



TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Historical Overview of Ukrainian Business Environment

On July 16, 1990, the Ukrainian Parliament passed the Declaration of State Sovereignty, formally announcing the country's intention to control its own destiny. Adopted in the Soviet climate with President Gorbachev's blessing, however, this declaration was largely a theoretical step towards Ukraine's upcoming political and economic independence. The real break with Moscow came rather unexpectedly more than a year later, on August 24, 1991, and was primarily due to failure of the hard-liners' coup in Moscow in the immediately preceding days. Thereafter, in December of 1991, Ukraine's independence was confirmed by a nationwide referendum.

The first wave of foreign investors started to arrive to Ukraine, a country the size of France with more than 48 million people, in early 1992. At that time, the Western business world viewed Ukraine as an enormous, yet "open" territory, full of business opportunities. Fueled by optimism, numerous foreign companies, large and small, rushed into what they perceived as the opening of a uniquely large market, void of competition. The abnormally high attrition rate in the foreign business community during the following decade sadly confirmed that comparatively few of those brave, pioneer souls have survived.

Until fairly recently, foreign entities still doing business in Ukraine could be categorized as either (a) large multi-national corporations with substantial capital and a long-term strategy for market penetration, or (b) a one-man shows with a few thousand dollars in their pockets, who came to Ukraine hoping to strike a gold mine. Notably absent were the mid-sized companies, and for a good reason. Large investors in category (a) have never relied upon (and did not require) profits from their Ukrainian investment for at least the first several years. Members in category (b) have enjoyed a surprising degree of resiliency and success in the often difficult, turbulent and unpredictable business climate.

In sharp contrast to these two groups, mid-size companies required predictability, regular turnover and profit for their day-to-day operations. And no harassment from the local authorities. As a result, this category of investors found it especially difficult to survive the notoriously harsh early Ukrainian business days. In the dark ages (1992-1994), mid-size foreign investors' repulsion at undertaking projects in Ukraine was understandable: in most cases, strict compliance with Ukrainian legislation, known for such unpleasant economic mechanisms as dual exchange rates, limitations on profit mark-ups and punitive taxation, rendered otherwise viable transactions

unprofitable. The lack of real property for industrial (production) purposes killed many large investment deals at the inception. Sudden, and often retroactive, changes in foreign investment legislation did not help the country's sinking reputation.

Fortunately, most of these drawbacks became history after the arrival of the Kuchma government, which reversed many of the previous government's near-idiotic legislation. As a historical curiosity, few people in Ukraine expected Leonid Kuchma to win the 1994 Presidential election against then President Kravchuk. Nevertheless, during the first year following his accidental emergence onto the world stage, President Kuchma brought economic and political stability to a large yet under-developed nation in the middle of economic revolution.

After coming to power in the summer of 1994, President Kuchma's team correctly assessed the root of the problem and immediately began to "clean the Kravchuk house" in a remarkably well-coordinated fashion. By November, Kuchma succeeded in quietly removing most political opposition, with the exception of the Parliament, which he increasingly ignored. Much of the former legislation was revised and implemented (with varying degrees of success) in an effort to transform Ukraine into a market-driven economy.

President Kuchma's second, and failed, assault on the Ukrainian government establishment became known as "administrative reforms," beginning immediately after his re-election to a second, and final, term in November of 1999. Many ministries were ordered to cut their massive staff, and several were actually reorganized (e.g., Ministry of Foreign Economic Relations was dissolved and its functions were delegated to the Ministry of Economy and Issues of European Integration which is currently known as simply the Ministry of Economy). In the end, however, the grandiose plans for comprehensive administrative reforms folded, evidencing that with the best of intentions, even the President can do nothing with the cumbersome government apparatus.

Concurrently, the Cabinet of Minister's aggressive privatization campaign, aimed at selling off state-owned enterprises, kept up the reform momentum. With most small and mid-sized Ukrainian enterprises already in the private sector, the Cabinet of Ministers specifically slated for privatization large-scale enterprises in a variety of lucrative sectors, such as steel and energy. Other state-owned enterprises were sold with the assistance of foreign consultants.

The Great Economic Cataclysm of August 1998 brought about a near-collapse in Russia and, consequently, in Ukraine, underscoring Ukraine's dependence on its "Big Brother." For several months after the crisis, the already minimal in-flow of foreign investment into Ukraine stopped altogether. Less than a year later, however, Ukraine's economic situation stabilized. By 2001, foreign investment picked up significantly. This time, the foreign investors were Russian multinationals, not their West European or American competitors. Still weary of doing business

.....
: If you wish to receive the entire article, please
: contact us at: office@frishberg.com.ua.
:
: Thank you.
:.....