Ukraine tempts pioneer spirits

UKRAINE

UKRAINE HAS RECENTLY UNDERPERFORMED COMPARED WITH ITS NEIGHBOURS IN TERMS OF FDI INFLOWS, BUT FOR BOLD INVESTORS, THE POTENTIAL IS THERE FOR RICH RETURNS, SAYS **NATALIYA KOZACHENKO**

Illustration by John Holcroft

Ukraine, as an investment destination, remains poorly explored in the international community. Many investors do not know much about the value creation potential of this country or what it has to offer the rest of the world. Once they do, many are unsure how to get started, and how safe and wise it is to commit their funds into this territory.

Surprisingly, Ukraine still does not have national, regional or district investment agencies – one-stop data centres – where investors from around the globe could get timely access to verified information about investment opportunities in the country. The closest the Ukraine comes to this is the state's investment agency, which is responsible for raising the capital for 11 national projects of strategic importance.

But in terms of meeting demand, the state agency is a drop in the ocean. In the past 10 years, there have been nearly 900 projects in Ukraine, not only in Kyiv and other major cities, but also in smaller towns and rural areas.

Also, the state agency usually has no value for international private equity and debt investors, who have different investment criteria.

Overlooked by investors

It is not surprising investors often bypass Ukraine. Similar to other countries in the Commonwealth of Independent States, Ukraine was economically isolated from the rest of the world for about 70 years until the early 1990s and its neighbours have well established investment agencies. Investors like predictability, and to predict, they need to know the market and have clear rules.

Despite these challenges, many investors from western Europe and North America have successfully invested in Ukraine over the past 20 years. If they were given a second chance to commit their funds and efforts to this country – knowing then what they do now – those investors have signalled they would make the same step again. To illustrate the point, look at the numerous initial public offerings of Ukrainian companies on the London and Warsaw stock exchanges, which are frequently many times oversubscribed.

Shaping up

Today, Ukraine is well positioned to compete with other developing economies for FDI. The country is in great shape and has a lot going for it. With the biggest area and the fifth biggest population in Europe excluding Russia, it also has a potentially big market for goods and services. It has a favourable geopolitical and economic location next to the EU, Russia, and it is in relative proximity to India, China and Turkey. It has one-third of the most fertile land in the world, as well as one of the biggest global reserves of iron, uranium, manganese and coal. And it has a highly skilled and relatively cheap labour force.

But Ukraine's FDI-per-capita and GDP-per-capita figures remain considerably smaller than other developing and advanced economies, including those that emerged from the same economic and political system more than 20 years ago. With all its riches, there must another reason why Ukraine is punching below its weight.

Many have blamed the legacy of the Soviet system. That may have been the case in the 10 years after the collapse of the Soviet Union, but not any longer. After all, Russia, Kazakhstan and the Baltic states share the same Soviet background, but their FDI-per-capita and GDP-per-capita figures are more promising.

Number crunching

To illustrate, GDP per capita in Ukraine is 2.7 times less than in Kazakhstan, 3.5 times less than in Russia and Latvia, 3.6 times less than in Lithuania and 4.6 times less than in Estonia. It is also 4.0 times less than in neighbouring Poland, 12.7 times less than in Germany and 11.8 times less than in the eurozone.

In the countries mentioned, there are strong associations between GDP per capita and FDI per capita; healthy GDP per capita is accompanied by healthy FDI per capita.

But FDI-per-capita figures in Ukraine leave much to be desired. It is 2.2 times less than in neighbouring Russia, 3.5 times less than in Poland and 8.4 times less than in Germany.

To date, Ukraine has attracted about $40bn of FDI into its economy, with the biggest instalments coming in 2005 and 2007 ($7.8bn and $7.9bn, respectively), and $4.7bn in both 2006 and 2010.

In the 2005-2010 period, the smallest amount of FDI was attracted in 2009 – this was a 'black' year for Ukraine, when its GDP and industrial output contracted 15.1% and 20.5%, respectively. The amount of FDI attracted in 2010 was about 60% of that attracted in 2007.

Comparing the FDI inflows in 2009 and 2010, the growth trend seems to be back, up 9.3% in 2010 compared with 2009. The question is, for how long?

Volatile economy

Ukraine's economy is quite volatile – when times are bad, it has been the worst performer, but in good times, it is one of the best. The upward trend in FDI inflows looks set to be repeated in GDP and industrial output figures. In 2011, Ukraine (and Russia) will enjoy the strongest GDP growth in the CEE region (5%), according to Raiffeisen International Bank.

To enjoy more consistent growth in the coming years, Ukraine needs to develop a fully functional domestic economy so it can take advantage of the opportunities in the global economy. To achieve that goal, Ukraine needs to secure many times more FDI inflows, especially when the loans from domestic banks are just not there for many big companies.

Ukrainian banks are still recovering from the recession, when the average non-performing loans rate in the country was 30% (one of the highest in the region). Although the International Finance Corporation, the International Monetary Fund and the European Bank for Reconstruction and Development intensified their co-operation in Ukraine in the past few years, they cannot meet the demand for funding. To meet that demand, Ukraine must become an attractive destination for major players in global capital markets.

Action plan

To achieve its aims, Ukraine needs to do two things. First, it needs to become more proficient with regards to economic freedom, ease of doing business, global competitiveness and corruption (in 2010, Ukraine was ranked 162nd, 145th, 89th and 134th in the world, respectively). Second, it should develop an action plan to improve the world investor community's perception of the country.

The ratings are not necessarily deal-breakers when it comes to making a decision about investing in the country. Many investors are more interested to see the results of due diligence done on a specific company or an individual seeking funding. That is, whether the idea/project is economically vital; how trustworthy and knowledgeable the people behind it are; their track record and so on. Investors commit funds to a specific project with real people behind it, and not just a country.

Still, it helps to operate in a favourable business environment with sound legal and court systems, which is not the case in Ukraine. As the recession years of 2008-2009 proved, many investors, especially those who are new to the territory, withdrew their money from the country at the first possibility.

Promoting stability

Obviously, Ukraine cannot do much about global recessions. What it can and should do is create a level playing field for international investors that would make them want to stay in the country in good and bad times.

President Viktor Yanukovych recently announced a programme that aims to see Ukraine enter 20 of the most developed economies in the world by 2020. It's an ambitious goal that will require not only sufficient funding, but also a lot of commitment, hard work and consistency.

UKRAINE HAS MUCH TO OFFER THE WORLD AND INVESTORS SHOULD NOT RULE IT OUT

To start with, the country needs to make its economy more energy-efficient, modernise its infrastructure, improve operational efficiency and operational standards in coking coal mining, enhance logistics and develop the Ukrainian stock exchange in line with the established European bourses.

Promising sectors

Ukraine has huge value creation potential in agriculture that could become a backbone for the economy in the mid to long term. The forthcoming 2012 UEFA European Football Championship, which will be hosted by Poland and Ukraine, will help to promote a positive image of Ukraine, and stimulate sectors including food and beverages, and commercial real estate (especially, office, retail and the development of budget hotels).

Ukraine has much to offer the world and investors should not rule it out automatically just because it has unfavourable international ratings. Anyone interested in Ukraine is advised to start with visiting the country and checking out the project and people involved, talking to peers who already invest there, and, most importantly, finding the right local partner who will make all the difference to the success of the venture.

Opportunistic investors are encouraged to commit sooner rather than later as by the time the situation and business climate in Ukraine changes for the better, many unique opportunities will be gone, along with the chance to generate super returns. ■

Nataliya Kozachenko is managing director of Vasant Connect, a London-based finance brokerage and advisory company focused on the CIS and Baltics region