equipment are manufactured in Zaporozhie.

Almost 28 % of all electric power in Ukraine is generated in the Zaporozhie area by three generating stations: Zaporozhie atomic power station, Dneproges hydroelectric power station and thermal power station Zaporozhie TPS.

There are about 160 large industrial enterprises in the region. The metallurgy of the region comprises Zaporozhstal and Dneprospetsstal – producers of steel and cast iron, Zaporozhie aluminium plant - the only producer of aluminium and alumina in Ukraine, Titanium-Magnesium Factory - the only producer of spongy titanium in Ukraine, leading enterprise in production of germanium and crystal silicon.

The machine-building in Zaporozhie represented by Motor-Sich - producer of engines for planes and helicopters for famous airplane producers like Antonov, Jakovlev, Tupolev, Beriyev, Kamov, Mil; Zaporozhabraziv - leading productions of abrasive materials and tools. Volume of industrial production in the area is 8.2 % of the total production in Ukraine.

The climate is very favourable for agriculture and tourism. The total area of agricultural land is about 22 400 km^2, including arable land about 19 000 km^2. The soil is mostly with highly fertile humus layer. The region is fifth in Ukraine in grain production and the first in sunflower production.

SUMY

Mineral resources of the Sumy region are represented by oil and natural gas deposits (in Ahtyrka, Romny and Lebedyn regions), which is approximately one third of all Ukrainian deposits. There are also large deposits of peat, phosphorite, potassium salt and gypsum.

The most important branches of production are machine building and metalworking, fuel, food, chemical and petrochemical industries.

Machine-building companies of the region specialize in the production of chemical and oil-producing equipment, gas pumping aggregates, pumps, industrial piping parts and other products. The largest enterprises in the region are Nasosenergomash, Konotop Motordetal, Okhtyrka Naftoprommash.

Chemical and petrochemical industry comprises chemical and chemical-photographic enterprises producing mineral fertilizers, sulphuric acid, mineral pigments, forage additions, chemical reagents, paint products, magnetic tape, cinefilm and photo film, mechanical rubber goods etc. The largest producers are Sumykhimprom and Svema.

5.3.3. Southern Regions

Table 41. The Main Economic Indicators of Southern Regions 2002

Region	Population, % of total	GDP per capita, real prices, USD	Industrial output per capita, USD	Agricultural output per 100ha arable land, USD thousand	Average monthly wage, USD	Fixed capital investments per capita, comparable prices, USD	Export per capita, USD	Import per capita, USD	Territory, % of total
Odessa	5.1	615.8	337.8	26.2	71.2	200.0	604.0	330.8	5.0
Crimea	4.2	384.8	232.1	23.2	67.3	136.6	172.8	67.4	4.3
Nikolaev	2.6	567.0	602.9	22.0	74.7	155.6	487.8	228.8	4.0
Kherson	2.4	411.8	241.4	21.7	54.2	63.7	159.3	37.8	4.7

Source: www.ipa.net.ua

ODESSA

Odessa is located on the Black Sea. Favourable climate, sand beaches, mineral water, famous sights, and developed tourism infrastructure position the region as an attractive place for summer holidays for both Ukrainians and foreigners.

Many developed industrial enterprises of machine building, metalworking, chemical and petrochemical, food, light and other industries are located in Odessa region.

Machine-building industry is represented by many unique enterprises. Odessa plant of radial-drilling machines is the only enterprise producing diamond-boring, radial-drilling machines in Ukraine. Odessa plant Tsentrolit is the only southern plant making casting of ferrous and non-ferrous metals for machine building in Ukraine. It is the biggest producer of ferrous metals in the southern region.

The enterprises of chemical and petroleum-chemical industry produce mineral fertilizers (Odessa plant, Yuzhne), paintwork material (Odessa), household chemical and plastic goods (Odessa), mechanical rubber goods (Odessa), cellulose and carton (Izmail), furniture (Odessa, Balta, Kotovsk), wooden and construction articles (Odessa).

Agriculture is well developed in the Odessa region. There are about 850 agricultural companies and about 5 600 small farms, specialising mainly in growing of grain, sunflowers and grape, cattle, poultry pig breeding.

CRIMEA

The Crimean peninsula due to favourable climate conditions and location (Black Sea) is an attractive tourist place.

Crimea's key manufacturing industries are machine building, metalworking, food and chemical industries. Machine building plants produce ship engines, equipment for food-processing industry, electrical and pneumatic devices, electric welding equipment and agricultural machinery.

Company Selma produces welding equipment, which is exported to many countries. The company is collaborating with the leading foreign manufacturers of welding equipment, including Polish OZAS, Swedish ESAB concern and Finnish KEMPPI. Factory Fiolent is the leading Ukrainian and CIS producer of control systems for the technical and navigational facilities for commercial and naval vessels and the leading manufacturer of household and industrial power tools in Ukraine. The company also produces precision micro-machinery, sensors and indicators and controlling security systems for nuclear power industry.

Crimea has deposits of non-ore raw materials (about 200 deposits): saw limestone, cement stock and marls. The annual output of construction materials is approximately 13 million cubic meters.

Crimean wine producers have been developing in the recent years: Industrial-Agricultural Association Massandra, sparkling wine-making plant Novy Svet, plant Koktebel and company Soyuz-Victan.

NIKOLAEV

Mineral resources in Nikolaev region comprise considerable deposits of construction materials: construction stones; granite, which is famous for its wide spectrum of colours and high decorative qualities; sawed stone; cement components, etc. Nikolaev is the large industrial centre, there many enterprises specialising in machine-building, shipbuilding, non-ferrous metallurgy, food processing, etc.

The region produces about 39.3% of ship-building products in Ukraine, about 100% of the gas turbines, 82% of alumina, about 9.7% of electric power. Electric power is generated by 5 enterprises: South-Ukrainian nuclear power station, Nikolaev thermal power station, Olexandrivka, Kostyantinivka, Pervomaysk hydro-power stations.

Ship-building is the most important industry in Nikolaev region, because of the location close both to the Black Sea and to Dnepr river. The biggest ship-building enterprises are: Chornomorskiy Sudnobudivnyi Zavod (Black Sea Ship-Building Plant); company Damen Shipyard Ocean.

In 2001, Dutch Company Damen Shipyard Group paid 26.3 million UAH for 78 % of shares of Shipbuilding plant Ocean located in Nikolaev. Company has started invest into materials purchasing and to allocate shipbuilding orders to be done on by the Ukrainian plant.

Zorya plant produces gas-turbine engines of 16 MW capacity, gas transportation units for compressor stations, reducers for wind power generating units and steel works, foundry and forging products, welded metal constructions and consumer goods.

Non-ferrous metallurgy is also important for the region's economy. Nikolaev alumina plant is the biggest aluminium producers in Europe. In Nikolaev, there is the only producer of asphalt laying and filtering equipment in Ukraine – Dormashina company.

Food industry is intensively developing in the region. Meat companies are processing products of the local farms. Milk processing is carried out by 12 enterprises, the most famous are Laktalis Ukraine, Pervomaysk milk factory, Voznesensk and Bashtan cheese plants. These milk companies produce more than 30 tns of butter and about 270 tns of milk products daily. Gileya company and Shelton-Nikolaev process sugar beets. Company Sandora produces beverages, canned juices and light wines. Company Nectar produces confectionery goods, mayonnaise, vinegar and beverages.

Like many other Ukrainian regions, Nikolaev is characterised by the developed agriculture. There are more than 20 000 km^2 of agricultural land, of which 17 000 km^2 are cultivated land. The main agricultural products produced in the region are sunflower, sugar beets, vegetables, melons, etc.

KHERSON

Kherson region comprises deposits of non-ore building materials, oil and gas. Power energy is supplied by Kakhovska hydro-power plant and Kherson thermal power plant. There are also many mineral water springs in the region.

There are about 200 industrial enterprises in the Kherson region. The main industries are food production, machine-building, metal processing, power and fuel industry, glass and china making, light industry, construction materials production, wood and pulp processing, paper industries.

Leaders in machine-building and metal processing are Kherson oil refinery, Kherson ship building plant, Kherson ship repair plant (producer of ocean tankers, dry cargo vessels, container carriers, passenger motor vessels, etc.) and Kherson Combine Harvester company producing agricultural machines.

Agriculture, meat and milk production and food processing play important role in the economy of Kherson region. There are approximately 22 000 km^2 of agricultural lands. Wheat, barley, corn, rice, sunflower, beans, millet, vegetables, fruits are growing in the region.

SEVASTOPOL

Nowadays Sevastopol – the port city - is the least developed industrial region in Ukraine. Sevastopol’s industry comprises mechanical engineering and metalworking, light and food industry. Sevastopol is rich in limestone; this mineral is used in the construction industry.

Food industry is the most important for Sevastopol’s economy. Location of the city on the Black Sea specifies development of wine factories, fishing and fish-processing branches.

Mechanical engineering specialises in shipbuilding, ship-repairing and instrument constructing. Sevastopol is the main base of naval transport refrigerating fleet of Ukraine.

5.3.4. Western Regions

Table 42. The Main Economic Indicators of Western Regions 2002

Region	Population, % of total	GDP per capita, real prices, USD	Industrial output per capita, USD	Agricultural output per 100ha arable land, USD thousand	Average monthly wage, USD	Fixed capital investments per capita, comparable prices, USD	Export per capita, USD	Import per capita, USD	Territory, % of total
Lvov	5.4	405.1	329.6	49.2	63.7	129.8	181.5	202.5	3.6
Vinnitsa	3.7	449.9	325.3	37.5	49.8	68.0	143.9	86.1	4.4
Ivano-Frankovsk	2.9	456.7	358.2	59.8	59.7	127.6	292.9	190.0	2.3
Khmelnitskiy	2.9	415.4	289.4	34.0	48.4	96.5	79.8	61.8	3.3
Zakarpatie	2.6	346.3	151.6	62.0	55.3	88.7	227.6	207.4	3.3
Rovno	2.4	440.0	327.6	38.6	58.6	112.8	106.3	101.5	3.3
Ternopol	2.4	342.8	177.7	34.7	44.5	52.8	58.9	44.1	2.3
Volyn	2.2	445.4	254.6	38.6	47.5	110.9	143.5	136.0	3.3
Chernovtsy	1.9	314.1	137.9	51.0	50.9	66.6	78.2	54.1	1.3

Source: www.ipa.net.ua

LVOV

Lvov region has deposits of fuel resources, potassium and rock salt, sulphur, gypsum, building and fire-clays. The most developed industries in the region are mining, chemistry and oil processing, machine-building, radio electronics, construction materials production, light and food industries.

Companies of mining, chemistry and oil processing are producing different types of fuels, chemicals, paints, and tools for oil and gas industries, geology, metal processing and mining operations. Lvov region produces buses, trolley-buses, minibuses, electric loading machines and electric carts, vans, bicycles and scooters and agricultural machinery.

In construction material production Lvov region specialises in production of tiles and ceramic equipment, roofing and heat-insulating materials, construction glass, cement, lime and gypsum. Light industry is known by clothes factories, producing about 50 % of the Ukrainian clothes output.

Food companies in Lvov region produce milk and dairy products, baby-food, mayonnaise, meat products, strong alcohol, beer, cigarettes, ice-cream, etc. Lvov confectionery factory Svitoch is one of the biggest confectioneries in Ukraine, producing sweets, caramel, chocolate, biscuits, waffles, etc.

Agriculture is also well developed in Lvov region. There are more than 12 000 km^2 of agricultural land. Grains, sugar beets, potatoes and corn are growing in the region.

VINNITSA

In Vinnitsa region, there are deposits of kaolin, fluorite, granite, garnet, etc.

There are over 500 industrial enterprises in the region: machine building, metalworking, chemical, electric, medical, food and microbiological branches. Such enterprises as Vinnitsa State Bearing Plant and Bratslav Experimental Agricultural Machine Manufacture Plant produce wide range of tools and equipment.

The enterprises of the region produce food: oils and fats, meat and dairy products, cereals and sugar. The quality of mineral water "Regina" is widely recognized. Companies Podilliaspyrt" and Nemiroff produce vodka and traditional liquors.

All branches of agriculture are represented in the region. There are many of sugar production plants, some of them are 150 years old. During the last years new capacities for processing grain, beans and cereals, fruit and vegetables have appeared.

IVANO-FRANKOVSK

The Ivano-Frankovsk region is rich in mineral resources. The availability of resources have defined the development of the industry of the region, like fuel and power production (oil, gas, brown coal, peat); chemical industry (rock and potassium salt, sulphur, phosphates); construction (gypsum, marls, marble, sandstone, sands and clay); Balneology (ozocerite, mineral waters). There are small deposits of iron and manganese ores, copper, zinc, silver and gold in the Ukrainian Carpathian mountings. Besides, the Ukrainian Carpathians are the richest Ukrainian region with mineral water deposits. The are over 800 various types of mineral water springs.

The region specializes in natural oil and gas production, electric power supply, production of mineral fertilizers, petrol, chemicals, paints, agricultural machinery, chemical machinery, construction materials, wood products, furniture, consumer goods, etc.

KHMELNITSKIY

Khmelnitskiy region produces electric power, power transformers, wood processing machine-tools, paper, cardboard, meat, butter, tinned meat and vegetables, pastry, mineral water, fat cheese, knitted fabric for garment and underwear, woollen fabric, foot-wearing, electric irons, etc.

In food processing the increase of output took place in meat production, butter and milk production and sugar manufacturing.

Agriculture plays an important role in the Khmelnitskiy region's economy. It is highly developed due to favourable natural and economic conditions. The largest agricultural areas are taken by the grains, including winter wheat. In the region barley, oats, buck-wheat, millet, bean-crops are also grown.

ZAKARPATIE

Zakarpatie region is rich in its forests, which occupies more than a half of its territory. In the region there are several types of minerals, including the ones, which are common only for the Zakarpatie geological province. There are almost 150 deposits of raw and mineral materials and more than 30 kinds of minerals.

The region possesses high recreational and resort potential. 360 sources of mineral and thermal waters have been discovered there. Zakarpatie is famous as one of the most popular places for medical treatment and recovery.

In Zakarpatie region there are more than 2 000 industrial enterprises of timber and wood industry (production of furniture, saw-timber, veneer sheets, parquet); timber-chemical industry (products of timber processing); food industry (production of wine, cognac, canned fruit and vegetables, soft drinks and mineral water); light industry (ready-made clothes, bed linen, footwear); machine-building industry (metal-cutting machines, engines, pipeline armature, domestic gas convectors, gas-meter); and of construction materials industry.

ROVNO

On the territory of Rovno region there are more than 600 deposits of minerals, only 80 of them are being exploited. Production includes chalk, kaolin, construction stones, basalt, cement raw material, mineral water, etc. There are deposits of phosphate, copper, diamonds, etc.

The main industries of Rovno region are electrical energy, chemical and petrochemical industry, machine-building and metal-working industry, pulp and paper industry, glass, china and faience industry, light and food industries, construction materials and consumer goods. Enterprises of the region produce plywood, chemical fertilizers, cement, amber, processed meat and milk products and agricultural products.

TERNOPOL

Ternopol region has limestone, dolomites, sandstone, clay and loams deposits. These minerals are widely used in the construction industry. In the northern and central parts of the region there are also deposits of fire clay, which are used for tile and pottery manufacturing. The peat is of great industrial importance in Ternopol region.

There are many springs of mineral waters in the region, which are used for medication. The wells of hydrocarbon, hydrogen sulphide and sulphate waters are also found on the territory of Ternopol region.

The main industries in the Ternopol region are: food industry, machine-building and metal processing, light industry, construction materials, food industry and wood processing industry. Food industry is the leader in the economy of the region. Companies produce sugar, meat, milk, vodka, confectionery, tobacco, flour, etc.

VOLYN

Volyn region has deposits of coal, turf, chalk, clay for brick and tiles production, construction sand. Besides, deposits of natural gas, phosphorites, basalt and natural copper were developed.

The industry comprises about 160 enterprises, representing practically all branches of production. Volyn has big enterprises in machine-building, light and food industries, wood-processing and chemical industries, as well as in construction material production.

The structure of economy of the region is changing dynamically due to the development of small and medium sized companies (SMEs). The number of SMEs has grown 1.5 times within the last two years and constitutes more than 3 000.

One of the advanced branches of the regional economy is agriculture and food processing. The region has started land ownership reformation based on the foreign experience and knowledge. They applied methods and software of Ronko consulting company (USA) and

"Project for land privatization and reorganization of collective agricultural land plots" by International Financial Corporation.

CHERNOVTSY

The region is rich in natural resources. Four oil and gas deposits (Lopushne, Chornoguzy, Krasnoilsk, Sheremetiv) are located in Chernovtsy region.

The availability of the construction materials in the region have reasoned the development of the construction industry. There are considerable deposits of gypsum in the Dniester area and the Prut basin. The northern and eastern districts of the region are rich in limestone. In Krasnoilsk there is a deposit of marble. There are also deposits of quartzite, potassium; springs of mineral water such as "Izhevsk", "Matsest", "Borzhomi", "Naftusia".

The leading branches of production in the region are: food industry, machine building, metal working industry, energy sector, wood industry and light industry. Agriculture of the Chernovtsy region is developing thanks to favourable climate conditions. Grains, potato, sugar beets, vegetables, sunflower are growing in the region.

6. FDI Scene in Ukraine: Business Examples

6.1. FDI Strategies

FDI inflow is important for all TEs. As mentioned above, Ukraine has not been very successful in the attracting FDIs. Experts state that FDIs flows to Ukraine are much lower than expected.

The most attractive branches for foreign investors are: food processing industry (16 %), wholesale and retail trade (18.5 %), mechanical engineering and metallurgy (14.1 %), financial activities (8.1 %) and energy sector. The percentages are derived from overall FDI-figures.

Foreign companies tend to centralize investment and do not go to remote regions. In such a way, FDIs are located mostly in Kiev (about one third), Donetsk, Zaporozhie, Poltava and Dnepropetrovsk regions.

Ukraine guarantees legally free profit and interest repatriation. However, there are many obstacles for investors: foreign companies still regard bureaucracy of the local authorities as the main constraint for the investment in the Ukraine.

6.1.1. The Typology of Foreign Companies Doing Business in Ukraine

Many experts regard FDIs beneficial from the point of view of the host country. However, the well-being of the host country is not a decisive motive for FDIs: investors are always seeking profit for the risks they take in FDI framework.

Companies invest in foreign production for three basic reasons: to obtain raw materials, to source products at lower cost and to penetrate local markets (*Root, 1994).*

Extractive investors establish foreign subsidiaries to exploit natural resources in order to acquire raw materials for their own industrial operations (backward vertical integration) or for sale on the world market. Ordinarily, these investors sell only a small fraction of their raw materials output in the foreign country of extraction (*Root, 1994).*

In Ukraine, the classic examples of this type of FDIs are investing in the mining and metallurgy, oil industry and other extracting industries.

Sourcing investors establish foreign operations to manufacture products that are entirely or mainly exported to the home country or to the third countries. The purpose of sourcing investments is to obtain lower-cost supplies of components, parts, or finished goods by taking advantage of abundant endowments of labour, energy, or other inputs in a foreign country *(Root 1994)*.

Many investors to the Ukrainian processing and production industries with higher added value are partly belonging to this group.

Market investors account for most investment abroad. Their objective is to penetrate a target market from a production base inside the target country *(Root, 1994)*

Companies producing consumer goods and private services in Ukraine like McDonald's, Philip Morris, Kraft Food, Nestlé, mobile operators and many other companies in food processing, tobacco, beverages, breweries, telecommunications, fast food, etc. have entered the Ukrainian market in order to *find new markets*. The main reason for the expansion to the Ukraine is that home markets are already saturated. Profit per every new unit sold is approximately the same in every country, and, if even small part of the Ukrainians would be able to buy their products, the total sales will increase.

For many foreign investors in Ukraine and other TEs, it is difficult to specify the type of investment they make. Many foreign companies entering these markets represent mixed type of sourcing and market investors.

Foreign investors in Ukraine normally take a long-term view. Their purpose is to occupy a new niche on the new Ukrainian market. In the current situation these investors might have even losses. This group includes trading companies investing to the processing plants, traders of agricultural technologies, plants' protecting means and agricultural products. The example of successful investments within this group is a large American company Cargill expanding its business in Ukraine.

Companies having a long-term experience of doing business in Ukraine, are knowledgeable in the Ukrainian specifics, having relatives or other personal networks.

Expansion of the *Russian oil companies*, like Lukoil investing in Oriana, TNK in LINOS, is a very positive investment signal for other foreign companies. Russians have already passed the development stage just started now in Ukraine; they understand better than others how to do business with Ukraine.

Strategic investors are interested in the purchasing larger share holding of a company (more than 50 %) to run and control the business. They have an interest to the company's size, market share and investment package of more than 100 million USD. The investment decisions of this type are made on the strategic level on the company's management pyramid based on the long tern planning (more than 10 years) including a serious study of political, legal and economic risks of the target region.

6.1.2. The Marketing Strategies of Foreign Companies in Ukraine

Five years ago foreign companies easily received high profits on the Ukrainian market. Nowadays, foreign firms compete not only with each others; but also with local companies.

The fast moving consumer goods (FMCG) sector – the mass segment with tough competition. The competition is very strong on the FMCG sector because many world famous companies are present on this market, and, local companies improve their position significantly.

New Brands – Average Price

The strategy of new brands with average price means developing and presenting of a new brand on the Ukrainian market (sometimes and on the other CIS markets and markets of Central and Eastern Europe) within average price category in order to make it competitive in price with local brands. This marketing strategy is used by many foreign companies operating on the Ukrainian market:

- Procter&Gamble introduced a new laundry detergent "Bonux", tooth-paste "Blendax" and shampoo "Shamtu";
- Kraft Foods Ukraine recently has started to sell coffee "Maxwell House";
- Philip Morris is promoting its new cigarettes brand "Next" which will be able to compete with local brands in the mid price category.

Brands with "Local Image"

Some foreign companies sell on the Ukrainian market not only their own famous brands, but develop new, local brands. For example: Kraft Foods – "Korona", Nestle – "Svitoch", Unilever – "Beseda". Companies make a market research and decide about marketing strategy: either developing a local brand, or adapting existing mega – brand. Often local brands are developed by foreign companies having production facilities in Ukraine.

- Baltic Beverages Holding (BBH) - owner of Slavutich Brewery entered Ukrainian market with local brand “Slavutich”, and recently developed a regional brand “Lvivs’ke” – which is distributed in western and central parts of Ukraine;
- Coca – Cola recently presented two local Ukrainian brands – “Yurske Jerello” and “FrukTime”. This strategic decision is based on local demand. The traditional drinks produced by Coca-Cola are consumed mainly by young people. But the audience purchasing sweet soda waters is much wider. People of middle age and elderly people have special requirement for this type of drinks with affordable price;
- Reemstra Ukraine, operating in the tobacco industry, launched 5 new local brands on the Ukrainian market during the last three years. For example, “Prima Optima” brand was launched in 2000. Local brands are very important for tobacco industry as they take about 60 % of the total market.

New promotion

Traditionally, foreign companies are the largest advertisers on the Ukrainian market. In 2002 the top 10 advertisers were: Procter&Gamble (35,170 million USD), Unilever (15 million USD), Nestle (14,890 million USD), Kraft Foods Ukraine (12,530 million USD). However, advertising strategies of many foreign companies have changed during the last years. Companies, which have developed local brands, have tried to separate them from the traditional international brands for the customers’ perception. Some western companies advertise cheap products without using their own logos.

Coca-Cola with many citrus flavour drinks, introduced a new “home - made” flavour for its “FrukTime”. Communication channels are very important for advertising strategy. The image trailers for major Coca–Cola brands are normally made abroad, but for local “FrukTime” the trailer was made in Ukraine.

Pharmaceutical company Sagmel (TM Health Life) applied direct advertising channels for its advertising strategy before 1998, but now it uses advertising via doctors and pharmacists.

Forced adaptation

After the crisis of 1998 many foreign companies have adapted their marketing strategies following the changes happened on the Ukrainian market. Consumers got used to a certain level of product quality, while the consumers’ purchasing power decreased. Because of the crisis period, Ukrainian local brands became more active on the market. As a result, traditional international brands of foreign companies started to lose customers. In the new environment, foreign companies were forced to adapt their marketing strategies, offering cheap alternatives.

6.2. Oil Processing Industry

United Ukrainian Energy System is fully dependent on the Russian gas and oil supplies. Ukrainian oil processing industry is characterizing by high dependency on the imported raw materials. The amount of oil extracted in Ukraine is enough to cover only for 15 – 20 % of refineries' demand. This is explained by historical facts of construction of refineries in the Soviet time for processing oil extracted in Russia and Kazakhstan. The only exceptions are Drogobychsky and Nadrirnyansky refineries built in the traditional oil extracting fields in Prikarpatie. However, today processing capacity of those refineries is much higher than the amount of oil extracted in Ukraine.

Russian companies[15] own four from six Ukrainian refineries, providing 80 % of total oil processing in Ukraine (19.5 million tns of oil processed in Ukraine in 2002): Kremenchugsky Refinery - Tatneft (majority owner); Lisichinsky Refinery (LINOS) - TNK (majority owner); Khersonsky Refinery and Sevastopol Oil Terminal - Alliance Group; Odessa Refinery – LUKOIL (majority owner). Based on the different sources of information, they control from 70 to 85 % of the Ukrainian oil products market.

Russian oil companies consider Ukrainian oil processing market as a possibility for serious investment. This is visible in the published investment plans of LUKOIL and Alliance Group. LUKOIL announced its plans to invest 500 million USD in its Odessa Refinery in 2003 – 2013. In 2004, the company plans to invest 40 million USD and later on 50 million USD more before the end of 2007. In the same time, the president of the Alliance Group declared the possibility of the company to invest 311 million USD to the modernization of Khersonsky Refinery during the next 7 years. With such investment, Alliance Group plans to increase its market share from 11 to 20 %. These large investments exceed many times the initial sums paid by these two companies for the Ukrainian refineries. This fact can be explained by increased requirements towards the quality of the oil products on the internal and export markets *(translated from Dubogryz, 2003, December).*

Toward the end of 2002 and the start of 2003, Tatneft had won a legal victory over the Ukraine State Property Fund and consolidated 26.9 % share in the republic's largest oil refinery, the Kremenchug company, Ukrtatnaft, with a capacity of refining 7 million tns of raw material a year. Because another 26.78 % of shares in the refinery belong to Tatarstan

[15] Some of Russian Oil Companies investing in Ukraine are discussed further in this chapter

State Property Committee (the biggest shareholder in *Tatneft*), Tatneft and Tatarstan jointly control 56 % of the refinery's shares. At present, Russian shareholders are expecting to buy the 43 % of shares that now are held by the Ukraine State Property Fund. The battle for this packet of shares may course a serious conflict - the Ukraine banks, Privatbank and Ukrsibbank*,* would like to acquire the shares. TNK-BP is also planning to take part in the privatization of Ukratatnafta. Moreover, TNK-BP would like to acquire other refinery operations as well as a marketing network in Ukraine (*Rosbalt, 2003*).

Gasoline retail network is dominated by Russian oil companies as well: TNK owns over 600 gasoline filling stations, Lukoil has about 200 own stations and about 500 franchisees. Russian expansion on the gasoline market reflects the degree of Russian influence in Ukraine: TNK network covers mainly eastern part of Ukraine, Lukoil – central and southern parts. In the western part of the country the main player on the gasoline market is the local company "Kontinuum" owning 300 gasoline stations. Many experts suppose that this company will go soon under the Russian control.

LUKOIL (Russia)

LUKOIL Company is the leader of the Russian fuel and energy sector. LUKOIL started its operations in the year 1991. It operates in 40 regions of Russia and in 32 foreign countries. Lukoil produces 24 % of the total Russian oil and 12 % of the oil products. The company owns more than 1100 gasoline stations in Russia and abroad. LUKOIL was in 2001 Russia's number 1 oil producer with total sales of 14.9 billion USD.

LUKOIL continued its growth in 2002 and in 2003. Expansion through exploration and acquisitions made LUKOIL the 2nd largest public oil company in the world in terms of oil reserves, and the 6th largest in terms of oil and gas production volumes *(Company's information).*

LUKOIL's refineries abroad have combined capacity of 17.8 million tns per year. The company's foreign refineries are LUKOIL Odessa Refinery (Odessa, Ukraine), LUKOIL Neftokhim Burgas (Burgas, Bulgaria) and Petrotel LUKOIL (Ploesti, Romania) *(Company's information).*

Holding LUKOIL-Ukraine is LUKOIL's subsidiary, combining oil refining and selling oil products: LUKOIL Odessa Refinery (oil processing plant), LITASKO Ukraine (product operator) and a company with foreign investments "LUKOIL Ukraine" (regional sales company).

LUKOIL-Ukraine has annual turnover of 600 million USD and sales of approximately 550 thousands tns of oil products in 2003 in Ukraine (440 thousands tns in 2002). Holding employs more than 3000 people and pays average salary of 1890 UAH (350 USD).

LUKOIL started business in Ukraine in 1997 when the first gasoline stations “LUKOIL” were opened in Simpferopol and in Sevastopol. Ukrainian subsidiary “LUKOIL-Crimea” was established. Purchasing on the competitive basis shares of Odessa Refinery in 1999 has expanded LUKOIL’s business in Ukraine. In 1999, LUKOIL’s Ukrainian network already included 4 gasoline stations owned by the company and 7 stations managed by franchisees.

The retail network was extended to 88 gasoline stations in 2001 and further to 164 in 2002. In 2003, LUKOIL-Ukraine invested about 50 million USD in its operations in Ukraine.

LUKOIL Odessa Refinery

Odessa refinery, bought by LUKOIL in 1999, was built already in 1937. In 2000, LUKOIL’s share in Odessa Refinery reached 99 %. When LUKOIL bought Odessa refinery, it worked only on 30 % capacity and with low quality of oil processing. In 2001, the oil processing volume doubled and Odessa refinery’s share in the Ukrainian oil processing increased to 14.7 %. The plant has refined 2.5 million tns of crude oil in 2002. The oil refining annual capacity of Odessa plant is 3.6 million tns.

In 2002, LUKOIL Odessa Refinery has got international quality certificate ISO-9001:2000 – the fist one given in oil processing industry in Ukraine. In 2003, LUKOIL Ukraine has got Environmental Management System Certificate ISO 14001 and industrial safety and labor protection certificate OHSAS 18001.

LITASKO

LITASKO, founded in 2000, is an exclusive product operator of LUKOIL, realizing corporate oil supplies from Russia to the Odessa Refinery for processing and wholesale supplies to the regional sales representatives of the LUKOIL Group in Ukraine, Moldova and Romania.

The company supplies monthly 250 thousand tns of Russian oil to the Odessa Refinery and sells 60 thousand tns of oil products in Ukraine (via LUKOIL-Ukraine) and exports 180 thousand tns of oil products.

LITASKO Ukraine is a daughter company of LITASKO S. A. (Switzerland) – the largest corporate operator of LUKOIL in oil and oil products supplies. The subsidiaries of LITASKO S. A. are operating in regions of LUKOIL's presence.

Foreign Investments LUKOIL-Ukraine was founded in 1999 in order to develop sales network of LUKOIL's oil products in Ukraine. With this sales unit, LUKOIL finalized the formation of the closed production cycle in Ukraine: raw material supplies, oil processing, transportation and retail sales. Nowadays, LUKOIL-Ukraine owns 179 gasoline stations in 17 regions of Ukraine. In 2003, LUKOIL invested 20.5 million USD in the development of the sales network in Ukraine.

TNK (Russia)

TNK International is a private company that is indirectly owned by two shareholders, *Access Industries/Renova and Alfa Group*. These two companies own 100 % of TNK International through their wholly owned TNK Industrial Holdings. TNK International indirectly holds 97 % of OAO TNK's shares and 91 % of OAO ONAKO's shares. The remaining 3 % of OAO TNK's shares and 9 % of OAO ONAKO shares are owned by minority shareholders (*Company's information).*

Access Industries is a New York-based investment firm established in 1986. In conjunction with its Russian affiliate, *Renova*, it serves both as principal investor and operator in a variety of industries both in United States and abroad. In addition to its headquarters in New York, the Group has offices in the U.K., Russia, Kazakhstan and Ukraine. The company's strategy in the CIS region is to acquire from 25% to 100% of equity in local firms and to increase shareholder value by providing capital, management and technical expertise to the acquired companies *(Company's information).*

Alfa Group Consortium is one of Russia's major financial - industrial groups. The consortium of businesses includes commodities trading, commercial and retail banking, securities trading, investment banking, retail trading and real estate development. *Alfa Bank*, the largest Russian privately owned bank, is the core of the Consortium. In 1998, Alfa Bank completed the merger with Alfa Capital, the investment banking division of Alfa Group. *Alfa Eco*, Alfa's wholesale trading subsidiary, is among the largest commodity trading companies in Russia and other CIS-countries specializing in petroleum products, sugar, tea and non-ferrous metals. The consortium of Alfa Group had consolidated revenues of approximately 5.7 billion USD in 2000 (*company's information*).

The story of the *TNK-BP Company* began on February 11, 2003 when one of the world's largest oil companies, British Petroleum, and the Russian Alfa Group in cooperation with Access/Renova Holdings (AAR) announced the formation of a strategic partnership and their intention to unite their oil assets in Russia and Ukraine. BP and AAR each own 50% of the TNK-BP shares. The new holding company is the third largest Russian oil company in terms of its reserves and production volume. Annual oil production is about 60 million tns, and five refineries of the company have a total capacity for 50 million tns a year. The holding company has a network of petrol stations throughout Russia and Ukraine in 2100 locations (*company's information)*.

In July of 2000 TNK took over one of the most problem-ridden enterprises of the Ukraine. The youngest Ukrainian oil refinery LINOS was hitting all records in loss-making. TNK purchased a 67 % of LINOS shares for 50 million UAH. This deal included investment commitments by TNK-Ukraine in excess of 100 million USD. The terms of LINOS contract are being met on time and in full volume. In 2003, TNK invested in LINOS 28 million USD (2002 - 8 million USD). The bulk of this money will go into construction of an asphalt plant and isomerization unit, which should promote production of high-octane petrol types. In addition, a portion of resources is scheduled to be committed in upgrading the LINOS worn-out equipment, labor safety program, environmental projects and IT/telecommunications development (*InvestGazeta, 10.08.2003*). TNK-Ukraine owns also 925 gasoline stations.

The Lisichansk refinery (Lisichansknefteorgsintez, LINOS) is located in the Lugansk Region in eastern Ukraine. The refinery was commissioned in December 1976. The nameplate capacity of the Lisichansk refinery is 16 million tns annually (*Company's Information*).

Table 43. TNK in Regions, 2002

	Oil Product Sales, thousand tns	**Number of Gasoline Stations**
Moscow and the Moscow Region	1 017.6	151
Ryazan Region	622.1	140
Orenburg Region	562.2	100
Tula Region	394.5	130
Kursk Region	389.7	122
Kaluga Region	321.2	130
Karelia Region	180.6	32
Rostov Region	480.5	69
Saratov Region	598.0	97
Ukraine	3 257.4	925
Other regions	628.2	46

Source: Corporate web pages

In 2003, LINOS increased its petrol production by 6 %. Diesel oil output went up by 4.4 % to reach 1.16 million tns; fuel oil – by 5.4 %, an increase to 1,359 million tns. The crude oil refining volumes grew by 7 % to reach 4,441 million tns. Crude oil supplies to the refinery grew by 25.1 % to 5,299 million tns. In addition, Russia increased supplies by 23.8 % to 5.186 million tns; Kazakhstan – by 99.7 % to 99.9 thousand tns. In 2002 the refinery stepped up the oil processing volumes by 16.6 % to 5,828 million tns (*Prime-TA, 2003*).

In 2003, LINOS refinery invested 28 million USD in equipment and in communication systems development.

Refining of oil at Lisichansk Refinery will become more intense as a result of implementing an investment project for introduction of a viscosity breaking plant with costs of 45 million USD that was provided by Chernomorsk bank for trade and development (CHBTR). It is planned to invest in introduction of viscosity breaking technology 15 million USD from the company's own account, out of which 1.35 million USD have already been used. Another 15 million USD are expected from CHBTR on LIBOR + 2-3 % annual interest terms, and approximately the same sum from commercial banks mediating on this credit in Italy, Greece, etc. The project term of implementation - 2 years, payback on credits - 5 years. According to the project developed by ABB (USA), viscosity breaking – dilution of bitumen with diesel fuel to black oil quintessence – will allow boosting production of high-octane gasoline by 6 %, The company's local profit will grow by 28-30 %. According to the program of reconstruction of Lisichansk Refinery for 2001-05, the company already started production of Ai-98 gasoline, winter diesel fuel and ecologically pure straw oil with serum content 0.05 %, TC-1 jet fuel, and use technology of utilizing oil-slime for production of serum. In 2001 investments for these purposes were 10.04 million USD, year 2002 – 6.81 million USD, first six months of 2003 - 18 million USD, and in total it is planned to use 23.77 million USD till the end of 2003, and in 2004 - 27.42 million USD (*Prime-Tass, 2003*).

Alliance Group (Russia)

Alliance Group is an interregional, multi-profile holding company, which was established in 1998. The company has operations in restructuring and renovation of enterprises in Russia and other CIS-countries, providing services in financial and legal consulting. Alliance Group owns 15 production units in 10 regions of Russia, Ukraine, Kazakhstan and Kyrgyzstan.

Since 1999, Alliance Group is operating in the Ukrainian machinery production (Stakhanovsky Vagon Building plant), oil processing (Kherson Refinery, Sevastopol Oil

Terminal) and oil products supplies. Oil Company Alliance Ukraine (2002) is a daughter company of Oil Company Alliance, part of the holding Alliance Group (Russia).

Alliance is combining resources of three countries: Russia, Ukraine and Kazakhstan. Russian company Rosneft, Alliance group and Kazakh company Kazakhoil have signed a two-year agreement on the development of Kherson Refinery. According to the agreement, Rosneft has to supply annually no less than 600 thousand tns of oil to the Kherson refinery for processing. In 2001 Kherson Refinery processed 1 747 231 tns of oil, what is 34 % more, than in 2000.

Kazakhoil Ukraine (via Trading House Ukrnefteproduct) owns 60 % of the Kherson Refinery. Alliance Group owns about 26 % of the refinery, and manage the plant on the behalf of Kazakhoil.

Kherson Refinery is the third largest oil processing plant in terms of size and oil processing volumes in Ukraine. The plant has annual refining capacity of 7.1 million tns of oil. Constructed in the 1930s, the plant needs renovation. Alliance Ukraine has significantly modernized the refinery, what is reflected in the products' quality improvement and production volume increase.

Alliance has developed a reconstruction and technical development program for the Kherson Refinery for 2001 – 2010. The program aims to attract about 1 billion UAH (187.6 million USD) investment. About 100 million UAH (18.8 million USD) are already invested in the refinery's modernization. Alliance Group plans to invest about 25.7 million USD to the Kherson Refinery. These investments would increase the monthly oil processing from 150 thousand to 230 thousand tns.

In spite of that Kherson refinery decreased oil processing by 4.3 % in 2002, compared with 2001, its market share remains significant – 11 – 12 %.

Kherson refinery supplies its products to the customers in Kherson, Odessa, Nikolaev, Zaporozhie, Dnepropetrovsk, Donetsk, Lugansk, Kiev, Khmelnitsky regions and in Crimea via the network of 150 gasoline stations. The number of gasoline stations is planned to increase to 200 by the end of 2004.

In order to provide Crimea with gasoline, Alliance has bought the Krymnefteproduct company's infrastructure, including 45 gasoline stations and 10 oil and petroleum storages located in Crimea. In this connection, Alliance plans to invest 27 million USD into gasoline network development in Ukraine, 45 % which will be invested in Crimea region.

6.3. Mining and Metallurgy

Iron Ore Mining

The global iron ore reserves are about 200 billion tns, of which one fifth (from 30 to 50 billion tns) is located in Ukraine. The Ukrainian iron ore annual production is 160 – 170 million tns – about 5 % of the world iron ore production. Ukrainian iron ore mining and processing enterprises (GOK[16]) practically completely satisfy needs of domestic metallurgy . About 34 % of iron ore production is exported, mainly to Eastern Europe and other CIS countries. As the steel consumption decreased in Ukraine during the last ten years, the iron ore mining declined significantly.

Iron ore mining industry consists of ten companies (GOKs) producing wide range of iron ore products (Table 44): lump ore, iron ore concentrate, pellets, and agglomerate. In 2001, only two largest GOKs – Inguletz and Central showed increase in output, while other enterprises decreased their production.

Table 44. Largest Ukrainian GOKs

	Share of iron ore production in Ukraine, 2001	Net sales, 2001, million USD	Net income, 2001, million USD
Inguletz GOK	20 %	148.35	32.48
Southern GOK	15 %	164.28	48.34
Northern GOK	12 %	126.10	32.06
Poltava GOK	10 %	n/a	n/a
Central GOK	8 %	85.30	0.88
Sukha Balka GOK	5 %	34.44	1.73

Source: SigmaBleyzer report, 2002

Ore mining and processing enterprises (GOK) are potentially attractive for foreign mining and metallurgical companies. The reason for this attractiveness is that every GOK has own iron or manganese ore reserves. Many ore mining and processing enterprises were privatized very fast in 2001 (Table 45) and at a low price.

Table 45. Privatization of GOKs in 2001

	Stake, %	Sales Price, Million USD	Implied Capitalization, million USD	Products
Poltava GOK	6.59	14.76	223.98	Iron ore
Poltava GOK	25.00	3.50	14.00	Iron ore
Central GOK	25.00	13.00	52.00	Iron ore
Ordzhonikidge GOK	25.00	4.08	16.31	Manganese ore
Marganetz GOK	25.00	3.00	12.00	Manganese ore

Source: SigmaBleyzer Report, 2002

[16] GOK – Ore Mining and Processing Enterprise

Foreign investors are actively participating in the privatization of Ukrainian iron ore mining industry. Central GOK is owned by Ukrrudprom (Ukraine, 50 %), Detroit Cold Rolling Company LC (USA, 25 %), Industrial Unit of Donbas (Ukraine, 12.43 %), SigmaBleyzer UGF Fund own (USA, 4.3 %), and other investors (8.27 %). SigmaBleyzer UGF Fund also has 5.62 % share in Northern GOK. Inguletz GOK and Southern GOK are owned by Lukoil North-West (more than blocking package of shares).

Metallurgy

Ferrous metallurgy

The ferrous metallurgy is one of the key industries in the Ukrainian economy. About 25 % of the total industrial production in Ukraine is produced by ferrous metallurgical plants (Table 46). This sector is characterized by very high exports ratio – abut 80 % of products are exported, mainly to Asia Pacific Region and the Middle East. Foreign investors are very interested in purchasing the Ukrainian metallurgy plants. Zaporizhstal, for example, is owned by Zaporizhstal Trading House LLC (25 %), Zahid-Reserv (23.34 %), Weybridge Investment Ltd. (20.83 %), Mawerton Ltd (16.93 %), SigmaBleyzer UGF Fund (1.73 %) and other investors.

Table 46. Key Ferrous Metallurgy Producers

	Steel production, 2001, million tns	Change, from 2000, %
Krivorizhstal	6.9	+ 11.8
Mariupol Illicha Steel	5.8	+ 5.0
Azovstal	4.7	+ 10.5
Zaporizhstal	4.0	+ 1.1
Alchevsk Metallurgical Plant	2.9	+ 0.3

Source: SigmaBleyzer report, 2002

Istil (Hong Kong)

Istil-Ukraine is a medium-sized company with 100 % of foreign ownership, processing secondary raw-materials (metal scrap). Istil-Ukraine is part of the transnational corporation Istil Group, which was established in 1991 by investors from Pakistan, Hong Kong and Thailand and registered in Hong Kong as Metalrussia Corp. Ltd. Metalrussia specializes on sales of steel, produced in CIS countries, to the Asian, European and Northern American markets. In 1993, Istil started its investment activity in Ukraine. Together with Odessa Sea Harbor, Istil established Metalukraine company. In 1995, this company had annual sales of 2 million tns of steel, and was among the 20 biggest metal selling companies in the world.

In 1996, the company was reorganized and got a new name – Istil Group. In the same year, Istil bought majority shares of a metallurgy plant in Donetsk, Ukraine.

The Ukrainian branch of Istil got the name “Mini metallurgical plant Istil-Ukraine”. By the word “mini” investors mean a plant with an annual steel smelting capacity of less than 1 million tns. Istill invested 86 million USD to the renovation of the Donetsk plant: old soviet machines were replaced with Italian ones made by Danieli – one the world leaders in the metallurgy machines production. In 2001, Istil got a 25 million USD loan from the EBRD.

The major part of the Istil-Ukraine’s production is exported: export share of the production volume was 92 % in 2002 (58 % in 2001). Generally, Istil is not satisfied with the investment climate Ukraine at present time.

MAIR (Russia)

MAIR was established in 1992 as a trading company. Nowadays it is in the fifth position in the world in the ferrous scrap processing with annual production of 4 million tns (turnover of 400 million USD in 2002).

The company owns a number of metallurgy plants in Russia (Sulinsky Metallurgy Plant - STAKS, Vogogradsky Pipe Plant, Saratovsky Sundries Plant, Verkhnesichansky Metallurgy Plant) and 6 plants collecting and processing ferrous scrap in Ukraine (in Kharkov, Cherkassy, Kherson, Nikolaev, Vinnitsa and Zhitomir). MAIR has entered Ukraine because the Russian market is saturated.

Ukrainian scrap-iron market is in a very bad condition: only 8 % of metal scrap is collected (compared with 35 – 40 % in Russia). MAIR has its own methods to improve the industry.

The first ferrous scrap plant in Kharkov (Ukraine) was bought by MAIR in 2000. In that time it processed just 1.5 thousand tns of scrap metals per month. Now, three years later, after production renovation and change in management, the plant processes 12 – 15 thousand tns scrap metals per month. MAIR is investing about 1 million USD per year machines and equipment on its Ukrainian plants.

Currently, MAIR’s market share in Ukraine is not very significant. It processes only 40 thousand tns metal scrap per month, while total scrap processing in Ukraine is about 800 thousand tns per month. The company plans to take about 10 % of the Ukrainian market. The company aims at a strong position on both Ukrainian and Russian markets.

Non-ferrous metallurgy

The Ukrainian non-ferrous metal industry produces aluminium, titanium, magnesium, nickel, cobalt, lead and zinc production, secondary non-ferrous metallurgy and rare earth metals. The resources for non-ferrous metal industry are more limited in Ukraine than for ferrous metal. The majority of companies (Table 47) use imported raw materials or process scrap and non-ferrous waste.

Table 47. Some of Non-ferrous Metallurgy Companies

Sector	Company	Production, 2001, tns	Change from 2000, %	Capacity, tns
Aluminum	Nikolaev Aluminous Plant	1 119 500	0	n/a
	Zaporozhie Aluminous Plant	106 093	+ 2.0	370 000
Titanium	Zaporozhie Titanium and Magnesium Combine	n/a	n/a	20 000
Zinc	Ukrzink (Konstantinovka Zinc Plant)	n/a	n/a	83 000
Mercury	Mykytivsky Mercury Plant	n/a	n/a	600 000
Brass	Artemovka Non-ferrous	8 044	+ 2.0	45 000
Copper	Metallurgy Plant	5 840	+ 24.0	7 000

Source: SigmaBleyzer report, 2002

With few exceptions, all non–ferrous metallurgy plants in Ukraine either are owned by Russian companies, or are in the state ownership. Zaporozhie Aluminium Plant is controlled by AvtoVAZ-Invest (majority owner); Pobugsky Ferronickel Plant is owned by Nikomed (majority owner).

In the non-ferrous metallurgy industry of Ukraine, there are still state-owned assets: titanium – magnesium plant in Zaporozhie – "TITAN" (the biggest CIS producer of titanium dioxide), GOK in Dnepropetrovsk (titanium and zirconium ore extraction).

Russian Aluminium (Russia)

Nikolaev Aluminous Plant is the largest alumina producer in the CIS with 1.1 million tns of annual production in 2002. Russian Aluminium (Rusal) has a lack of own production capacity, and Nikolaev plant is the key enterprise in the production process. In 2000, Rusal bought 35 % shares of Nikolaev Aluminous Plant, and, later, Rusal's daughter company, Ukrainian Aluminium, purchased 30 % more of Nikolaev Aluminous Plant from the government.

Purchasing 30 % of Nikolaev Aluminous Plant from the state, Ukrainian Aluminium has planned to start building a new alumina plant in 2002 in Ukraine with minimum annual production capacity of 200 000 tns. However, the company has not started constructing the new plant yet, even if a site for construction is bought in Kharkov region. The government of Ukraine is threatening to review its privatization of the complex and to take back the Russian 30 % share.

6.4. Banking Sector

The Ukrainian banking sector is playing significant role in the developing of the local economy. Ukraine has about 150 banks (in Russia 1300). Two of them are state-owned: the savings bank - Oschadny and UkrExImbank, previously named Vnesheconombank (VEB) - External Economy Bank. Most banks are located in Kiev (about 50 % of all banks) and other industrial centres of Ukraine: Dnepropetrovsk, Donetsk, Kharkov, Odessa and the Crimea. Many Ukrainian banks are members of the Worldwide International Financial telecommunication Society (S.W.I.F.T.) – the telecommunication system providing international settlements. Ukrainian banks have business relations with 870 foreign banks, 40 % of which are Russian banks. USA and Germany have a large number of correspondent accounts with Ukrainian banks.

Since 1994, banking institutions have used a multi-currency regime in the automated electronic system of interbank settlements. For this system to function in each region of Ukraine, regional clearing agencies (centers) were created. In order to ensure final clearing settlements, they were unified into a state system of clearing centers with the Central Clearing center at the top *(SigmaBleyzer report, 2002*).

The key players on the Ukrainian banking sector are 8 large banks (Table 48): four of them have emerged from the former state banks (Prominvestbank, Ukrsotsbank, Oshchadny Bank and Ukreximbank); other four banks are newly established: Bank Aval (Kiev), Privatbank (Dnepropetrovsk), the First Ukrainian International bank (FUIB, Donestk) and Ukrsibbank (Kharkov).

Table 48. The Largest Ukrainian Banks, 2001'

Bank	Assets, mln USD	Equity, mln USD	Liabilities, mln USD	Net Profit, mln USD
Aval Bank	955.5	48.1	907.4	0.8
Privatbank	854.0	68.8	785.3	6.7
Prominvestbank	735.1	146.0	589.1	14.5
Oshchadny Bank	566.0	44.9	521.1	0.3
Ukreximbank	482.8	54.2	428.7	1.7
Ukrsotsbank	374.3	69.2	305.1	1.3
Ukrsibbank	238.9	39.1	199.8	2.9
FUIB	220.0	60.2	159.8	4.5

Source: *SigmaBleyzer report, 2002*

In June, 2003, total bank assets in Ukraine amounted approximately to 15 billion USD (in the end of 2002 – 12 billion USD). The top 10 banks account for 60 % of these assets, and the top 50 account for about 85 %.

The Ukrainian banking industry is of interest for both domestic and foreign investors. The first seven banks in the Table 54 are Ukrainian. Ukrainian founders also formed 50 % of the FUIB's statutory fund. The second half belongs to Western founders, including the European Bank for Reconstruction and Development (10 %) (*SigmaBleyzer report, 2002*).

By 2002, the Ukrainian financial sector (commercial banks and insurance companies) received about 361.3 million of foreign investments (what is about 8.2 % of the total FDIs to Ukraine). In 2001, there were already 28 banks with foreign capital, 7 of them (Table 49) have 100 % of foreign capital and five are headquartered in Kiev: Credit Lyonnais Bank Ukraine (1993), ING (1997), Citibank (1998), Raiffeisen Bank (1998) and HVB (1998).

Table 49. Banks with 100 % Foreign Capital in Ukraine, on 01.01.2003

Bank	Assets, mln USD	Equity, mln USD	Net Profit, mln USD
Raiffeisenbank Ukraine	274.5	40.5	1.5
ING Bank Ukraine	134.5	12.7	1.9
Credit Lyonnais Ukraine	55.8	6.0	0.7
Microfinance Bank	30.8	9.7	n/a
Bank Pekao Ukraine	8.6	6.3	0.1
Bank HFB Ukraine*	70.9	13.6	1.1
Citibank Ukraine	163.7	20.2	4.2

** 01.12.2002*
Source: Ukrainian banks association

Other foreign banks have representative offices in Ukraine: Deutsche Bank (Germany), Commerzbank (Germany), Bank TuranAlem (Kazakhstan), Parex Bank (Latvia), Multibanka (Latvia), Snoras (Lithuania). Russian banks have about 1.4 % of Ukrainian banking system assets (by 01.01.2003): Vneshtorgbank, Promsvjazbank, Alfa-Bank Ukraine (Investment company "Alfa Capital"), KievInvestbank (Alfa-Group), Petrokommerts Ukraine (Petrokommerts Bank), and NRB-Ukraine (NRB).

Raiffeisen Bank (Austria)

RZB-Austria (Raiffeisen Zentralbank Oesterreich AG) is the main institution of the Austrian Raiffeisen Banking Group, the largest purely Austrian private banking group in terms of consolidated total assets (114.2 billion EUR). The foundation of Raiffeisenbanks goes back to an initiative of the Herman Friedrich Wilhelm Raiffeisen (1818-1888), who, by founding the first Raiffeisen cooperative banking association in 1862, has laid the cornerstone of what has since become the global organization of Raiffeisen cooperative societies *(company's web pages)*.

RZB regards itself as a major partner for the emerging markets in Central and Eastern Europe. Today, the RZB Group has 14 network banks and 2 representative offices spread across 14 TEs. With more than 16,000 employees in 675 offices RZB operates one of the densest banking networks within the region. RZB-Austria is regarded as a pioneer in Central and Eastern Europe (CEE) and ranks today among the leading banks in the region covering the following countries with both commercial and investment banking services: 1991 Slovakia Tatra banka, 1991 Poland Raiffeisen Bank Polska, 1993 Czech Republic Raiffeisenbank, 1994 Bulgaria Raiffeisenbank (Bulgaria), 1995 Croatia Raiffeisenbank Austria, 1997 Russia Raiffeisenbank Austria, 1998 *Ukraine Raiffeisenbank Ukraine*, 1998 Romania Raiffeisen Bank, 2000 Bosnia and Herzegovina Raiffeisen BANK Bosna i Hercegovina, 2001 Serbia and Montenegro Raiffeisenbank, 2002 Slovenia Raiffeisen Krekova Banka, 2002 Kosovo Raiffeisen Bank Kosovo, and 2003 Belarus Priorbank *(company's web pages).*

Joint Stock Commercial Bank Raiffeisenbank Ukraine started its business in 1998. The Bank quickly established itself in the market and managed to create a serious customer base. RBUA does not only deal with leading multinational and Austrian companies but also with large Ukrainian producers, importers and exporters of oil, agricultural, metallurgical and chemical products. The bank has a special focus on structured trade finance products, tailor-made for the complicated and risky local environment. Currently, RBUA is among top 10 Ukrainian banks in terms of total assets, capital and loan portfolio. It services corporate as well as private customers with the complete range of banking products *(company's web pages).*

Raiffeisenbank Ukraine provides the following product groups: *Account and Payment Services* (Current account services in UAH and FCY, Domestic and international funds transfer services, Commercial check collection, Cash payments, Plastic Cards Servicing, Cash collection and night cash service); *Documentary business* (Export L/C, Import L/C, Documentary Collections); Guarantees (Bid Bonds, Performance Bonds, Advance Payment Guarantees, Payment Guarantees, Standby L/C, Credit Repayment Guarantees); *Loans* (Structured Trade Finance Short-term Loans, Commercial Short & Medium-term Loans, Investment Loans, Overdrafts); *Treasury Services* (Term Deposits, FX Spot Transactions, Banknotes); *Capital & Stock Market Services* (Brokerage Services, Securities Trade, CD Issuance, Bills of Exchange); *Retail Banking Products* (Current account services in UAH and FCY, Deposit accounts /Certificates of Deposit in UAH and FCY, Domestic and international funds transfer services, Operations with Travel/Commercial Cheques, Plastic Cards Servicing)[17].

Raiffeisenbank Ukraine continues expanding in Ukraine. In 2003, Lvov Branch was opened. The branch will serve corporate clients and individuals. RBUA opens a new segment of financial and banking Ukrainian market - operations with individuals and also small and medium enterprises. By the end of 2003, RBUA planned to open a branch in Kharkov and two more retail branches in Kiev.

Alfa-Bank (Russia)

Founded in 1990, Alfa Bank has developed rapidly to become Russia's largest privately owned bank. It provides a full range of banking services — commercial banking, investment banking, asset management, trade finance and insurance. Alfa Bank has more than 100 branches in Russia and foreign subsidiary offices in Kazakhstan, Ukraine, the Netherlands, the United Kingdom, and the United States *(company's web pages).*

Alfa Bank, consisting of Alfa-Bank, AlfaStrakhovanie Group (Insurance), daughter banks and financial companies, is one of the five largest financial corporations in Russia. As estimated for the year 2002, Alfa Group's assets were 4.127 billion USD, net profit – 104 million USD, equity owned – 422 million USD, and credit portfolio – 2.4 billion USD.

Alfa Bank Ukraine is the central link of the financial-industrial consortium of Alfa Group in Ukraine, having interests in oil industry, telecommunications, trade, banking, insurance business and food industry. Alfa Bank was registered in Ukraine in January, 2001. Alfa Bank Ukraine is aiming at combining the opportunities provided by Russian bank with the experience and accumulated knowledge about Ukrainian business. Alfa Bank Ukraine has authorized capital stock of 73 million UAH (about 13.7 million USD).

Alfa-Bank is gradually and successfully developing in Ukraine as an universal bank possessing all types of banking licenses and having developed network of branches, applying the latest technologies in the banking business and winning a niche on the Ukrainian market.

Alfa-Bank was chosen as the leading bank in Ukraine by Investgazeta in 2003 (*Investgazeta, 18.11.2003*). The rating was based on the net wealth and the net wealth dynamic ratio in 2002 compared with 2001. The growth of the net wealth of Alfa-Bank was 134.4 % in 2002.

[17] Official information presented on the bank's web-pages www.raiffaisenbank.com.ua

Alfa Bank has expanded into Ukrainian regions. It has opened branches and subsidiaries in Donetsk, Kharkov, Dnepropetrovsk (2002), Nikolaev (2002), Kiev, representative offices in Zaporozhie, Lvov and in Simpheropol.

Besides traditional commercial banking services, Alfa-Bank keeps one of the leading positions among Russian investment banks by actively investing in real estate business, food industry, telecommunication, television, radio, consumer goods production, trade, tobacco industry, banking, insurance business and pharmaceutical industry. Alfa-Bank owns shares in following companies: TNK, Golden Telecom, Kievstar, Akrikhin, Bolshevik, Pemos, Borsky Glass Factory, Alfa-Arbat-Centre, CTC, Mus-TV, etc. Alfa-Bank purchases companies for the time period from 3 to 6 years in order to increase company's market value, and after that sells them to strategic investors.

Furthermore, Alfa-Bank Ukraine has assets in mass media and pharmaceutical business: Novyi Kanal (New Channel), Nashe Radio (Our Radio), Diorama and Galichpharm.

Novyi Kanal was established in 1998, and in five years developed a wide broadcasting network covering 235 towns and villages reaching about 30 million people, of which 85 % are urban). Novyi Kanal is in the top three TV channels in Ukraine.

Nashe Radio was opened in 1997 and by this day, is in the top three Ukrainian radio stations. Nashe radio covers 26 towns and about 30 million people.

Diorama is a publishing house founded in 1998. It prints "Diorama Plus Moskovsky Komsomolets" – one of the most popular weekly socio-political periodicals. The edition of 93 thousand copies is very significant for Ukrainian market. The "Moskovsky Komsomolets" share on the market has achieved 10.7 % in April, 2003.

Galichpharm is one the leading pharmaceutical companies in Ukraine. The company, certified according quality standards ISO 9001:2001, is actively developing.

Alfa-Bank is creating a Direct Investment Centre aiming at investing in medium-sized companies with high value added and average annual turnover of 30 – 50 million USD located in Russia and Ukraine. Alfa-Bank plans to invest 10 – 50 million USD in each project.

ING Bank (Netherlands)

ING Bank is the international corporate and investment banking arm of the Netherlands-based ING Group, one of the largest financial services groups in Europe, with market capitalization of 53.3 billion USD (March 2002) and assets of over 705 billion EUR. ING Group has over 110 000 employees in more than 65 countries, and is the largest foreign employer in Central and Eastern Europe with approximately 15 000 employees in the region. ING Bank is one of the leading banks in emerging markets, including TEs, Asia and Latin America. ING Bank N.V. opened a representative office in Kiev in 1994 and, in December 1997, was registered as a 100-percent foreign-owned bank. ING Bank Ukraine commenced its banking operations on April 3, 1998. ING Bank Ukraine was voted "Best Foreign Bank in Ukraine in 1998" by Euromoney and "Best International Bank in Ukraine in 2000" by Central European. ING Bank Ukraine is a universal bank offering the full range of corporate and investment banking services for its clients, including: traditional corporate banking services for multinational corporations as well as leading Ukrainian enterprises, cash management, commercial lending, domestic and international payments, electronic banking and trade and commodity finance; foreign exchange and money market operations; securities division operations; arranging and underwriting eurobonds, local currency bonds, and various other forms of sovereign, municipal, and corporate debt; public share offerings with listing on domestic and international stock exchanges; advisory services for, and financing of, mergers and acquisitions; project finance; financial and advisory participation in international privatization tenders for Ukrainian companies (*Company's web pages information).*

Custody is a core business of ING Bank Ukraine. It is not a support service to its brokerage clients, but a stand alone profit center. 98 % of ING Bank Ukraine's custody revenues are from non-ING group clients. In the fall of 1998, The Bank of New York appointed INGBU as its custodian for all its ADR programs. Over the last two years, the client base has grown significantly and now includes roughly 80 % of all foreign investors in Ukraine, major global custodians and almost all active brokerage houses in the country. By using its position of the dominant market player, INGBU plays an active role in development of securities market legislation and practices aimed to bring Ukrainian securities market to the internationally accepted standards (*Company's web pages information).*

In the end of 1999, INGBU was selected by the State Property Fund for safekeeping the state-owned stakes designated for privatization. In November 1999, ING Bank Ukraine completed a 259 million USD custody transaction, which involved transferring 259 million USD face value of Gazprom bonds, a dollar denominated bearer paper bond issued by the Ukrainian

Ministry of Finance in 1995 to off-set Ukrainian debt to Russian RAO Gazprom for gas deliveries in 1994 and 1995, into its direct custody from the National Reserve Bank of Russia. Along with the State Printing Company, ING staff had to count, authenticate, package and transport 51 830 bond certificates with a par value of 5 000 USD to ING Bank Ukraine's vault, all in one day. The transfer was orchestrated under a very tight time frame thanks to coordinated effort between Kiev, London and Amsterdam operations staff. As the result of this transaction, INGBU has become the second depository for Gazprom bonds along with the National Reserve Bank of Russia (*Company's web pages information).*

In mid 2000, ING Bank Ukraine restored a lost registry of shareholders of a large Ukrainian company from the scratch. In late 2000, ING Bank Ukraine acted as a settlement agent in the acquisition of a controlling interest in one of the Ukrainian companies from a number of sellers by a foreign strategic investor. In late 2000 and early 2001, ING Bank Ukraine acted as the settlement advisor and agent for a number of block trades (in excess of 15 million USD) in one of Ukraine's oil majors. In early 2001, ING Bank Ukraine offered to foreign investors its share acquisition capabilities on a retail level, the service previously neglected by foreign financial institutions (*Company's web pages information).*

ING bank considers Ukraine as a long term perspective market and expands its investments.

Credit Lyonnais Bank Ukraine

In 1993, four years before any other Western bank, Credit Lyonnais Bank Ukraine (CLBU) became fully operational. Credit Lyonnais Bank Ukraine has all required licenses to do banking and securities transactions in Ukraine. Trained and strong team of 80 employees, serves more than 500 corporate and institutional customers, processing 3 000 transactions per day. Credit Lyonnais Bank's partnership with National Bank of Ukraine, Ministry of Finance and its involvements into Boards of the American Chamber of Commerce and Association of Ukrainian Banks evidence this. Credit Lyonnais Bank Ukraine relies on a powerful international network with 150 years of experience and presence in 50 countries (*Company's web pages information).*

HVB Bank Ukraine

The HVB Group enjoys a leading position in the economic hub of Germany, Austria and Central and Eastern Europe, a market of some 160 million people. It is the second largest bank in Germany and one of the biggest banking groups in Europe having its headquarter in Munich. It has offices in all the world's major financial centers. HVB Group is located worldwide - with its representative offices it is able to create a presence all over the world. The HVB Group is a focused full-service bank targeting market leadership in private and corporate customer business. It concentrates on its core competencies in real estate banking, integrated corporate finance, capital markets business, retail banking and wealth management (*Company's web pages information).*

In 1997/98 Creditanstalt AG, Austria started its activities in Ukraine. Subsequently it merged with Bank Austria. In summer 2000 Bank Austria Group was integrated into Bayerische Hypo- und Vereinsbank AG. Effective February 21, 2002 "Bank Austria Creditanstalt Ukraine" changed its name into Joint Stock Commercial Bank HVB Bank Ukraine. Today HVB Ukraine is the only operating German bank in Ukraine (*Company's web pages information).*

6.5. Agricultural Sector

Moderate-continental climate and rich land resources and long farming traditions make agriculture one of the Ukrainian economy's most important sectors. Arable land accounts for 42 million hectares, or 70 % of Ukraine's total land area. Ukraine's soil is one of the most fertile in the world, as the country accounts for 70 % of the world's "chernozem", or highly fertile black soil, which in turn makes up half of the country's ploughed land. In general, weather conditions in Ukraine are particularly favourable for growing grain and oilseed crops, root and fibber crops, temperate fruits and vegetables. Favourable crop growing weather lasts 90-120 days every year. At the same time, due to the country's large territory, climate varies from region to region. Humidity ranges from below 70 % in central and southern regions (less than 400 mm of rain annually) to very high levels in the north and west *(BISNIS, 2003).*

Table 50. Ukraine vs. Other TEs, 2002

	Ukraine	Russia	Poland	Hungary	Romania
Agriculture Value Added (% of GDP)*	13.0	7.0	3.0	5.0	12.0
Agricultural Land (mil. ha)	41.8	216.8	18.4	5.9	14.8
Prod. Index per Capita (% of 1989-1991)	56.7	70.4	86.8	78.4	87.3
Wheat Production (mil. tns)	20.5	50.0	9.3	3.9	4.4
Wheat Yield (x100 kg/ha)	30.4	22.3	36.5	35.3	19.9
Milk Production (mil. tns)	14.1	33.0	12.0	2.3	4.8
Meat Production (mil. tns)	1.6	4.6	3.0	1.2	0.9
Wool (mil. tns)	3.3	40.0	1.3	2.9	16.9

**Except for Ukraine, estimated figures are provided*
Sources: Food and Agriculture Organization, World Bank, CBR, Ministry of Agricultural Policy of Ukraine, National Bank of Hungary, Hungarian Central Statistics Office, Dragon Capital (2003)

After Ukraine declared independence in 1991, the country's unreformed agriculture, heavily subsidized in the Soviet time, experienced a downfall along with the rest of the economy. In addition to sluggish government efforts to restructure and privatize this loss-making sector, several key factors affected Ukrainian farms: rapid growth in input prices (fuel and fertilizers), falling trade with other former Soviet republics and lack of credits. As a result, in 1999 agricultural output was only 49 % of the 1990 level.

Radical reforms that began in the agricultural sector in 2000 immediately yielded results, with agricultural output surging 9.8 % in 2000 and 9.9 % in 2001. In 2002, real output growth slowed to 1.9 % due to a low harvest. In value terms, the 2002 agricultural output totalled 12.4 billion USD which represents 13.4 % of 2002 GDP *(BISNIS, 2003).*

Despite three consecutive years of growth, Ukraine's agriculture remains besieged by many problems that require radical solution. Due to the sector's low technological development, farms' output is critically dependent on weather conditions. The state retains its heavy regulatory presence in agriculture, while a number of relevant laws (particularly those related to different aspects of land ownership) have yet to be approved. Material handling infrastructure (transportation, storage, export facilities) requires radical improvement as well as mechanisms for trading agricultural goods (exchanges, including futures/forward markets).

In 2002, 46 % of Ukrainian agricultural companies posted profits, although this sector's net financial result was a loss of 55 million USD (as compared to net income of 155 million USD in 2001). Among the most profitable branches were production of sunflower (net margin of 77 %), grain (19 %) and potatoes (17 %), while the livestock, meat and wool segments remained loss-making.

For the 2002/03E marketing year (MY), total supply of grain in Ukraine is estimated at 44.4 million tns, with demand expected at 40.8 million tns (including 5.7 million tns of grain for food consumption, 18.5 million tns for fodder, 3.2 million tns for seed, 10.7 million tns for exports and 2.7 million tns for losses and other purposes) *(BISNIS, 2003).*

The population of cattle in Ukraine stabilized at 9.2 million heads in 2002 after declining for over a decade. The population of pigs followed the same pattern before growing 7.9 % to 9.0 million heads, in 2002. The number of animal farms was brought down in the early period of transition. It was caused by serious fodder shortages in the previous years and volatile prices of meat and dairy products, which hurt price-sensitive and cash-strapped livestock and dairy producers. However, the butchering was not reflected in higher meat production as livestock weights also fell. Besides, most of the cattle in Ukraine are dairy and dairy-and-meat breeds, while the share of beef cattle totals only 3 %. Per capita consumption of pork and beef in Ukraine was estimated at 12.6 kg and 11.0 kg respectively in 2002.

Over the past several years milk production in Ukraine averaged 13 million tns as compared with 25 million tns in 1990. However, production has been rising gradually since 2001 and is expected to grow further. In 2002, per capita consumption of milk and processed dairy products in Ukraine totalled 286 kg.

Ukraine is a net exporter of dairy products, with respective exports and imports totalling 145 million USD and 28 million USD in 2002. Meat exports are directed to other CIS countries and, to a lesser extent, the Middle East.

Grain has traditionally accounted for a larger share of Ukraine's trade in agricultural goods and, over the past two years, also for a substantial part of Ukraine's total exports. The main competitive advantage of Ukrainian agricultural products is low production costs, high natural productivity thanks to land fertility and improving quality (primarily that of vegetable oils, grains, meat and milk).

Parliamentary approval of the Land Code in October 2001 provided the much needed legal base for accelerating reforms in the sector. The Code legalized the right to own land, trade it and use land as collateral. The sale and alienation of land by its owners and its use as a share capital contribution will be allowed after 2005. Additionally, both Ukrainian and foreign citizens now can lease land for a short (up to five years) or a long term (up to 50 years.)

The government also maintains a number of privileges for agricultural producers. These include exemption from income tax; partial VAT refunds conditioned on an equivalent increase in CAPEX; repeated write-offs of deferred taxes and fines; and partial compensation of interest payments on commercial bank loans.

The grain harvest which is not exported is sent to grain processing plants (including elevators) for storage or processing. Currently, there are about 630 grain storage and processing companies in Ukraine. Grain reception stations account for 34 % of this number, feed plants for 13 %, bakeries for 25 %, elevators for 15 %, sale stations for 5 %, grain stations for 7 % and flour mills for 1 %. Ukraine's total grain storage capacity is estimated at 30 million tns. About 24 grain reception plants have storage capacity of more than 160 thousand tns each, 54 - from 100 to 160 thousand tns and 76 - from 25 to 50 thousand tns. The largest and most important grain facilities are located in densely populated central and eastern Ukrainian regions where bumper grain harvests are collected.

The government regulates the grain market via state joint stock company Khlib Ukrainy (Bread of Ukraine) which was established in 1996. It controls 81 grain processing plants. The state also controls another 19 grain processing plants via the State Reserve. The state, via Khlib Ukrainy, makes interventions on the grain market and purchases grain for the State Grain Reserve, but these measures have not been efficient in smoothening seasonal price volatility.

Attempting to manage the exposure to heavy government regulation in the sector, most agribusiness producers and traders operate via a network of affiliated companies. Due to complicated business schemes they employ, it is practically impossible to analyze accurately the performance of local agricultural companies, especially if they trade within Ukraine and do not export. In this report, we thus focus only on the largest agricultural producers and traders, including foreign giants operating on the local market (Glencore International, Louis Dreyfus, Alfred C. Toepfer International and Cargill) as well as several domestic market players (W. J. Grain, United Grain Group, Ecoprod) that dominate in particular regions *(BISNIS, 2003).*

Glencore International AG, one of the world's largest commodity traders, comprises 78 subsidiaries in 51 countries. In 2001, the company's turnover reached 44.5 billion USD. The group trades over 20 million tns of grain and soybean products annually. Glencore's exports of agricultural products (grain and oils) from Ukraine were estimated at 2.4 million tns in 2002.

Louis Dreyfus, another worldwide commodity trader with annual sales of over 20 billion USD, is present in more than 50 countries. The company's 2002 agricultural exports from Ukraine were estimated at 1 million tns.

Alfred C. Toepfer International operates in over 40 countries and trades around 40 million tns of agricultural products annually. In 2002, its exports of agricultural products from Ukraine were estimated at 0.9 million tns, or 51.4 million USD (up 83 %) in value terms.

Cargill has been present in Ukraine since 1991. It owns two elevators, a fertilizer warehousing and blending facility and a sunflower seed processing and extraction plant that was built in 2000. The plant has a capacity of 350 thousand tns. Besides, Cargill Ukraine trades agricultural products. Its sales in 2001 were estimated at 92 million USD, while exports totalled 63 million USD.

United Grain Group was set up in 1995 and currently owns three elevators with a total capacity of 249 thousand. tns. The company also processes grain at Mykolayiv and Ternopil grain processing plants. UGG's grain operations are conducted via the subsidiary Ramburs. The latter posted 2001 net sales of 33.8 million USD, with exports at 23 million USD.

W. J. Group, a Hungarian company, is one of the largest agricultural producers and traders in Eastern Europe and the CIS. It owns an elevator in Kherson (annual capacity of 0.4 million tns) and a crushing plant in Russia (annual capacity of 120 thousand tns of sunflower seed and 120 million bottles of oil annually). The company also owns farms in Ukraine, Russia and Moldova.

Table 51. Ukraine's Agricultural Statistics

Year	1997	1998	1999	2000	2001	2002
Area (thousand hectares)						
Total Agricultural Land	41 854	41 827	41 830	41 827	41 817	41 820
Total Cultivated Area including:	30 304	28 790	28 313	27 173	27 928	28 120
Grain Crops	15 051	13 718	13 154	13 646	15 586	15 447
Wheat	6 674	5 793	6 048	5 619	7 113	6 751
Industrial Crops	3 348	3 770	4 340	4 187	3 779	3 590
Sugar Beet	1 104	1 017	1 022	856	970	1013
Sunflower	2 065	2 531	2 889	2 943	2 502	2 719
Potatoes and Other Vegetables	2 185	2 066	2 166	2 277	2 188	2 206
Fodder Crops	9 720	9 236	8 653	7 063	6 375	5 738
Gross Crop Harvest (ths. tns)						
Grain Crops	35 472	26 471	24 581	24 459	39 706	38 792
Wheat	18 404	14 937	13 585	10 197	21 348	20 549
Sugar Beet	17 663	15 523	14 064	13 199	15 575	14 376
Sunflower*	2 308	2 266	2 794	3 457	2 251	3 270
Potatoes	16 701	15 405	12 723	19 838	17 344	16 619
Vegetables	5 168	5 492	5 324	5 821	5 907	5 825
Yields (100 kg/ha)						
Grain Crops	24.5	20.8	19.7	19.4	27.1	27.3
Wheat	27.6	25.8	22.5	18.1	30.0	30.4
Sugar Beet	176	174	156	177	183	188
Sunflower*	11.5	9.3	10	12.2	9.4	12.0
Potatoes	106	102	82	122	108	104
Vegetables	114	123	111	112	123	124
Livestock (ths. heads)						
Cattle	15 313	12 759	11 722	10 627	9 421	9 183
Pigs	9 479	10 083	10 073	7 652	8 370	9 033
Sheep & Goats	2 362	2 026	1 885	1 875	1 965	2 023
Total Livestock Output (ths. tns)						
Meat	1 875	1 706	1 695	1 663	1 517	1 602
Milk	13 768	13 753	13 362	12 658	13 444	14 138
Eggs (mil.)	8 242	8 301	8 740	8 809	9 668	11 297
Wool	6.7	4.6	3.8	3.4	3.3	3.4

*Note: *sunflower seed only (after initial processing);*
Source: State Statistics Committee, Agriculture Ministry, APK Inform, Dragon Capital

Ecoprod is a large agricultural producer and trader in the Donetsk region operating on 10,000 hectares of farmland. The elevator, built as a greenfield project in 1998, operates MSF York equipment and has a capacity of 20 thousand tns. It was one of the first privately built elevators in the region. The company also distributes imported plant production chemicals and agricultural machinery and equipment. In addition, Ecoprod is growing steadily into a large livestock and dairy operator in the area. In 2002, it reported net sales of 5.7 million USD.

Cargill (USA)

Cargill is an international marketer, processor and distributor of agricultural, food, financial and industrial products with some 80,000 employees in 65 countries. Since it came to Ukraine in 1991, Cargill has been involved in agribusiness activities, including medium-sized industrial joint ventures and the trading and export of grain, steel and sugar. With headquarters in Kiev, the company today employs 434 people in total (*Company's web pages information).*

Cargill began its activities in Ukraine with the establishment of a Corn Research Institute, in Dnepropetrovsk. In 1994, Cargill opened a permanent representative office in Kiev. From here the company started to merchandise grain, oilseeds, petroleum, steel, sugar, fruit juice concentrate and cocoa. In 1995 company built a modern seed production plant and opened a fertilizer warehousing and blending facility in 1997. In 1999, the company bought its first grain elevator from the State and recently started buying shares in a second.

The largest project Cargill has in Ukraine is the world class greenfield sunflower seed processing and extraction plant in Donetsk - Cargill Industrial Complex. This is the first edible oil factory to be built in CIS in the 1990s and produces sunflower oil and meal. Construction started in 1998 and was completed in April 2000. The initial cost of the project was 50 million USD. The plant crushes mainly domestically-produced sunflower seeds. The oil is used in food, soaps the meal for animal feed. The plant is processing 350 thousand tns of sunflower seeds per year (*Company's web pages information).*

The Cargill Grain and Oilseed Supply Chain Europe business unit, which runs the sunflower plant, is involved in the sourcing and export of grains. Cargill Ukraine now trades wheat, barley, sunflowers, sunflower oil and corn. The Steel Division is also represented in the Ukraine, exporting 300000-400000 mt of metal products per year, to support trading and production activities of Cargill Ferrous International.

With more than 85 million USD invested, Cargill is the largest foreign investor in Ukraine's agricultural sector – one of the few areas of the world with a dramatic potential to increase agricultural production. From 1992 to 1998, it was difficult for farmers to plant and harvest.

Banks couldn't provide financial help. The government dictated prices and supplied the fertilizer. A lot of business was based on barter.

Then, in 1999, Ukraine took the bold step of issuing a privatization decree. The whole agricultural sector changed in three months. Cargill's fertilizer sales have tripled since 1999, and almost all of it is for cash instead of credit. 2001 – 2002 were excellent. Cargill is buying grain from 200 country elevators and exporting it through ports on the Azov Sea and the Black Sea. Edible wheat goes to North Africa, Korea, Saudi Arabia and Israel. Feed wheat goes to Western Europe.

In only a few years, Ukrainian agriculture has changed radically. The change has opened up Cargill's ability to offer customer solutions. Initially, many of those solutions are built around basics: quality and ethics (*Company's web pages information).*

6.6. Food Industry

Ukrainian food industry includes over 5000 enterprises of different ownership types producing about 3700 different brands of products. 89.8 % of the previously state owned companies were privatized by the end of 1999. Food industry is growing fast with average annual growth rate of 9 % and is on the leading position in the FDIs attraction: about 21 % of total FDIs stock in Ukraine is in this sphere.

Ukrainian food industry is processing 4 million tns of meat and poultry, 20 million tns of milk, 45 million tns of sugar-beet, and 2.5 million oil contained plants per year. Companies annually produce about 1 million tns of confectionary products, 35 thousands tns of margarines, 0.58 billion litres of spirits, 0.46 billion litres of alcoholic drinks, 1.7 billion litres of beer, 1.4 billion litres of other beverages (*Atlanta Capital, 2001*). Food industry consists of 20 sectors: milk, meat, oils, beverages and beer, strong drinks, confectionery, flour and bakery, canned products, fish, and others.

The number of joint ventures or foreign-owned food processing enterprises in Ukraine is currently growing. Economic instability highlighted by unfavourable press coverage is the primary reason that many foreign or multinational food processing companies have been reluctant to invest in Ukraine to the same extent they have invested in Eastern Europe and Russia. Given the nature of the food processing industry (the importance of global market share and international brand recognition), it is anticipated that once Ukraine has made more economic progress, these companies will enter the Ukrainian market and seek investment opportunities (*BISNIS Report, 1999*).

Heinz (USA) is in Poltava and Odessa producing liquid and dry baby food. Commodities International Limited (C.I.L.), a USA -Ukrainian joint venture, is working with a Khmelnitskiy-based enterprise to process and package beef and pork for sale in the Russian and Ukrainian markets. Kraft Foods has bought into a confectionery plant in Sumy. In July 1996, Midnight Sun Inc. (Sweden) established the joint venture "South Food Inc." to produce tomato sauce, ketchup, and canned vegetables under the "Chumak" brand name. In 1996, McDonald's opened its first restaurant in Ukraine (Kiev) and invested 72 million USD in Ukraine *(BISNIS Report, 1999*).

Confectionery

649 companies are operating in confectionery market in Ukraine. Almost 600 of them produce cookies and biscuits, 16 – chocolate and 57 – caramels. In 2002, industry produced 743.4 thousands tns of products (approximately 600 million USD), what is 3.1 % more than in 2001 (721 thousands tns). The leaders on the market are (Table 52): AVK (Donetsk), Dnepropetrovsk Confectionary Factory (Dnepropetrovsk), Kiev-Konti (Donetsk), Svitoch (Lvov) and Confectionery Corporation Roshen (Kiev). Confectionery producers consider Ukrainian market as practically saturated. Only few large foreign investors are playing in this market: Nestlé (Svitoch), Kraft Foods Ukraine (Trostyanets) and Sigma Bleyzer (Poltavakonditer). Producers state than more than 250 million USD was invested in to Ukrainian confectionery industry during the last years (Ukrainian and foreign investments).

Table 52. The shares of Ukrainian Confectionery Manufacturers, 2002, tns and %

Company	**Production, tns**	**Share, %**
ROSHEN Confectionery Corporation, Kiev	175 038	23.6
AVK, Donetsk (***25.1 % owned by WesternNIS Fund)***	72 083	9.7
Kiev-Konti, Donetsk	66 925	9.0
Svitoch, Lvov (***Nestlé***)	39 676	5.3
Dnepropetrovsk Confectionery Factory, Dnepropetrovsk	33 296	4.5
Svit Lasoscshiv, Cherkasy	26 665	3.6
Poltavaconditer, Poltava (***Sigma Bleyzer***)	23 558	3.2
Kraft Jacobs Sushard Ukraine, Trostyanets	21 634	2.9
Zhitomyrskie Lasoscshi, Zhitomyr	21 586	2.9
Odessa, Odessa	21 328	2.9
Zaporozhie Confectionery Factory, Zaporozhie	20 245	2.7
Kharkov Bisquit Factory, Kharkov	18 833	2.5
Kharkovchanka, Kharkov	18 127	2.4
The rest of 550 manufacturers	183 833	24.7
Total	742 827	100.0

Source: www.roshen.com

This market is producing more than 200 different brands of confectionery in different segments: candy (production decreased last year by 4.1 %), chocolate (output decreased by 3.4 %), cookies and biscuits (increase of 15.3 %). The prices on the confectionery products are expected to increase by 5 – 10 % in 2004 due to higher raw materials prices. Cacao prices were doubled in 2002, and wheat prices also grew.

ROSHEN Confectionery Corporation is the largest Ukrainian confectionery manufacturer. Its factories in Kiev, Vinnytsa, Mariupol and Kremenchug produce about 30% of all Ukrainian confectionery. Its product range comprises more than 200 kinds of sweets, chocolate, sugar candies, cookies, waffles, fruit jellies and cakes. The total production volume is up to 200 000 tns of confectionery a year. Roshen's products are available in Russia, Kazakhstan, Moldova, Estonia, Latvia, the USA, Canada, Germany and Israel (*Company's web pages*).

Nestlé (Switzerland)

Nestlé (Switzerland) is one of the leading food producing companies in the world with turnover of 60 billion USD in 2002. Company employs 224 thousands people and owns 468 factories and industrial enterprises of food industry, perfume and cosmetics production and pharmaceuticals in 84 countries.

The first half of the 1990s proved to be a favourable time for Nestlé: trade barriers crumbled and world economic markets developed into a series of more or less integrated trading areas. The opening of Central and Eastern Europe, as well as China, and a general trend towards liberalization of FDI was good news for a company with interests as far-flung and diverse as Nestlé. While progress since then has not been as encouraging, the overall trends remain positive. Consolidation since 1996 has been demonstrated by the acquisition outright of the Italian mineral water concern San Pellegrino (1997), the acquisition of Spillers Petfoods of the UK (1998), and also with the decision to divest the Findus brand in order to concentrate on high added-value frozen food products (1999). Since then, Ralston Purina was acquired (2002) and the pet care business is now joint world leader and known as Nestlé Purina PetCare. In the same year, the former Perrier Vittel water business was re-named Nestlé Waters, recognizing the fact that the dynamic bottled water business accounts for a growing share of Group's sales (*company's web pages*).

December, 1994, Nestlé has established its representative office in Kiev, Ukraine and started active promotion of its famous brands: Nescafe (nowadays, it takes about 50 % of the Ukrainian coffee market), Nuts, Nesquik and Maggi. Today, Nestlé is one of leading companies in Ukraine in the food industry and the leader of the coffee market. Nestlé strengthens its position in Ukraine by investing in to the local production and industrial infrastructure, active brands promotion and development of the national distribution network.

In 1998, Nestlé has bought majority of shares of confectionery factory “Svitoch” in Lvov. Since that time Nestlé invested 40 million USD into technical and industrial re-equipment of the factory. Nestlé company planned in 1998 to invest 41 million USD to the confectionary production development on the Svitoch factory in Lvov. In the mid 2001 about 50 percent of planned investments were made.

Svitoch is one of the oldest Ukrainian factories and one of the leaders of the Ukrainian Confectionery, producing high quality chocolate under the modern technology. Svitoch was privatized in 1996. According to the official statistics, Svitoch produced 38.6 thousands tns of confectionary products in 1999 (in 1998 – 34.7 thousands tns). In 2001 production increased by 14 % to 42 thousands tns of confectionary products.

November, 7, 2003, Nestlé signed agreement on purchasing 100 % shares of Volynholding (Lutsk) – the leader of the Ukrainian ketchup and mayonnaise market (company controls about 60 % of the ketchup market and 35 % of the mayonnaise market). Volynholding, founded in 1994, produces products with the brand name “Torchin product”.

In this way, Nestlé is successfully diversifying its business in Ukraine, which initially was presented only by coffee and chocolate brands. By purchasing “Torchin product”, Nestlé got a strong local brand in Ukrainian market.

Kraft Foods (USA)

Kraft Foods is a part of the Philippe Morris Corporation possessing 121 enterprises in different parts the world. Kraft Foods Ukraine is one of the leading confectionery producers in Ukraine.

Kraft Foods bought chocolate factory “Ukraine”(Trostyanets) in 1994. The production capacity of the factory was relatively low in that time – only 15 thousands tns per year. Kraft Foods introduced first new brand “Korona” in 1995. Since that time, the company is developing all the time and produces several famous brands of chocolate. The existing production capacity of the factory is 35 – 40 thousands tns per year. Kraft Foods has about 50 % of the chocolate bars market in Ukraine. The company does not plan to buy new confectionery factories in Ukraine, but develop the existing one.

Currently, Kraft Foods is operating mainly on the three segments of the Ukrainian food market: confectionery (“Korona”, “Milka”, Siesta), coffee (“Jacobs”, “Maxwell House”) and snacks (chips “Lux”, extrusion “Cerezos”).

In 1999, the company bought a factory producing chips. Chips “Lux” takes almost 80 % of the chips market in Ukraine. In 2003, Kraft Foods has launched new product Cerezos – extruded salted snacks. The company plans to occupy about 18.5 % of this market segment by the end of 2004.

Kraft Foods has spent more than 200 million USD in Ukraine, including 75 million USD to industrial capacities, and much more into promotion, advertising, marketing.

Milk Processing Industry

Ukraine has about 400 dairies. Nearly 80% of Ukraine's dairies are members of the National Association of Dairies. The leaders of the Ukrainian diary market are Galakton (13 % market share), Laktaris Ukraine (8 %), Pavlogradsky Dairy (5 %), Wimm-Bill-Dann (5 %) and Pridneprovsky Dairy (3 %).

There are a number of the foreign companies working in the dairy sector. *Parmalat (Italy)* has a share of the Kiev Dairy No. 4. *Estonian United Dairies* has invested 2 million USD to build a "*United Dairy Plant of Ukraine*" in Zaporozhie. In 1999, the company launched a dairy processing facility with a projected capacity of 80 tns per day. *Developed Technology Resource, Inc*. (USA), through its ownership in Food Master International L.L.C. (FMI), purchased a controlling interest in a *Ukrainian dairy in Uman*, located 210 kilometres south of Kiev. *The Uman Dairy* produces a variety of dairy products for the Ukrainian market, including ice cream, yogurt, sour milk and sour cream. Developed Technology Resource, Inc. received a 500 000 USD development grant from USAID (*BISNIS Report, 1999*).

41 % of the equipment used for processing milk products is imported, mainly from Germany, Switzerland, Italy, Finland, Denmark and Hungary. Ukraine has recently started producing separators, which previously had only been available from Russia and Western Europe.

<u>Galakton (Russia)</u>

Galakton was founded in 1995 on the base of Kiev City Dairy number 2, built in 1961. Since 2002, the majority owner of Galakton is Russian Group “Planet Management”. Company employs 1000 people. Currently, Galakton is processing about 400 tns of milk daily; annual turnover is about 45 million USD. The company has about 10 % share in the Ukrainian annual milk production volume.

Galakton is one of the most successful companies in the Ukrainian milk processing sector. The company's capitalization is more than 20 million USD. Galakton invested 3 million USD into new production line in 2000.

Wimm-Bill-Dann (Russia)

Wimm-Bill-Dann Foods is the market leader in the dairy and juice products in Russia. Wimm-Bill-Dann grew from a leased production line at the Lianozovsky Dairy Plant in 1992 to a publicly listed food conglomerate, employing more than 18,000 people. Today Wimm-Bill-Dann owns 24 manufacturing facilities in 20 locations in Russia and the Commonwealth of Independent States (CIS), as well as distribution centres in 26 cities in Russia and abroad. The company also distributes its products in Canada, Germany, Israel, the Netherlands, the UK and the United States through both its own distribution network and independent distributors. In Moscow alone, there are over 2000 shops working directly with Wimm-Bill-Dann, offering its wide range of products to consumers. The company also supplies its products to Russia's Presidential Administration, Federation Council, embassies and banks, airlines and schools, to name but a few. On February 8, 2002, Wimm-Bill-Dann became the first Russian consumer company to list Level 3 ADRs on the New York Stock Exchange (NYSE) and the third Russian company ever to be listed on the NYSE. Financial Highlights of 9 months 2003: Sales amounted 684.6 million USD; Gross profit amounted 208.4 million USD; Net income amounted 20.8 million USD (*Company's web pages*).

According to the AC Nielsen study of 9 major Russian cities in 2002, Wimm-Bill-Dann Dairy was the leader in many packaged dairy products with a market share, in terms of sales volume, of 38.4 %. In the 1st half 2003, Wimm-Bill-Dann Juice's market share in Russia was 35 % in terms of sales volume. Wimm-Bill-Dann has a strong and diversified branded portfolio. Its dairy brands include "Little House in the Village" and "Chudo", and its best known juice brand, J7, enjoyed 99 % awareness in Moscow as of July 2001 according to a study conducted by Independent Marketing Consultants Association, a Russian market research company (*Company's web pages*).

In 1995, Wimm-Bill-Dann acquired a majority share of the Lianozovo Dairy Plant. In 1996 and 1997, company acquired majority stakes in the Moscow Baby Food Plant, the Tsaritsino Dairy Plant and the Ramenski Dairy Plant. In 1998 and 1999, Wimm-Bill-Dann began to expand into regions outside Moscow, acquiring dairy plants in Novosibirsk, Nizhny Novgorod and Vladivostok. In 2000 and 2001, the company acquired majority stakes in dairy plants in Bashkortostan and the Krasnodar region in Russia, as well as plants in Kiev, Ukraine and Bishkek, Kyrgyzstan. In July 2001, Wimm-Bill-Dann completed the acquisition of additional 15% interests in Lianozovo Dairy Plant and Tsaritsino Dairy Plant. In 2001, it acquired 100% interests in dairy plants in Altaisky and Voronezh regions of Russia. In May 2002, Wimm-Bill-Dann Foods acquired control of Gulkevichsky Maslozavod ZAO (Krasnodar Region), Moloko Veidelevki OOO (formerly Veidelevsky Factory of Dry Fat-free Milk, Belgorod Region), and obtained operational control of Novokuibyshevskmoloko (Novokuibyshevsk, Samara Region).

In 2000, Wimm-Bill-Dann bought 60 % shares of *Kiev City Milk Plant number 3 (KGMZ)*. In November, 2002, Wimm-Bill-Dann paid approximately 1.7 million USD for 76 % shares of *Burynsky Dried Milk Plant* (Sumy region, Ukraine). This transaction has supplied the company with own dried milk facilities on the strategically important Ukrainian market. Burynsky Dried Milk Plant was built in 1974 and renovated in 1985. The plant employs 150 people and is able to process 300 tns of milk daily and produce 18 tns of butter.

In July, 2002, Wimm-Bill-Dann has paid about 4.5 million USD for a 75 % share of *Kharkov Dairy* – one of the leading in Ukraine milk processing plants. The plant was built in 1973 with capacity of 500 tns daily milk processing. Currently, 200 tns of milk is processed daily. Wimm-Bill-Dann considers Kharkov Dairy as a strong player on the Ukrainian milk market with experienced employees, good raw-materials supplies, significant market share (8.7 %) and famous brands. Nowadays, Kharkov Dairy produces more than 60 milk product brands. Starting from 2001, the plant produces its products under the trade mark "ROMOL". The company produces about 2 500 tns of milk products monthly. 70 % of the company's products are sold in Kharkov, where Kharkov Dairy has a 24 % market share (Amer Nielsen Investigation on 4 main Ukrainian cities).

In 2003, Wimm-Bill-Dann invested 8.1 million USD in the new production line of yogurts on the Kharkov Dairy. The equipment for production is supplied by Tetra Pak (Sweden) and for packaging by Hassia (Germany). The production capacity of the line is 5000 kilograms per hour.

On January 26, 2004, Wimm-Bill-Dann announced about the installation of new manufacturing lines at the Company's two dairy plants located in Ukraine. This investment is part of a company-wide programme to install the latest high technology equipment in the dairy business to enhance productivity. Total investment in equipment was over 13.3 million USD.

Equipment made by ASMA (Italy) has been installed for the bottling of milk products in plastic bottles at Kiev Dairy Plant number 3. The total cost of the project exceeded

6.1 million USD. At the Kharkov Dairy Plant, the Company installed and launched a filling line for pasteurized dairy products packaged in 500g and 1 000g Tetra Brik Square containers, made by Tetra Pak (Sweden), with a production capacity of six thousand containers per hour. The total cost of the project was approximately 1.1 million USD. In addition, Wimm-Bill-Dann installed an ERCA-47001, made by ERCA-FORMSEAL (France) for the filling and packaging of cheese desserts with a production capacity of three tns of finished products per hour. The total cost of the project was approximately 6.1 million USD (*Company's web pages information).*

6.7. Soft Drinks and Beer Sector

Ukrainian beer and soft drinks industry is considered one of the best branches for foreign exports into the foodtec and packaging market. This market has grown 20 % annually. Currently, Ukraine does not manufacture brewery, bottling or packaging equipment. Because of high profitability in the beverages industry, producers are seeking new technologies to expand market shares (*FINPRO*).

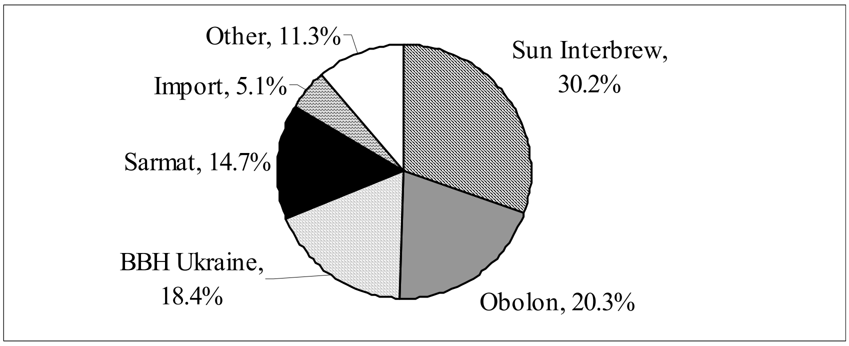
Beer Market

The year 2002 was successful for the Ukrainian breweries. Production volumes increased by 15 % (in 2001 – 21.4 %), exports increased by 16.6 %, and imports grew by 40 %. According to preliminary estimates, sales in 2003 exceeded 1.65 billion litres. Ukrainian beer market is characterized by the strong seasonal fluctuations, as more than 70 % of sales are made between end of April and end of September. The sales structure is as follow: 80 % - lager beer, 10 % – dark beer, and 10 % - strong beer.

There are over 30 large breweries (about 100 all together) in Ukraine with total production of about 200 beer brands. In 2002, total beer production in Ukraine was about 1.5 billion litres, and the market potential is estimated to be 2.5 billion litres. It is assumed that the beer consumption will increase from 28 litres to 50 – 60 litres per capita. The leaders of the market are: Sun Interbrew, Obolon, BBH Ukraine and Sarmat (Table 53). They control about 90 % of the beer market in Ukraine. Sarmat is a group of regional companies with major beer production in Donetsk brewery and Krym brewery.

Obolon, established in 1980, is the only large Ukrainian beer producer without foreign participants in the share capital. The company employs 2400 workers. Obolon's beer market share in Ukraine is about 22 % and annual turnover exceeds 1 billion UAH. In order to increase production capacities, the company uses EBRD credits. In 1997 Obolon has taken 40 million USD credits for equipment purchasing and working capital increase.

Table 53. Market Shares of the Beer Producers in Ukraine, 2002



Source: www.analitics.com.ua

Smaller breweries, which operate mainly on the local markets, are not able to compete with large companies with foreign capital. In 2002, as the total beer production increased significantly, small breweries cut their output by 2.6 %.

The largest *Turkish brewery Efes Beverage Group* strengthens its position on the Ukrainian market. Brewery Efes Ukraine in Odessa produces three beer brands and is planning to launch Russian brand "Stariy Melnik".

FDI interest in the Ukrainian beer market seems to continue. In is expected that in 2004 one more international player will come to the Ukrainian market. The most attractive for foreign investors is Obolon company with developed distribution network – number 1 Ukrainian brand.

Three companies leading on the Ukrainian beer market (Sun Interbrew, BBH, Obolon) have finalized forming of their brand portfolios. Sun Interbrew has the strongest brand portfolio: Chernigovskoe, Rogan, Yantar, Stella Artois brands covering all price segments from the lowest to the most expensive. In 2001, Sun Interbrew launched in Ukraine Stella Artois brand - the famous Belgian beer. Stella Artois has been originally brewed in Belgium since 1366. The beer is brewed using the original recipe of Belgian monks, but locally produced ingredients. The advertising campaign in Ukraine is likely to focus on Stella Artois' long history, as the presentation ceremony featured a simulation of medieval times.

Obolon is focusing on the sub – brands production based on the same trade mark. BBH has three brands: Slavutich, Lvovskoe beer and high price Tuborg. Radically new beer brands are not awaited on the Ukrainian market.

BBH – Baltic Beverages Holding Ukraine

Baltic Beverages Holding (BBH) is a company half – owned by Scottish & Newcastle (S&N), UK and Carlsberg Brewery (Denmark). BBH was established in 1991, and currently owns four breweries in Baltic countries, five breweries in Russia and two breweries in Ukraine. The company purchased its first brewery in Ukraine in 1996 and second in 1998.

In 2002 BBH finalized unified management system of its enterprises in Ukraine, what aims to increase company's efficiency and decrease costs. BBH is a majority owner (70 %) of Slavutich (Zaporozhie) (production capacity of 24 million dekalitres) and Kolos (42 %) (Lvov) (production capacity of 10 million dekalitres). In 2002 BBH Ukraine increased its market share in Ukraine by 2 % and currently controls over 20 % of this market. BBH has invested about 40 million USD in the Ukraine by the year 2000.

BBH acquired the Ukrainian company Slavuta Malting – the biggest malting facility in the country. In 2003, the company sold its malting business to Soufflet, the French commodity trading group. The reason of divestment of profitable business was that BBH wanted to concentrate on its beer production, and to get money for construction of a new brewery in Kiev. In 2002, BBH has already invested 50 million USD to the construction of its plant in Kiev.

According to a research made in 1999 about the BBH's entry strategies on Ukrainian markets, BBH considered Ukraine having a positive investment climate, more stable than that in Russia. The size of the Ukrainian market is equal to the market of France or England. When BBH started its operations in Ukraine, it had no foreign competitors there. Also in Russia BBH was the first foreign investor in brewing (*Itämeri, 1999*).

Sun Interbrew (Belgium)

Company SUN Interbrew was established in spring 1999 by Belgian Interbrew and international financial and investment group SUN for work in the markets of Russia and Ukraine. SUN Interbrew is a public company registered in Jersey, whose shares are listed and traded on the Luxembourg, Frankfurt and Berlin exchanges. Interbrew has operations in 110 countries and takes the second place in the world in beer production.

Russian and Ukrainian branches of the company own 34.25 % share of "SUN Interbrew". The company, employing 3138 people, has in Ukraine an annual turnover of 780 million UAH.

Sun Interbrew owns four breweries in Ukraine (Table 54): Rohan in Kharkov, Desna in Chernigov, Yantar in Nikolaev and Krym in Simpheropol.

Table 54. Sun Interbrew in Ukraine, 2002

Company	Location	Sun Interbrew's share, %	Market share; %	Investments mln EUR
Rohan	Kharkov	81.4	15.3	10.5
Desna	Chernigov	75.0	7.4	7.7
Yantar	Nikolaev	97.5	8.7	6.7
Krym	Simpheropol	80.0	2.0	N /A

Yantar Brewery (Nikolaev, Ukraine)

Nikolaev Brewery Yantar is a modern and dynamically developing enterprise in the Black Sea region. *The main brands*: Yantar, Getman, Taller, and Chernigovskoe. Large brewery in Nikolaev was built in 1975 and was equipped with a Czech production line. Yantar Brewery has stepped into a qualitatively new technological era together with SUN Interbrew. Modernised bottling lines have been expanding since 1999. Currently the company has a capacity of 240 kegs, 6,000 PET-bottles and 36,000 glass bottles per hour. New fermentation facility was launched in the year 2000. The elevator was reconstructed in 2002. It helped to advance grain sorting and to improve maintenance safety. There is also a new centrifuge for unfiltered «white» beer set up. Beers brewed at Yantar are noted for their unfaltering quality. They also enjoy stable success among customers (*Sun Interbrew's information*).

SUN Interbrew announced in summer 2003 about the finalizing of the deal on acquisition of a 41% share of the Yantar Brewery in Nikolaev, Ukraine, from INVESCO Asset Management, one of the world's largest investment management funds. Thus, SUN Interbrew now owns 97.5% shares of the brewery.

According to Joseph W. Strella, Chief Executive Officer of SUN Interbrew, the increase of the company's stake in the brewery evidences that the company's management believes in Ukraine's further stable economic development and evaluates positively prospects for the beer market growth.

Rogan Brewery (Kharkov, Ukraine)

Rogan Brewery is one of the fastest developing and newest breweries in Ukraine. *The main brands are* Rogan Tradiciyne (Traditional), Rogan Monastirske Svitle (Monastic Light), Rogan Monastirske Temne (Monastic Dark), Rogan Vesely Monakh (Jolly Monk), Rogan Zolotaya Era (Golden Era), and Rogan Non-Alcoholic. Rogan brewery is one of the youngest in the CIS countries. Today the brewery shows the fastest growth rates in Ukraine and is in the third place by production volumes. Rogan Brewery joined SUN Interbrew "as a holiday gift" - three days before the year 2000 started. Bureau Veritas Quality International, a worldwide auditing company, endorsed Rogan Brewery BS EN ISO 9001: 1994 certificate in 2001. It affirms high quality of product and its compliance with world standards. This certificate has built up Rogan's image at the local market and gave access to the international ones (*Sun Interbrew's information*).

Desna Brewery (Chernigov, Ukraine)

Chernigov Brewery «Desna» is a flagship enterprise of SUN Interbrew group of companies and one of the most successful Ukrainian breweries. *The main brands are* Chernigivske Bile (White), Chernigivske Mitsne (Strong), Chernigivske Premium, Chernigivske Svitle (Light), Chernigivske Temne (Dark), Stella Artois and Taller.

Construction of a brewery in Chernigov started in 1974 with the aid of Czech specialists and was completed in December 1976. Its facilities occupy ca 8 ha. The brewery received a name of Desna, Dniper's tributary. In 1996, SUN Interbrew obtained the majority stock of Desna shares. Since then Chernigov Brewery has turned into a business that works in accordance with European standards and with European technologies. Modernisation of Desna Brewery consisted of several phases. Contemporary bottling lines were set up for kegs, cans, PET and glass bottles. A new laboratory equipped with brand new facilities guarantees consistently high quality of beer. In 2002, Desna Brewery was ranked 1st in quality among SUN Interbrew enterprises in TE-region (*Sun Interbrew's information*).

Sun Interbrew's Investments

The investments of Sun Interbrew in Ukraine are determined by market needs and company's long term business development strategy on the local market. Every year, company adapts its strategy according to the economic and political instability factor, changes in macro-environment, competition and company's performance results. Investment purposes are marketing, distribution, production, logistics and information technologies. The majority of investment goes to the production development not only in order to increase output volumes, but to quality improvement and innovation.

The Sun Interbrew intends to invest 11 million EUR to the Rohan brewery and 66 million EUR in Ukraine overall. Company representatives inform that investment goes towards developing the bottling line, pasteurization of beverages and modernization of the lager fermenting division. In particular, the installation of two new bottling lines, with a capacity of

50 000 bottles an hour at the Rohan brewery is planned. Sun Interbrew has intentions to build a malting house which will supply all Ukrainian breweries owned by the Sun group. Investments for this purpose will amount to 55 million EUR.

In 2002 Sun Interbrew Ukraine invested 25.43 million EUR (18.67 million EUR in 2001) mainly in the reconstruction of its breweries Yantar (6.7 million EUR), Desna (7.7 million EUR) and Rohan (10.5 million EUR). The total amount of the company's investments in Ukraine is about 45 million USD.

Soft Drinks Market

Soft drinks industry in Ukraine has a production capacity of 1.5 billion litres, and only one third of the capacity is utilized. However, annual market growth rate is 20 %. High competition stipulates low import volume (only one % of domestic production) *(FINPRO)*. The top 6 companies – leaders of the soft drinks industry (Table 55) take more than 60 % of the total market. Obolon's market share is 10 % (2 % in 1991).

Table 55. Leading Companies in Soft Drinks Industry in Ukraine

	Company	Production, mln liters
1	Coca - Cola	74
2	Obolon	53
3	Rosinka	46
4	Rosy Bukovyny	n/a
5	Orlan	31
6	Rogan	20

Source: FINPRO

The mineral water production is developing dynamically; the annual growth has been 20 – 25 % in the recent years. About 15 – 20 companies (from more than 200 companies producing mineral waters) are producing approximately 80 % of total Ukrainian mineral water output (Table 56). Ukraine produced 81.17 dekaliters of mineral waters in 2002, what is 25.5 % more than in 2001 (64.67 dekaliters).

About 400 companies produce juices in Ukraine, among them only 30 large firms. The companies leading in juices production in Ukraine are: 1) Sandora (brands: TM Sandora Gold, Sandora Classic, Novyi Dar, Sadochok); 2) JV Vitmark Ukraine (brands: Jaffa, Jaffa Gold, Jaffa Grand, Sokko, Nash Sik); 3) Vinnifruit (brands: Vinni, Vinni Gold); 4) Napoi (brands: Smak, Frutiko); 5) Vimm Bill Dann (brands: J7, Rio Grande, Ljubimyi Sad, Chudo Jagoda); 6) MST Region (brands: Mrija, Lisova Jagoda); 7) Maibel (brands: Jusik, Juice).

Table 56. Leading Producers of Mineral Waters in Ukraine

	Company	Location of production
1	Coca-Cola Beverages Ukraine	Kiev
2	Corporation "Ukrainian Mineral Waters"	Odessa, Svaljava (Zakarpatie)
3	Mirgorod Plant of Mineral Waters	Poltava
4	Morshinsky Mineral Waters Plant "Oskar"	Lvov region
5	Obolon	Kiev
6	Rosinka	Kiev
7	Rohan	Kharkov

Juices market production capacity is estimated as 800 million liters. However, the output was only 225 million liters in 2002, what is 27 % more than in 2001. The consumption per capita has not exceeded 4.6 liters (8 liter per capita in Russia, 20 – 40 liters in developed countries). However, annual growth has been 5 – 10 % during the recent years. The amount of brands available on the market has tripled in the last years.

Companies producing juices in Ukraine mostly use concentrates (Table 57) imported from other countries. Some local companies continue production of natural juices from the local fruits. However, there is a lack of vegetable juices.

Table 57. Sales of Juices in Ukraine in 2002

Product range	Description	Share in sales
100 % natural juices	Juices, produced from the juice concentrates and water	45.6 %
Nectars	Mixtures of juice (more 25 %), water and sugar	44.6 %
Juice containing drinks	Containing 25 % or less of juices	9.7 %

In 2002, Russian companies continued active expansion on the Ukrainian Juice market. *Russian company Nidan Foods* (brands: Moja sem'ja, Champion, Da!) has purchased a juice plant in the western region of Ukraine and in the second quarter 2002 it had 2.4 % of Ukrainian market. *Russian juices producer "Lebedjansky*" (brands: Ja, Tonus, Fruktovyi Sad) is very active in retail distribution. And *Russian company "Multon*" (brands: Dobryi, Dary Leta, Nico) is preparing to enter Ukrainian market.

Ukrainian producers consider Russian expansion as a threat for their business, because Russian companies have much stronger production capacities and financial means. However, Ukrainian local producers have advantages of established distribution networks and consumers' loyalty towards national brands.

Coca-Cola (USA)

Coca-Cola entered Ukraine in 1992, and started production in 1994, in Lvov. In 1998, company opened a new plant in Kiev – having the highest capacity in Europe. In 1994 – 1998, the company invested more than 280 million USD in Ukraine. In 1998 – 2000, the company faced some problems resulting from the financial crisis in Russia and in Ukraine. In 2001, Coca-Cola Ukraine became profitable.

Coca-Cola Beverages Ukraine has occupied about 22 – 25 % of the Ukrainian market of non-alcoholic drinks. The company considers low market demand as one of the main problems. The demand is low due to the fact that the non-alcoholic drinks consumption is very low in Ukraine in comparison to West European countries.

The company employs more than 1000 people in Kiev, including three foreigners. Coca-Cola is famous with its brands like Coca-Cola, Fanta and Sprite.

The company is active in attracting FDIs to Ukraine from other companies. Coca-Cola's manager is a member of the Foreign Investments Consulting Board under Ukrainian president.

The main competitor of Coca-Cola, PepsiCo International doesn't have own production facilities in Ukraine. However, in 2000, the company has made a long term agreement with Baltic Beverages Holding (BBH) on manufacturing, marketing and distribution of soft drinks in Ukraine. BBH and PepsiCo used to cooperate since 2000 in the Baltic States, Norway, Finland and Sweden. Currently, Pepsi products like Pepsi, Mirinda and 7 up are bottled on the Svavutich brewery (Zaporozhie).

French Soufflet Buys Ukrainian Slavuta Maltings

Soufflet, the French commodity trading group, has bought the Ukrainian company Slavuta Malting from Baltic Beverages Holding (BBH), the joint venture brewing group owned by Carlsberg and Scottish & Newcastle. The price paid was not disclosed. Soufflet said that Slavuta was the leading malting unit in Ukraine with a production capacity of 70.000 tns a year, but that BBH, which acquired the company in 1999 as part of its takeover of the Slavuta brewery, did not consider it a core part of the business.

The French company, which claims to be the biggest malting producer in the world, first began expanding operations in the TE-region in 1998. It now has 25 malting units in eight different countries: France, the Czech Republic, Poland, Hungary, Ukraine, Romania, Russia and Kazakhstan. The company produces a wide range of products: malt from spring and winter barley, wheat malts, kiln dried (Pilsen, Munich, Vienna) or roasted malts, roasted cereals, grits and corn flakes.

The Slavuta acquisition will take Soufflet's malting capacity to over 1.36 million tn a year. Soufflet said it would also invest in malting barley production in Ukraine in order to ensure future supplies for the malting. Production capacity there is expected to be increased in order to meet higher demand for malt as the Slavuta brewery, and other BBH companies, continue to expand (*Beverage Daily Website, Montpellier, France, July 8, 2003*).

6.8. Fast-Food Sector

The concept of "fast food" is relatively new in Ukraine. Fast food restaurants did not exist in Ukraine before McDonald's came to the market in May 1997.After that, the market for fast food establishments has developed dynamically. However, McDonalds is still the only multinational brand in the fast food category in the marketplace. The absence of legal franchising instruments is a key factor frustrating other international fast food chains from entering Ukraine (*BISNIS Report, 2002*).

Ukrainian fast food brands started to mushroom in Kiev in 2000. The most notable local brands are Mr. Snack, McSmack, Shvydko, Domashnya Kuhnya (Home Cuisine), Shelter, Roasticks, Pan Pizza (based in Odessa), Amigo (based in Crimea), Pizza Celentano and Potato House (Lvov). Local companies operate three to fifteen restaurants in average and tend to show rapid growth. Experts and operators report that Ukrainian fast food facilities currently operate with up to 25 % profitability (*BISNIS Report, 2002*).

Two home-grown entries in Kiev’s burgeoning fast-food market, Mr. Snack and McSmack, have been successfully serving sandwiches, pizza and desserts, and both have aggressive expansion plans. McSmack’s founder Yury Tkach said that he invested 50000 USD in his first six-table restaurant *(Shchur, 2002).*

Despite absence of legislation regulating franchising, a Lvov-based company that owns the trademarks "Pizza Celentano" and "The Potato House" is an example of a successful local franchiser. The company has created a nationwide chain of pizza and potato restaurants, having penetrated even small Ukrainian towns. The number of the company’s franchisees in Ukraine, Russia and Poland has grown to 42. The company also currently promotes a new brand for coffeehouses, "Lavazza Point," and plans to open 100 outlets. Baskin Robbins (USA) ice cream restaurants opened in Kharkov and Odessa (two in each city) in 1999, operated by local franchisees (*BISNIS Report, 2002).*

The trade mark Shvydko is constructed and positioned as a restaurant of fast cooking offering the original Ukrainian kitchen to the clients. In the first year of existence, the fast food chain Shvydko has achieved the second position in the market of Ukraine occupying more than 15 % of the market.

The first restaurants of this company were opened in May, 2000. Presently, six restaurants located in different parts of Kiev work successfully. Shvydko plans to have a network covering all Ukraine by franchise scheme. The company plans to open 50 restaurants, of which 20 will be located in Kiev. Strategically important direction of development is the introduction of new format of restaurants Shvydko, one of which will be Shvydko–express. A concept of the thematic restaurants shaped according to the chosen national topics is being developed.

Mister Snack Restaurants

Mr. Snack unveiled its flagship restaurant in downtown Kiev on Dec 1 (2000) as part of an ambitious plan to become Ukraine's second-largest fast food operation after McDonald's. The first Mr. Snack outlet opened in Ukraine in 1996. Today, the chain comprises seven restaurants, including its most recent restaurant opened in February, 2002. Mr. Snack was founded with a 2 million USD investment from Commercial Capital, a Greek firm (*Shchur, 2002*). The overseas partner is Greece-based Commercial Capital, a company that has already pumped more than 10 million USD into various ventures in Ukraine. The company has projects in chemical production and distribution, real estate and consumer goods in Ukraine.

Kiev's restaurant veterans Robert Koenig and Falk Nebiger, co-owners of the Arizona Group (USA), are driving the chain's expansion. The Arizona Group also runs Arizona BBQ, San Tori, Edelweiss and Kozak Mamai restaurants. They bought Mr. Snack's first restaurant from its pervious owners.

Mr. Snack restaurant specializes in providing inexpensive sandwiches offering customers about 20 ingredients, with a full meal going for about 9 UAH. It also serves Pepsi, beer and desserts. All of Mr. Snack's ingredients are locally processed.

McDonald's

McDonald's is the world largest fast food network operating in 103 countries and annual turnover of 32 billion USD. Ukraine has become the 102nd country, where McDonald's opened a restaurant. The local company "McDonald's Ukraine" was registered in December, 1995 and the first restaurant was opened in May, 1997.

McDonald’s has invested more than 82 million USD into new fast food restaurants in Ukraine. Nowadays, McDonald’s buys 35 % of products for its restaurants locally, in Ukraine: beverages, milk products, vegetables, mayonnaise, etc. Specifically, McDonald’s sells beverages produced by Coca-Cola (Ukraine), milk products from milk factory Galakton (Kiev), salads from Slavjanka company (Kiev region), cucumbers from Chumak company (owned by Swiss company South Foods) and ice cream cups from CBC company (Kiev).

Opening of a new restaurant in Ukraine costs approximately 1 million USD. By the year 2004, McDonald’s plans to expand its network to 85 restaurants, with total investment in Ukrainian economy amounting to 100 million USD.

With McDonald’s entry, Ukrainians have learned to demand to be treated efficiently and politely in inexpensive public eateries. Restaurant owners are learning that their business' survival may well hinge on how well they serve customers (*Sych, 2000*). According to McDonald's data, some 60 million people have visited the company's restaurants in Ukraine.

After the arrival of McDonald’s, local firms have been quick to compete for consumer attention. Now Rostik's, Shvydko and other restaurants provide clean stores that quickly serve good quality, economic fare to customers. This trend, initiated by McDonald's, has made it possible to get a lunch for two in downtown Kiev for less than 50 UAH (9 USD).

McDonald’s employs about 2,000 young Ukrainians, who earn starting salaries of 100 USD a month for full-time work. Doesn't sound like much? Consider the staggering low average Ukrainian wage of 40 USD per month (*Sych, 2000*). McDonald's employees who show promise may earn the opportunity to attend company training at "Hamburger University" in Chicago. The work ethic and managerial skills taught to McDonald's employees can help them build careers that extend far beyond the company's burger grills and deep fryers.

McDonald's received no tax breaks as a foreign investor. The company regularly makes payments to various budgets and is frequently raided by tax police officers, as are many other businesses. McDonald's doesn't offer Ukrainian officials 'financial incentives,' but the restaurant chain does tout its community involvement, sponsoring numerous events and allocating means for charity.

In 2003, McDonald’s invested about 5.5 million USD in Ukraine. In 2003, one new restaurant was opened in Donetsk. Nowadays, the company is collaborating with 40 Ukrainian suppliers. In 2001, with East Balt Ukraine Company, McDonald’s has opened a bakery plant in Dnepropetrovsk. In 2003, together with German partner L&O Company, a meat processing plant was opened in Kiev. According to company's information, McDonald's has invested more than 82 million USD in its restaurant network comprising 52 restaurants in 16 cities. Currently, McDonald's market share is about 15 %.

In September, 2003, McDonald's announced about its investment strategy restructuring, which aims to increase effectiveness of investment. The company plans to restructure investments from new restaurant opening to the increasing service quality, expansion of the existing restaurants, developing suppliers cooperation networks and attracting partners' investment. According to the McDonald's, this new policy doesn't mean decreasing investment in Ukraine.

6.9. Tobacco Industry

The Ukrainian Tobacco Market is headily developing. In 2002 the highest production volume was achieved – 81 billion cigarettes (Table 58) – what is 16 % more than in 2001. About 95 % of this amount was produced by five largest Ukrainian companies with foreign investments (Table 59).

Table 58. Cigarettes Production in Ukraine, billion cigarettes

	1997	1998	1999	2000	2001	2002
Production	54.5	59.3	54.1	58.8	69.4	81.0
Export	3.6	3.7	5.7	6.9	3.0	1.9
Import	7.6	5.7	3.0	1.8	2.2	1.0

According to the experts evaluation, in 2003 (10 months) were produced 81.7 billion cigarettes, what is 22 % more than in the same period of 2002, and 6 billion cigarettes more than the market demand. This fact is emphasizing a risk of over production.

Table 59. Leaders of Ukrainian Tobacco Market

Company	Production bln cigarettes		Turnover 2002 mln UAH	Employees	Share in production %
	2002	2003 (10 months)			
British American Tobacco Ukraine	24.0	21	N / A	900	29.6
Reemstra Ukraine	21.0	18	1000	1350	25.7
Philip Morris Ukraine	19.0	19	N / A	N / A	23.8
JT International Ukraine[18]	6.9	7.6	470	750	8.5
Ligette-Dukat Ukraine	5.8	11.7	N / A	N / A	7.2
Total	*76.7*	*77.3*			*94.8*
Companies without foreign capital	4.3	4.4	N / A	N / A	5.2
Total Industry	***81.0***	***81.7***			***100.0***

Source: COBAT association data, authors' calculations

[18] Japan Tobacco International, before 1999 – R. J. Reynolds

In 1992, transnational corporations (TNCs) have invested 66 million USD (Table 60) to the 6 of 11 existing in Ukraine tobacco factories with total annual production capacity of 55 billion cigarettes and de facto production of 48.5 billion cigarettes. It was expected that the initial investments would be followed by more significant financial flows to the developing Ukrainian industry. According to the Deloitte & Touche auditing statement made in 1995, it was claimed that foreign companies plan to invest more than 520 million USD to the Ukrainian tobacco sector in 1995 – 1999. The reality is that the five largest TNCs have invested only approximately 210 million USD by 2001.

Table 60. The Initial Investments of Foreign Companies to Ukrainian Tobacco

Company	FDIs stock, mln USD		Factories owned
	1992	2001	
R. J. Reynolds Tobacco	17	50	Lvov, Kremenchug
Philip Morris	6	62	Kharkov
Reemstra	16	70	Kiev, Cherkassy
British American Tobacco	25	28	Priluky
Total	***66***	***210***	***6 factories***

Source: www.adic.org.ua, authors' calculations

The major part of FDIs (about 80 %) was utilized by the companies for the ownership and equipment purchasing. Foreigners did not consider the local machine building, and practically all equipment was imported. Practically, they supplied Ukrainian factories with second hand machines purchased on the own factories in other countries. Owing to the investments in Ukraine, TNCs got opportunities to reequip their western factories with newest machines with a minimum costs.

British American Tobacco Ukraine (UK)

The leader of the market is *British American Tobacco Ukraine* purchased 65 % of Priluky Tobacco factory in March, 1993 and promised to invest 25 million USD to the development of the factory in the nearest five years. In 2002, company produced 24 billion cigarettes on its factory in Priluky, what is 26 % more than in 2001 (growth ratio 2001 / 2000 was much higher: 76 %). More than 50 % of total production falls into local brand "Priluky Osoblivy" – 12.8 billion cigarettes. This way, Company has an orientation to the middle and low price segments.

Reemstra (Germany)

Reemstra, nowadays, is the second largest cigarettes producer in Ukraine. It came to Ukraine in the end of 1993 and bought 65 % of tobacco factories in Cherkassy and in Kiev. Besides, a new company "Reemstra Ukraine" with 100 % foreign capital was established. In 1996, Reemstra started construction of new factory near Kiev to substitute existing production facilities and finalized construction in 1998. New factory has an annual production capacity of 30 billion cigarettes.

In 2001, Reemstra sold its tobacco factory in Cherkassy to the British company Gallagher and, than merged with British company Imperial Tobacco. The company concentrates its production only on the tobacco factory in Kiev. In 2002, Reemstra produced about 21 billion cigarettes, what is approximately the same amount of 2001 of both factories in Cherkassy and Kiev. On its factory in Kiev, Reemstra settled the production of “R1” brand, which was earlier imported from Germany. The company has launched to the market a new brand “Boss Classic”.

Philip Morris Ukraine (USA)

Philip Morris Companies, Inc. – is a holding company, owning “Philip Morris Incorporated”, “Philip Morris International Inc.” and “Kraft Foods Inc.”. The core business area of Philip Morris is production and sales of tobacco, cigarettes and packaged food products. The most famous cigarettes brands of “Philip Morris International” are: Marlboro, L&M, Philip Morris, Bond Street, Chesterfield, Parliament, Lark, Merit and Virginia Slim. The company has a market share of more than 15 % in more than 50 countries.

Since 1994, the company owns 51 % of shares of tobacco factory in Kharkov, in which it has invested about 6 million USD. In 1995, Philip Morris invested 10 million USD more and increased its share up to 72 %. Currently, the company owns 99.9 % of the factory. In 2002, tobacco factory in Kharkov produced 19.32 billion cigarettes, what is 1.5 % more than in 2001. During the nine year of work on the Ukrainian market, Philip Morris has invested about 63.9 million USD to the tobacco industry. In 2003 - 2005 Philip Morris intends to allocate about 100 million USD to the building of a new tobacco factory in the Kharkov region with an annual capacity of 30 billion cigarettes.

Philip Morris estimates its share in the Ukrainian tobacco market as 29.8 %. For the company, Ukraine is the 12th biggest market. However, the market share is low. For example, in Baltic countries, Philip Morris’s market share is 60 %. The company’s management underlines the competition on the Ukrainian tobacco market as practically all the world largest tobacco companies are actively operating in Ukraine.

Philip Morris is oriented to the middle and high price segments. Sales of the middle price level cigarettes take about 70 % of the company’s total sales. The company started to produce new cigarettes brand "Next" on its factory in Kharkov. In the same time, production of this type of cigarettes started in Russia and some other countries. During the year 2002, Philip Morris launched to the Ukrainian market 14 new variants of famous brands.

JT International Ukraine (Japan Tobacco)

JT International Ukraine (before 1999 – R. J. Reynolds) is operating on the Ukrainian market since 1992 by starting negotiations about purchasing of 70 % of tobacco factories in Lvov and Kremenchug. In 1993, company invested 9.3 million USD to Lvov factory and 7.3 million USD to Kremenchug factory. Nowadays, JT International owns 92 % of Kremenchug tobacco factory.

The company has focused on the selling the cigarettes of high and middle price groups. The company has an annual turnover of 470 million UAH. In 2002 it produced 6.9 billion cigarettes on its factory in Kremenchug (what is 6.4 % less than in 2001). The company is the largest tobacco exporter in Ukraine: it has strong position on the Caucasus and Moldovan markets. *JT International Ukraine* is increasing its export volumes. The company's share in total tobacco exports from Ukraine increased from 42 % in 2000 to 79 % in 2002. *JT International Ukraine* started the production of "More King Size" and "More King Size Light" brands on its factory in Kremenchug in January, 2003.

Lvov Tobacco Factory[19] started working in Ukraine in the period, when this area was a part of Austria. The Joint Venture "R. J. Reynolds Tobacco Lvov" was established in 1993. Foreign investors have received benefit from the government to avoid paying income tax during 5 years. The company's management has promised to renovate factory in 5 years time and launch the productions of such famous brands like "Camel" and "Winston".

However, in November, 1998, the company's management announced that the factory will be closed. They promised to pay generous dismissal pay for those workers who signs the voluntary dismissal paper. As for now, 617 from 620 workers have signed this document.

Liggette-Dukat Ukraine (Gallagher, UK)

Liggette-Dukat Ukraine, the current owner of Cherkassy Tobacco factory, produced 5.8 billion cigarettes in 2002. The company is significantly increasing its market share: in 6 months 2002 its markets share was only 4 %, but by the end of the year it increased to 7 %.

[19] Information adapted from the Report "Economy of tobacco control and health care in Ukraine" from www.adic.org.ua

The history of this company started when in 2001 British producer Gallagher bought Cherkassy factory (99.23 % of shares) from Reemstra. Few years ago, Gallagher paid 390 million USD for tobacco factory in Moscow, owned before by American company Liggette. The company has announced that Ukrainian factory was renamed to Liggette-Dukat Ukraine and its operations will be unified with Russian factory.

Competition intensified on the tobacco market in Ukraine in 2002, especially in the not expensive cigarettes segment (Table 61) between "Priluky Osoblivy" (British American Tobacco Ukraine) – 12.8 billion cigarettes, "Troika", "Saint George", "City", "LD" (Ligette Dukat Ukraine), "Next" (Philip Morris) and "More King Size", "Monte Carlo" (TJ International). Reemstra – Imperial is actively participating in competition: the changed package of "Prima Lux" and "Prima Sribna" appeared on the Ukrainian market in 2002.

Table 61. Cigarettes Production in Different Price Segments

Price Category	Production, bln cig.
1 – 2 UAH	47.7
Less 1 UAH (without filter)	18.0
2 – 4 UAH	14.0
4 – 6 UAH	0.8

The foreign players are leading and in the top brands ratings (Table 62). No Ukrainian company was mentioned in the top 10 of the brands sold in Ukraine in 2002.

Table 62. Top 10 Brands of Cigarettes in Ukraine (Dec., 2002)

	Brand	Market Share, %	Company
1	Priluky Osoblivy	11.9	British American Tobacco
2	L&M	6.7	Philip Morris
3	Prima Optima	6.6	Reemstra
4	Bond Street	5.1	Philip Morris
5	Prima Sribna	4.8	Reemstra
6	Kozak	4.5	British American Tobacco
7	Chesterfield	3.7	Philip Morris
8	Prima	3.2	Reemstra
9	Prima Lux	3.2	Reemstra
10	Malboro	3.0	Philip Morris
	Total	52.9	

Source: ACNielsen Ukraine[20]

There might be obvious threat to the tobacco market stability in Ukraine. This possibility is closely connected with tobacco production in Russia. In 2002, Russia produced 390 billion cigarettes with the internal market demand of only 280 – 300 billion. It is natural, that the excess should be exported. However, the largest importer of Russian cigarettes to Ukraine, British company Gallagher has bought the own factory in Cherkassy and stopped exporting its

[20]*ACNielsen Ukraine – Marketing agency, specializing on the research of FMCG markets*

products from the factory in Moscow. All transnational corporations, operating in tobacco industry, have approximately the same brand portfolio both in Russia and Ukraine.

6.10. Retail Trade

Ukraine's retail trade turnover has posted a sharp recovery following a slump in the aftermath of the 1998 financial crisis in Russia and the subsequent depreciation of the hryvna by two-thirds in 1998-2000. Since 1999, thanks to gradual hryvna stabilization and growth in household income and consumer spending, the rate of growth in retail turnover outperformed that of real GDP, making retail trade one of the Ukrainian economy's fastest growing sectors (Table 63) (*Dragon Capital, 2003*).

Table 63. Ukraine vs. other TEs (2001)

Country	Ukraine	Russia	Poland	Hungary	Romania
Total Retail Sales (USD mil.)	11 455	77 568	81 365	13 545	8 106
Per Capita Retail Sales (2001; USD)	233	536	2 103	1 347	363
Top Three Retailers' Market Share	>1%	1%	11%	26%	n/a

Sources: Euromonitor, State Statistics Committee, Dragon Capital estimates

In 2000, retail trade grew 8.1 %, and added another 12.6 % in 2001. In 2002, the growth accelerated to 16.4 %, reaching 12.3 billion USD (Table 64), with higher turnover recorded in all segments. In 2002, visible retail trade, which represents total sales reported by chains, stores and kiosks, increased by 14.8 %, to reach 7.4 billion USD (*Dragon Capital, 2003*).

Table 64. Ukraine's Retail Trade Statistics

Year	1997	1998	1999	2000	2001	2002
Retail Turnover (million USD)						
Total Sales of Consumer Goods	n/a	n/a	n/a	9 119	11 455	12 314
Visible Retail Trade	9 365	7 264	4 962	4 901	5 935	7 358
Incl. Urban	8 333	6 543	4 452	4 332	5 216	6 475
Rural	1 032	720	511	569	720	883
Incl. Food Stuffs	5 994	4 286	2 680	2 549	2 991	3 605
Non-food Items	3 371	2 978	2 283	2 353	2 944	3 753
Retail Space and Outlets						
Number of Retail Outlets (ths.)	132	128	121	112	103	96
of them Stores (ths.)	105	100	94	85	78	72
Stores' Total Space (ths sq. m.)	n/a	n/a	8 767	7 755	7 029	6 600
Stores' Space (sq. m. per 10,000 inhabitants)	2 042	1 918	1 750	1 560	1 426	1 347
Kiosks (ths.)	27	28	27	26	25	23
Open Air Markets (units)	1 231	1 551	2 120	2 320	2 514	2 720
Total Space (ths. sq. m.)	n/a	11 955	12 164	12 818	13 354	14 000

Source: State Statistics Committee, Dragon Capital estimates

Despite the noticeable growth in per capita income in Ukraine in recent years, Ukrainian consumers remain extremely price conscious, which explains the popularity of open air markets offering food and other goods. It is price that mostly determines local consumers' decision to buy, far outweighing convenience, prestige, or health/safety concerns. Ukrainian consumers favour cheap, locally produced and mostly low value added items over more expensive imports. Thus, over 75 % of the total items sold via official retail trade in 2001 were domestically produced. The share of domestically produced items was even higher in the food segment, accounting for over 90 % of the total items sold, while among non-food items only 60 % were domestically produced (*Dragon Capital, 2003*).

The share of non-food items sold has increased to 56 % of all sales in 2000, compared to 40 % during the years 1995 to 1997. Market experts predict the share of non-food items to reach an estimated 63 % of all sales by 2005. This trend may signify the recovery of the Ukrainian economy and development of a middle class (*BISNIS Report, 2001*). Several regions with above average per capita income, such as the city of Kiev, have seen the share of food items shrink to 44 % of the total retail turnover (*Dragon Capital, 2003*).

Retail trade in Ukraine remains highly unconsolidated. Fast growth in organized open air markets contrasts with nascent modern chains in the major cities (about 4% of visible retail trade) and the overall decline in retail space and the number of stores. Ignoring open markets, producers and distributors face the prospect of losing their market share and thus have to maintain trading or marketing outlets at open markets. Development of modern retail chains in Ukraine is currently restricted to large urban areas. The total number of modern mini-, super- and hypermarkets in Ukraine was estimated at only 550 as of the end of 2001 and grew to an estimated 590 at the end of 2002. These stores focus mostly on foodstuffs and other daily products. Out of the total number of stores in Ukraine, 11 % are still state-owned and over 32 % stores are owned by Ukropspilka association (*Dragon Capital, 2003*).

The collapse of the centralized system stimulated the development of FDI in retail trade in Ukraine. In 1999 - 2001, international and local companies have developed 14 "cash-and-carry" centers in Kiev alone. Since 1999, "cash-and-carry" outlets have rapidly developed in major Ukrainian cities including Kiev, Dnepropetrovsk, Donetsk, Kharkov and Odessa (*BISNIS Report, 2001*).

Market experts predict further growth of supermarkets in large Ukrainian cities. The following three types of supermarkets will be in demand in Ukraine: classical (10 000-12 000 items on sale); economy (1 500-3 000 items on sale, with 100% self-service); convenience stores. Supermarkets are expected to gradually replace the existing cash-and-carry stores.

Ukraine's largest food retailers are presented in Table 65:

Table 65. Ukraine's Top 5 Retailers*

Company	Specialization	Sales (mln USD) 2001	Sales (mln USD) 2002	Change, %
FOZZY Group	Supermarket	75.0	140.0	87
Garantiya Trade (Furshet)	Supermarket	70.0	100.0	43
BILLA-Ukraine	Supermarket	43.1	51.8	20
EuroMart	Cash & Carry	26.5	23.6	(11)
TsUM	Department Store	20.3	22.3	10

** Reliable data for MegaMarket, Spar, Rainford, Foxtrot, Eldorado are not available;*
Source: Companies, media reports, Dragon Capital estimates

- *BILLA*, a subsidiary of Germany's Rewe group, was the first foreign chain to enter Ukraine in 1998; operates eight supermarkets in Kiev, Kharkov, Dnepropetrovsk and Zaporozhie and is growing rapidly;
- *EuroMart*, helped by capital and know-how from foreign investors, operates a chain of cash-and-carry stores in Kiev, Dnepropetrovsk and Zaporozhie, and discount supermarkets in Kiev and Kharkov;
- *FOZZY Group* is also one of the fastest growing chains that consists of two hypermarkets near Kiev and Odessa, 32 stores under the brand Silpo (including one in Moscow) and Bud Zdorov drug store chains;
- *Furshet* - runs nine stores in Kiev;
- *Rainford,* a trading and industrial group that produces alcoholic beverages and confectionary and also operates Cash & Carry stores in seven locations around the country and several supermarkets;
- *MegaMarket* - operates three supermarkets in Kiev;
- *Trading House Brig* - operates a chain in Kharkov and a few other cities;
- *Spar* - this international chain entered the Kiev market in 2001;
- *Metro*, one of the world's largest retailers, has opened first hypermarket in Kiev and plans to expand in other cities;
- *Velyka Kyshenya* -- a chain of four stores in Kiev. As the chain's relatively early start slowed its growth. Yet the stores' format is better than that of most of its competitors.

The Western NIS Enterprise Fund (USG Investment Fund) was the first major foreign investor in the development of "cash-and-carry" retail distribution in Ukraine. In 1999, this USG funded investment institution developed the first cash-and-carry centers in Ukraine (two in Kiev and one in Kharkov, Odessa, and Zaporozhie each). Western NIS invested on average 2-3 million USD in each store. The stores contain a combination of sales area, warehouse, extensive parking and security. In 2000, the German retail operator REWE invested 9.4 million USD into the development of western type supermarket chain in Ukraine, having become the second largest foreign investor in Kiev (after McDonalds). REWE announced plans to open 5-7 supermarkets under the name BILLA every year in Ukraine for the next five years. The first three BILLA chain outlets have been built in the outskirts of Kiev (approximately 2000 square meters of shopping space each). As of July 2001, BILLA stores were the only western managed retail outlets in Ukraine (*BISNIS Report, 2001*).

METRO SUPERMARKET (Germany)

Metro Cash & Carry was established in Germany in 1964. In 1967 the company Franz Haniel & Cie became its partner. A little bit later Schmidt-Ruthenbeck joined them. Each partner had one-third part of the whole business Metro Cash & Carry. In 1968 this business crossed the border of Germany, and closed a deal with Dutch company Steenkolen Handelsveriniging N.V. In 1996, as the result of the merger of three companies - Metro Cash & Carry, Kaufhof Holding AG and Asko Deutsche Kaufhaus holding, Metro AG was created. Metro is the fifth largest retailer in the world and the third largest in Europe.

The internationalization of the Metro Group is progressing swiftly. Metro now has operations in 27 countries (365 shops), and its Metro Cash and Carry wholesale division is present in 25 countries. The company's turnover in 2002 was 92 billion Euro. The structure of Metro AG includes such trading networks as Metro Cash & Carry, Real (supermarkets), Extra (the shops of everyday purchase), Media Market (household appliances), Saturn (music stores), Praktiker (everything for house decoration), Kaufhof (department stores).

In August, 2003 German retailer Metro opened its first Metro Cash and Carry wholesale store in Kiev, the Ukrainian capital. The new supermarket near the Okrugnaja road covers an area of 6.7 hectares. Trading space is 10 thousand square meters with 42 points-of-sale. New supermarket’s management now collaborates with 800 suppliers of products; over 20 thousand items are on offer, and 550 highly skilled Ukrainian employees work in the shop.

Classical "Cash and Carry" represents wholesale (in small lots) grocery and manufactured goods of everyday demand store that serves only business-clients - owners of retail trade companies (85 %) and owners of public catering establishments (15 %). The main features of cash & carry format are: wholesale prices, a minimum of extra charge (2-5 %), exclusive access, a wide range of goods (15 thousands items and more) and parking place nearby.

The most striking detail in the new supermarket is the good information system of the trading room. The client can easily detect, where the necessary good can be found. Near the entrance, there is a department of certification and documents circulation, where every buyerentrepreneur, owner of client-card METRO, can receive on-line documentation that is needed in their further trade activity.

Currently prices in Metro Cash & Carry store are 20-50 % lower than in retail outlets. All the asked shop-managers suppose that the forthcoming retail operations of Metro AG will intensify competition on the trading market. Some may hope that Metro will suffer from the sluggishness of a big unit with a complicated decision-making system. However, Metro AG has successfully run its operations in many countries.

In August 13, 2003 Metro announced to build a second supermarket in Ukraine. The CEO of Metro Group, Hans-Joahim Kerber, and representatives of Metro AG were present at a procedure of endorsement of a corresponding protocol between the Kiev Administration and Metro AG.

Metro is the first major international retailer, which is operating in Ukraine. With 48 million inhabitants and a continuously rising purchasing power, Ukraine holds an enormous market potential for Metro Group.

Metro Group was observing Ukrainian market and found out a number of factors motivating company's entering this new market. The market is stabilized and the economy is growing. The inflation is decelerating and the purchasing power is growing. All these economic factors induced the company to start operations in Ukraine.

The company has invested 50 million Euro in its first Ukrainian cash and carry, and plans a network of seven stores in the medium term. In 2003, Metro intended to invest about 100 million USD in building "Cash and carry" supermarkets network in Kiev and other five largest cities (with populations of more than 1 million) of Ukraine.

6.11. Mobile and Telecommunications Sector

Ukraine, the second largest CIS market, has improved telecommunications infrastructure by introducing modern operating standards in the recent years. The contribution of telecommunication sector to the Ukrainian GDP has reached 5 % in 2002 and the prospects for growth of the Ukrainian telecommunication market are huge.

For example, the telecom and computer penetration levels in Ukraine are far lower than European averages. In particular, fixed line penetration in 2001 was 21 % vs. more than 40 % in Europe, mobile telephony – 4.7 % vs. more than 50 % in Western Europe, the Internet – 3 % vs. more than 36 % in Europe. Thus, it is not surprising that Ukrainian telecommunication sector is growing, while in North America, Japan and Western Europe face saturation (*AVentures Company*[21]*, 2002*).

The statistics illustrate the extreme concentration of the Ukrainian market: two leading wireline operators UTEL[22] and Ukrtelecom[23] process 95 % of long distance and international calls (43 % of total sectoral revenues). However, this sub-sector is losing its position as the most profitable telecom segment *(Beliaev, 2003).*

Despite of the restrictive regulatory regime on the telecommunication market, a number of foreign telecommunication companies are active in Ukraine. However, the sector remains underinvested in spite of the improving investment climate in the recent years.

In July, 2003 the Ukrainian Parliament adopted after three years of debate a new law "On telecommunications". Experts believe that the main value of the new law is in separating regulatory authority and industry management by delegating these two roles to two different government agencies, and in establishing a clear definition and distinction of different services and technologies applied in telecommunications. As the old legislation lacked norms and definitions necessary to establish the legal status of many modern services and technologies such as IP Telephony, wireless local loop, etc., regulatory government bodies ruled the sector at their full discretion (*BISNIS, 2003)* (Table 66).

In October, 2003, the new law "On telecommunications" was finally accepted. According to this law, the National Commission on Communication Regulations should be formed during 2004 and start working from the beginning 2005.

According to the previous version of law "On communications" adopted in 1995, The State Committee of Communications of Ukraine, the successor of the former Ministry of Communications of Ukraine, was fulfilling regulatory functions in the field of communications, determining the strategy of work and regulating the activities in the field of communications, broadcasting and postal services.

Two companies dominate the national and long-distance fixed-line networks: Ukrtelecom and UTEL. There are a number of private, mostly regional, providers of fixed-line services, such as Golden Telecom Business Solutions, Kancom/Andrew, Optima, Farlep and Crymtel, whose total market share does not exceed 20 % *(AVentures, 2002).*

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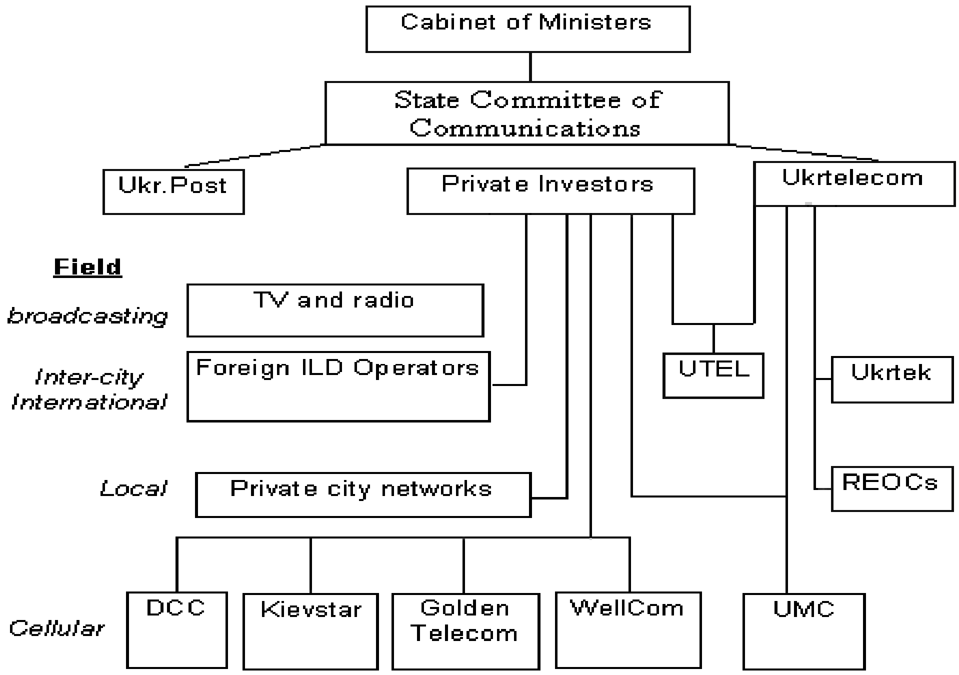
[21] AVentures is a private investment banking and venture capital firm working in the telecommunications sector in CIS, primarily Ukraine and Russia
[22] UTEL - is a company providing services in long–distance domestic and international telephone communications, owned by Ukrtelecom (51 % shares)
[23] Ukrtelecom - Ukrainian state telecommunications enterprise

Table 66. Operational Control and State Regulation (Law 1995)



Source: Alfa–Capital

UKRTELECOM

Ukrainian state telecommunications enterprise "Ukrtelecom" (since 2000, Ukrtelecom) was founded in 1993. Ukrtelecom is the largest and most powerful player on the telecommunication market in Ukraine, providing all basic kinds of telecommunication services: international, long–distance (via UTEL) and local telephone communication, re-diffusion, radio communication broadcasting and TV, documentary telecommunication, videoconferencing, ISDN service[24], Frame Relay data communication service, digital channel leasing, Internet access.

Ukrtelecom is a holding, which controls 35 enterprises with a total staff of 130 thousand employees. It has the following structure: Ukrtek (Directorate for operating primary networks, owns international and inter–city trunk lines); Infotel (Center of informational telecommunications); Giprosvyaz (State project institute of communications); Ukrsvyazproyekt (State project institute of communications objects); Ukrsvyazsputnik (Ukrainian state enterprise of satellite communications); 24 Regional Telecommunications Companies; Kievelectrosvyaz (Kiev state telecommunications enterprise); Krymtelecom

[24] ISDN - Integrated Services Digital Network; a fully digital telecommunications network access method which works over copper wires. There are two types of ISDN, basic rate and primary rate. Basic rate ISDN provides subscribers with two 64 kbps information channels and a single 16 kbps control channel. Primary rate provides users with thirty 64 kbps information channels and a 64 kbps control channel.

(Crimean republican telecommunications enterprise); Sevastopoltelecom (Sevastopol telecommunications enterprise); Kiev Telegraph (Kiev wire broadcasting network).

The major aspects of Ukrtelecom privatization were stated by the corresponding law in 2000. In spite of this fact the privatization process is still slow. Ukrainian government promised to announce an open tender to attract strategic investor for Ukrtelecom in April 2002. It is planned to keep 50 % plus one share in Ukrtelecom, and offer 42.86 % to a strategic investor. Probably, the long expected privatization will become a significant event in 2004. Among the possible investors are Russian Svjazinvest, Alfa-Group, AFK Sistema and Ukrainian financial group with Turkcell (Turkey).

UTEL

UTEL was established in 1992 with collective investment fund of 10.6 million USD. The company provides services in long–distance domestic and international telephone communications. In 1994 UTEL became a joint – stock company owned by Ukrtelecom (51 % shares), American company AT&T (19.5 %), Deutsche Telekom (19.5 %), Netherlands PTT Telecom (10 %). UTEL is one of the 15 most profitable Ukrainian companies.

UTEL invested 190 million USD in the Ukrainian telephone networks. As a result, a number of new town ATS[25] with a total capacity of 230 thousand lines were commissioned. These new ATS are leased to local telecommunications companies, which get the right to buy them out in the future (*Ukrainian Telecommunications: a survey, June 2000*).

UTEL is an operator of international and regional communications network. In 2002, the company planned to invest 45 million USD into communications development in Ukraine. For the further business development, UTEL planes to invest 9 – 10 million USD into construction of local ATS with total capacity of 70 thousands ports. Altogether, during 8 years of the company's operations on the Ukrainian market, its investment amounts to 200 million USD. In 2001, UTEL invested 4.5 million USD to business expansion, structure perfection and services quality improvement; 2 million USD to local ATS development with capacity of 11 thousands ports.

Mobile Operators

Mobile communications (MC) is the most active sub-sector of the telecom industry in Ukraine. MC revenues grew 32.4 % in 2002 amounting to 500 million USD and 650 million

[25] ATS – Automatic Telephone System

USD in 2003 (preliminary estimate). The MC sector in Ukraine is 90 % controlled by Russian companies.

There are five mobile operators: UMC, Kievstar GSM[26], Golden Telecom GSM, DCC, and Wellcom. They offer wireless mobile services in the following standards: GSM900/1800 (UMC, Kievstar GSM, Wellcom, DCC), DCS[27] 1800 (Golden Telecom GSM), and D-AMPS[28] (DCC). Late in 2002 and early 2003 four out of five Ukrainian mobile operators changed their shareholders.

By end of year 2001, the number of MC customers in Ukraine exceeded 2.1 million. More than 98 % of MC customers used the services of two operators: UMC and Kievstar GSM. The remaining providers (DCC, Golden Telecom, and Wellcom) are far behind. Reportedly, the number of MC users continued growing in 2002 reaching 3.5-4 million by the end of 2002 with 52 % of customers serviced by Kievstar GSM and 46 % by UMC *(Beliaev, 2003)*.

<u>UMC (Russia)</u>

Ukrainian Mobile Communications (UMC) was officially registered in 1992. Originally, Ukrtelecom owned 51 % of shares in UMC, while the rest 49 % of the shares were equally divided between Deutsche Telecom (Germany) (16.33 %), Telecom (Denmark) (16.33 %) and PTT Telecom (Netherlands) (16.33 %).

In November, 2002 Russian company Mobile Telesystems (MTC) announced its purchase of 57.67 % shares of UMC. MTC has bought 16.33 % UMC's shares from Holland KPN and 16.33 % from Deutsche Telecom (55 million USD paid to each company). 25 % more were purchased from Ukrtelecom for 84.2 million USD. Though UMC's minor shareholders had tried to break up the transaction, MTC proved in the court that it is the legal owner of UMC. MTC invested in 2003 about 200 million USD for the UMC's development.

[26] GSM - Global System for Mobile Communications, second generation mobile cellular radio technology, originated in Europe but now used in over 100 countries around the world. GSM supports voice, data and text messaging and allows roaming between different networks. GSM systems currently operate at 800 MHz, 900 MHz, 1800 MHz or 1900 MHz frequency bands.

[27] DCS 1800- Digital Cellular System, a modification of GSM 900 cellular radio standard used outside of the U.S. DCS 1800 operates in the 1800 MHz frequency band.

[28] D-AMPS - Digital Advanced Mobile Phone System, TDMA–based second generation cellular radio standard originated in North America. D–AMPS is widely used throughout the Americas, and uses frequencies in the 800 MHz and 1900 MHz frequency bands.

KIEVSTAR (Norway, Russia)

Kiev Star is a joint stock company established by the Ministry of Energy, the State Committee for Oil, Gas, and Oil Processing, the Ukrainian Railroads (51 %), Tiller International (UK) and the Impex Group (Luxembourg).

In summer 2003, Russian Alfa – Telecom (the division of Alfa Group) purchased 50.1 % shares of Ukrainian company Storm, controlling 32.39 % of Kievstar GSM – the largest Ukrainian mobile operator.

Kievstar GSM has invested 140 million USD to Ukrainian economy during 1997 – 2002, including 80 million USD to the mobile network construction. Nowadays, the company has more than 2 800 000 subscribers. Today the Kievstar network is deployed in more than 313 cities and covers the territory where 72 % of the country's population resides (about 34 million people).

On December, 9, 1997, the first call in the Kievstar network was made. The company started with market share of 4.2 % in the end of 1997. In November 2001, the number of subscribers reached one million. Currently Kievstar's market share is more than 50 %. Kievstar was the first mobile communications operator in Ukraine, in which network incoming calls were free. Telenor became Kievstar GSM's shareholder in March, 1998. In 2002, it became the main shareholder with a 54.21 % share and in 2003 it increased its share to 60 %. In 1997, Kievstar started to cooperate with Ericsson, whose equipment supplies gave to Kievstar the opportunity to control technical processes of its activity and constantly improve the quality of communications and additional services. Successful collaboration with Comverse Company gives Kievstar a stable competitive advantage on the prepaid mobile communication services market[29]

Digital Cellular Communications Company (DCC)

Digital Cellular Communications Company (DCC) was founded in 1995 in Donetsk as a joint venture with a statutory fund of 6 million USD. The company initially purchased 5 million USD of equipment from Ericsson. In early 1996, DCC began operation of a small D–AMPS (IS–136) network in Donetsk with 300 – 500 clients (*Ukrainian Telecommunications: a survey, June 2000*).

[29] Official company's data, adapted from www.kyivstar.net

Currently, the company has more than 2,500 clients in Donetsk. DCC now covers city of Kiev, regions of Donetsk, Kharkov, Odessa, Dnepropetrovsk and Crimea. The company's marketing strategy includes establishing independent regional/city networks. To lower its tariffs, DCC does not provide automatic roaming to other cities, regions or countries.

Golden Telecom (Russia)

Golden Telecom – provider of telecommunications services, including fixed and mobile communications, and internet access, was established in 1996 by Global Telesystems Group of the U.S. (49 %) and Ukrainian company Bankomservice (51 %).

Presently, Golden Telecom is a holding company owned by Russian Alfa Group, Global TeleSystems, the EBRD, Capital International Global Emerging Markets Private Equity Fund, Baring Vostok Capital Partners, the Soros Group, and a variety of institutional investors (*Ukrainian Telecommunications: a survey, June 2000*).

During its presence on the Ukrainian market, the company has invested 60 million USD, including 35 million USD to mobile communications. In 2001 Golden Telecom invested 21 million USD to telecommunications development in Ukraine. Golden Telecom as has a low market share (only 36 000 subscribers).

6.12. Summary of Investment Projects in Ukraine

Some of the successful investment projects in Ukraine are summarized in the Table 67. The information in the table includes names of the companies with foreign investments, field of activity, the promised investments and investments made de facto.

Many investment projects have failed in transitional Ukraine. The majority of unsuccessful investments were carried out with credits from international organizations, involving governmental guarantees. Ukrainian companies, credit recipients have not paid credits off in time. Thus, in 2001, Ukrainian government has been forced to settle unpaid foreign loans. The total foreign debt of Ukrainian companies is estimated to be 873 million USD.

AvtoZAZ – Daewoo

AutoZAZ-Daewoo - joint company with 300 million USD capital stock, was established in April, 1998 by Korean company Daewoo Motors Co. and Ukrainian AutoZAZ (with equal shares). The company is oriented to the production of following car brands: Lanos, Nubira, Leganza, Tauria and Slavuta.

According to the initial investment project, AutoZAZ-Daewoo planned to produce in Ukraine 250 – 300 thousands cars annually, and extend its production to 400 thousands cars per year. In November, 2001, AutoZAZ-Daewoo decreased the production volume by 70 %; in 10 months of 2002, the company had losses of 12 million UAH.

Table 67. The Most Successful Investment Projects in Ukraine

Company	Field of Activity	Investment announces	Investment realized	Investment purpose
		Telecommunications		
UTEL	Telecommunications	>= 245 mn USD	200 mn USD	Network development, construction of local ATS
Kievstar GSM	Telecommunications	>= 240 mn USD	140 mn USD	Network coverage in most of the towns and highways of Ukraine
Golden Telecom[30]	Telecommunications	About 100 mn USD	60 mn USD	Providing complex telecommunications services
		Food and Beverages Industry		
Cargill[31]	Food Industry, agriculture	N / A	About 85 mn USD	Increase food and grains production and exports volumes
McDonald's[32]	Public catering, fast - food	About 100 mn USD	>= 70 mn USD	Increase of own fast – food network
Nestlé	Confectionary	>= 41 mn USD	>= 20 mn USD	Increasing production volumes of confectionary in the Lvov factory "Svitoch"
Sun Interbrew	Brewery industry	>= 40 mn USD	>= 40 mn USD	Re-equipment of 3 purchased breweries, increasing market share
Kraft Foods	Food industry, Confectionary	>= 20 mn USD	19 mn USD	Increasing confectionary production volumes and market share
		Other Sectors		
Lukoil	Oil and Chemical Industry	>= 37 mn USD	N / A	Technical re-equipment of Oriana Concern, recommencement of production of olefins and polymers
Damen Shipyards group	Shipbuilding	N / A	shares purchased	Placing ship building orders to the plant Ocean, investing the materials supplies for the construction needs
Microfinance bank, organized by international investment organisations[33]	Banking	N / A	>= 10 mn EURO	Small and medium size business crediting in Ukraine

Source: Adapted from Investgazeta, 29.03.02

[30] Golden Telecom aims to combine all telecommunications services in one mobile operator, what creates an extra competitive advantage on the Ukrainian market
[31] Cargill constructed hybrid sunflowers' seeds production plant in 1995, and mixed fertilizers plant in 1997. In 2000 sunflower oil plant started its operations with the total capacity of 300 000 tn
[32] Company plans to expand it's fast – food network to 85 restaurants in Ukraine, what will create 5500 new work places
[33] EBRD (The European Bank for Reconstruction and Development), IFC (International Financial Corporation), Investment Fund "Western NIS Enterprises", German - Ukrainian fund, German Investing company IMI, and Holland Investment Fund DOEN

The investment project of developing Ukrainian automobile failed twice. First, the demand for Daewoo cars produced in Ukraine never became high. Second, the main investor, Daewoo announced its bankruptcy in 2002. The car manufacturing outlet of Daewoo was acquired by General Motors in 2002. This deal did not include Daewoo's foreign operations.

Wood&Company

International investment company Wood&Company stopped its operations in Ukraine in 2001.

International investment company Wood&Company with headquarter in Prague, opened its representative office in Kiev in 1996. Wood&Company, was one of the first foreign companies to start work on the Ukrainian stock exchange serving foreign clients. Currently, this market is very narrow (market volume is less than 300 thousands USD daily) and is not of interest to large international investment companies. From 200 companies listed in the PFTS (First Securities Trading System), 194 are not of interest to foreign investors. The Ukrainian stock exchange includes only 6 big companies: Centrenergo, Donbassenergo, Dneprenergo, Zapadenergo, Kievenergo, and Ukrneft. Besides, corporate risks are very high in Ukraine. This makes foreign investors to work on the other TE markets: Czech Republic, Poland, Turkey, and Hungary.

6.13. Summary of Russian FDIs in Ukraine

According to the official statistics, USA is the main source of foreign investments in Ukraine. In the same time, many of the core industries of Ukraine are practically under control of Russian companies (Table 68).

Russian influence is enormous in the context of FDIs. The moderate 5th place in the official FDI statistics can be explained by the fact that Russian and Ukrainian companies actively use offshore companies in Cyprus, the British Virgin Islands, Switzerland and some other countries to repatriate their flight capital to the home country. Experts estimate, that 30 – 55 % of FDIs comprise legalized Russian and Ukrainian capital from the "offshore" companies.

Russian capital is involved in the Ukrainian tyre industry. Russian – Singapore Group "Amtel" owns 51 % shares of Joint Venture Rosava, – the biggest automobile tyre producer in Ukraine. Group "Amtel" started the business in Russia as a natural caoutchouc supplier from South – East Asia to Russia and other CIS countries. Today it controls six large tyres producers and few chemical companies, including one in Ukraine – Khimvolokno in

Chernihiv. Rosava exports 70 % of its products to Russia. Ukrainian experts estimate, that "Amtel" Group covers nowadays 15 % of tyre market in Russia and 80 % in Ukraine.

Russian investors play a very active role in some other sectors. "Energetichesky standard" Group has shares of more than ten *regional energy companies* in Ukraine, Sibirski Aluminium has invested to the Nikolaevsky *Aluminium plant,* Avto VAZ Invest has shares of Zaporoghsky aluminium plant. Russian *food companies* have expanded in the Ukranian market: Wimm-Bill-Dann company owns large milk factories in Kiev, Kharkov, Sumy region; Company Planeta – Management has bought milk factories in Kiev and Kremenchug. Cosmetic company Kalina has purchased "Alye Parusa" in Ukraine.

Russian investment in the Ukrainian market is not surprising. Unlike Western investors, Russian companies are not afraid of possible problems and difficulties linked with investment climate in Ukraine. Russia and Ukraine were parts of the same federation (Soviet Union) until 1991. Thus, Russian investors have special knowledge of Ukraine.

Russian expansion into the oil refining of Ukraine is very natural, as Russia is a major oil producer. Vertical integration of Russian oil companies in Ukraine is the same as in Russia – comprising production and retailing of oil products. Ukraine produces only 20 % of its oil consumption, while 50 % is imported from Russia. Russia satisfies 30 % of Ukraine's need of gas. In nuclear fuel the equivalent figure is 100 %.

It can be assumed that Russian investment in Ukraine will grow in the future comprising metallurgy, telecommunication, pharmaceutical and other industries. Ukraine is a natural playing field for Russian companies in their internationalisation drive in the post-soviet world.

Table 68. Russian Companies in Ukraine

Russian participation	Expansion perspective	Possible risks
1. OIL INDUSTRY		
Russians own four from six Ukrainian oil processing plants, providing 80 % of total oil processing in Ukraine: • **Kremenchug Refinery** - ***Tatneft*** (majority owner – m.o.) • **Lisichi Refinery –** ***TNK,*** m.o. • **Kherson Refinery**, **Sevastopol Oil Terminal -** ***Alliance group*** • **Odessa Refinery** – ***Lukoil,*** m.o.	1. Privatization of oil extracting company **Ukrneft** 2. Privatization of refineries 3. Privatization of Ukrainian oil transportation system, oil terminals and sea ports terminals 4. Participation of Lukoil and TNK in the privatization of **Azmol** company	1. Competition between Russian companies and large Ukrainian FPG(Financial Industrial Groups) 2. Political resistance from USA and EU on oil transportation
2. TELECOMMUNICATIONS		
Russian companies participate in many mobile operators. • **UMC –** ***MTC***, m.o. • **Kievstar GSM -** ***Alfa Telecom***, 40 % • **Golden Telecom -** ***Alfa Telecom***, m.o.	Privatization of Ukrtelecom – national communications operator	1. No decision on the Ukrtelecom 2. Competition between Russian and Ukrainian companies
3. NON - FERROUS METALLURGY		
With few exceptions, all non – ferrous plants in Ukraine either are owned by Russian companies, or are in the state ownership. • **Nikolaev Aluminous Plant - Rusal,** m.o. • **Zaporozhie Aluminium Plant -** ***AvtoVAZ-Invest***, m.o. • **Pobugsky Ferronickel Plant –** ***Nikomed***, m.o.	Privatization of titanium – magnesium plant in Zaporozhie – GAK "TITAN" (the biggest in CIS producer of titanium dioxide), GOK in Dnepropetrovsk (titanium and zirconium ore extraction), developing new fields of rare-earth metals	No political decision on the privatization of mentioned objects
4. FOOD INDUSTRY		
Russian companies control over 30 % of milk products market: • **Kiev Milk Plant number 3, Kharkov Milk Plant, Burynsky Dried Milk plant –** ***Wimm-Bill-Dann***, m.o. • **Galakton** and **Kremez** – ***Planet Management,*** m.o.	Purchasing of the Ukrainian companies with popular bands	Low image on the internal consumer market
5. CHEMICAL INDUSTRY		
• **Lukor** (oil chemicals production) – ***Lukoil,*** *m*.o. • **JV Rosava** (tires) – ***Amtel*** (51 %)	Privatization of state fertilizers firms. Purchasing companies on the secondary market.	Competition between Russian and large Ukrainian FPG
6. MACHINE BUILDING		
Russian participation is not significant still, but share of non – privatized companies is very high. • **Stakhanovsky machine building plant –** ***Alliance Group*** (m.o.) • **Kharton –** ***ASKOND*** (24 %)	Privatization of Luganskteplovoz, Energy Machine Building, Chernomorsky Shipbuilding company, Agriculture machine building companies	1. Political obstacle for Russian capital inflow 2. Competition between Russian and Ukrainian FPG
7. MILITARY INDUSTRY		
Privatization in the military industry has not started yet	1. Privatization of Ukrainian military enterprises. 2. Integration of Ukrainian air defence system with Russian defence holdings, mergers of companies in aircraft industry. 3. Privatization of Ukrainian aerospace companies	No political decision on the privatization of military companies International competition (in aerospace industry)

8. ADVERTISING AND MASS MEDIA		
Russian companies are participating in national TV channels in Ukraine and control about 50 % of TV AD market. • TV channel **Inter** – ***Pervyi kanal*** – blocking package • TV channel **STB**, **Weekly "**Delovaja **Stolitsa"**, and Radio **"Apelsin"** – ***Lukoil*** (m.o.) • **Video International Ukraine –** ***Video International*** • Advertising agencies **IMS and AITI** – ***Carat Group*** (m.o.) • TV channel "**Novyi Kanal**" and radio "**NasheVremya**" – ***Alfa Group***	1. Russian publishing companies and periodicals (mainly, journals and magazines) are actively entering Ukrainian market 2. Mergers of large Ukrainian advertising agencies by Russian companies	High political risks entering mass media market due to approaching elections (president elections in 2004 and parliament elections in 2006)
9. ENERGY SECTOR		
Companies with Russian participation control over 25 % of Ukrainian energy supplying companies "Oblenergo". Sevastopoloblenergo, Zhitomiroblenergo, Poltavaoblenergo, Khersonoblenergo, Lvovoblenergo, Sumyoblenergo, Kirovogradoblenergo – According to information of Ukrainian mass media, all these companies are owned by shareholders of Russian football club CSKA (so called "Luzhnikovskaya Group")	1. Privatization of other energy companies – Oblenergo, energy generating companies 2. Participation in nuclear fuel creation company in Ukraine 3. Purchasing energy companies on the secondary market. Possibly, RAO "EES Russia" will buy majority shares of Kievoblenergo and Rovnooblenergo from AES company (USA)	1. No political decision on the privatization in energy sector 2. Competition between Russian and Ukrainian FPG 3. Resistance from the USA and EU
10. GAS INDUSTRY		
Offshore companies have privatized about half of 50 regional Ukrainian gas distributing companies ("gorgaz" and "oblgaz"). It is possible, that among those offshore companies shareholders there are Russian companies.	Currently, Russian – Ukrainian consortium is negotiating about getting possibility to manage gas transportation system of Ukraine (including gas pipelines and gas storages)	Tough political resistance of USA towards the establishing of such a consortium
11. FINANCIAL MARKET		
Russians own about 1.4 % of Ukrainian banking system assets (by 01.01.2003) • **Alfa-bank Ukraine,** Investment company **"Alfa Capital", KievInvestbank –** ***Alfa-Group*** • **Petrokommerts Ukraine –** ***Petrokommerts Bank*** • **NRB-Ukraine** - ***NRB***	Russian investing companies are planning to expand into Ukrainian market, particularly, is it expected that subsidiary of NIKoil will enter Ukrainian stock exchange market.	Ukrainian financial market is underdeveloped
12. FERROUS METALLURGY		
Russian participation is not significant, excepting metal mining industry and iron-and-steel scrap processing (10 % of scrap market) and participation in iron ore GOKs privatization (Lukoil North-West). • **Inguletsky GOK and Yugny GOK–** ***Lukoil North-West*** (more than blocking package of shares) • **Zhitomirvtormet, Khersonvtormet, Nikolaevvtormet, Cherkassyvtormet, Vinnitzavtormet** – **MAIR Group**	Purchasing private metallurgy companies	1. High politic risks 2. Privatization of metallurgy usually is realized considering concrete Ukrainian FPGs 3. High prices for energy 4. Low capacity of internal metal market

Source: Adapted from Expert, Special Issue on Ukraine, 2003

7. EBRD Projects in Ukraine

The first decade of the transition has shown that there has not been any absolute shortage of capital in TEs. Capital formation (savings rates) has been reasonable and TEs have had access to international capital and money markets. Thus, real investment figures show strong growth rates in several successful TEs, especially in Poland *(Tiusanen, et. al., 2002).*

Very soon after the systemic change in Eastern Europe a proposal came from the former French president Mitterrand to establish a development bank to mitigate capital shortage in TEs. Already in May 1990, an agreement establishing the bank was signed. The European Bank of Reconstruction and Development (EBRD) had its inauguration in London in April 1991. It is noteworthy that EBRD was established before the collapse of the Soviet Union and before the break-up of the Socialist Federal Republic of Yugoslavia. It means that in the 1990s the number of TEs (potential recipients) has exploded *(Tiusanen, et. al., 2002).*

In the turn of the century, EBRD had some 60 shareholder states (donors and recipients) including some non-European emerging markets, such as Mexico, Morocco, Egypt, Korea and Israel. The EU is represented by the European and the European Investment Bank (EIB) *(Tiusanen, et. al., 2002).*

According to the bank's own documents, EBRD was established to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the countries of central and Eastern Europe and the Commonwealth of Independent States (CIS) committed to and applying the principles of multiparty democracy, pluralism and market economies. The EBRD seeks to help its 27 countries of operations to implement structural and sectoral economic reforms, promoting competition, privatization and entrepreneurship, taking into account the particular needs of countries at different stages of transition. Through its investments it promotes private sector activity, the strengthening of financial institutions and legal systems, development of the infrastructure needed to support the private sector. The Bank encourages co-financing and foreign direct investments from the private and public sectors, helps to mobilize domestic capital and provides technical co-operation in relevant areas. It works in close co-operation with financial institutions and other international and national organizations. The Bank also promotes environmentally sound and sustainable development in all of its activities. [34]

[34] The official homepage of EBRD, About the EBRD, http://www.ebrd.com/english/index.htm [referred 5.11.2001]

It is important to notice that EBRD is not only a bank (allocating credits), but also a venture capital outlet. According to the founding documents of the Bank, 30% of its capital can be invested in equities. Thus, EBRD can provide risk capital for TE-companies. Obviously, in equity investments, the Bank provides seed money with minority stakes and always creates an exit strategy. This means that long-term shareholdings in TE-firms is not aimed at. Naturally, in every exit, the Bank hopes to make a profit (expects the value of shares to increase, while possessing the shares) *(Tiusanen, et. al., 2002).*

In the "Ukraine Strategy", approved by EBRD in 2002, the Bank states, that even if Ukraine's economy has achieved lately some high growth rates, it still requires major restructuring, including privatisation. The Bank promises to remain strongly engaged, promoting private sector involvement and supporting public sector projects. The need to improve the investment climate is recognised by the Bank[35].

The level of the Bank's future investments will depend on the extent to which Ukraine can improve its investment environment by making progress towards a consistently implemented tax regime, properly managed regulations and a truly independent judiciary. This includes the implementation of concrete steps to combat corruption, a major deterrent to investment. The size of the Bank's existing portfolio mirrors the slow transition process and does not reflect the size or potential of the country. The Bank's local presence will give it the ability to identify business opportunities in the private sector, while improving the performance of the portfolio, which has suffered from uneven project implementation, a slow pace of disbursements and some cancellations *(EBRD, 2002).*

Financing will be offered for large-scale privatisation-related investments as well as smaller private sector investments in power generation and distribution. Regular policy dialog on energy sector reform and privatisation with the authorities, coordinated with donor agencies and other stakeholders, has proved successful, resulting in milestone privatisation of electricity distribution companies. The Bank also plans to be active in rail and air transportation, areas where both the public and private sectors are involved, and where the Bank can have an impact on tariffs, procurement practises, sectoral consolidation, as well as further privatisation. In telecommunications, the Bank urges the government to take a consistent approach to sectoral reform *(EBRD, 2002).*

The Bank will continue to invest in projects in the municipal service sector with the goal of improving efficiency and changing the state's role from an operator to regulator. Based on

[35] Ukraine Strategy Overview. www.ebrd.com

recent experience, the Bank will work with those regions/municipalities able to demonstrate a strong and lasting commitment to administrative and tariff reforms, improved fiscal discipline and transparency, as well as the provision of better services to the local population. It will seek in the future to build a stronger local/national level of consensus on individual projects and to ensure successful implementation of all schemes agreed upon *(EBRD, 2002).*

As at the end of 2002, the EBRD had signed 74 projects in Ukraine for a total of 1.3 billion EUR of loan and equity financing (Table 69). Out of 74 projects, 64 were private companies and only 10 state enterprises. More than 50 % of projects were signed in Ukraine between 1998 and 2001.

Table 69. EBRD Signed Projects in Ukraine in the end of 2002

Sector	Number of Projects	EBRD debt (€'000)	EBRD equity (€'000)	EBRD total (€'000)
DIRECT INVESTMENTS	63	1 166 800	66 937	1 251 781
General Industry	8	74 581	20 654	95 234
Agribusiness	14	305 678	7 050	312 727
SME finance	1	3 816	2 000	5 816
Bank Equity	5	9 068	8 469	17 537
Bank Lending	14	236 567	0	254 612
Equity Funds	3	0	20 474	20 474
Natural Resources	3	94 456	0	94 456
Property and tourism	3	22 982	8 289	31 271
Transport	5	159 491	0	159 491
Infrastructure	1	26 715	0	26 715
Power and Energy	3	175 170	0	175 170
Telecommunications	3	58 280	0	58 280
REGIONAL INVESTMENTS	11	1 552	39 171	41 276
Equity Funds	6	0	26 124	26 124
Bank Lending	2	0	0	553
Power and Energy	1	1 000	0	1 000
Agribusiness	1	552	0	552
Telecommunications	1	0	13 046	13 046
Signed projects total	**74**	1 169 356	106 106	1 294 611

Source: EBRD, authors' calculations

Recent good harvests have shown the potential of Ukraine as a major grain producer and exporter, but farmers are hampered by inefficient practices in the chain that takes the grain from farmers to storage in warehouses and on to export. The EBRD is now assisting Toepfer, a worldclass international trading company, to streamline this chain and to provide fair prices to farmers for their produce *(EBRD, 2002).*

The EBRD's 76.3 million EURO credit will allow Toepfer to expand its grain operations in Ukraine and increase grain exports. Toepfer will buy the grain from farmers, store and transport it and control the chain from harvest to the export terminal. By cutting out inefficient operators and middlemen, Toepfer can pay consistent and fair prices to farmers.

Toepfer is committed to introducing best practices to the market and to building a longterm relationship with farmers. Its size and experience in running modern grain storage and transport operations sets new standards in Ukraine and acts as an example of best practice for local operators *(EBRD, 2002).*

German Bosch GmbH received a 14 million Euro EBRD loan, to improve car servicing maintenance networks.

EBRD provided a 18.4 million Euro loan to the Ukrainian brewery Slavutich. The EBRD financing helped to strengthen Slavutich's market position, improve strong brand and foster competition within the Ukrainian brewing sector.

EBRD sighed several projects in Ukraine in 2003 (Table 70).

Table 70. EBRD Signed Projects in Ukraine in 2003

Project name	Sector	Date
Ukrrichflot III	Shipping	31 Jan 03
Second Ukraine Railways Development Project	Transport	4 Feb 03
Consumers Sklo Zorya	General industry	12 Feb 03
Rubizhansky Cardboard and Packaging Mill	General industry	11 Jun 03
Gostomel glass factory - Phase II	Agribusiness	20 Aug 03
UkrEsco II	Energy Efficiency	10 Oct 03
WNISEF ESCO Project - 'Energy Alliance'	Energy Efficiency	10 Oct 03
Framework for Mortgage Financing	Financial institutions	11 Dec 03

Source: EBRD, authors' calculations

Ukrrichflot III project with total cost of 39.3 million USD, is a dry cargo vessel renewal program. Ukrrichflot Joint Stock Shipping Company is the largest ship operator in Ukraine. Its principal business is domestic and international transportation of small to medium sized dry bulk cargoes on river, river-sea and short sea routes. In addition, the company operates its own passenger fleet and owns its own river port facilities in Ukraine. EBRD provides loan of 31.26 million USD and issues a guarantee of 8 million USD in favour of the shipyard producing the vessels.

Energy Alliance project with total cost of 13.34 million USD, aims to establish a new private sector energy service company (ESCO) in Ukraine, known as Energy Alliance. Energy alliance will be majority owned by the Western NIS Enterprise Fund, along with the Gostomel Glass group and Turbo-Spektr, a local engineering consultancy. Energy Alliance will finance and develop co-generation projects for industrial clients in Ukraine. The Bank's loan will be used by Energy Alliance to finance the purchase of the co-generation equipment. EBRD gives 10 million USD loan for this project.

Rubizhansky Cardboard and Packaging Mill (RCPM) project with total project cost of 44 million USD, includes modernisation and expansion of RCPM's paper and corrugated packaging operations in Rubizhne, Eastern Ukraine and near Kiev. EBRD will finance part of RCPM's capital expenditure and working capital increase with a 14 million USD loan.

Rubizhansky Cardboard and Packaging Mill is a joint stock company with participation of a strategic partner, DS Smith from UK, and a leading producer of paper and corrugated packaging in Ukraine with a domestic market share of 25%.

Gostomel Glass Factory is continuing its major phased development project to enhance profitability by increasing production capacity, improving product quality and operation standards. The proposed project consists of the implementation of the second phase of the company's long term strategic business plan. The objective of the Project is a 30 % increase in production capacities via erection of the fourth furnace equipped with highly productive top-notch equipment and know-how. The total value is 20 million USD.

Gostomel Glass Factory is the largest producer of glass packaging for the food and beverage sector in Ukraine and one of the largest in the CIS. GGF is the only glass container manufacturer in Ukraine to have ISO 9001 certification for the quality assurance system of its products.

EBRD plans to finance this glass factory's modernization project with a 17 million USD long-term loan facility out of which up to 12 million USD may be syndicated on a best-efforts basis.

Consumers Sklo Zorya (CSZ) project, which aims to increase CSZ glass production, costs 20 million USD. The project would put into operation a new (2nd) furnace, an additional set of forming lines and upgrade the existing equipment.

Consumers Sklo Zorya is a closed joint stock company incorporated in Ukraine. CSZ is Ukraine's leading manufacturer of premium-quality glass containers with a domestic market share of 19% in 2001 and in 2002. EBRD provides a 13 million USD loan to finance part of the company's capital expenditures for new glass making equipment.

<u>*Microfinance Bank*</u>

The European Bank for Reconstruction and Development (EBRD), International Financial Corporation (IFC), Investment Fund "Western NIS Enterprises", German - Ukrainian fund, German Investing company IMI, and Holland Investment Fund DOEN in 2000 have established “Microfinance bank” in Kiev with a capital stock of 10 million EUR (approximately 48 million UAH).

EBRD, IFC, Investment Fund “Western NIS Enterprises” and German - Ukrainian fund have 20 % of shares each; IMI and DOEN 10 % each. The Bank is focusing on the small and medium size business crediting in Ukraine. Micro loan is defined in the law “About Special Organisations in Microcrediting” as a sum not exceeding 15 000 EUR provided for the period no longer than 1 year and does not require collateral. Microfinance bank has affiliates in Slavutich, Donetsk, Kharkov and Lvov.

CONCLUSIONS

Ukrainian transitional process has in the 1990s been an extremely difficult one. Economic activity and living standard declined rapidly. Price stability was not taken very seriously in the economic policy-making during the early period of transition.

Thus, Ukraine was a stagnant, inflation-prone economy in the previous decade, when her western neighbours (Poland, Slovakia and Hungary, as well as some other TEs), started to grow strongly. Living standard gaps between TEs widened.

In the turn of the century, Ukrainian economy started to grow. At the same time, relative price stability was achieved. Economic prospects have improved essentially.

Ukraine is relatively resource-rich country with various minerals and extremely fertile soil, and thus, with excellent preconditions for agro-business. However, her oil and natural gas reserves are very limited.

Potentially, Ukraine is an interesting market for international companies. The country has a population of almost 50 million. Nominal wages and also unit labour costs are extremely low even in TE-comparison. Thus, there are certain incentives for western companies active in labour intensive branches.

However, FDI (foreign direct investment) figures are very modest in absolute and in per capita terms.

Many Russian companies are active investors in certain basic industries (metallurgy, oil refining, etc). Western investors are mainly active in spheres which can be called "income inelastic products". Food, tobacco and beverage industry belongs to this category: everybody must drink and eat (probably smoke) independently of income level. Agro-business has plenty of potential in Ukraine. Low overall purchasing-power sets limits to FDIs in retail trade.

In the early years of the new century, Ukrainian economy has improved considerably. This fact is an important component of the "investment-climate". Thus, it can be realistically assumed that FDI-inflow to Ukraine will increase in the near future. The most important precondition for that is that Ukrainian economy will show signs of sustainable economic growth combined with relative stability in the economy, as well as in political sphere.

FDI stock per capita is presently very modest in comparison to those TEs with EU-accession. Everywhere in post-communist economies FDI development shows so called cumulative effect. When a “core investment” takes place (for example, acquisition of Skoda car factory by Volkswagen in the Czech Republic), there will so called “coat-tale” operations: core industry attracts suppliers who serve the core investor (car part manufacturers in the Skoda-case).

In sum, in the first decade of the 21st century Ukraine is likely to be a country with increasing activities by foreign investors. Ukraine is now a direct neighbour of the enlarged European Union.

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EU's New Neighbours: The Case of Ukraine

This book tells about Ukraine - one of the largest European countries, but surprisingly unknown for many Europeans. Authors aim to provide readers with overview of Ukrainian economy and politics and discuss investment climate in Ukraine, Ukrainian regions and investment in the different Ukrainian industries.

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The Northern Dimension Research Centre (NORDI) is a research institute run by LUT. NORDI was established in the spring of 2003 in order to co-ordinate research into Russia. The most outstanding characteristic of NORDI's research activities is the way in which it integrates technology and economics. NORDI's core research areas are:

- Russian business and economy
- Energy and environment
- The forest cluster
- The ICT sector
- Logistics and transport infrastructure.

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