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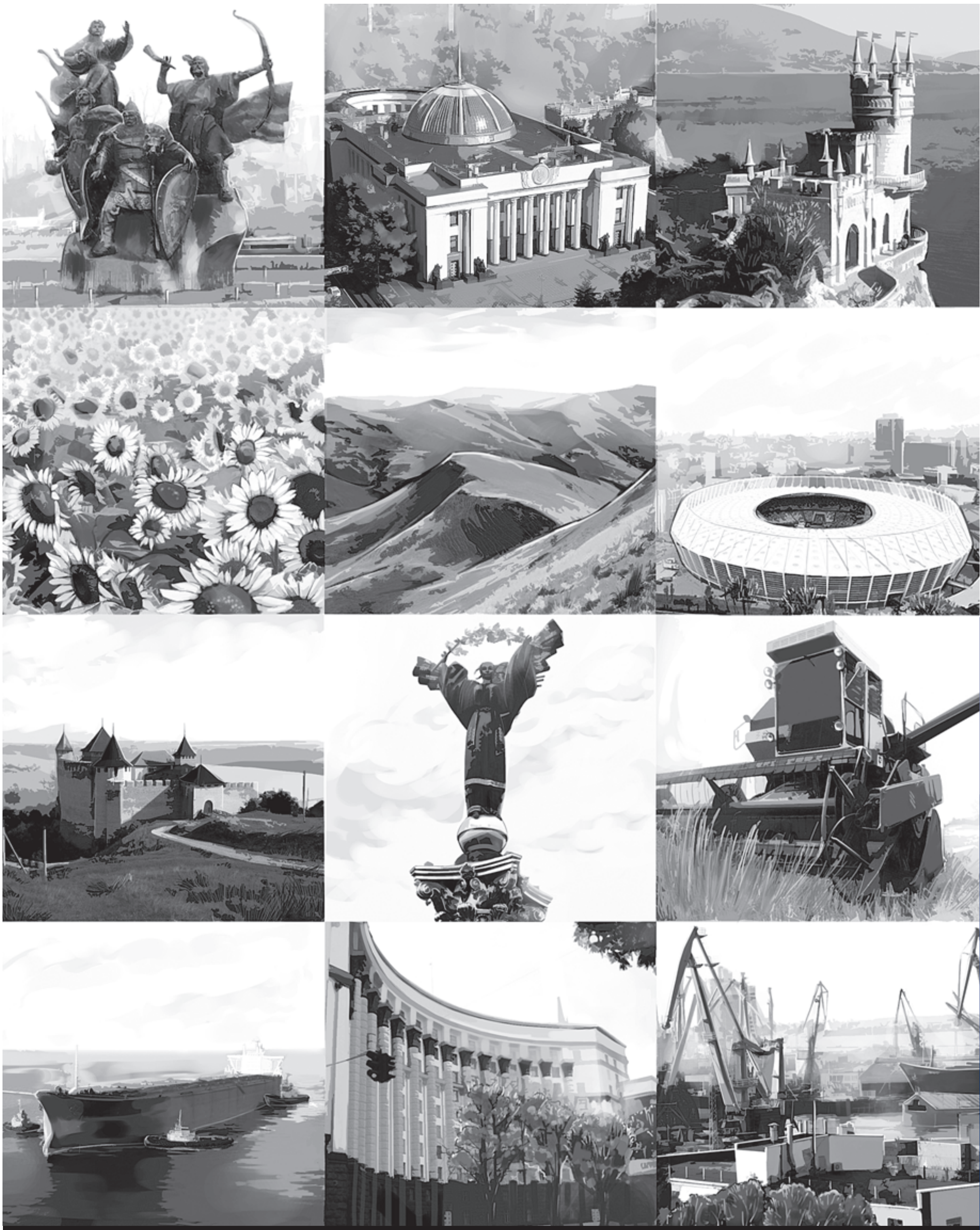
Uniting Leading Companies from over 50 Nations Across the Globe



COUNTRY PROFILE 2013

UKRAINE AT A GLANCE

The American Chamber of Commerce in Ukraine


My bank is
Crédit Agricole.
It makes sense

That calls for a Carlsberg™

Carlsberg — is a famous Danish beer whose history dates back to 1847 when J.C. Jacobsen established his own brewery in Copenhagen.

A regular in millions of bars across 140 countries world wide it is a truly international brand and a beer of exceptional taste and quality.

Carlsberg is brewed from pure water, selected barley and hops grown especially for Carlsberg. But without good yeast, you don't get great beer, and Carlsberg's is exceptional. In the late 1800's the Carlsberg Brewing laboratory pioneered a groundbreaking method for propagating pure yeast. Before that discovery, impurities in yeast meant that beer would often turn sour during production or transportation.

This discovery, and the resulting yeast, aptly named «Saccharomyces Carlsbergensis» would revolutionize the brewing industry. In fact, the yeast's effect on the beer was so extraordinary that Carlsberg chose to share the yeast with the world by giving it away to other brewers for free.

To this day, whenever and wherever you enjoy a lager, there's probably a little Carlsberg in it.

Step up and do the right thing, rewarding yourself with a Carlsberg for your efforts.

Dear Friends,

My sincere congratulations on the new issue of the Membership Directory and Country Profile 2013 published by the American Chamber of Commerce in Ukraine.

It has been an additional source of information about our country's economic and investment policy for several years in a row.

The Directory has become the voice of business, creating new jobs, implementing socially important investment projects, taking part in the development of territories, and contributing to the prosperity of Ukraine.

Today we are confidently going down the reform path in order to improve the functioning of business entities, make the investment climate better, and raise the competitiveness of the national economy.

In this process the state takes into account the opinions of international experts and studies the comments of domestic and foreign investors as regards doing business in the country. The consequence of this is the development of clear rules of the game.

I wish all of you the fulfilment of your plans and new victories and accomplishments.

December 1st, 2012

President of Ukraine,
Viktor Yanukovych

Dear readers,

Ukraine attaches great importance to the development of mutually beneficial cooperation with the United States, which we consider a strategic investment and trade partner.

It is no coincidence that the modernization of our economy is being carried out, inter alia, with the use of US technologies and equipment and investment and credit resources.

The American Chamber of Commerce in Ukraine plays a special role in establishing new business contacts, attracting investment, and enhancing mutually-beneficial cooperation between our countries. Through efficient management, hard work, and the active positions of its members, the American Chamber of Commerce has gained a reputation as a reliable partner for the Ukrainian authorities in the area of economics, business, and investment.

We regard your activity as an important and integral part in the development of mutually beneficial trade and investment relations between our friendly nations.

Over the 20 years of its activity the American Chamber of Commerce in Ukraine has become a powerful player in the domestic business environment, bringing together over 600 member companies from more than 50 countries.

I hope for further fruitful cooperation aimed at improving the investment climate in Ukraine and promoting vital economic reforms.

I am convinced that the inexhaustible energy of the management and the members of the American Chamber of Commerce, their high professional level, and

their active public stance, in combination with an effective dialogue between the authorities and business, will further the positive transformations in our country.

I would like to thank you for your contribution to the development of Ukrainian-American economic cooperation and for strengthening bilateral relations between the governments and business communities of our countries.

I wish you the successful realization of your new projects and initiatives in our country.

I am confident that the American Chamber of Commerce in Ukraine's regular annual publications, "Membership Directory" and "Country Profile," will prove useful for the Ukrainian and international business communities.

December 1st, 2012

Sincerely,
Prime Minister of Ukraine
Mykola Azarov

Dear readers,

I would like to extend my sincere congratulations on the occasion of the release of the 2013 Chamber Membership Directory and Country Profile publications.

I am sure that profound and professional analysis of the Ukrainian economy will help readers to make the optimal business decisions.

The Ukrainian Government has recently taken a number of steps to improve the investment climate in the country. The conditions for doing business are being simplified and administrative pressure on enterprises is being reduced. A range of important measures to stimulate investments and reform the tax legislation have also been taken.

American Chamber of Commerce member-companies are making a significant contribution to the development of the Ukrainian economy, introducing modern standards for doing business and strengthening the country's competitiveness.

Today one of the Government's key tasks is creating new jobs. That is why our further actions will be aimed at stimulating the development of business, attracting investments, and improving the conditions for entrepreneurship.

I believe that cooperation between the Government and the American Chamber of Commerce in Ukraine is effective and extremely useful for the development of the Ukrainian economy. On my side, I always try to consider the suggestions and remarks that Chamber members make when I prepare draft laws and bylaws on entrepreneurship.

I am sure that our cooperation has great potential for growth, since the implementation of leading global experience is an important factor for moving the country forward and for increasing social standards for our citizens.

I wish all Chamber members new achievements and interesting investment projects in Ukraine!

December 1st, 2012

Sincerely,
Vice Prime Minister of Ukraine/
Minister for Social Policy
Sergiy Tigipko

Dear Ladies and Gentlemen, Dear Readers,

My cordial congratulations to all readers of the 2013 Chamber Membership Directory and Country Profile publications. I wish you inspiration and optimism on the way to accomplishing your goals. On behalf of the whole business community I want to express my sincere gratitude to the American Chamber of Commerce in Ukraine for its active involvement in the development of the business environment and in shaping the business image of Ukraine.

I am sure that the publication of these special editions by the American Chamber of Commerce in Ukraine will contribute to further informing the business and diplomatic communities on key economic development trends and achievements in our country's investment policy. This, in turn, will lay a solid foundation for bilateral cooperation, contributing to the strengthening of Ukraine's integration into the global community.

The United States are a strategic partner for Ukraine, especially in the economy and financial sectors. Our countries' bilateral relations are becoming closer in all areas of our cooperation. The USA is one of top ten investors in Ukraine's economy. Along with investment, Ukraine has acquired business know-how, new IT and manufacturing technologies, software and other intangible assets. Many well-known American companies are currently working successfully in Ukrainian market and consider it profitable and promising.

On our part, we are actively working towards creating an attractive investment climate that will enable Ukraine to compete effectively in the global capital markets. Ukraine has real economic potential to raise considerable foreign investment. Therefore, effective action to improve the investment environment is a top-priority objective of Ukraine's state agencies, including the National Bank of Ukraine.

It is also important for us to attract foreign investments to Ukraine's banking sector. The National Bank of Ukraine is making active and diligent efforts to improve the banking legislation, in particular as regards strengthening investor and creditor rights, improving corporate governance, regulating issues in cash flow organization, etc. The stable functioning of the banking system is a key prerequisite for Ukraine's economic and social development.

We are looking at the prospects for cooperation between the National Bank and the American Chamber of Commerce in Ukraine with optimism.

I believe that given joint efforts and well-coordinated action we shall be able to meet both internal and external challenges with dignity and effectively perform our functions and reach our goals.

December 1st, 2012

With best regards and sincere wishes,
Governor of the National Bank of Ukraine
Sergiy Arbuzov

Dear readers,

Allow me to congratulate you sincerely on the occasion of the release of the 2013 Chamber Membership Directory and Country Profile publications.

I would like to thank the American Chamber of Commerce in Ukraine for its contribution to informing the global community of the main activities and accomplishments in the country's economic and investment policy.

Among the numerous problems with which modern society is concerned is the environmental problem, which is drawing more and more attention. That's why the state's environmental policy is of special importance and its development is an important task for the Ministry of Ecology and Natural Resources of Ukraine. It is the most important mechanism for balancing the economic interests of society and the reproductive capacity of the biosphere.

Today Ukraine is actively developing its international environmental cooperation. Integrating the environmental element into the leading national programs, the Ministry is always open for cooperation with international companies, as only the joint efforts of the authorities, the business world, and international organizations will enable us to react effectively and in a timely manner to global challenges.

I am hopeful that the analysis of the economic situation in Ukraine that these publications present will open up new opportunities to roll out investment projects and serve as an important step towards international cooperation.

I wish you all prosperity and stability, fruitful ideas and their successful implementation, and peace, goodness, and reliable partners in business!

December 1st, 2012

Minister of Ecology and Natural Resources
Eduard Stavytskyi

Dear readers,

My congratulations to you on the release of the 2013 Chamber Membership Directory and Country Profile business edition!

It would not be an exaggeration to say that each new issue of these editions is a remarkable event.

Up-to-date and complete information and objective and unbiased opinions are of the essence in the contemporary business world – for companies, for government agencies, and for society as a whole. Fifteen years ago the first issues of the Membership Directory and Country Profile reached their professional audiences, audiences that have remained committed to them ever since.

Being a professional user of the American Chamber of Commerce in Ukraine's publications, I can say that their materials are special in terms of their depth of economic analysis, their competence, their expert evaluations, their scientific approach, their objectivity, and the high quality of their presentation. The publications present a large volume of data on the development of the Ukrainian economy's branches; analysis of government bodies' activities in the key areas of state policy; and information on the most important economic trends and processes. For many Ukrainians – businessmen, politicians, officers, and scientists – the editions have long been invaluable guidebooks the importance of which can hardly be overestimated.

I wish for the American Chamber of Commerce in Ukraine to continue to enhance its potential, and I wish inspiration, creative achievement, and further success to the editorial team.

December 1st, 2012

Minister of Trade and Economic Development of Ukraine
Petro Poroshenko

Dear Friends,

First of all, I would like to express my deep gratitude to the American Chamber of Commerce for this opportunity to address the readers of the 2013 Chamber Membership Directory and Country Profile.

Life has convincingly proven that these are not just corporate media products geared only to the business community. They are also extremely important and effective components of communication for broad audiences in the public, private, and business segments of Ukrainian society. I am sincerely grateful to everyone involved in publishing these yearbooks, which provide up-to-date and interesting information on key trends in the development of the Ukrainian economy and make them clear and accessible for the international community.

Investments are badly needed to support deep systemic reforms in construction, infrastructure, and regional development. Thanks to publications like those of the American Chamber of Commerce, investments can be raised more easily and quickly. Ukraine has set extremely ambitious goals for itself. I can assure the readers of the publications that the investment climate in the above-mentioned industries will be getting better. This is also evidenced by the fact that the world's leading experts are involved in improving industry-specific law. Deregulation and implementation of best world business standards will continue in construction, housing, and the utilities sector. The country is becoming more open to the world and to investments. I am sure that this will bring us success and benefit all of us.

I wish you success and never-ending optimism with all my heart! Good health and prosperity to you and your families!

December 1st, 2012

With best regards and sincere wishes,
Minister for Regional Development,
Construction and Utilities of Ukraine
Anatoliy Blyzniuk

Dear members of the American Chamber of Commerce in Ukraine,

On behalf of the Ministry of Finance of Ukraine and from me personally, please accept our congratulations on the occasion of the release of the consecutive issue of the 2013 Chamber Membership Directory and Country Profile.

First of all, I would like to note that for Ukraine the year 2012 has been a year of continuous implementation of structural reforms. Due to positive economic growth dynamics, we managed to amend the state budget and to ensure that the social initiatives of the Ukrainian President have been implemented this year. We also increased expenditures for social programs in 2013.

The 2013 Budget continues support for the steady growth of the priority sections of the economy. It supports the fuel and energy complex, the agriculture complex, aircraft construction, construction of infrastructure facilities, and more. I am sure that next year's budget will ensure the implementation of the strategic, social, and economic tasks necessary to developing the state as well as to improving the welfare of its citizens.

In addition, while a lot has been done on the reform path this year, there is still a lot to be done. I would like to assure you that the Ukrainian government's budget policy will always be based on the principles of rationality, priority, and effectiveness. The social and economic parameters of the state, Ukraine's international image, and Ukraine's investment attractiveness depend on that.

The year 2012 was a significant one for Ukraine, as the country hosted the European football championship. I am convinced that this event had a positive impact on Ukraine's international image, as the quality of the championship's organization was evaluated highly by the global community.

In addition, this year the American Chamber of Commerce is celebrating its 20th anniversary. Twenty years is a long time for any organization. I can state with confidence that over this period you have earned your status as one of the most active and influential business associations in Ukraine.

I wish you new achievements in the interests of the prosperity of Ukraine!

December 1st, 2012

Best regards,
Minister of Finance of Ukraine
Yuriy Kolobov

Dear members of the American Chamber of Commerce in Ukraine,

Ukraine is systemically working to create a favorable investment climate and equal competitive conditions for both Ukrainian and foreign companies. State policy aims to make the “rules of the game” in the tax sphere understandable for business and easily predictable.

In 2010, Ukraine took a strategically important step by approving the Tax Code. This document was the outcome of the systematization of tax legislation. Taxes and duties decreased in number from 43 to 23 and tax rates also gradually went down, The profit tax rate was brought down to 16% and the VAT rate to 17%. By 2014 Ukraine will thus be able to offer investors one of the most liberal tax rates in Europe.

Along with the Code, the business community also obtained a number of advantages, such as an automated VAT refund system. More than half of VAT amounts are refunded automatically without unnecessary checks, following a simplified procedure.

At the moment, we continue to work on simplifying the tax administration procedure, reducing paperwork, and making communication between taxpayers and the tax service fully electronic.

For medium-sized and small business, we created in less than a year a wide network of 460 service centers with a long list of functions and state-of-art infrastructure. We have provided large companies with an individual approach in the Central Office for servicing large taxpayers.

All the innovations have been introduced in close dialogue with the business community. All the innovations are the results

of negotiations and consultations, and not purely of administration regulation. One example is the fruitful cooperation between the State Tax Service of Ukraine and the American Chamber of Commerce in Ukraine. Over the period from March to September of 2012 alone, eight joint meetings took place, including some involving the Head of the State Tax Service.

Work related to transfer pricing and agricultural issues is also underway in specially established working groups.

I would like to thank the American Chamber of Commerce for its fruitful cooperation, during which we obtained a lot of interesting ideas on how to improve the tax system in Ukraine. I hope that our relations will remain friendly and constructive in the future.

December 1st, 2012

Best regards,
Head of the State Tax Service of Ukraine
Oleksandr Klymenko

Dear readers,

I would like to congratulate you sincerely on the occasion of the release of the Chamber Membership Directory 2013!

A favorable investment policy is a prerequisite for the successful development of a country in the modern world. Our parliamentary committee is consistently working on legislative regulations to reform different sectors of the economy, such as the financial, banking, tax, and customs sectors. This is one of the key conditions of an effective investment policy, the first signs of which have recently became evident. The steady growth of investments into Ukraine's national economy in recent years is proof of this fact.

The Chamber Country Profile's release is always an important event, as the publication performs an important social mission, raising awareness among the international and local business communities and among a range of experts about the main trends and achievements in the Ukrainian economy. The Country Profile also demonstrates the country's potential to foreign partners. First of all, I would like to thank the team and all those contributors whose fruitful work aims to improve the investment and business climate in Ukraine. I wish all of you inspiration and continued success!

December 1st, 2012

Head of the Verkhovna Rada Committee for Finance, Banking, Tax, and Customs Policy
Vitaliy Khomutynnik

Dear ladies and gentlemen,
Dear members of the business community,

On behalf of the State Service of Ukraine for Regulatory Policy and Entrepreneurship Development I want to congratulate you on the new 2013 Chamber Membership Directory special edition.

Our key objective is to improve the business climate and create a favorable environment for investment. It is necessary to make the conditions for entrepreneurship development as favorable as possible, because over 40% of the country's working population is employed in the small and medium-sized business sectors.

Entrepreneurs advance innovative ideas and boldest concepts. Their work strengthens domestic commodity manufacturers, helps create a civilized competitive environment, develops private initiative, solves the employment problem, and improves the country's international image.

It is the task of the authorities to create an up-to-date and high-quality regulatory framework for the proper functioning of business. Deregulation is ongoing in Ukraine: the procedures for starting and winding up a business have been simplified; efforts to simplify the procedure for obtaining permits and licenses and reducing their number are in processes. State policy in the government supervision area has been changed for the benefit of business. The innovative law "On Development and State Support of Small and Medium Entrepreneurship in Ukraine" was adopted on the basis of the Small and Medium Business Act for Europe. We have defined new criteria for micro, small, and medium-size businesses that satisfy European standards, as well as new mechanisms for the state support of small and medium-sized business.

A lot has been done, but still more is ahead. We will always support and protect an honest businessman and hold an open dialogue while shaping and implementing state policy in the area of business development.

Everyone who is proactive and wants to make a difference is invited to cooperate.

December 1st, 2012

Head of the State Service of Ukraine for Regulatory Policy and Entrepreneurship Development
Mykhailo Brodskyi

With respect and best wishes, I welcome the organizer of this special information media project, the American Chamber of Commerce in Ukraine, as well as all of the project's readers – members of the Ukrainian and international business community and representatives of the diplomatic world!

I am pleased to note that Ukraine has become a country that is truly attractive in terms of investment – for both international and domestic companies. Such progress in promoting investment in Ukraine is possible in part as the result of the 20 years of solid work by the American Chamber of Commerce in Ukraine. Over this time period the Chamber became a powerful player in the domestic business environment, bringing together over 600 great companies.

Thanks to the effective, professional, and creative management and active stance of its members, the Chamber has gained a reputation as a reliable colleague for the State Service for Intellectual Property of Ukraine in questions related to the use of intellectual property objects in a broad spectrum of sectors. The Chamber also provides good suggestions on how to improve the legislative framework.

I am sure that by working in close cooperation we will achieve the best results: improve our country's law as regard intellectual property issues, and, in more global terms, improve the business environment in Ukraine and boost domestic and foreign investment into the domestic market.

So my congratulations to the American Chamber of Commerce in Ukraine on the release of these necessary publications: Chamber Membership Directory and Country Profile 2013.

I hope that the information these editions contain will serve as convincing evidence of the transparency, fairness, and stability of the rules for business in our country and support Ukraine's further integration into the global economy.

May the dream of a better future encourage every one of us to implement successful projects that are worthy of Ukraine!

I wish health, inspiration, and achievements to all of you.

December 1st, 2012

Deputy Head of the State Intellectual Property Service of Ukraine
Volodymyr Dmytryshyn

Dear Members of the American Chamber of Commerce in Ukraine,

The American Chamber of Commerce has long been a reliable partner of the Customs Service of Ukraine.

The new Customs Code took effect this year, and the international business community represented by the American Chamber of Commerce in Ukraine played an important part in its development. It was owing to the Chamber's attention that the Customs Service now has an up-to-date and advanced customs law.

Experts have noted the new Code's positive effect on the business environment, on commodity turnover, and on tax revenues to the budget.

We have managed to achieve these considerable successes in cooperation with the Chamber, thanks to the highly professional work of the Chamber team.

During our regular meetings with American Chamber of Commerce Members, every single issue is addressed and quickly responded to.

This approach allows us to solve issues with maximum competence and within the shortest period of time.

The Customs Service considers the American Chamber of Commerce to be an influential center for the international business community in Ukraine. It is a reputable partner that protects the interests of companies and is guided exclusively by the principles of honesty and transparency.

I wish the Chamber team further successful realization of its mission, as well as fulfilment of its tasks and well-being!

I wish new Member Companies of the American Chamber of Commerce in Ukraine new victories, stability, growth, and interesting projects with reliable partners!

December 1st, 2012

Head of the State Customs Service of Ukraine,
Ihor Kaletnik

Dear colleagues,

I am happy to congratulate you on the release of the Chamber Membership Directory and Country Profile 2013 publications.

Ukraine is currently making every effort to reform its drug quality control system, aiming to implement the European regulatory and legal framework in domestic legislation. As a result of its longstanding persistent efforts in this area, the State Administration of Ukraine for Medical Products has become part of the Pharmaceutical Inspection Convention and Pharmaceutical Inspection Co-operation Scheme (PIC/S). I am pleased to note that our regulatory body has become a member of this respected organization together with the US Food and Drug Administration (FDA).

The State Administration is always happy to conduct a constructive dialogue with pharmaceutical business representatives, including importers of medical products and devices from the United States, which are represented by the American Chamber of Commerce in Ukraine. This is evidenced not only by the involvement of Chamber representatives in the Public Council operating under the State Administration, but also by State Administration officials' regular meetings with members of the Chamber's Healthcare Committee.

I am hopeful that the information these publications contain will help American entrepreneurs understand the possibilities of doing business in Ukraine and make informed decisions about investing in the Ukrainian pharmaceutical branch in particular. I am convinced that due to the efforts of the State Administration, dedicated associations, and citizens associations, there is now a more transparent process for implementing state policy aimed at quality control of medical products and devices and their turnover in Ukraine.

December 1st, 2012

Head of the State Administration of Ukraine on medicinal products
Oleksiy Solovyov

Dear readers,

I would like to congratulate you on the release of the Chamber Membership Directory and Country Profile 2013. These authoritative publications are a perfect example of the setting of strategic goals and of effective cooperation with investors. The publications will no doubt help in rolling out investment projects and developing the domestic economy.

Due to the noticeable growth in its economic, financial, scientific, technical, and intellectual potential, Ukraine today is confidently moving forward on an international level and gaining equality in its relations with the leading countries in the world.

Protecting Ukrainian agricultural producers and advancing them on global markets is impossible without land reform. Land reform in Ukraine will allow for protecting landowner rights, create transparent turnover of agricultural lands, and attract investment to the domestic agricultural sector.

Our task is to create an adequate legal framework for building and maintaining the state land cadastre, to accelerate a land inventory, to improve the regulation of appraisal activity, to introduce personal certification of land planning agents, and to drastically simplify the procedure for separating state and municipal land.

The State Agency of Land Resources of Ukraine is currently improving the legal framework, implementing state decisions on the development of land relations, and preparing organizational, economic, environmental, and other measures to foster the rational use of land.

World history shows that attracting investment is an effective way to improve a national economy. Ukraine's continuous social and economic growth depends on a favorable business climate.

I hope the information the publications offer opens up new opportunities for business cooperation and is useful for investors seeking cooperation.

December 1st, 2012

Head of the State Agency of Land Resources of Ukraine
Sergiy Tymchenko

Dear friends,

On behalf of the National Committee for the State Regulation of Communications and Informatization and from me personally, I would like to congratulate you on the occasion of the publication of the Chamber's Membership Directory and Country Profile 2013

The National Committee, as well as Ukraine's communications and informatization associations, highly appreciate the efforts the American Chamber of Commerce in Ukraine has made to comprehensively inform the international community about Ukraine's investment climate and its conditions for doing business and about the opportunities the domestic economy provides for international investors.

The rapid development of the information society is a global phenomenon, and each country is seeking its place in the new post-industrial future, even while developing national strategies to facilitate entrance into the information world. Ukraine, like most countries, believes that further economic growth is impossible without effective state regulation of information and communication technologies in order to ensure sustainable and dynamic growth.

The present state of the world economy necessitates consolidated action between the public and private sectors, NGOs, experts, and investors. This is exactly what the American Chamber of Commerce is offering, simultaneously providing important information, supporting the reform processes in Ukraine, and providing qualified expert opinion on pressing issues.

Investments today are a resource that may help in speeding up the development of Ukraine's communication and informatization sector in the nearest future. That is why one of our most important tasks is to boost the investment attractiveness of our country and to increase investments into the domestic economy and high-tech development. The National Committee for the State Regulation of Communications and Informatization is doing its best to implement state policy and ensure fair and transparent rules of the game on the market, creating the conditions for investor trust.

We are eager to absorb international experience and understand the potential of electronic communications – the sector that, in the present conditions, must form the basis for the social and economic transformation of the country, creating an efficient economy, developing civil society, and integrating Ukraine into Europe.

The communications and informatization sector's compliance with the highest world standards will largely influence Ukraine's image in the international community.

December 1st, 2012

Head of the National Committee for the State Regulation of Communications and Informatization
Petro Yatsuk

Dear Members of the American Chamber of Commerce in Ukraine:

On behalf of the Verkhovna Rada Committee on Agrarian Policy and Land Relations, please accept my sincere greetings on the occasion of the release of the special electronic publication Directory 2013.

Ukraine's agricultural sector plays a leading role in the President of Ukraine's long-term strategy, the goal of which is to build up an efficient, competitive economic sector and guarantee the country's food security.

Land reform is one of the Verkhovna Rada's most important tasks. It will provide a significant impulse for the further development of the nation's agricultural sector by increasing investment.

Foreign investment is currently boosting the efficiency of Ukrainian enterprises. The proof of this is in the activity and prospects for development of Ukraine's numerous modern agro-industrial units with foreign investment. These enterprises create new jobs in Ukrainian agriculture, confidently offer their products on world markets, use the latest technologies, and conform to modern European and world standards.

Information about these groups and their leaders will help develop partnership opportunities and improve Ukraine's image in agriculture circles in Europe and beyond.

Our mission is to create a sophisticated investment policy in the agriculture sector, boost investment, and develop an insurance market to protect investor rights, all to make Ukraine as attractive as possible.

We sincerely invite domestic and foreign investors to cooperate with us in order to create mutually beneficial conditions for agriculture, trade, and production.

We wish you success and prosperity!

December 1st, 2012

Chairman of the Committee of the Verkhovna Rada of Ukraine on Agrarian Policy and Land Relations
Hryhoriy Kaletnik

Dear Readers,

I would like to congratulate you on the release of Chamber Membership Directory 2013 edition and to present my compliments to the organizers of this project.

Over the period of its work, the American Chamber of Commerce in Ukraine has launched a number of initiatives to improve the investment climate and strengthen the economy of our country. Special attention should go to the "Partnership for Ukraine to successfully compete in the Global Economy" project, which involves close cooperation between the authorities and business. I am convinced that the successful implementation of this project will not only improve the investment attractiveness of Ukrainian enterprises, but will also consolidate Ukraine's image as a sustainable independent country with a dynamic market economy.

Ukraine has a considerable workforce capacity and resource potential. Ukrainian energy, industry, agriculture, and banking are of great interest to foreign companies. We have a lot to be proud of and we should properly present our achievements. The American Chamber of Commerce in Ukraine has successful experience in conducting the "Insight into investing in the regions with the Chamber" seminars in Dnipropetrovsk, Sumy, Kharkiv, and other regions. I am confident that these initiatives will also be implemented in all regions of our country.

I wish you further fruitful work, reliable partnerships, and successful implementation of new projects. May all your plans and ideas be successful for the benefit of our country.

I wish you good luck and prosperity.

December 1st, 2012

Sincerely,
President of the State
Property Agency of Ukraine
Dmytro Kolesnikov

Dear readers of the 2013 Chamber Membership Directory and Country Profile

On behalf of the Entrepreneurs Council under the Cabinet of Ministers of Ukraine, please accept my sincere congratulations on the publications of these periodicals.

Small business and trade in particular is an important component of economic relations in Ukraine today: it employs millions of people, while the commodities and services it produces create the foundation for social, scientific, and technical progress. The Council of Entrepreneurs believes there should be an open dialogue between the government authorities and business. Small and medium-sized businessmen are the key drivers for developing the state, improving people's living standards, and strengthening the country's authority outside our borders.

I wish to you all further prosperity, the most favorable business environment, understanding on the part of the authorities and high profits and happy clients.

May every day bring clarity to your thoughts and let you live your life to its fullest. I wish you harmony in your families, hearts full of love, and the energy of life to realize your noble, blessed intentions!

December 1st, 2012

Sincerely Yours,
Chairman of the Council of Entrepreneurs
under the Cabinet of Ministers of Ukraine
Leonid Kozachenko

To the readers of the 2013 Chamber Membership Directory and Country Profile,

On behalf of the Ukrainian Union of Industrialists and Entrepreneurs, let me extend my welcome to the readers of the 2013 Chamber Membership Directory and Country Profile 2013 publications.

The Ukrainian economy is currently passing through an important stage, which is characterized primarily by intense integration into the global and European economic space. This path is irreversible for Ukraine. Its key objective is to enhance the competitiveness of the economy, create a favorable investment climate, and raise people's living standards.

Systemic cooperation with the American Chamber of Commerce, based on an underlying agreement concluded on May 28, 2012, is highly important for the Ukrainian Union of Industrialists and Entrepreneurs. These activities enable us to coordinate our positions and act in an effective and well-concerted manner to protect entrepreneur and investor interests.

The American Chamber of Commerce's support for integration processes in Ukraine contributes to bringing our economy closer to the European level. I am convinced that your activities will further facilitate social progress, strengthen the social foundations of the market economy, and transform and democratize the state's political system.

The future destiny of Ukrainian business and the Ukrainian economy largely depends on every one of us – on our activity, decisiveness, and commitment to our common mission.

December 1st, 2012

Sincerely yours,
President of the Ukrainian Union of Industrialists and Entrepreneurs People's Deputy, Advisor to the President of Ukraine
Anatoliy Kinakh

Dear friends,

Ukraine today is improving its competitiveness. A foundation for stable economic growth and social progress is being laid in the country. At a difficult time for the world, we have launched structural changes focused on innovation and the consistent implementation of investment policy.

Reform is an objective necessity for us, since in the new post-crisis reality only an economy that keeps moving forward can be a strong one. We must implement new technologies in the real sector, develop innovative managerial decisions, and regain the trust of business and the country's people.

The new Ukraine is becoming of interest to the world, which recognizes our achievements in building innovative infrastructure, establishing a modern legal framework for scientific and technological development, and creating a favorable environment for investment in high-tech sectors.

In 2012 our country became an Associate Member of the European Organization for Nuclear Research (CERN) and joined the Open Government Partnership global effort. It is currently successfully implementing electronic governance. We are actively taking part in international research on materials, electronics, biotechnology, and information and communication technologies.

Ukraine is open for cooperation in the scientific, technological, and economic sectors and ready to improve its business climate to make it more attractive for investment.

I am sure that we will continue to strengthen our relations with the American Chamber of Commerce in Ukraine and to successfully implement all our joint projects.

December 1st, 2012

Sincerely,
Chairman of the State Agency for Science, Innovation and Informatization of Ukraine
Volodymyr Semynozhenko

Dear Members of the American Chamber of Commerce in Ukraine,

The tasks that the Chamber set for itself 20 years ago have been successfully accomplished. High-level information support, effective promotion of business interests, representation and protection of the interests of foreign investors operating in Ukraine – the Chamber has been highly effective in each of these areas, justly earning a high level of trust among the business community.

The best indicator of the Chamber's effectiveness and influence has been the steady increase of the number of its members, hailing from over 50 countries.

Close interrelation with the government agencies of Ukraine and the United States is another Chamber competitive advantage. It allows the Chamber to actively disseminate Western business practices in Ukraine and facilitate our country's integration into the global economic community.

The thorough analysis of Ukraine's business environment that Chamber Members perform has for years helped foreign businesses enter the Ukrainian market. The success stories of its Member companies are the best publicity for the positive changes that are taking place in Ukraine's investment and business climate.

Ukraine and the United States conduct a regular economic dialogue via the Ministry of Economic Development and Trade of Ukraine and the Office of the U.S. Trade Representative.

This dialogue helps us promptly to identify any obstacles that hinder trade and investment cooperation between Ukraine and the United States, as well as to enhance intersectoral cooperation. The public authorities and non-governmental institutions of Ukraine and the United States strive to remove barriers to trade in goods and services, foster investment, and improve the environment for US business activity in Ukraine, and vice versa.

In this context, we highly appreciate the assistance that the American Chamber of Commerce provides to the Ukrainian Embassy in the United States in organizing events with the participation of US business, both in Ukraine and in the United States.

One should particularly note the significant personal contribution that Mr. Jorge Zukoski made to organizing the last meeting of the Trade and Investment Council, which took place on 31 July in Washington, D.C. Mr. Zukoski is more than just an effective manager and a proponent of the development of Ukrainian-American relations – he is also a true friend of Ukraine and of the Ukrainian Embassy in the United States.

We look forward to further fruitful cooperation between the Ministry of Foreign Affairs and the Chamber, particularly in conducting presentations about Ukraine's investment potential and other economy-related events.

I wish you success in your activities and further expansion of the Chamber Membership.

December 1st, 2012

Ambassador of Ukraine to the United States,
Olexander Motsyk

Dear Members of the American Chamber of Commerce in Ukraine,

Let me congratulate you on the significant progress made in the last year. The Chamber enjoyed real success in the energy and agriculture sectors, while also improving Ukraine's competitiveness and business climate through thoughtful legislative and reform initiatives. President Jorge Zukoski continues to lead the Chamber with a drive and vision that is not only laying the groundwork for Ukraine's long-term economic stability, but also creating an environment that will allow all of your businesses to grow and prosper.

Among the Chamber's many achievements, the creation of a legislative framework that allowed for new gas Production Sharing Agreement (PSA) tenders marked a major step forward for Ukraine's energy sector. The Chamber was instrumental in working with the government to establish a more transparent bidding process, and we're excited at the new possibilities for member companies to help develop energy resources. In the agriculture sector, the Chamber's efforts resulted in liberalization of grain certification procedures, critical to many agriculture companies working in Ukraine.

The Chamber successfully advocated for important changes to the tax and customs code. The implementation of a new Customs Code in June has provided many improvements for members importing goods and equipment into Ukraine, and the Chamber's cooperation with the tax service has also paved the way for more constructive dialogue.

Over the past 20 years, the Chamber has played a vital role in the growth of the U.S.-Ukraine bilateral economic relationship. This has not only been through advocacy for specific issues, but also through a commitment to improving business conditions across all economic sectors. I look forward to building on this tradition in the next year.

However, I would like to caution that the year ahead will have many challenges. Ukraine's business climate remains difficult, and far below its potential. I count on the members of the Chamber to be a force for positive change.

Wishing all members a prosperous 2013!

December 1st, 2012

US Ambassador to Ukraine,
John F. Tefft

Dear Members of the American Chamber of Commerce in Ukraine,

Congratulations on the 2013 Membership Directory and Country profile – a key reference point for international and Ukrainian businesses operating in Ukraine, and indeed for the diplomatic community.

As a relative newcomer to Ukraine, I have been struck by the important role played in this country by the American Chamber of Commerce in Ukraine and its sister organization, the European Business Association. The government listens to you and as a result you have been successful in pursuing our shared goal of an improved business environment, although, as your members are well aware, a great deal more still needs to be done.

In 2012 the European Union and Ukraine completed negotiations aimed at establishing closer economic and political ties. The EU hopes that during 2013 we will be able to sign the Association Agreement with Ukraine, including a so-called Deep and Comprehensive Free Trade Area. This agreement would not only reduce or eliminate the tariffs applied to each other's products, but would also result in Ukraine aligning its rules and regulations with those of the EU, thereby giving Ukraine access to the EU's Single Market of 500 million people. The Association Agreement offers Ukraine a great opportunity to diversify and expand its economy and attract substantial investments, thus generating prosperity and higher social standards.

I strongly believe that the implementation of the Association Agreement would be good news for all businesses operating in Ukraine, regardless of national original or affiliation. The Chamber can make a major contribution to the process of preparing the business community and other relevant Ukrainian stakeholders for such a challenging opportunity.

I therefore look forward to fruitful cooperation with the Chamber during my time here and I wish you continued success in your lobbying efforts to achieve a modern and forward-looking business and investment climate in Ukraine.

Finally, I would like to wish a successful 2013 to all your members.

December 1st, 2012

Sincerely,
Head of Delegation of the
European Union to Ukraine
Jan Tombinski

Dear Chamber Members,

Despite all of the political and financial challenges that 2012 has put in Ukraine's path, the Chamber and the executive team remain focused on the future and look forward to the continued successes in the years to come. Over the last 20 years, the Chamber has been striving to unite leading international companies in Ukraine, irrespective of their national origin, to work together to create a better business environment and facilitate new investment into the country's economy. The celebration of the organization's 20th Anniversary – a major milestone in the Chamber's history – provided yet another opportunity to once again think about how much the country has accomplished since 1992. We are proud to witness and participant in Ukraine's development as an independent nation as it has aspired to embrace the principles that are the hallmarks of successful market economies.

Over the course of this year, the Chamber has successfully maintained an effective dialog between the business community and the Government of Ukraine. The Chamber worked diligently to provide our Members with relevant information, high level engagement, and access to key decision makers as well as continued to push for the implementation of comprehensive economic reform that Ukraine desperately needs to successfully compete in a challenging global marketplace and attract much needed domestic and foreign investment.

The Chamber paid special attention to strengthening the Committee structure and Policy Team performance to ensure that the correct mix of Committees and Working Groups is in place. The results of the 2012 Chamber Membership Satisfaction Survey clearly showed positive trends in reinforcing advocacy and policy activities, including the Chamber Committees' performance and internal and external communication. The Chamber also improved on the development of the Business Networking platform – the Chamber has focused on further delivering a well-rounded offering of benefits and services by being proactive, innovative, and oriented toward customer service.

On behalf of the Board of Directors, I would like to once again express our sincere gratitude for the support and involvement of every one of our Member Companies. Their efforts have been critical in driving the Chamber's activities throughout the year. While the path has not always been clear or easy, we have worked closer together and supported each other and have collectively experienced and delivered on more than we could have expected.

I would also like to personally thank Jorge Zukoski and the Chamber Team who are working diligently every day to make the Chamber and the member companies a success!

My commitment as Chairman of the Board of Directors in 2013, will be to further develop the benefit and service mix of the Chamber through tapping into the resources of the Membership and the Board of Directors as we all strive to create a more prosperous market economy and overall quality of life for Ukrainians in this country of opportunity.

My best wishes to all of you in the New Year!

December 20th, 2012

Sincerely,
Chamber Board of Directors
Walter Gordon

Dear Chamber Members,

Enhancing Ukraine's global competitiveness remains a key priority for the American Chamber of Commerce in Ukraine. Despite the financial uncertainty, driven by the Euro zone, which has created a bit of trepidation within the business community, in 2012 the country managed to significantly improve its positions in rankings by two internationally recognized organizations – the World Economic Forum (WEF) and the World Bank (WB). Such improvements are major successes in terms of the country's positioning in the international arena and have everything to do with the implementation of hard-won reforms, many of which the American Chamber of Commerce in Ukraine was directly involved in shaping and advocating for.

More, of course, needs to be done as the country's leadership strives to rise to the top of this important list. But moving from the bottom of the list to the middle over the years has itself been a major accomplishment. In 2012 the business community that the Chamber represents has observed a positive tendency with respect to the readiness of state officials on all levels to engage in a focused dialog, taking into consideration the international best practices that the expert, business, and diplomatic communities can offer. The Domestic and Foreign Investors Advisory Council (DFIAC) under the President of Ukraine is a good example of the leadership of Ukraine's commitment to creating more favorable conditions for investors.

We at the Chamber continue to focus our efforts on ensuring that the organization remains relevant and value-added. We stay nimble and adjust to the needs of our Membership as the business, investment, and political landscapes change. We will continue to focus on the future, doing what we can on behalf of our Members, to identify new opportunities, to protect their interests through focused lobbying and advocacy efforts aimed to increase Ukraine's competitiveness, to provide quality segmented networking opportunities, and to serve as a strong information platform helping all of our Members to succeed.

We look forward to working with our Membership in 2013 and beyond, as we all strive to succeed in this challenging and rewarding environment.

December 1st, 2012

Sincerely,
Chamber President
Jorge Zukoski

CONTENTS

Developing Ukraine's International Competitiveness

2012–2013 Partnership for Ukraine to Successfully Compete in the Global Economy

According to the results of the 2013 Doing Business Report by World Bank, which assesses the quality of business environment, Ukraine's rank has significantly improved, as the country was ranked 137th out of 185 as compared to 152th a year before. The 2012 Global Competitiveness Report developed by the World Economic Forum (WEF) to provide comprehensive competitiveness rankings has also registered progress in Ukraine's competitiveness, and ranked Ukraine 71st out of 129 countries (in comparable lists) as compared to 79th in 2011 and 86th in 2010.

Despite the notable progress, there is still a long way to go in order to build a successful and highly Ukraine. Some of the lowest rankings that Ukraine received according to WEF were within the Institutions category. Here Ukraine was ranked the 134th economy out of a total 144 in regards to the "Property rights" and 141st in regards to the "Efficiency of legal framework in settling disputes" and "Protection of minority shareholders' interests." It was ranked 139th in "Efficiency of legal framework in challenging regulations," 135th in "Burden of government regulation" and 133rd in "Irregular payments and bribes."

Another pillar for which Ukraine received very low rankings was that of "Goods market efficiency." Ukraine demonstrated the following low rankings: it was 139th in "Extent and effect of taxation," 138th in "Burden of customs procedures," 136th in "Prevalence of trade barriers" and "Agricultural policy costs," and 132nd in "Effectiveness of anti-monopoly policy" and in "Business impact of rules on FDI."

The American Chamber of Commerce in Ukraine (the Chamber) together with its Partners throughout the business, diplomatic, and expert community, as well as from the government of Ukraine, monitors country progress within the international rankings and each year develops Action Plan of Policy, Legal, and Regulatory Reforms aimed at increasing Ukraine's competitiveness. The Action Plan is the part of the Chamber's Annual Report "Partnership for Ukraine to Successfully Compete in the Global Economy," which outlines the reforms and actions that need to be implemented to significantly improve these rankings. Below we provide a brief summary of the progress achieved in selected sectors and policy areas examined by the Chamber and its Partners.

Agriculture. While in the 2010/2011 marketing year direct state interventions into the functioning of agricultural markets (export quotas and duties, as well as non-tariff barriers) were characteristic of the development of this sector, over the past year due to relentless efforts aimed at remedying the situation and, in particular, signing a Memorandum of Understanding between major market players and the Ministry of Agricultural Policy and Food of Ukraine, the situation has become more predictable both for the traders and for the Government whose main concern is to ensure the food security of the country.

Agriculture is one of the sectors that contributes greatly to the country's exports and, therefore, to improvement of the economic situation at large. In addition to the restoration of the country's reputation as the breadbasket of Europe, other steps to improve the sector are urgently needed. Thus, the proclaimed acceleration of agricultural land market reform is a very positive signal for investors; the prospects for its introduction, however, remain uncertain, largely due to the extension of the Moratorium of agricultural land sales, which was prolonged until 2016. Old VAT arrears to major agricultural traders still remain an issue, while the overall situation has somewhat improved by offering small monthly payments to major companies and introducing the automatic VAT reimbursement system.

The Chamber strongly believes that a more efficient agricultural industry must be based on free market principles and on the abolishment of restrictions. Government involvement in the market has to be minimized and, instead, non-governmental organizations have to proactively participate in market regulation activities. Therefore, we will continue targeting our efforts at widest possible introduction of free-market principles, minimizing future ad hoc direct state interventions, and ensuring a transparent and predictable market environment is established and maintained in the country. Both the decision makers of the Ministry and other stakeholders will be heavily involved in this activity.

Banking and Financial Services. Over the past year the sector was in the process of a slow recovery after the 2008–2009 financial crisis and can currently support Ukraine's economic development only to a limited extent. 2011 saw a revival of growth in the Ukrainian banking sector after the stagnation of 2010 but remains highly defragmented despite the growing share of the big local banks. Some negative trends were observed in late 2011: banks' free liquidity decreased sharply as a result of the NBU policy to prevent speculation against the UAH which also caused collateral damage by increasing the price of capital for corporate clients thus contributing to the slowdown of economic development at large.

Lending revived compared to the previous year, mainly due to the corporate segment. For the first time since 2007, non-performing loans have declined along with loan loss provisions. The capital positions of the banking system strengthened visibly, and profitability indicators improved. A gradual return to the results of the pre-crisis period for the Ukrainian life insurance market was observed which was partly conditioned by the 2011 pension reform.

At the same time, the legal environment remains quite unfavorable, with the rights of creditors still protected very poorly. The Chamber's Action Plan for the sector remains quite ambitious and is aimed at further improvement of regulatory foundations, facilitating the development of the financial intermediation sector and increasing its transparency. Special attention is paid to continued harmonizing Ukrainian legislation with international best practices which will improve Ukraine's competitive positions.

Fuel and Energy. Reforms in Ukraine's energy sector are at the top of the country's policy agenda, and energy independence through equal access and fair competition remains one of the Chamber policy priorities for many years to come.

2012 was a year of substantial changes in the Ukrainian fuel and energy industry. In the upstream sector the government started to attract major foreign investment by having held two successful tenders for production sharing agreements for the two oil-and-gas fields, with two more subsoil plots awaiting their investors. Other notable developments include the start of the Naftogaz monopoly reformation by the Government, as well as adoption of a new Procedure for Granting Access to the Unified Gas Transportation System.

There is actually no government policy for supporting and developing the downstream sector. The country's oil products market is still highly import-dependent, and beginning of the year saw shutdowns of major oil refineries due to inability to compete with cheaper oil products from neighboring countries. On the other hand, the Ukrainian leadership has finally approved the transition to international fuel quality standards, as well as adopted a law aimed at increasing the share of bioethanol in mixed motor fuels.

Development of renewable energy industries has been defined as an important component of Ukraine's national economic growth strategy. To use the available potential in the most efficient way, an adequate legislative and regulatory framework should be developed and implemented.

Electricity sector remains highly depreciated, lacks investment and cannot meet constantly increasing demand for new capacities. An effective tool for channeling investments into modernization of aging networks is to implement relevant incentive regulation, including increase in retail tariffs for households to economically justified levels.

Hospitality and Tourism. Two very important issues had a substantial influence on sector dynamics in 2007–2012: the preparation for the EURO 2012 football championship and the global economic crisis. While the European tournament stimulated increase in foreign visits to Ukraine (especially in the host cities), the ongoing global stagnation caused a decrease in the number of Ukrainian citizens traveling abroad. As for the hospitality market, its most developed part is represented by 4 and 5 star hotels. The lack of regular and substantial funding as well as some legislation and regulatory problems prevent Ukraine from achieving competitive positions in the global tourist market. To boost the sector's development, it is important to improve the country's infrastructure, increase the level of service standards, train personnel, establish a well-functioning network of information centers for visitors to ensure exchange and dissemination of complete and reliable information about Ukraine's tourism assets, and improve taxation in the sphere.

Information and Communication Technologies. The ICT sector in Ukraine continued its rapid growth in 2011–2012. Due to its traditional advantages, which include the availability of highly-qualified ICT experts and relatively low manpower costs, Ukraine is among the leading countries in terms of growth prospects in this sector. Internet connectivity continues to increase at a record pace in cities, with the number of rural users remaining rather low. E-commerce prospects still remain largely unregulated, and more vigorous introduction of E-Government elements is needed to achieve the goals set by the country's leadership in this sphere, including increased government openness. It is important to note that the customs authorities started using electronic customs declarations intensively, and the State Tax Service has been providing free e-signature keys for the submission of electronic reports since May 2012. E-documents have become widespread in the field of financial control as well. The Country's huge capability in the area of software development creates good prospects for foreign investment in this sector and its further growth. With introduction of amendments to the law "On Personal Data Protection" and other important legislation and regulatory acts, including a better taxation regime, expectations for improvements in the ICT sector may materialize.

Logistics and Transportation. Against the background of recent global and European trends, the Ukrainian logistics and transportation industry is in the formation and consolidation phase: sector infrastructure is undeveloped, principles of consolidation and distribution management are not used on a mass scale by freight owners, and the country poses administrative-economic risks. This having been said, logistics and transportation is rapidly developing and, according to many international experts, remains one of the few sectors in the Ukrainian economy that is attractive for investment. The main risk for powerful international logistics operators is that Ukraine remains unpredictable in terms of legislation, law enforcement, regulatory state policy, and the business climate. Recently some important pieces of legislation and regulations have been introduced; national regulatory policy, however, often remains non-transparent and stifles competition.

Real Estate and Construction Development. The real estate and construction industry suffered the most during the recent economic crisis. Following the protracted financial crisis, the Ukrainian government undertook efforts to simplify and even eliminate completely certain bureaucratic procedures that businesses face in the real estate and construction fields. Among the most significant events of the previous year was the introduction of the Law of Ukraine "On the Regulation of City Construction (Reduction of the Permission Procedures in Construction). The Law of Ukraine "On the State Land Cadaster," and the legislation on land auctions seems to be quite progressive. On the other hand, from the business community viewpoint, some major drawbacks of the Land Code of Ukraine must be eliminated. In addition to proper legislation to be adopted, major emphasis should be put on its enforcement, and recovery in the sector will largely depend on political situation.

Retail Trade. The retail market in Ukraine is dominated by domestic retailers, most of which operate on a regional level, with the number of international companies still being rather low. Neighborhood stores, which mostly remain Soviet-style outlets, are of immense importance to the national food supply. Despite having been hit hard by the crisis, the sector evinces high potential given the low share of chained retail trade and the significant room for growth for modern retail formats. Should the country overcome its economic instability, administrative barriers, and low consumer spending, retail market development might speed up.

On the legislative and regulatory side, it is hoped that the Draft Law "On Internal Trade" pushed through the parliament by some lobby groups will either be rejected or can be amended from its current version so that it does not harm the industry. The list of so-called "socially important food products" is the second most important topic of discussion, and the development of modern retail in Ukraine during the next few years will definitely depend on these two documents.

In addition to sectoral reviews, the Chamber experts have presented their views on macroeconomic and political developments influencing the country's competitiveness levels.

Anti-Bribery Policy. Despite several significant steps to prevent and fight corruption taken in 2011–2012, bribery in the country remains rampant and pervasive, with Ukraine ranked 152 out of 182 countries surveyed by Transparency International. Its position in the 2011 Corruption Perception Index ranking even dropped significantly, and the adopted legislation has so far proved to be of a declaratory and populist nature.

In 2011 the Chamber established its Anticorruption Working Group, consisting mostly of compliance officers, legal advisers, and consultants. In the course of the year the Working Group has analyzed and discussed the most controversial provisions of the new Anticorruption Law and Anticorruption Strategy and will continue its effort to improve the legislation and ensure its enforcement with renewed energy.

Customs Policy. The State Customs Service of Ukraine administrates almost a third part of the total revenues of the State Budget of Ukraine, which makes state customs policy extremely important for the government and eventually for each company engaged in the international trade. Adoption of the new Customs Code has actually brought the country's customs regime in line with the EU Customs legislation and international conventions, as well as with the Framework Security and Trade Facilitation Standards of the World Customs Organization. It is noteworthy that the State Customs Service has also created an appropriate environment for implementing the Code. Despite the noticeable progress in this field, some major issues like controversial customs valuation methods alongside with improper actions of customs officers at some local posts need further addressing.

Healthcare Policy. Improvements in healthcare sector management and policies are extremely important for Ukraine given the long-term demographic challenges the country faces, such as continuing depopulation and population ageing. Meanwhile, the end of 2011 and first half of 2012 was marked by growing regulatory pressure on international producers of medicines coming to Ukraine. Regulatory vagueness, lack of transparency in regulatory policymaking, and shrinking of the policy dialogue between Ukrainian healthcare authorities and representatives of international pharmaceutical industry have led to a situation in which industry representatives have had to concentrate on firefighting instead of on strategic planning. Some pilot projects have been launched, and their results still need to be closely monitored and objectively assessed for companies active both in the health services provision and in the pharmaceutical industry. The business community in Ukraine expects new reforms to continue to be introduced and anticipates their implementation in a transparent and market-friendly manner.

Human Resources and Labor Policy. Higher education and training and labor market efficiency are important enhancers of Ukraine's competitiveness. While most of Ukraine's institutional characteristics are strong competitive disadvantages for Ukraine, the general quality of the human resources field is an advantage for the country. However, just as last year, the factors adversely affecting the functioning of the Ukrainian labor market include contradictions between state personnel policy and the requirements of the transformational processes in the country, imperfect legislation, the lack of a strategic focus on personnel training to meet the needs of society, and the poor functionality of personnel management structures. Among Chamber's major contributions to improving the HR situation in the country has been its heavy involvement in drafting relevant provisions of the Labor Code that could reflect the realities of the modern world. However, the process has been basically halted because of the 2012 parliamentary elections that prevent legislators from including the provisions very much needed for population's development but could cost them some loyal votes.

Intellectual Property Rights Protection. An effective state system for protecting intellectual property rights is crucial for Ukraine's competitiveness. Over the last several years, however, the situation in Ukraine has not improved, with the country occupying rather low 110th place among 131 countries in the IPR coefficient estimated by the World Economic Forum. Moreover, in 2011–2012 the Ukrainian intellectual property protection system saw a number of dubious and unsettling developments, including continued internet piracy and patent rights infringement, poor enforcement of laws or even easing criminal responsibility, and lack of public awareness campaigns about the importance of intellectual property rights protection. Considering the lack of proper IPR enforcement, Ukraine may face another round of trade sanctions from the United States and other unpleasant consequences if the situation does not improve dramatically and in line with internationally recognized standards.

Tax Policy. Adoption and enforcement of the new Tax Code, changes in the leadership of the State Tax Service of Ukraine (STSU), and introduction of E-Government elements in the activities of this agency were among the most important features of the tax policy as of late. The World Bank 2013 Doing Business Report indicated a significant improvement of the Ukrainian tax system, ranking it 165th out of 185 countries, compared to 183rd last year that reflects some major developments in this sphere. Due to the efforts of domestic and international business community, as well as continuous dialog with the Ministry of Finance and the STSU, it became possible to address certain issues such as automatic refund of current VAT obligations; tax loss carry-forward procedures. At the same time, the refund of past due VAT amounts, transfer pricing mechanisms and other important issues such as the recently proposed tax reform that could introduce turnover tax, new charges for social payments and re-imposition of tax for hard currency sales will remain in the focus of business-government talks, and mutually acceptable solutions must be found through building partnership relations and mutual understanding.

Private-public partnership legislation and practices assessment is the highlight of the Chamber Partnership Report this year. It is even more important that despite the relevant law of Ukraine having been in place for the past two years, there is no universal understanding of PPP in the country, and for the majority of Ukrainian population this concept remains a foreign one. Furthermore, not a single PPP project has been implemented in the country so far.

The in-focus report contains an objective analysis of the current legislative base in this area, and provides certain recommendations for the start of these activities. The Chamber strongly encourages our Members and partners to familiarize themselves with this important section of the Partnership Report and join our efforts to establish a PPP Expert Center in a broad partnership with those who are interested.

Continuous dialog among various stakeholders, such as the private sector, experts, diplomatic and donor community, and international financial institutions, as well as Ukrainian political elites, is critical to developing structured, consensus-driven policies and thus improving the business environment and competitiveness in Ukraine and increasing the national competitiveness level of the country where we live and work.

Selected World Economic Forum Global Competitiveness Index Ranking

1. Global Competitiveness Index rankings

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
76	El Salvador	81	Trinidad and Tobago	74	Romania	66	Sri Lanka
77	Peru	82	Philippines	75	Albania	67	Colombia
78	Sri Lanka	83	Algeria	76	Macedonia, FYR	68	Morocco
79	Guatemala	84	Argentina	77	Botswana	69	Slovak Republic
80	Gambia, The	85	Albania	78	Trinidad and Tobago	70	Montenegro
81↓	**Ukraine**	**86↓**	**Ukraine**	**79↑**	**Ukraine**	**71↑**	**Ukraine**
82	Algeria	87	Gambia, The	80	Namibia	72	Uruguay
83	Macedonia, FYR	88	Honduras	81	Guatemala	73	Vietnam
84	Argentina	89	Georgia	82	Argentina	74	Georgia
85	Trinidad and Tobago	90	Jamaica	83	Honduras	75	Romania
86	Philippines	91	Serbia	84	Algeria	76	Botswana

2. Burden of Government Regulation

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
100	Côte d'Ivoire	112	Vietnam	113	Jamaica	115	Russian Federation
101	Burundi	113	Belgium	114	Poland	116	Poland
102	Spain	114	France	115	Philippines	117	Slovak Republic
103	Vietnam	115	Argentina	116	Belgium	118	Belgium
104	Colombia	116	Colombia	117	Portugal	119	Argentina
105↓	**Ukraine**	**117↓**	**Ukraine**	**118↓**	**Ukraine**	**120↓**	**Ukraine**
106	Mongolia	118	Philippines	119	Argentina	121	Serbia
107	Argentina	119	Portugal	120	Russian Federation	122	Kuwait
108	Poland	120	Russian Federation	121	Greece	123	Hungary
109	Belgium	121	Greece	122	Serbia	124	Croatia
110	Philippines	122	Serbia	123	Hungary	125	Algeria

3. Life Expectancy

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
86	Guatemala	86	Guatemala	85	Indonesia	83	Paraguay
87	Trinidad and Tobago	87	Azerbaijan	86	Guatemala	84	Morocco
88	Azerbaijan	88	Egypt	87	Azerbaijan	85	El Salvador
89	Egypt	89	Trinidad and Tobago	88	Egypt	86	Guatemala
90	Indonesia	90	Thailand	89	Trinidad and Tobago	87	Azerbaijan
91↓	**Ukraine**	**91**	**Ukraine**	**90↑**	**Ukraine**	**88↑**	**Ukraine**
92	Tajikistan	92	Russian Federation	91	Thailand	89	Trinidad and Tobago
93	Bolivia	93	Kyrgyz Republic	92	Russian Federation	90	Guyana
94	Kyrgyz Republic	94	Guyana	93	Kazakhstan	91	Kyrgyz Republic
95	Russian Federation	95	Tajikistan	94	Guyana	92	Indonesia
96	Bangladesh	96	Nepal	95	Kyrgyz Republic	93	Russian Federation

4. Extent and Effect of Taxation

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
119	Jamaica	121	Romania	123	Burundi	119	Hungary
120	Bosnia and Herzegovina	122	Bosnia and Herzegovina	124	Belgium	120	Portugal
121	Bolivia	123	Italy	125	Argentina	121	Argentina
122	Italy	124	Croatia	126	Italy	122	Croatia
123	Zimbabwe	125	Belgium	127	Croatia	123	Greece
124↓	**Ukraine**	**126↓**	**Ukraine**	**128↓**	**Ukraine**	**124↑**	**Ukraine**
125	Denmark	127	Argentina	129	Brazil	125	Belgium
126	Belgium	128	Hungary	–	–	126	Italy
127	Argentina	129	Brazil	–	–	127	Romania
128	Hungary	–	–	–	–	128	Burundi
129	Brazil	–	–	–	–	129	Brazil

5. Prevalence of Trade Barriers

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
101	Sri Lanka	113	Mozambique	121	Bolivia	117	Cote d'Ivoire
102	Malawi	114	Brazil	122	Ethiopia	118	Russian Federation
103	Mozambique	115	Malawi	123	Russian Federation	119	Madagascar
104	Pakistan	116	Dominican Republic	124	Chad	120	Bolivia
105	Nigeria	117	Tajikistan	125	Burundi	121	Chad
106↑	**Ukraine**	**118↓**	**Ukraine**	**126↓**	**Ukraine**	**122↑**	**Ukraine**
107	Lesotho	119	Nigeria	127	Venezuela	123	Burundi
108	Dominican Republic	120	Burundi	128	Ecuador	124	Benin
109	Azerbaijan	121	Kyrgyz Republic	129	Argentina	125	Ecuador
110	Egypt	122	Bolivia	–	–	126	Algeria
111	Ethiopia	123	Azerbaijan	–	–	127	Venezuela

6. Business Impact of Rules on FDI

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
113	Lithuania	114	Serbia	113	Burundi	113	Italy
114	Mongolia	115	Lithuania	114	Serbia	114	Russian Federation
115	Paraguay	116	Algeria	115	Slovenia	115	Chad
116	Iceland	117	Bulgaria	116	Mauritania	116	Bolivia
117	Croatia	118	Russian Federation	117	Greece	117	Kyrgyz Republic
118↓	**Ukraine**	**119↓**	**Ukraine**	**118↑**	**Ukraine**	**118**	**Ukraine**
119	Kyrgyz Republic	120	Kuwait	119	Algeria	119	Burundi
120	Italy	121	Croatia	120	Bolivia	120	Slovenia
121	Russian Federation	122	Chad	121	Kuwait	121	Ecuador
122	Algeria	123	Iceland	122	Kyrgyz Republic	122	Greece
123	Kuwait	124	Argentina	123	Chad	123	Algeria

7. Hiring and Firing Practices

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
12	Kazakhstan	13	El Salvador	12	Kenya	11	Kenya
13	Qatar	14	Qatar	13	United Arab Emirates	12	United Arab Emirates
14	United Arab Emirates	15	Canada	14	Kyrgyz Republic	13	Guyana
15	Gambia, The	16	Cameroon	15	Canada	14	Canada
16	Taiwan, China	17	United Arab Emirates	16	Cameroon	15	Qatar
17↓	**Ukraine**	**18↓**	**Ukraine**	**17↑**	**Ukraine**	**16↑**	**Ukraine**
18	El Salvador	19	Bangladesh	18	Armenia	17	Nigeria
19	Mongolia	20	Guyana	19	Guyana	18	Cameroon
20	Albania	21	Albania	20	Bangladesh	19	Kyrgyz Republic
21	Canada	22	Saudi Arabia	21	Albania	20	Bangladesh
22	Armenia	23	Mongolia	22	Brunei Darussalam	21	Pakistan

8. Pay and Productivity

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
17	Azerbaijan	21	Israel	37	Morocco	20	Azerbaijan
18	Lithuania	22	Czech Republic	38	Germany	21	Japan
19	Albania	23	Bahrain	39	India	22	New Zealand
20	Kazakhstan	24	Korea Republic	40	Australia	23	Lithuania
21	Gambia, The	25	United Kingdom	41	Armenia	24	Canada
22↓	**Ukraine**	**26↓**	**Ukraine**	**42↓**	**Ukraine**	**25↑**	**Ukraine**
23	Denmark	27	Denmark	43	Chile	26	Latvia
24	United Kingdom	28	Iceland	44	Oman	27	Thailand
25	Iceland	29	Thailand	45	Poland	28	Czech Republic
26	Canada	30	Canada	46	Finland	29	Cambodia
27	New Zealand	31	Oman	47	Bulgaria	30	Bahrain

9. Ease of Access to Loans

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
80	Madagascar	116	Latvia	114	Cameroon	102	Mali
81	Uganda	117	Nigeria	115	Jamaica	103	Tanzania
82	Nepal	118	Zimbabwe	116	Nigeria	104	Vietnam
83	Mexico	119	Jamaica	117	Ghana	105	Serbia
84	Kazakhstan	120	Kyrgyz Republic	118	Korea Republic	106	Lithuania
85↓	**Ukraine**	**121↓**	**Ukraine**	**119↑**	**Ukraine**	**107↑**	**Ukraine**
86	Philippines	122	Mali	120	Mozambique	108	Lesotho
87	China	123	Cameroon	121	Kyrgyz Republic	109	Portugal
88	Bosnia and Herzegovina	124	Mauritania	122	Ireland	110	Kazakhstan
89	Tajikistan	125	Argentina	123	Ethiopia	111	Costa Rica
90	Serbia	126	Burundi	124	Argentina	112	Malawi

10. Soundness of Banks

2009–2010		2010–2011		2011–2012		2012–2013*	
Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country	Rank out of 129	Country
124	Kazakhstan	123	United Kingdom	123	Azerbaijan	122	Zimbabwe
125	Kyrgyz Republic	124	Burundi	124	Nigeria	123	Iceland
126	Iceland	125	Zimbabwe	125	Algeria	124	Slovenia
127	Zimbabwe	126	Mongolia	126	Burundi	125	Burundi
128	Mongolia	127	Iceland	127	Iceland	126	Greece
129↓	**Ukraine**	**128↑**	**Ukraine**	**128**	**Ukraine**	**127↑**	**Ukraine**
–	–	129	Ireland	129	Ireland	128	Algeria
–	–	–	–	–	–	129	Ireland
–	–	–	–	–	–	–	–
–	–	–	–	–	–	–	–
–	–	–	–	–	–	–	–

* The WEF 2012–2013 Global Competitiveness Report includes 144 countries. We have compared Ukraine only to the 129 countries that were included in all WEF surveys from 2009 to 2012 in order to control for the addition or subtraction of the surveyed countries. In total we excluded 19 countries from the lists: Angola, Belize, Cape Verde, Gabon, Guinea, Haiti, Islamic Republic Iran, Lebanon, Liberia, Libya, Moldova, Rwanda, Seychelles, Sierra Leone, Suriname, Swaziland, Syria, Tunisia, and Yemen.

1. Agriculture

Cargill

Grain and Oilseed Agriculture in Ukraine: Overview, Prospects, and Challenges

Agriculture in Ukraine is traditionally of great importance for the country's economy. Even the national flag, depicting a blue sky over a yellow wheatfield, reflects that importance. Until 1991 Ukraine was regarded as the "breadbasket of the Soviet Union." Over the subsequent years, agriculture was affected by the country's overall economic decay. However, a clear upward trend has been evident in the past few years, as the core conditions for high-yield agriculture – the climatic and soil conditions (including Ukraine's vast black earth terrain) – have remained unchanged.

Ukraine has changed from being a net importer to a net exporter, becoming one of the largest suppliers of agricultural products worldwide, along with the USA, the EU, Russia, Australia, Argentina, and Canada.

Meanwhile, the sector has also become attractive to financial institutions and equity providers, which is illustrated by the allocation of credits and by sizable IPOs. Giant agro holdings have formed using both these and their own funds. Notwithstanding all their advantages, the IPO remains a rather exotic and inaccessible way of obtaining additional financing for most Ukrainian companies, including agricultural enterprises. That's because of the high-level requirements for companies that want to carry out an IPO and because of the high costs of preparing for one. However, the leaders on the Ukrainian agricultural market have already conducted several successful IPOs on international stock exchanges, which, to our mind, is evidence of the potential for enterprises operating in this sector. In particular, media reports state that IPOs have garnered $322.5 million for Myronivskyi Khliboprodukt OJSC, $187.5 million for Agroholding Avangard LLC, and $221 million for Kernel Holding. Taking into account the immense potential of Ukraine's agricultural market and the continuously growing interest on the part of foreign investors in enterprises operating here, we believe that over time IPOs will become more popular with Ukrainian agricultural enterprises.

In the last few years Ukraine established itself among the leading grain, oilseeds, and sunflower oil exporters of the world. The State Statistics Service and the National Bank reported in 2011 that agriculture accounted for around 8% of GDP by PPP and for 15% of export in the current account of the balance of payments.

Over 60 million hectares of land, of which roughly 42.8 million are agricultural, with around 32.5 million arable hectares, provide an excellent basis for the production of temperate crop and animal products. (Around 71% of Ukraine's land area is arable; in the EU and the USA this indicator is around 44–45%, according to World Bank data.) Over half of Ukraine's arable land consists of black chernozem soils, ideally suited for field crop production. Roughly one-third of the worldwide stock of these soils is located in Ukraine. Due to Ukraine's relatively low average population density (77/km2, whereas France's is 108/km2, Germany's is 229/km2, and Poland's is 124/km)2 and the temperate climate throughout its territory, the acreage-based

Table 1.1. Overview of production and export of grain and oilseeds in Ukraine

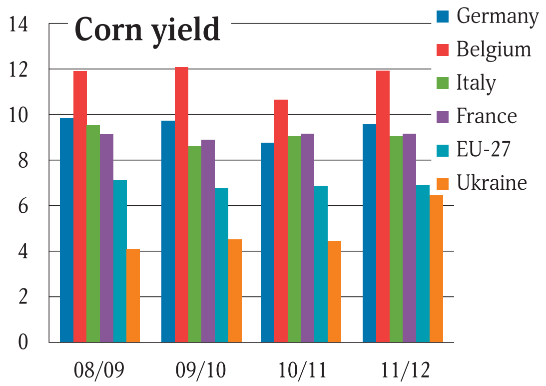
Commodity	production (million metric tons)					Export (million metric tons)			
	09/ 10	10/ 11	11/	% of Global Production in 11/12	Global Rank in 11/12	09/ 10	10/ 11	11/ 12	Global Rank in 11/12
Wheat	12	16,85	20,8	3%	11th				8th
Barley				7%	4th	6,23	2,79	2,5	5th
Corn	10,5	11,95	20	3%	5th	4,87	5,01	13,55	2nd
Sunflower oilseed	7,55	9,52	9,38	25%	1st	0,34	0,43	0,3	2nd
Sunflower oil	6,38	6,68	7,98	25%	1st	2,64	2,65	3,27	1st
Rapeseed oilseed	1,87	1,47	1,63	2%	8st	1,79	1,14	1,2	5th
Soybeans	1,03	1,56	2,14	1%	4st	0,20	0,95	1,2	4th
Total grain and oilseeds	51,35	49,4	62,56			22,59	14,48	23,98	

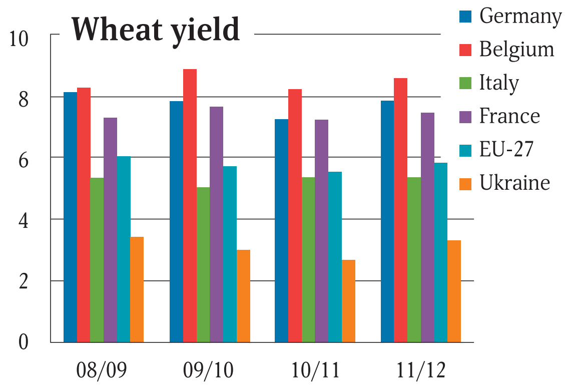
Source: USDA, IGC, in-house calculations

production potential implies export potential. Ukraine has the capacity to produce much greater volumes of grain, oilseeds, and livestock products than its population can be expected to consume. Ukraine's agricultural export propensity is supported by additional geographic advantages. These natural advantages are moderated by several important factors, which lead to specific production risks. Precipitation is often a limiting factor for crop production, falling from an average of roughly 700 mm/year in the northeast to as low as 350 mm/year as one moves south and east. Winters can be harsh and are not always accompanied by enough snow to protect winter crops and provide sufficient moisture in the spring. It is fair to say that some combination of drought and winter-kill will have a significant impact on agricultural production every three to five years. It remains so far unclear how global warming will influence rainfall in Ukraine in the future. Considerable investments in improved farm practices and farm management are necessary to intensify production and to achieve higher yields.

Regarding rapeseed, soybean, and sunflower seed yields, the situation is more or less equal, without significant spillover beyond the general trend as compared to the country's closest competitors. The difference in corn, wheat, and barley yields is rational and proper to the highly efficient soils, and can be explained by a lower productivity rate and by the use of inappropriate and obsolete machinery and planting techniques. Due to insufficient application of fertilizer and crop protection products and to lack of modern machinery in the fields, agricultural yields in Ukraine are lower than they are on average in the European Union and the rest of the world. Ukraine's current fertilizer rate stands at 78 kg/ha, as used for the 2011 harvest. This is higher than in neighboring Russia (33 kg/ha) but still lower than in, for example, Slovenia (195 kg/ha), China (130 kg/ha), or the developed EU countries (120 kg/ha on average). The US reports the highest fertilizer usage rate in the world: 150 kg/ha. Despite low fertilizer use, Ukrainian farms have demonstrated superior crop productivity per unit of fertilizer applied thanks to the country's fertile soil. Ukraine reported 52 kg of crop output per 1 kg of fertilizer applied in 2010.

Those figures show that Ukraine could at least double its production, becoming an even more significant supplier of agricultural commodities all over the world and boosting its export cash flows from approximately 5 to 15 billion, just by enhancing the yield rate to the normal world average, assuming that world grain prices remain attractive. To improve the situation, clear rules should be set for crop input sales, seed import, and domestic research and production. The current uncertainty creates a lack of clarity in terms





of the market's rules. This increases transaction costs, which in the end reduces the profit of all involved parties.

Ukraine's great advantage on the way to becoming a global agricultural power is its location at the crossroads of east and west and north and south. Its location effectively connects markets, creating efficient supply chains throughout the Black Sea, Mediterranean, Middle East, and Atlantic regions and providing food for people all over the world. The country's Black Sea harbors remain ice-free year round and provide direct access to world markets. As per the figures mentioned below it is crucial to create an additional 10–15 mln mt of storage capacity to ensure safe storage of crops at the current level of production.

Based on information from various market associations and experts, the supply chain infrastructure has a number of limitations, which may have a negative impact on agricultural potential:

- Ukraine has about 720 silos, with a storage capacity of around 35 mln t;
- Half are technically outdated and need modernization or renovation;
- There is disproportional storage distribution throughout Ukraine, with a surplus in the south and a deficit in the north;
- There is a lack of qualified storage services (drying, ventilation, and cleaning services and time-effective loading operations);
- There is a potential storage deficit given the experts' current crop forecast of 70 mln t in five years;
- Grain rail-transportation services are exclusively provided by the state-owned company Ukrzaliznytsya;
- There is a huge deficit of rail hoppers (there are currently around 9,000 available railcars, while a minimum of 15,000 are required);
- There is a difficult certification procedure for grain moved by rail;
- The system of river ports along Ukraine's shoreline is outdated;
- 13 large and medium-sized ports with access to the ocean (4 panamax ports);
- Trans-shipment capacity is about 30 mln t per annum;
- That number includes 6–8 mln mt transshipped directly from rail cars, which implies a lot of logistical risks and inefficiencies;
- There is a lack of modern and effective trans-shipment terminals and of sufficient grain storage in ports;
- Investment is needed in port infrastructure (rail and auto access roads, berth modernization, draft deepening);

Creating new export terminals with deeper drafts is of obvious necessity in order to move surplus from increased production. Ukraine will face the need to increase port storage by creating modern vertical bins and loading systems and by implementing progressive transport-technological systems that correspond to world standards. All of these required actions represent a great challenge and require investment and new port operation technology, which can be covered in part by the experience of multinational companies operating on international agricultural markets.

Ukraine is an agricultural net exporter, and has an advantage given its access to liberal trade regimes, which enhance its accessibility to the global market. As a member of the WTO, Ukraine has a great variety of obligations, including a 10.66% bound agricultural average export tariff and non-usage of the export quantitative limitation and methods of restrictions (with an exception in the case of a "critical deficit of a product" on the internal market). Ukraine introduced grain export limitations four times in the last six years (2006/07, 2007/08, 2010/11, 2011/12). Those limitations were in the form of export quotas, involving the implementation of a non-transparent system and procedure for distribution. Such actions create an uneven playing field for market players, leading to reduced competition and, in the end, to lower financial returns for farmers.

Summary

In sum, it's quite obvious that Ukraine has great prospects in the agricultural sector, given its good natural conditions, the liberalization of the market, and its openness to international investors. But Ukraine, which remains humbled by the tasks it faces, should understand that leadership is not something that is given once and for all; it must be earned. On its challenging path towards prosperity, Ukraine should increase its agricultural productivity and crop yields, approach world standards, establish transparent and fair rules and laws, promote investment, modernize, and bring new technologies to the industry. Effective regulation of the port infrastructure, enabling market participants to develop their supply chains, and clear and transparent regulations should enhance the country's overall position in global agriculture.

2. Banking & Financial Services

CRÉDIT AGRICOLE

Banking Sector Currency Control Regime Anti-Money Laundering Set-Up

1. Banking Sector

1.1. Overview

As of 1 July 2012 Ukraine had 176 active banks (Russia had around 900 and Poland had around 80).

Total banking system assets as of 1 July 2012 were UAH 1,104bn (USD 138bn). Since the beginning of the year asset growth has been +UAH 50bn or 9.5% p.a. Approximately 90% of the banking system's assets and capital are concentrated in the top 50 Ukrainian banks.

The top 10 banks account for about 50% of the banking system's assets and capital. Concentration has been stable over the past three to five years and is at a lower level than in the EU zone and neighboring Eastern Europe, where about 50% of the market is covered by the top five banks.

Asset dynamics in 2012 followed two main patterns: replacement of foreign currency loans with loans denominated in the Ukrainian hryvnya and renewal of lending to selected corporates and private individuals. Analysis of the overall structure of the loan portfolio indicates net growth of the corporate loan portfolio. Increase was seen mainly on the balance sheets of Russian-owned and Ukrainian private banks. Large state corporations were among the clients who were reported to have obtained new credit. Banks continued to buy Ukrainian government T-bills (the total volume was up by 19% p.a.).

Ukrainian banks' sources of capital are generally well-balanced. Ukrainian state and private owners together control 65%, up from 53% in January 2009. Foreign banking groups maintain 35%, although Western banks have substantially downsized their activity, even while Russian banks have continued their development.

The Ukrainian state historically owns the Oschadny savings bank and the universal/commercial UkrEximBank. The latter was a part of the USSR's Vnesheconombank, and focuses on export/import operations and facilitating relations between the Ukrainian government and international financial institutions.

Three more banks were bailed out by the government to calm crisis waves in 2008. Rodovid Bank was supposed to be instrumental in bad debt management. The

Total Assets of the Top-20 Ukrainian Banks in 2012

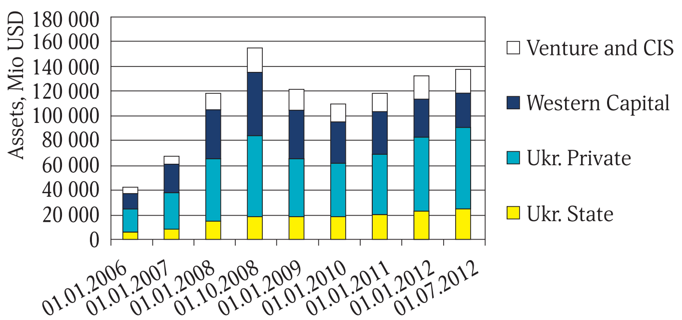
Rank by Assets	Total Assets, in Mio USD	Date		Changes	
	Bank Name	01.01.2012	01.07.2012	+/-, % p.a.	+/-, M$
	Total	**131 954**	**138 179**	**9%**	**6225**
1	Privatbank	18 163	20 236	23%	2 073
2	Oschadbank	9 253	10 602	29%	1 344
3	Ukreximbank	9 400	9 452	1%	52
4	Raffeisenbank Aval	6 427	5 940	-15%	-486
5	Prominvestbank	4 776	5 130	15%	353
6	Ukrsotsbank	5 032	5 004	-1%	-28
7	VTB Bank (Ukraine)	4 639	4 776	6%	136
8	First Ukr. Intl. Bank	4 364	3 936	-20%	-428
9	Delta	2 906	3 634	50%	728
10	Ukrsibbank	4 114	3 584	-26%	-529
11	Alfa-Bank Ukraine	3 500	3496	0%	-4
12	Nadra	3 347	3 071	-16%	-276
13	Finance and Credit	2 754	2 776	2%	22
14	Brokbusinessbank	2 371	2 744	31%	373
15	OTP Bank	2 852	2 669	-13%	-183
16	Ukrgazbank	2 273	2 615	30%	342
17	Sberbank of Russia	2 119	2 534	39%	415
18	VAB Bank	1 143	1 657	90%	515
19	KreditPromBank	1 565	1 574	1%	9
20	ING Bank Ukraine	1 343	1410	9%	62

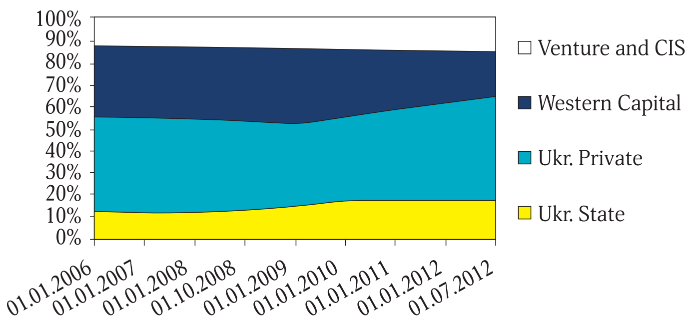
Total Assets Evolution of the Ukrainian Banking System in 2006–2012 (Equity Ownership Structure)

Interim data

Total Assets, Mio UAH	Date								
Group by Ownership	**01.01.2006**	**01.01.2007**	**01.01.2008**	**01.01.2008**	**01.01.2009**	**01.01.2010**	**01.01.2011**	**01.01.2012**	**01.07.2012**
1. Ukr. State	25 595	40 088	71 643	91 599	139 103	149 733	159 599	179 103	192 752
2. Ukr. Private	93 344	144 950	257 287	315 338	350 662	332 277	387 094	482 756	526 247
3. Western Capital	69 957	115 382	195 026	245 684	313 599	270 161	261 581	240 461	226 789
4. Venture and CIS	24 982	39 759	75 440	102 983	122 723	121 279	133 810	151 952	158 607
Total	**213 878**	**340 179**	**599 396**	**755 604**	**926 086**	**873 450**	**942 084**	**1 054 272**	**1 104 395**
+/-, %		59.1%	76.2%	26.1%	54.5%	-5.7%	7.9%	11.9%	4.8%
Share of Western Banks	32.7%	33.9%	32.5%	32.5%	33.9%	30.9%	27.8%	22.8%	20.5%
Total Assets, Mio USD									
1. Ukr. State	5 068	7 938	14 187	18 843	18 065	18 752	20 046	22 417	24 117
2. Ukr. Private	18 484	28 703	50 948	64 870	45 540	41 613	48 619	60 422	65 843
3. Western Capital	13 853	22 848	38 619	50 541	40 727	33 834	32 855	30 096	28 375
4. Venture and CIS	4 947	7 873	14 939	21 185	15 939	15 188	16 807	19 018	19 844
Total	**42 352**	**67 362**	**118 692**	**155 439**	**120 271**	**109 386**	**118 327**	**131 954**	**138 179**

Share	**Y-to-D**	
%	%	Mio UAH eq.
17.5%	7.6%	13 649
47.7%	9.0%	43 491
20.5%	-5.7%	-13 672
14.4%	4.4%	6 655
100.0 %	4.8%	50 123





strategy for and the further re-privatization of UkrGazBank and Bank Kyiv are being discussed by the government and the regulator.

The first wave of Western banks arrived in Ukraine in the 1990s: Credit Lyonnais, ING, Citibank, Raiffeisen, HVB, Unicredito, and PKO targeted companies from OECD countries and selected a number of local banks. ProCredit Bank Ukraine started in 2001 as MicroFinance Bank and was the first to pave the way to a new approach to banking.

After the Orange Revolution in 2004 foreign banks were again interested in Ukraine, as a country with 45m people and an under-developed consumer banking market. SEB, Raiffeisen, BNPP, Credit Agricole, OTP, Swedbank, Commerzbank, Intesa, and Unicredit bought banks with nationwide networks.

2007 and 2008 saw the massive arrival of banks from regional and neighboring countries – "followers" with a business model similar to that of the Western banks we mentioned above. This business model involved concentrating on cheap external funding for the development of consumer, car, and mortgage lending. Thus did second-tier banks like Universalbank (EFG Eurobank Ergasias), Piraeus Bank, Astra Bank, Marfin Bank (Greece), Bank of Cyprus (Cyprus), Credit Europe Bank, Credit West Bank (Turkey) and BG Bank (Georgia) establish their presences in Ukraine.

Russian banks were selective in their path to Ukraine. Although they were all firm in following a strategy of supporting client business outside Russia, each bank entered the market in a specific way. Alfa-Bank has demonstrated successful organic growth since the 1990s. In 2004 VTB Bank bought Bank Mriya, which serviced many businesses involved in trade with Russia. Sberbank of Russia, a regional leader in retail banking, was given authorization to start corporate banking in 2007 and only later got approval to enter the retail sector. VEB, a Russian state-owned bank, entered the Ukrainian market when the crisis of trust and liquidity at the end of 2008 was testing the viability of Prominvestbank (which was No. 6 at that moment) and of the banking system in general. A capital injection and a credit lifeline helped to save and even improve Prominvestbank's standing.

The sector thus saw just one big failure of a bank in the "systemic" top-20 group – UkrPromBank, which fell a victim to chaotic government measures to protect the interests of private depositors (their accounts were transferred to Rodovid Bank and the bank's business model was broken).

2011 saw the resolution of the most burning issue in the banking sector – the future of the biggest bank in NBU receivership. Bank Nadra got a powerful private investor – Dmitry Firtash, owner of businesses in the gas and energy, agriculture, and chemistry fields.

The year 2012 was marked by the decisions of several Western banks to scale down or quit the banking business in Ukraine. Swedbank and SEB sold their retail networks, Commerzbank found a buyer for its subsidiary Bank Forum, and Societe Generale is going to close its ProFin Bank. Partially these losses might be linked to the difficult global strategic standings of the subject banks and the need to focus on domestic and strong regional markets. The Ukrainian business sphere, although reinvigorated by Euro 2012, remains complicated, depends on export industries, and is characterized by political uncertainty.

The end of 2012 was marked by the merger of two Credit Agricole subsidiaries in Ukraine – Credit Agricole CIB and Credit Agricole Bank – into one entity, Credit Agricole Bank.

Ukrainian Banks – Subsidiaries of Banking Groups from OECD Countries and Cyprus

Data as of: 01.07.2012   1 USD = 7,993   UAH   ***Data in Mio USD***

Rank by Assets	Rank Change	Bank Name	Country	Rank by Profit	Total Assets	Due to Banks	Accounts Corpo-rates	Accounts Indi-viduals	Net P&L
4	–	Raiffeisenbank Aval	AT	3	5 940	1 243	1 470	1 972	2
6	-1	Ukrsotsbank	IT	6	5 004	1 723	739	1 378	1
10	-1	Ukrsibbank	FR	1	3 584	251	874	1 419	7
15	-2	OTP Bank	HU	21	2 669	892	467	686	- 5
20	-1	ING Bank Ukraine	NL	0	1 410	638	482	3	36
22	–	Erste Bank	AT	21	1 231	549	106	155	- 8
29	3	Universal	GR	22	971	266	80	341	- 11
30	–	Credit Agricole Bank	FR	6	920	188	202	371	1
32	4	Citibank Ukraine	US	1	707	50	503	3	22
33	–	Pravex	IT	21	706	139	74	300	- 2
34	-3	UniCredit Bank Ukraine	IT	2	705	344	125	94	3
37	-10	Swedbank	SE	22	649	357	42	4	- 24
42	-4	Marfin Bank	CY	10	580	189	133	175	0
45	-3	Credit Agricole CIB	FR	1	494	21	349	3	18
46	–	Kredobank Ukraine	PL	21	486	47	99	213	- 6
52	-9	Piraeus Bank ICB	GR	4	420	162	26	108	1
55	-8	Platinum Bank	US	2	399	0	38	252	4
63	1	Bank of Cyprus (Ukraine)	CY	4	339	117	41	86	1
69	-3	Procredit Bank	DE	6	302	4	54	143	1
77	58	Deutsche Bank DBU	DE	2	256	0	232	0	3
83	-4	Astra Bank	GR	3	220	6	22	48	2
87	-1	Idea Bank	PL	13	207	10	23	145	0
93	-9	Credit Europe Bank	TR	10	170	80	12	4	0
109	-55	SEB Bank	SE	7	117	87	11	0	0
140	6	CreditWest Bank	TR	5	57	25	10	3	1
141	8	ProFinbank	FR	18	57	6	14	13	0
		Grand Total			*28 600*	*7 394*	*6 228*	*7 919*	*47*

1.2. Assets Evolution

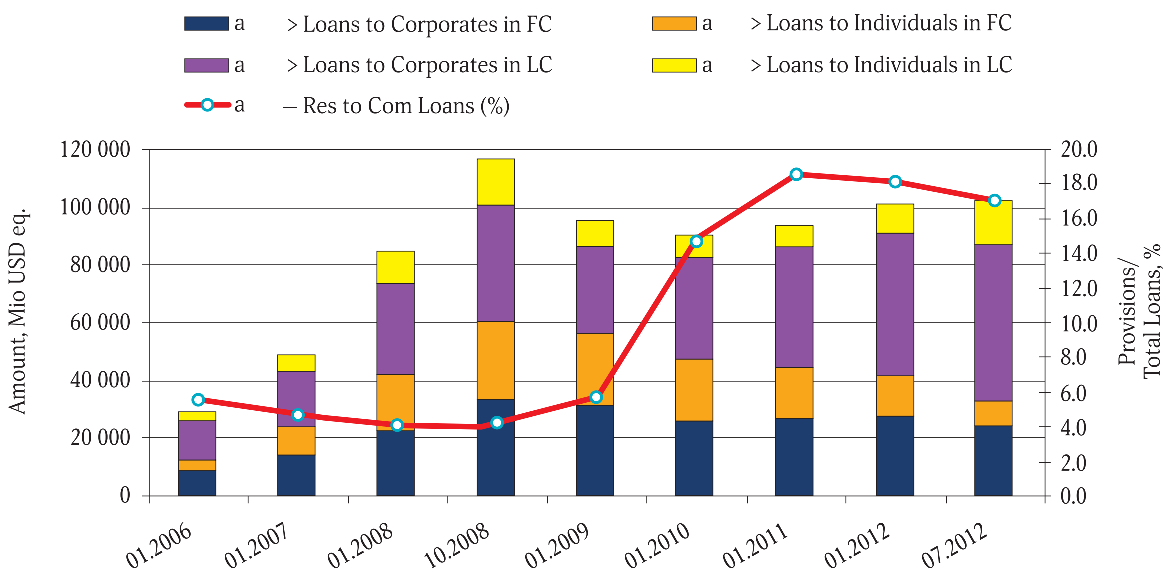
Ukrainian Banking System – Loans Portfolio

Clients & Currency Structure

Date of report	27.11.12		*Interim data*

Date:		01.01.06	01.01.07	01.01.08	01.01.08	01.01.09	01.01.10	01.01.11	01.01.12	01.01.12
UAH per 1$		5.05	5.05	5.05	4.8611	7.7	7.985	7.9617	7.9897	7.9925

	Units	01.01.2006	01.01.2007	01.01.2008	01.01.2008	01.01.2009	01.01.2010	01.01.2011	01.01.2012	01.01.2012
Total Clients' Loans	**Mio USD**	**28 174**	**48 618**	**85 159**	**117 339**	**96 340**	**90 956**	**94 268**	**101 864**	**102 100**
Growth rate (Y-to-D)	% p.a.		72.6%	75.2%	50.4%	13.1%	-5.6%	3.6%	8.1%	0.5%
Clients' Loans in FC	**Mio USD**	**12 305**	**24 047**	**42 191**	**59 569**	**56 336**	**47 352**	**44 334**	**41 578**	**39 426**
Growth rate (Y-to-D)	% p.a.		95.4%	75.5%	55.8%	33.5%	-15.9%	-6.4%	-6.2%	-10.3%
Clients' Loans in FC	**Mio USD**	**16 098**	**24 530**	**42 336**	**56 569**	**38 978**	**43 205**	**49 411**	**59 578**	**62 674**
Growth rate (Y-to-D)	% p.a.		52.4%	72.6%	44.8%	-7.9%	10.8%	14.4%	20.6%	10.4%
FC Loans/UAH Loans	%	76%	98%	100%	106%	145%	110%	90%	70%	69%
Total Loans to Corporates	**Mio USD**	**21 608**	**33 221**	**54 737**	**75 229**	**61 423**	**61 267**	**67 893**	**76 400**	**78 877**
Growth rate (Y-to-D)	% p.a.		53.7%	64.8%	49.9%	12.2%	-0.3%	10.8%	12.5%	6.5%
• Loans to Corporates in FC	Mio USD	8390	14 110	22 296	33 031	30 573	26 009	26 360	27 375	26 975
• Loans to Corporates in UAH	Mio USD	13 379	18 920	31 451	40 637	29 236	35 357	41 533	49 025	51 330
• FC Share Loans to Corporates	%	39%	42%	41%	44%	50%	42%	39%	36%	31%
Total Loans to Individuals	**Mio USD**	**6 565**	**15 397**	**30 422**	**42 110**	**34 916**	**29 291**	**25 852**	**24 755**	**23 223**
Growth rate (Y-to-D)	% p.a.		134.5%	97.6%	51.2%	14.8%	-16.1%	-11.7%	-4.2%	-12.4%
• Loans to Corporates in FC	Mio USD	3 914	9 937	19 869	26 818	25 763	21 343	17 974	14 203	12 451
• Loans to Corporates in UAH	Mio USD	2 719	5 610	10 885	15 933	9 742	7 948	7 878	10 553	11 343
• FC Share Loans to Corporates	%	60%	65%	65%	64%	74%	73%	70%	57%	54%
Loans Loss Provision	***Mio USD***	***-1 811***	***-2 556***	***-3 891***	***-5 590***	***-6 136***	***-14 170***	***-18 606***	***-19 681***	***-18 417***
• as of Total Commercial Loans		*5.5*	*4.7*	*4.0*	*4.2*	*5.7*	*14.8*	*18.6*	*18.2*	*17.0*
Total Loans to Fis + Securities	***Mio USD***	*7 838*	*11 128*	*21 597*	*23 821*	*16 876*	*9 385*	*15 352*	*17 775*	*19 546*
Growth rate (Y-to-D)	*% p.a.*		*42.0%*	*94.1%*	*13.7%*	*-21.9%*	*-44.4%*	*63.6%*	*15.8%*	*19.9%*



In 2010–2012 the banking sector as a whole saw modest loan portfolio and asset growth. Loan portfolio growth was +3.6% in 2010 and accelerated to +8.1% by the end of 2011. However, the 2012 figures reflect insufficient sources to stimulate further growth, as an increase of only around 1% in total loans may be expected by the end of the year.

This "adjustment" came after a boom and bust period: in the three pre-crisis years total bank assets grew from +/- USD 42bn (December 2005) to USD 120bn (December 2008). There was growth of 300% overall (in USD), with the peak reached in October 2008 — USD 155bn (just before the UAH devaluation). Commercial loans grew even faster between 2006 and 2009: loans in UAH grew 3.7 times; and loans in foreign currencies grew 4.6 times, from USD 12bn in 01/2006 to USD 60bn in October 2008.

Devaluation of the local currency from ~5UAH per 1 USD in 2005–2008 to ~8UAH per 1 USD within 4Q 2008 had a major impact on the economic environment in Ukraine.

Development of the loan portfolio in 2009–2012:

- UAH-denominated loan totals went up, driven by massive state support to state companies and banks, replacement of foreign currency loans with UAH-denominated ones, and growth of local business ahead of Euro 2012: +11% in 2009, +14% in 2010, +21% in 2011, and +10% in H1 2012.
- Foreign currency loans, if accounted in USD equivalents, showed slides of -16% in 2009, -6% in both 2010 and 2011, and -10% in H1f 2012.
- After corrections in 2009–2010 (-18% and -1% respectively) loans to individuals in local currency have become popular again with consumers and retail banks: +34% in 2011 and +15% at the beginning of 2012. The segment of short-term credit to private individuals has been spotted by many banks and massive advertising was followed by the advent of a variety of products.
- Corporate loans in UAH grew vigorously during the post-crisis years: +20% in 2009 and +18% in 2010 and 2011. The main directions of expansion were infrastructure projects including those for Euro 2012 (stadiums, roads, transport), agriculture and food-processing businesses, and selected import-replacement consumer goods production. Slower growth of +10% p.a. in 2012 may be explained by project cycle dynamics, but also by more reserved business activity in anticipation of political uncertainty.

Overall commercial loans in USD terms increased 6% since the big drop caused by the crisis and since the local currency was devalued at the end of 2008. Loans have been massively prolonged when borrowers have been incapable of repaying them during the current market slide or else restructured in exchange for partial repayment. Some foreign currency loans to individuals, upon the advice and with the support of the National Bank of Ukraine, have been converted into the local currency to ease the burden of interest payments.

Lending is weak, as banks still have to provision their assets, the economy is progressing at a slow pace, and the legal environment remains uncomfortable for lenders. In 2009–2012, however, loans to individuals almost stabilized around USD 23bn (the decrease in foreign currency loans was balanced by the UAH credit portfolio). Banks have not lent in foreign currencies since the 2008 crisis. Loans to corporations had increased to USD 78.9bn as of 1 July 2012 and +USD 11bn since 1 January 2011. The increase over the last 18 months is the result of loans to Naftogaz, Ukrainian Railways, Ukravtodor, Energoatom, and certain other state companies.

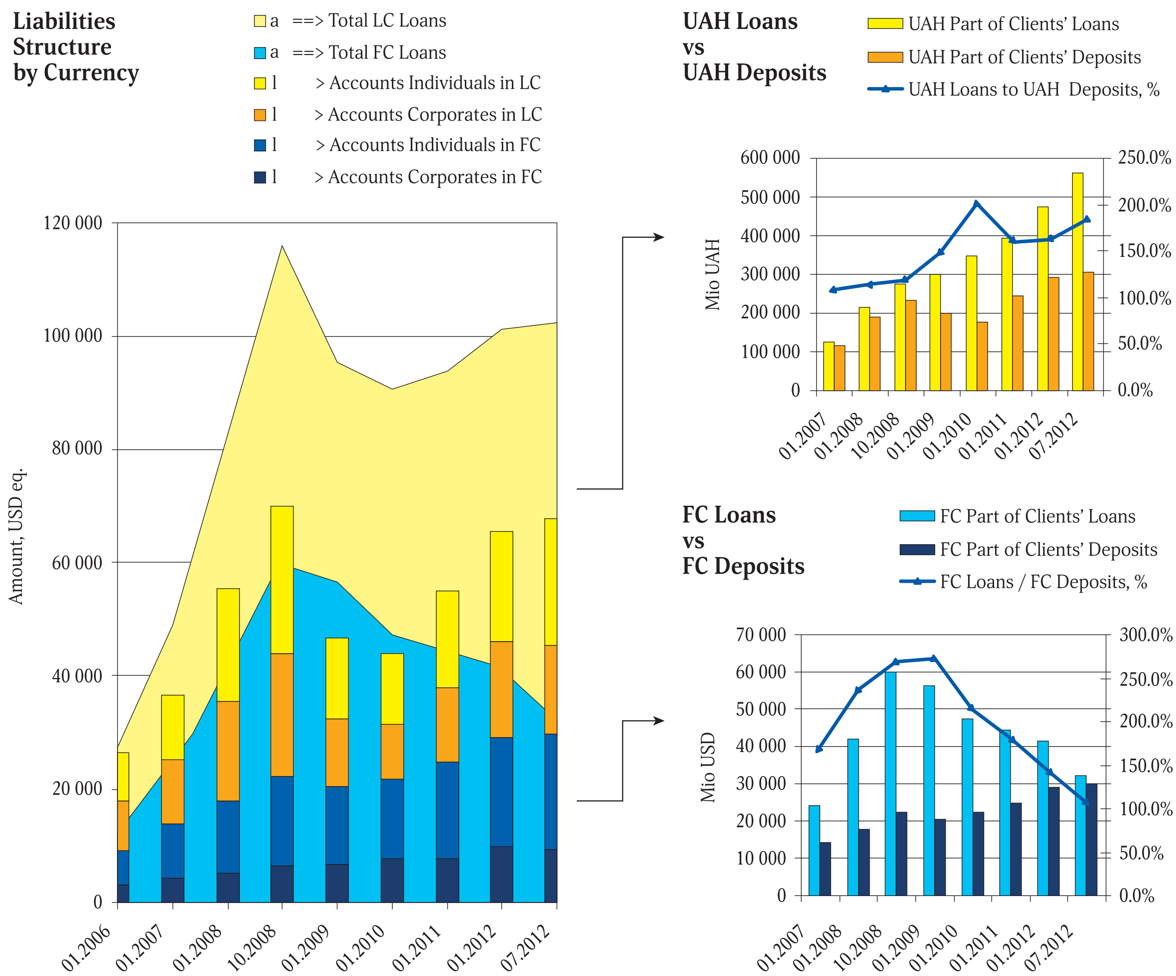
Rating agencies mention that as of the middle of 2012 the banks that they rate have restructured loans by more than 35% on average. Overdue loans, meanwhile, exceed 10% of total loans. Banks used to sell their loan portfolios to SPVs to improve the reported quality of their loans. Another way to get rid of heavily provisioned assets has been to sell a selected portion of the portfolio to a collection company.

Non-performing loans are a major problem for the banking system, for all categories of banks. Reserves accumulated by banks are building up quickly: from 4% of loan portfolios in October 2008 to 18.2%

at the end of 2011. They started sliding downward in 2012 (17%). However, analysts estimate that loan portfolios remain under-provisioned.

In 2010–2012 banks put an excess of funds into the securities market, where the stakes held by banks have grown by almost three times: from USD 4.8bn (UAH 38.6bn) at the end of 2009 to USD 13bn (UAH 104bn) by the middle of 2012. Securities are concentrated among the top-20 banks, and in fact three state-owned banks hold 40% of government securities. Only around 15% belongs to private Ukrainian banks. Foreign banks, restricted by their mother groups in terms of their lending policies, hold the biggest share (~45%) of these risk-proof and low-income assets.

1.3. Sources of Funding



As funding from abroad was interrupted by the crisis and the situation has not become easier over the last three years, Ukrainian banks have refocused on domestic deposits. By raising rates and marketing new short-term and bonus products, banks achieved a visible stabilization of funding in UAH and foreign currencies attracted from private individuals and corporate clients. The banks have kept and even increased their deposit base since 1 January 2009 as follows:

- Population deposits grew up by USD 14.8bn (+53%) to reach USD 43bn (UAH 343bn) as of 1 July 2012; that amount was equally split between foreign currencies and UAH.

- During the same period corporate accounts saw a dramatic drop from USD 28bn to USD 17bn in 2009, and then a recovery to USD 26.8bn in 2011; in 2012 there was again a squeeze to USD 25bn (UAH 200bn).
- It should be noted that up to 65% of corporate accounts involve "at-sight" money, while private individuals are motivated by banks to place at least short-term (one-month to one-year) deposits, which make up >75% of the money kept with banks.
- The bank loan to deposit ratio is improving: it was 2.19 at the end of 2009 and 1.5 as of 1 July 2012. Foreign currency to foreign currency deposits were almost matched at 1.08 in mid-2012.
- Foreign currency borrowings from banks abroad decreased from USD 42bn to USD 34bn over 2009 and then stabilized at the USD 30bn level, Western-owned banks being the biggest beneficiaries of the funding.

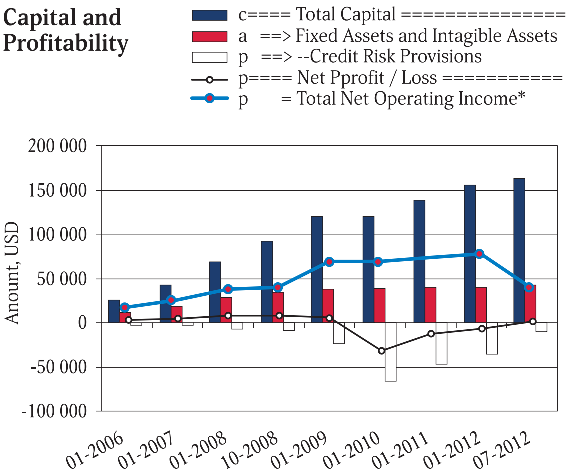
Net banking income at banks was stable in 2009—2011: USD ~9bn. for the year 2012 shows little growth, but the banking sector as a whole may finally become profitable.

In 2012 interest income has comprised 66% of NBI (vs. 72% of NBI in 2010), while commissions income has been stable at 20%.

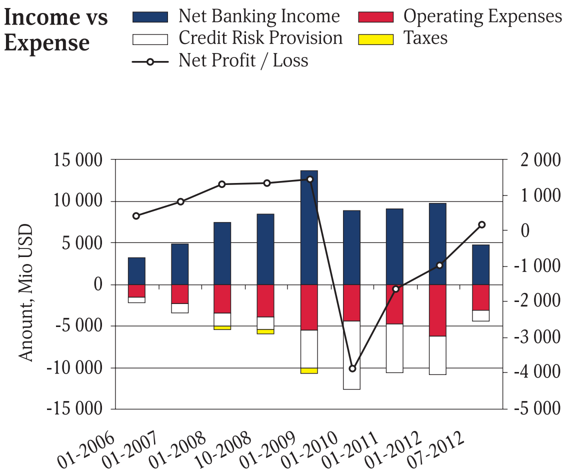
The operating expenses up-shift over 2009–2011 was capped in 2012 thanks to

1.4. Income and Expenses

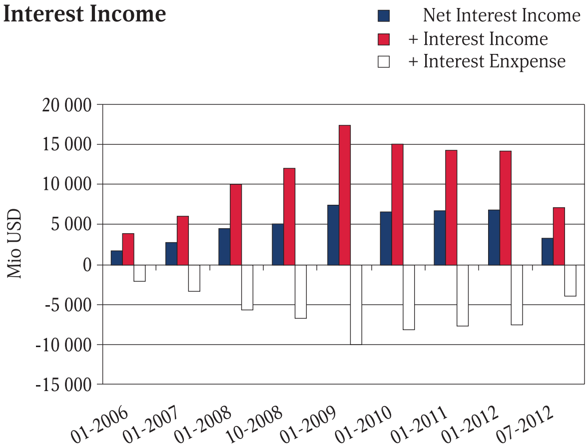
Capital and Profitability



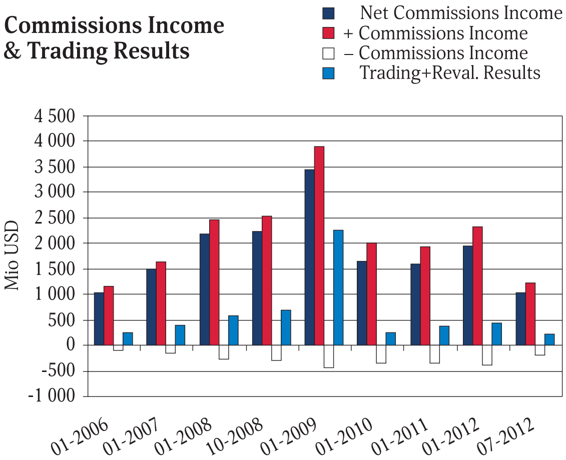
Income vs Expense



Interest Income



Commissions Income & Trading Results



cost and staff expense control. Administrative and staff expenses were USD 4.6bn in 2009, USD 4.9bn in 2010, and USD 6.3bn in 2011 and hopefully should remain the same in 2012. The cost-to-income ratio deteriorated from 52% in 2009 to around 65% in 2012.

Net result is pointing to marginal profit in 2012: loans loss provisions produced less pressure on earnings, finally decreasing in 2012 (forecast) to USD 2.6bn. Compare that to USD 4.4bn in 2011 or USD 8.2bn in 2009, the hardest year.

Capital increase has been a big concern for banks. After an urgent "emergency" capital infusion of UAH 35bn in 2009, the banks continued the pace in 2010 by adding UAH 27bn in 2010 and a further UAH 22bn in 2011. But banks are adequately capitalized today.

1.5. Market Regulator

The National Bank of Ukraine (NBU), with more than 11,000 employees, has since 1991 regulated banking activity. Banks are subject to very significant constraints in their day to day activities, and report "everything," but the NBU's enforcement capacity is imperfect. The banking sector, and particularly its portion that is not western-owned, faces such challenges as fragmentation, including the presence of many small banks (whose minimum regulatory capital will have to stand at UAH 120m as of 1 January 2012), capital adequacy, insider loans, tax games, and insufficient provisioning.

The change in the political landscape in 2010 also led to a change of the NBU's management team. Thanks to IMF support, certain positive changes were made: NBU independence was reinforced (a challenging task), the obligation to reveal beneficiary owners was established (in December 2011), and the necessity of focusing more on inflation management and less on the "peg" between the UAH and the USD was stressed (although the peg is unfortunately still being maintained). In addition, the capacity to transmit foreign exchange risk to economic sectors thanks to the development of forwards became possible in mid-2011, although in a very restrictive way.

1.6. Conclusion

The Ukrainian banking sector remains halfway between stabilization and growth. Anti-crisis measures are still in effect, like the sale of 50% of foreign currency proceeds as mandated by the regulator to keep the UAH/USD rate manageable. At the same time, sources of growth depend solely on the Ukrainian economy, which is too dependent on growth in Europe and emerging markets and on key export/import partners.

Profitability is limited by the overall law of efficiency of business. Non-performing loans, as well as restructured loans, still account for +/- 30–40% of its gross loans. UAH currency funding is made difficult by devaluation fears and by the authorities' decision to prevent this event. All these factors have led banks to stop increasing their loans for the time being.

Banks showed their resilience in the 2008 crisis and have received the required capital. Their capitalization is today adequate.

Banks moved forward in 2012: credit products for the population and loans to agriculture business saw active development.

The western banks in Ukraine have continued to decrease their relative presence, from one third to one fifth of the market over the last 3.5 years.

2013 will be again a challenging year for banks in Ukraine, one in which the global and national business environments will demand quick, precise measures from banks.

2. Currency Control

Currency control is very strict and complex in Ukraine. It is governed by law and by the regulations of the National Bank of Ukraine (NBU). Regulations frequently change, so it is wise to consult your banker.

The purpose of currency control is to prevent the illegal export and import of valuables, goods, and services and the transfer of funds abroad. It is also to control the timely settlement of payments for goods and services under external trade contracts.

For individuals

Import/export of cash:

- Residents and non-residents may export and/or import without declaration the equivalent of EUR 10,000.

  An amount exceeding the equivalent of EUR 10,000 should be accompanied with a written declaration. For an amount exceeding EUR 10,000 there should be presented a confirmation from the bank evidencing that the funds were withdrawn from the individual's account.

- Funds @ disposal (the possibility of withdrawing cash wired from abroad without opening an account):

  Disposable funds are limited per transaction and per day to the equivalent of UAH 50,000 (this is applicable for both residents and non-residents).

Non-commercial transactions:

- Wire transfers in foreign currency are limited to the equivalent of UAH 15,000 per day without the need to open an account, for both residents and non-residents. Residents do not need supporting documents; non-residents require confirmation of the source of money.

- Wire transfers of foreign currency in an amount exceeding the equivalent of UAH 15,000 per day can be performed by residents and non-residents from their current accounts (residents and non-residents need supporting documents).

  Since 27 November 2012 the NBU has introduced mandatory sale of incoming foreign currencies in favor of private individuals if their total amount per calendar month exceeds the equivalent of UAH 150,000 (regardless of the method of payment: via a current account or without opening an account). Amounts exceeding UAH 150,000 should be paid in UAH via a current account opened with a Ukrainian bank.

For more details, please ask your banker.

For commercial operations/companies

The following administrations are involved in the currency control process:

- Customs – controlling the export/import of goods and valuables.

- Banks – authorized by the National Bank of Ukraine, they control all operations and inform the NBU and State Tax Service (STS) of violations; they are liable if the control is not executed properly.

Main activities subject to currency control and certain key rules or constraints:

- Export/import of valuables, goods, and services:

  - Exporting companies should receive payment within 90 days after shipment of goods. This requirement will remain in effect until 19 May 2013.

  - Importing companies can pre-pay 100% of the cost but should receive the goods or services within 90 days. This requirement will remain in effect until 19 May 2013.

  - 50% of foreign currency proceeds from export operations are to be mandatorily sold within one banking day upon their receipt by a Ukrainian bank. This requirement will remain in effect until 19 May 2013.

- Capital market operations (sale/purchase by non-residents of domestic securities; sale/purchase by residents of foreign securities; dividend payments abroad, etc.).
- Cross-border loans (loans granted by non-resident lenders).
- Currency purchases.

Main documents used to perform currency control:

For sale/purchase of goods: trade contracts, customs declarations (in electronic form in the Customs Register), invoices.

For services (including royalties): contracts and documents proving that the services were provided. When such services provided by the same foreign supplier exceed the equivalent of EUR 100,000, it is required to obtain in addition a certificate on price relevance from a designated state entity (Derzhzovnishinform).

For capital market divestments including dividend payments: an investment agreement and a document proving that the investment was made and registered in Ukraine.

If shares are sold by a non-resident, or if a divestment was originally made in kind and the proceeds are to be repatriated, an “estimation certificate” issued by a licensed Ukrainian appraiser is required. In addition, cash divestments of investments made in kind must have been made possible by a treaty between Ukraine and the divestor’s country.

For cross-border loans: loan agreement, NBU registration notice, and the local bank’s consent to service the loan.

For currency purchases: contracts, invoices, and customs declarations, as mentioned above. Currency purchase under each particular contract should be performed via a single bank that was specifically assigned by the customer.

Purchased foreign currencies must be transferred within 10 banking days.

3. The anti-money laundering set-up in Ukraine

Anti-money laundering measures are regulated by the new Law “On prevention and counteraction to the legalization (laundering) of the proceeds from crime” of 18 May 2010, #2258-VI (hereinafter the Law). For banks they are regulated by NBU Regulation #189 “On performance by banks of financial monitoring” in NBU resolution edition #22 dated 31 January 2011 and registered at the Ministry of Justice of Ukraine on 07 April 2011 (hereinafter – the Resolution).

In the context of the Law, “legalization (laundering) of the proceeds from crime” is any action related to funds (property) received as result of a crime aimed at the concealment of the origin of the funds (property) or assistance to a person who is an accomplice in the crime.

The Law excludes tax crimes from the list of crimes that are subject to it. Laundering in Ukraine is understood to relate to prostitution, terrorism, drug and arms sales, and other crimes. The authorities are also inclined to include tax crimes in this group.

The financial monitoring system consists of two levels: the initial level and the state levels.

The following entities are involved in/subject to the initial financial monitoring level:

- banks, insurance (reinsurance) companies, credit unions, pawn shops, and other financial institutions;
- payment organizations, members of payment systems, acquiring and clearing institutions;

- commodity, stock, and other exchanges;
- professional operators on the securities market;
- asset management companies;
- postal operators and other institutions executing financial fund transfer operations;
- branches and representative offices of foreign subjects of economic activity rendering financial services in Ukraine;
- subjects of entrepreneurial business rendering intercessory services during the execution of sale-purchase real estate operations;
- subjects of economic activity executing trade of precious metals, precious stones, and related goods for cash when the related operations equal or exceed UAH 150,000 in worth or the equivalent in foreign currencies;
- subjects of economic activity conducting lotteries and gambling games, including casinos and electronic (virtual) casinos;
- notaries, law firms, auditors, audit companies, physical persons/entrepreneurs rendering accounting services, subjects of entrepreneurial business rendering legal services;
- physical persons-entrepreneurs and legal persons executing financial operations with goods (rendering services, performing works) for cash when the said operations equal or exceed UAH 150,000 in worth or its equivalent in foreign currencies;
- other legal persons rendering financial services that are not financial institutions by legal status.

The following entities are involved in financial monitoring on the state level:

- National Bank of Ukraine
- Ministry of Finance of Ukraine
- Ministry of Justice of Ukraine
- Ministry of Transport and Communication of Ukraine
- Ministry of Economy of Ukraine
- State Ukrainian Commission for Securities and the Stock Market;
- State Ukrainian Commission for Regulation of the Financial Services Markets;
- State Service for Financial Monitoring of Ukraine (hereinafter – FMU).

The FMU is a central executive power body the head of which is nominated by the Cabinet of Ministers. FMU activity is directed and coordinated by the Cabinet of Ministers via the Minister of Finance.

Financial transactions subject to compulsory financial monitoring:

A financial transaction shall be subject to compulsory financial monitoring if its amount equals or exceeds UAH 150 000 or its equivalent in foreign currencies (for subjects of economic activity conducting lotteries and gambling games the threshold is UAH 13 000 or its equivalent in foreign currencies) and if the financial transaction also has one or more of the specific features stipulated in Article 15 of the Law, i.e. if certain objective criteria are met. When both conditions are fulfilled, reporting to the FMU is compulsory. All insurance-related incomings or payments above UAH 150,000 must be reported.

Financial transactions subject to internal financial monitoring:

1. A non-standard or complicated financial transaction or several related financial operations that have no evident economic sense or obvious legal purpose.
2. A financial transaction that does not comply with the activity of the client of the subject of the initial level of financial monitoring.
3. Repeated financial transactions the nature of which gives grounds to believe

that their purpose is to evade compulsory financial monitoring procedures.

4. Financial operations defined by the typologies of international organizations fighting against money laundering.

Internal financial monitoring (article 16 of the Law) can also apply to other financial transactions when subjects of the initial level of financial monitoring have grounds to believe that the financial transactions are aimed at the legalization of "laundered" proceeds.

Subjects of entrepreneurial business rendering intercessory services during the execution of sale-purchase real estate operations have to perform internal financial monitoring if the said operations equal or exceed UAH 400,000 or its equivalent in foreign currencies.

Reporting to the FMU on a financial transaction subject to internal financial monitoring is the result of an assessment by the reporting institution, and based on defined subjective criteria.

FMU has the right to stop, for up to five business days, all debit operations in a customer's accounts if the customer's operations are suspected to be related to money laundering.

Subjects of the initial level of financial monitoring are obliged to "know their customers" and be able to prove it. Their files should contain evidence that their customers (legal entities, individuals, banks, and other financial institutions) have been identified according to the identification rules defined by the Law and by the Resolution, if banks are in question. The identification rules require the identification of ultimate/beneficial owners ("controllers" >=50% ownership), shareholders ("owners of essential participation" >=10% ownership), and managers/authorized persons. The identification rules also prescribe identifying non-resident politically exposed persons (PEP) among the group of customers.

Banks that are subjects of the initial level of financial monitoring are obliged to classify their customers according to the likelihood that they will perform money laundering operations. This classification has to be performed in accordance with the requirements of the Resolution, taking into consideration the criteria defined by the FMU. The Resolution also requests that banks classify customers by their reputation.

The Resolution requires from banks compulsory maintenance of electronic KYC forms ("anketas") of the prescribed format, and in Ukrainian. These "anketas" are to be stored and must contain all the historical data pertaining to banks' relationships with customers. The levels of customer risk and customers' reputations must be indicated in the customers' "anketas."

The Resolution also requests that, each quarter, banks analyze customer operations as to their correspondence with customers' financial conditions and activity. The results of these analyses must be recorded in customers' "anketas."

The Resolution obliges banks to make their internal documents regarding financial monitoring (programs, rules, standing orders, etc.) consistent with it.

The Law and the Resolution also cover activities related to "terrorism." The subjects of the initial level of financial monitoring are required to prevent for up to two days a financial operation if a participant or a beneficiary of the transaction is on the list of terrorists provided by the FMU. The FMU has the right to extend this period to up to 12 business days.

The Law and the Resolution in many aspects respect international AML practice (for instance, in the extension of the list of entities that are subjects of the initial level of financial monitoring, in the identification of PEP, and in customer risk-based classification). But they substantially increase the volume of transactions subject to compulsory financial monitoring and mandatory reporting to the FMU. They also increase the volume of processing work related to customer identification and maintenance of customer "anketas."

* * *

After more than nine years of implementation, Ukraine's anti-money laundering protocols have resulted in more than seven million transactions being reported to the FMU by subjects of the initial level of financial monitoring.

As of 1 October 2012, there were 174 banks among 12,285 subjects of the initial level of financial monitoring, as registered by the FMU.

For 3 quarters of 2012, 716,821 transactions were reported to the FMU. Of these 695,507 (97%) transactions were reported by banks. In addition, 452,010 (63%) reported transactions were subject to compulsory financial monitoring.

Of the 490,346 reports that the FMU received for H1 2012, only 330 dossiers were sent to Ukrainian enforcement bodies. The total funds related to money laundering in these dossiers come to UAH 54.6 bn.

In H1 2012 only 42 new criminal cases were initiated. They were based on 38 dossiers sent by the FMU to Ukrainian enforcement bodies. In addition, 96 dossiers sent by the FMU to Ukrainian enforcement bodies have been used in 97 already-open criminal cases. The courts considered only 34 criminal cases out of this group.

3. Customs Regulation

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The new Customs Code: Making Some Positive Changes

***Igor Dankov**, Senior Manager*

***Robert Zeldy**, Manager, PwC Ukraine*

The new Customs Code of Ukraine took effect on 1 June 2012. It was the result of a long working process by various state authorities and businesses. The American Chamber of Commerce took an active part in this process. The authors of this article, for example, were members of the relevant Governmental and Parliamentary working groups and submitted numerous proposals that became provisions of the Code. We discuss these provisions in detail below.

The proposals were based on the best practice available around the world. Ukraine has declared its adherence to EU values and a willingness to join that organization in the future. For it to do so, its legislation must be aligned with the EU's. Adapting Ukraine's customs legislation is a priority task for the state authorities.

The EU has successfully implemented the WTO's customs valuation principles and accumulated many best customs practices. Logically enough, we studied this experience and tried to borrow from it while preparing our proposals.

The purpose of this article is twofold. On the one hand, we summarize our contributions to the new Code. On the other hand, we discuss a variety of complex customs issues that remain unsolved in Ukraine.

1. General characteristics of the new Customs Code

Opinions about the new Code vary. Some say that it is worse than the previous Code. Many believe there are a lot of good changes as compared to the previous legislation.

It is obvious that many changes to the Code are good for business. The unambiguous successes include:

- Customs clearance at any customs office without any additional approvals (previously, entities had to seek permission for customs clearance in a customs office other than the one in which they were registered);
- A legislative reduction of the duration of customs clearance to four hours (previously customs clearance had to be finalized within a day, but in practice it lasted longer);

- A real reduction in the percentage of goods inspected (from 70% in 2009 to 9% in 2012);
- A significant increase in the amount of goods declared electronically to customs (50% by the end of 2012). There is, however, room for improvement here.

Businesses may also benefit from the following provisions of the Code:

- The conflict of interest rule: if customs legislation is unclear or allows for multiple interpretations, the customs authorities are required to decide in favor of entities;
- The customs authorities may issue customs rulings at the request of entities. If an entity followed a ruling that was subsequently cancelled, penalties do not apply;
- The Code makes the customs authorities responsible for losses caused to business entities. Upcoming legislation should establish the procedures relevant to this responsibility. A draft already exists and we are working on proposals to make this piece of law one that adequately protects business activities;
- The Code introduces the authorized economic operator institution (AEO). Entities that have acquired AEO status will enjoy a simplification of customs procedures. We do not expect that there will be many AEOs, as the compliance requirements are strict. However, the readiness of the customs authorities to simplify procedures for bona fide entities is very much welcome in the business community;
- The customs procedures (regimes) have been significantly improved. This presents new opportunities for doing business in Ukraine. There have been updates related to the customs procedures of processing, temporary import/temporary export, re-import, and re-export;
- And, finally, customs audit procedures have improved. The global tendency is to relax customs control at the moment of import and shift the bulk of control to the moment following the goods' release into free circulation. If Ukrainian customs borrows this best practice, it would be a positive move. Otherwise, post-audit control will become another instrument for collecting more revenue.

The new Customs Code is certainly not perfect. It is difficult to create an ideal document that will satisfy both the fiscal authorities and the business community. The following areas call for further improvement:

- The right of the customs authorities to set up specific locations for customs clearance of certain goods. In principle, there is a rationale for this provision. However, bad experiences in the past suggest that this could potentially create a problem for business;
- Huge penalties levied on individuals for violations of customs rules. This is justified neither fiscally nor economically. It is unrealistic for an individual (i.e., the declarant) to pay a penalty amounting to 100% of the value of the goods. The law does not establish higher or lower penalties that take into account circumstances that could mitigate responsibility. Logically, then, it would be better to penalize business entities, rather than individuals;
- The list of cases when a declarant can release goods into free circulation by providing guarantees. At the moment this is possible only for cases when disputes about customs valuation or classification issues arise. World Customs Organization guidelines, however, hint that if there is a dispute the declarant should have the right to release the goods by providing custom payment guarantees.

The Customs Code could be improved in other areas as well.

Below we summarize certain provisions we drafted towards making the Code more effective.

2. Customs valuation

Historically, customs valuation has been an area of dispute between importers and the customs authorities. The customs valuation provisions of the old Code were based on WTO principles (the Agreement on Implementation of Article VII of the GATT). However, the customs authorities have often misused these provisions in order to increase revenue collections, as:

- The focus was not on the rules for determining the customs value of goods, but on the supporting documents;
- Customs did not explain why they rejected declared values;
- The authorities used information from their internal price database to define customs value.

As a result, the customs authorities have challenged declared value without sufficiently explaining their reasons for doing so. The basis for such a challenge could be the availability of higher prices in their internal database. The next step was to request that the importer present additional documents to support the declared value. As a rule, customs was requesting documents that either did not exist (e.g., price calculations of the goods) or that were difficult to obtain (e.g., a foreign export customs declaration, even if the exporter could declare the goods electronically).

Should the importer fail to present the additional documents, the customs authorities have the right to define customs value themselves. The old customs valuation rules were thus favorable for customs and denied the importer the ability to determine customs value.

We focused our efforts on changing this situation and making the customs authorities explain (preferably in writing) every step they take when rejecting a value as well as how they arrived at the new customs value.

We proposed the following minimum provisions (they were included in the new Customs Code).

1. Cases of rejection of a declared value

We suggested that a customs office may reject declared value only in the following cases:

- The declarant calculated the customs value incorrectly;
- The declarant failed to submit the main supporting documents;
- The declarant elected a customs valuation method incorrectly;
- The declared value was proved untrue based on official information obtained from foreign customs authorities.

However, practice shows that the customs authorities have often misunderstood these provisions. We would thus advise further clarifying the terms “incorrect calculation of customs value” and “incorrect election of a customs valuation method.”

2. Customs must substantiate a rejection of declared value

There are three different cases in which customs must present arguments if they do not accept a declared value:

- The seller and buyer are unrelated entities – in this case, customs must argue that the declarant declared inaccurate or false information about the customs value or defined it incorrectly. Otherwise, the customs value is considered to be accepted automatically;
- The seller and buyer are related entities – in this case, customs must ar-

gue that the relationship impacted the price. These arguments must be submitted in writing. If customs does not present any arguments, it is considered that the relations did not impact the price of the goods;

- The declarant submitted additional documents supporting the declared value within 30 days after the release of the goods against financial guarantees. If, within the next five days, customs fails to explain why they cannot accept the declared value, it is considered that the declarant defined the customs value correctly. Customs must release the financial guarantee.

We recommend that an importer use these beneficial provisions of the Customs Code. If customs fails to argue why they rejected a declared value, a declarant will have a good chance of winning a court case. There is no need to hold the goods under customs control until the dispute is resolved. It is possible to release the goods against financial guarantees and then appeal against the customs valuation.

3. Documentary support of the customs value

As we mentioned above, the customs authorities have often demanded excessive documents, in the hopes that the declarant will fail to present them. In this situation, customs obtains the right to determine the customs value itself. Even when the declarant submits the requested documents, customs can disagree with it and reject the declared customs value.

We thus suggested determining the list of documents required to support declared customs value as follows:

- There is a basic set of documents that should be submitted to the customs authorities. These documents include the cross-border contract, the invoice, the transport waybill, etc.;
- Customs may request additional documents only where the main documents contain discrepancies or signs of forgery or do not contain complete information. These documents may include contracts with third parties, accounting documents, the seller's price lists, etc.;
- If customs has sufficient grounds to claim that the relationship impacted the price (in transactions between related parties), it may ask for specific documents (e.g., price calculations, prices for identical/similar goods in the exporting country, etc.).

These Code provisions prevent customs officials from demanding arbitrary documents.

4. Format of a customs value adjustment

We proposed strengthening the requirement that the customs authorities must substantiate an adjustment of a customs value. Specifically, they need to provide the following information:

- Arguments supporting the rejection of the declared value;
- Available information that generates doubts about the truth or accuracy of the declared value;
- What the declarant must do for customs to accept the declared value;
- A numerical calculation of the value.

If customs fails to provide this information, it will be easier for the declarant to appeal against the adjustment.

5. Release of goods against financial guarantees

The customs authorities release goods against financial guarantees when:

- The declarant disagrees with the customs value determined by customs;
- The declarant is unable to submit additional documents as requested by customs.

We managed to improve the process as follows:

- Originally, the Code proposed that the declarant had to ask customs to release the goods against guarantees (i.e., customs had to approve this). We proposed that the release against guarantees should be at the sole discretion of the declarant (i.e., there is no need to obtain consent from customs for this);
- Customs had to explain why additional documents were insufficient for accepting the declared value. If such substantiation is missing, it should be considered that the declarant has determined the customs value correctly and that the customs authorities have to accept it and release the guarantee.

Also, we proposed that a financial guarantee remain in effect until the final resolution of a customs valuation dispute. For instance, even if the declarant cannot convince customs within 80 days, it will be possible to appeal to a higher customs body or to a court. Until there is a decision from these authorities, the financial guarantee should continue to apply. Unfortunately, this proposal was not implemented in the Customs Code.

6. Implementation of the WTO's Customs Valuation Decisions

We suggested that the Customs Code incorporate certain WTO Customs Valuation Decisions that Ukraine committed to following. In our opinion, this would facilitate the practical use of these Decisions.

Cases where customs administrations have reasons to doubt the truth or accuracy of the declared value (Decision 6.1)

We suggested that this Decision be broadly implemented by requiring the customs authorities to substantiate their decisions for rejecting and adjusting declared values. We proceeded from the fact that the Decision requires the customs authorities to have reasons to doubt the declared customs value. See above for how this was implemented.

We note that Ukraine did not commit to follow this Decision. In our opinion, a failure to follow it is not in line with the general principles of customs valuation.

Valuation of carrier media bearing software for data processing equipment (Decision 4.1)

This relates to customs valuation of carriers (e.g., CD, DVD, etc.) with computer software. In this case, for customs valuation purposes only, the value of the carrier medium should be taken into account. The customs value should not include the value of the software provided that it is distinguished from the value of the carrier medium (i.e., they are separate on the invoice).

The designation "carrier medium" does not include integrated circuits, semiconductors, or similar devices incorporating such circuits or devices. This rule thus will not apply, for example, when software is recorded on a laptop hard drive.

Treatment of interest charges in the customs value of imported goods (Decision 3.1)

This decision relates to the customs treatment of interest charges in the customs value of imported goods. It is particularly relevant to the import of assets under a financial leasing contract. In this case, a question may arise as to whether interest charges should be added to the customs value of the imported assets.

The Code (following Decision 3.1) stipulates that interest charges will not be a part of the dutiable value when the following conditions are met:

- The charges are distinguished from the price actually paid or payable;
- The financial arrangement is made in writing;
- The buyer can demonstrate that the goods are actually sold at the declared price and the interest does not exceed the market level.

It is not relevant whether the financing is granted by the seller, the bank, or any other legal entity or which customs valuation method is applied for valuing the goods.

Treatment of payments in respect of broadcasting/distribution rights of sound or cinematographic recordings

This opinion of the Customs Code Committee of the European Commission's Directorate-General for Taxation and Customs Union deals with the customs valuation of sound or cinematographic recordings imported on media carriers for distribution and/or diffusion by television and cinema networks. The Committee concludes that the amounts paid by the buyers of the audiovisual programmes in question with respect to the charge for broadcasting/distribution rights should be regarded as equivalent to payment for the right to reproduce the imported goods. Consequently, these amounts should not be taken into account in determining the customs value (provided that they are distinguished from the price paid or payable for the support media).

Unfortunately, this opinion of the Committee has not yet been taken into account by the customs authorities. However, we continue to work to align the customs valuation legislation with this and with other opinions of the European acquis communitaire.

3. Other provisions

While working on proposals for the new Customs Code, we focused on a number of other important areas. We discuss these proposals below. Many of them were developed further based on our initial ideas.

1. Customs rulings (consultations)

The Tax Code allows the controlling authorities (including customs) to issue rulings on the application of tax legislation. We thought it would be good to oblige customs to grant rulings on the practical application of customs legislation. Thus, the customs authorities can now issue rulings on a wider range of customs issues (not only tax ones). The important points about the customs rulings are as follows:

- Like tax rulings, customs rulings can be of an individual nature (for use by particular taxpayers that requested them) and of a general nature (these may be used by any taxpayer);
- Customs may issue rulings verbally, in writing, or electronically;
- If an entity has followed a ruling issued in writing or electronically, it cannot be held responsible if it was subsequently changed or cancelled (i.e., penalties will not apply);
- The requestor can appeal against a ruling to a higher authority or court. Recognition of the ruling as invalid by a court is grounds for the authorities to issue a new ruling based on the court's conclusions.

2. Conflict of interest

If the customs legislation is unclear and may be interpreted in favor of both the declarants and the customs authorities, the decision should be taken in favor of the declarants. This provision allows for favorable treatment of the customs legislation if it lacks clarity.

We supported this provision and recommended including it in the Customs Code.

3. Single window

This concept is not new. Rather, the Ukrainian customs authorities have long known about it. We proposed that the customs authorities follow this concept and it was included in the Customs Code.

According to this concept, various types of control over goods should be performed using a single customs information system (Recommendation UNECE/CEFACT № 33, 2005). The customs authorities would coordinate all communication with other state authorities. Thus, the importer would need only to provide all information about the goods to customs. The latter would then connect with other authorities regarding licenses and permits.

The customs authorities have already committed to start implementing the single window concept from 2013.

4. Electronic declaration

According to the WCO's approach, introducing the e-declaration of goods is an area of priority development for customs administrations. We have supported the Code's provisions concerning introducing e-declaration in Ukraine. Ukraine's customs authorities have committed to fully introducing e-declaration by the end of 2013.

We fully support the following approaches:

- Minimum supporting documents should be filed together with the e-declaration. Other documents should be available at the declarant's premises for review by the customs authorities during post-entry audits;
- Circulation of documents between customs, other authorities, and declarants happens in an electronic format.

E-declaration represents a significant facilitation of cross-border trade. At the current stage, trade is hampered by outdated IT systems and by the absence of electronic circulation of documents between various state authorities. E-declaration may be fully implemented within four to five years.

5. Amendments to customs declarations

We support the following provisions of the Customs Code:

- A declarant can amend a customs declaration for three years after customs clearance;
- If the declarant has revealed undeclared goods and disclosed this to the customs authorities by amending a customs declaration, penalties will not apply.

6. Customs brokerage activities

The draft Code envisages insuring customs brokers' liabilities for a minimum of EUR 300,000. This could be a serious blow to customs brokers' activities in Ukraine. We actively moved against this provision of the Code and it was excluded.

4. Conclusion

The general conclusion is that the new Customs Code is a rather progressive document. Much will depend on how the customs authorities implement it. The likelihood of improper implementation will rise if business fails to demand that the authorities follow the rule of law.

There is no ideal document, and the Code has room for improvement. The main areas for improvement include:

- Customs valuation;
- Responsibility for customs offences (the current fines are unrealistically high);
- Introduction of centralized customs clearance;
- Re-introduction of zero VAT on re-export after processing based on contract manufacturing (except for tolling) and sale for export of earlier imported goods from a customs bonded warehouse;
- Bringing foreign exchange control in line with new customs regulations.

We have already started polishing the customs law in the following areas:

- Customs treatment of royalties;
- Compensation of losses caused by the customs authorities.

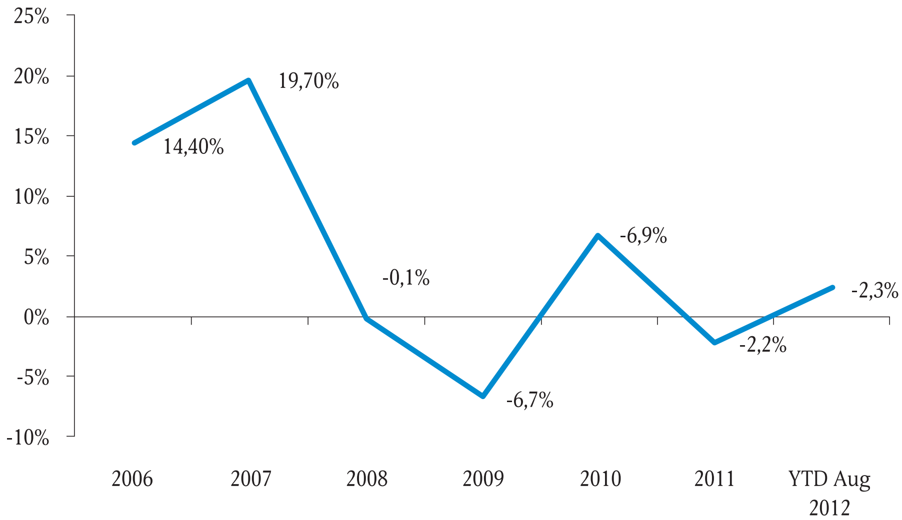
As active members of the Chamber's Customs Committee, we will continue making all efforts to lobby for the interests of the business community.

4. FMCG Market

Ukrainian Beer, Kvas and Cider Market Overview

1. Ukrainian beer market overview

- Since 2008, the beer market has been experiencing a period of stagnation. The first growth on the beer market was observed in 2010, when the market grew by 3.6%. According to internal Carlsberg Ukraine data, in 2011 the beer market declined by 2.2%. In the first half of 2012 poputhere was short-term growth of 2.7% due to EURO 2012TM and the warm spring weather. In the second half of 2012 beer consumption volumes began to fall again.



Beer market dynamics 2006–2012, mln l

Source: Carlsberg Ukraine internal data

- In 2012 we also saw beer consumption fall due to the Ukrainian economic slowdown in the third quarter and the strengthening of the population's deflationary expectations. For the first six months of 2012, beer consumption in Ukraine was 58 l per capita.

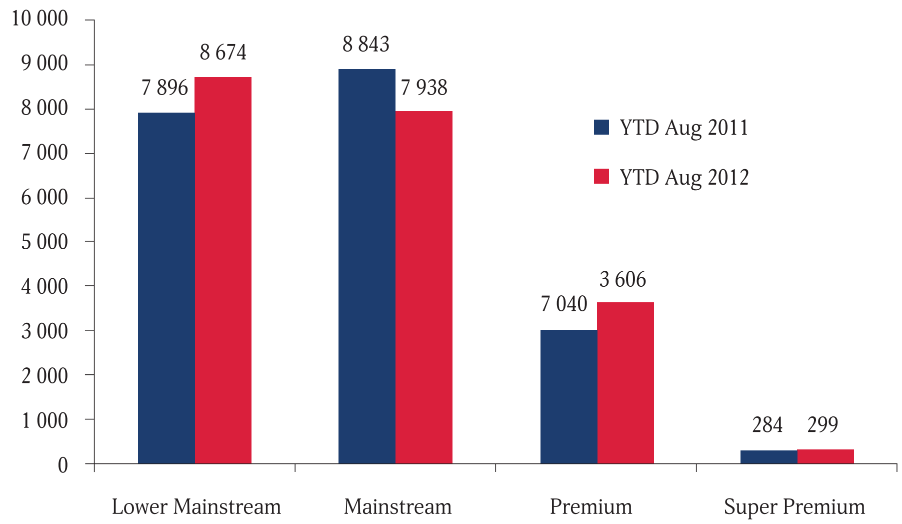
Beer consumption per capita

Year	2005	2006	2007	2008	2009	2010	2011	2012(F)
Consumption per capita, l	45	51,5	61,1	61,6	57,3	60,8	59,7	58

Source: Carlsberg Ukraine internal data

- In 2012 the mainstream price segment was most affected. It showed a decline over the past few years. At the same time, the premium and lower mainstream segments continued to grow.

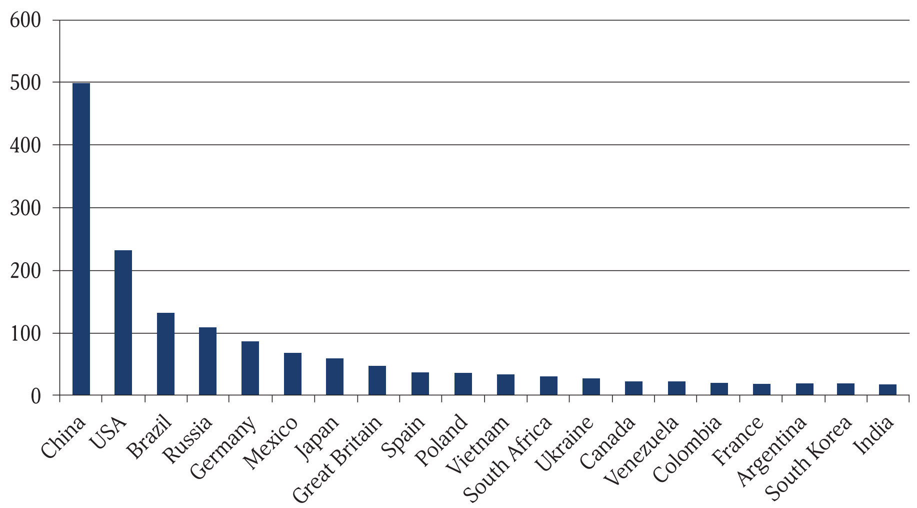
Beer market volume according to segments, KHL



Source: Carlsberg Ukraine internal data

- The situation as regards the ratio of packaging preferred by domestic consumers has not changed since last year. According to Carlsberg Ukraine internal data, consumer preference by packaging types can be estimated as follows: 35% – glass bottles, 7% – cans, 13% – kegs, 45% – PET (plastic bottle).
- 2012 saw beer prices on the market rise by nearly 13.5%. The main reason for this growth was the rise of materials costs (particularly for barley) and the rise of the hops production tax. So far the retail price of beer in Ukraine is at the level of the average European price, while the Ukrainian price for vodka is one of the lowest in Europe.

Beer market volume in 2012, KHL

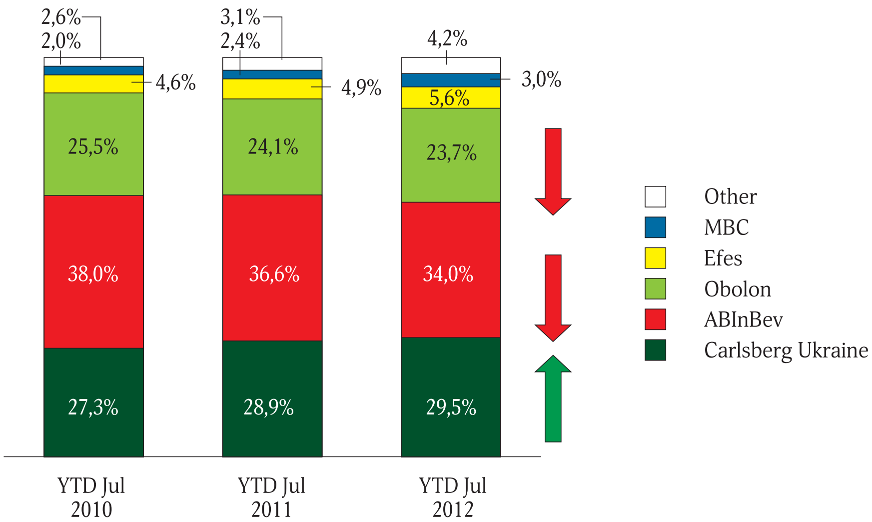


Source: Canadean

- Among the major competitors on the Ukrainian beer market are three foreign companies: AB InBev (1st position); Carlsberg Ukraine (2nd position); Efes (formerly SABMiller) (4th position); and a local company – Obolon (3rd position).

- It is worth mentioning that in 2012 competition on the Ukrainian beer market increased. This is associated with the appearance of new competitors — the Russian brewing company Moskow Brewing Company, which acquired the Radomyshl Brewery (Zhytomyr oblast) and First Private Brewery (Lviv), and Efes (a Turkish company), which acquired the assets of SabMiller.

Market share of the main producers on the beer market of Ukraine



Source: AC Nielsen

Segmentation of the beer market

Segment	Share
Super Premium	2,9%
Premium	18,8%
Mainstream	40,4%
Lower Mainstream	37,8%

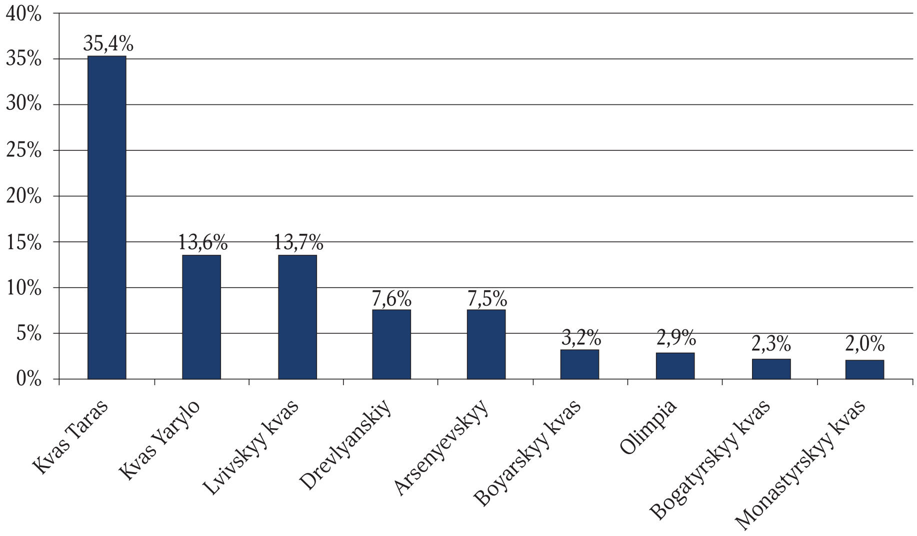
Source: AC Nielsen

- In 2012 brewers faced several legal restrictions. In January 2012 the fee for water resource utilization rose by exactly +17,9%, to 30,18 UAH.
- In addition, in January 2012 the excise tax rose by 9%, from 0,74 UAH per 1l of beer to 0,81 UAH. A further excise tax rise is expected in January 2013: by 11% to 0,90 UAH.

2. Ukrainian kvas market overview

- The kvas market in Ukraine is repeating the path of the development of the beer market as it stood 10 years ago.
- Currently in Ukraine kvas consumption is nearly 2,6 l per capita a year, while in Russia it is 3,2 l, and in Belarus it is 6,4 l. In the Soviet Union kvas consumption was 18 l, indicating the potential for market growth in the future.
- The kvas market is becoming more structured. The number of small, regional competitors is decreasing. At the same time TM Kvas Taras is holding the leadership position on competitive market.

Market share of main brands by volume:

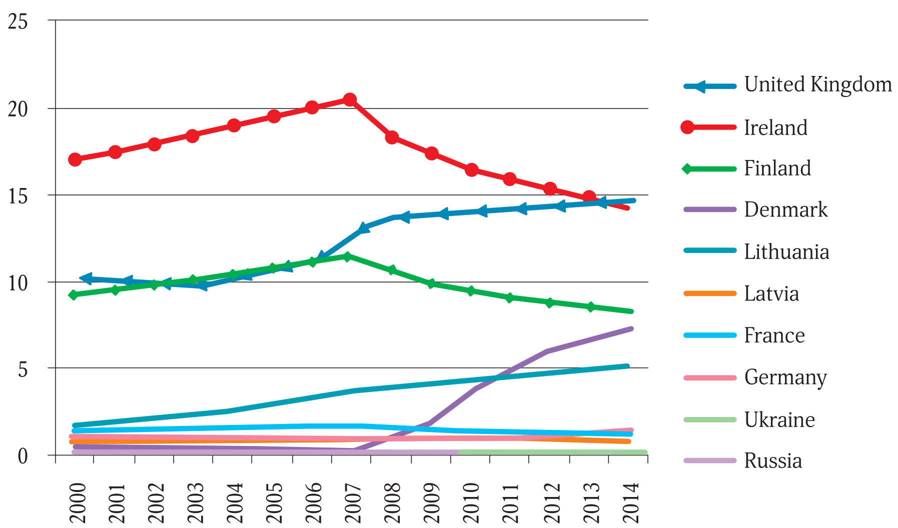


Source: AC Nielsen as of August 2012.

3. Ukrainian cider market overview

- As of 2012 the cider market in Ukraine is in the process of formation. It is currently not yet formed – one of the first competitors in the segment is the natural fermentation cider, Somersby, which launched on the Ukrainian market in 2011.
- According to the experts' estimations, in the next few years the cider market will be 3–4% of the beer market, that is, nearly 10–12 million Dl. Experts estimate cider market volume today as 460 thousand Dl. Somersby, produced by Carlsberg Ukraine, takes up 85% of the market.
- At the present moment cider consumption in Ukraine and Russia amounts to only 0,1l per capita a year. In Europe consumption is significantly higher. Apple cider is mostly consumed in Great Britain and Ireland.

Cider consumption in Europe



- The cider market is thus quite promising and has huge development potential.

METRO

Retail Sector Overview

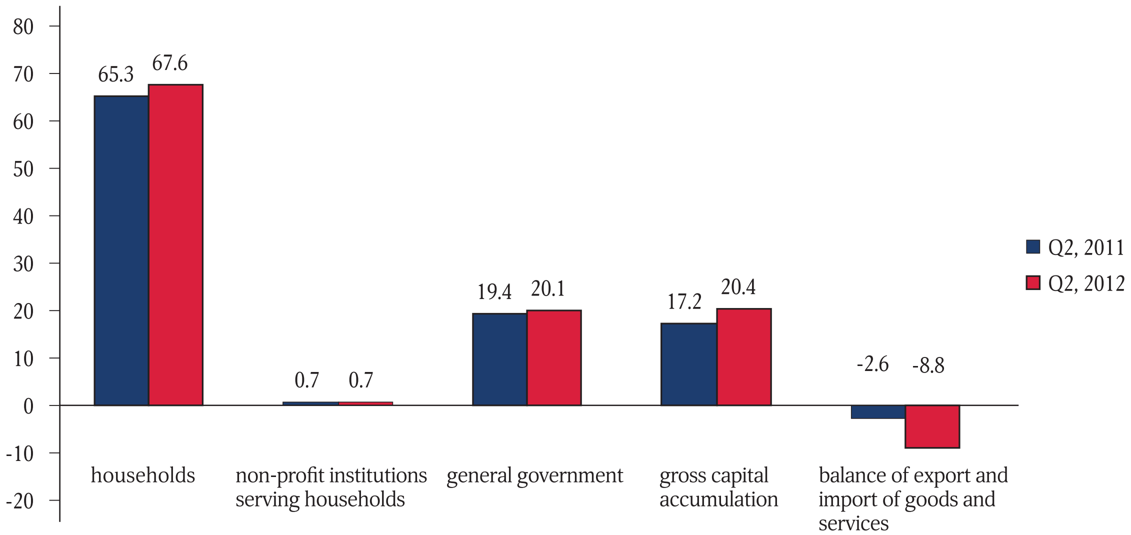
1. Macroeconomic overview

High domestic demand in the second quarter of 2012 accelerated the growth of GDP (which was up 3% in annual terms and 1.9% for the quarter, excluding seasonal factors). According to the National Bank of Ukraine the main factors driving positive GDP were stable high rates of growth in real wages, increasing public funding for projects, and favorable weather conditions.

The main factor holding back GDP growth was unfavorable external economic conditions that negatively affected the activities of export-oriented industries. Metallurgy output declined by 0.7% in annual terms and engineering declined by 0.6%. This affected both overall industry performance and exports of goods and services.

The structure of GDP indicates the increasing role of household consumption. It made up 67.5% of national GDP in the second quarter of 2012.

GDP structure by final consumption categories, %



Source: State Statistics Committee

In October 2012 the consumer price index remained the same as it was last year. These price dynamics and the real wage growth of the population stimulated domestic demand, which was a major factor supporting the country's economic activity during the reporting period. According to the National Bank of Ukraine, the reduction of the overall level of consumer prices against the background of increasing household income led to growth in the population's purchase capacity, which positively affected the dynamics of retail. Growth in retail turnover in January-October remained high: at 15.0% compared with the same period of the previous year.

Increased instability on the international financial markets led to a reluctance to take risks. Investors tried to reduce their investments in developing countries, including Ukraine. The investment situation may get worse given the uncertainty about the successful stabilization of the Eurozone and about a potential world domino effect due to the deepening crisis in Europe. Ukraine's access to financing is already limited due to investor concerns about the stability of its macroeconomics and about an insufficient investment climate.

According to Planet Retail, the build-up to UEFA Euro 2012 had a positive impact on Ukrainian GDP growth. It led to some improvement in the country's infrastructure, and the foreign investment that the country saw may result in greater transparency on the property market. For the retail market, however, the development process is unlikely to speed up, because there remain many gaps in the country's infrastructure and the market itself is still hampered by bureaucracy and corruption, which discourages international players from entering.

According to the World Bank, Ukrainian GDP growth is projected to accelerate to 3.5% in 2013, but the economy will need rebalancing. This scenario assumes a slow but orderly resolution of the crisis in Europe, with the Eurozone returning to growth of 0.7%. Further improvement in the external environment in 2014 will enable Ukraine's GDP growth to pick up to 4% in 2014. Higher external demand will help the Ukrainian economy accelerate, but this alone will be insufficient to restore macroeconomic equilibrium and stabilize expectations.

2. Consumer behavior

The highest rates of consumer confidence in 2012 were observed in January, May, and August, according to GfK Ukraine's monthly survey of Ukrainian consumer confidence. From August 2011 to January 2012, the consumer confidence index exceeded for the first time the value of 80 and returned to the level of the end of 2010. Ukrainian's expectations concerning changes in personal financial standing saw the most significant increase, while economic expectations remain low.

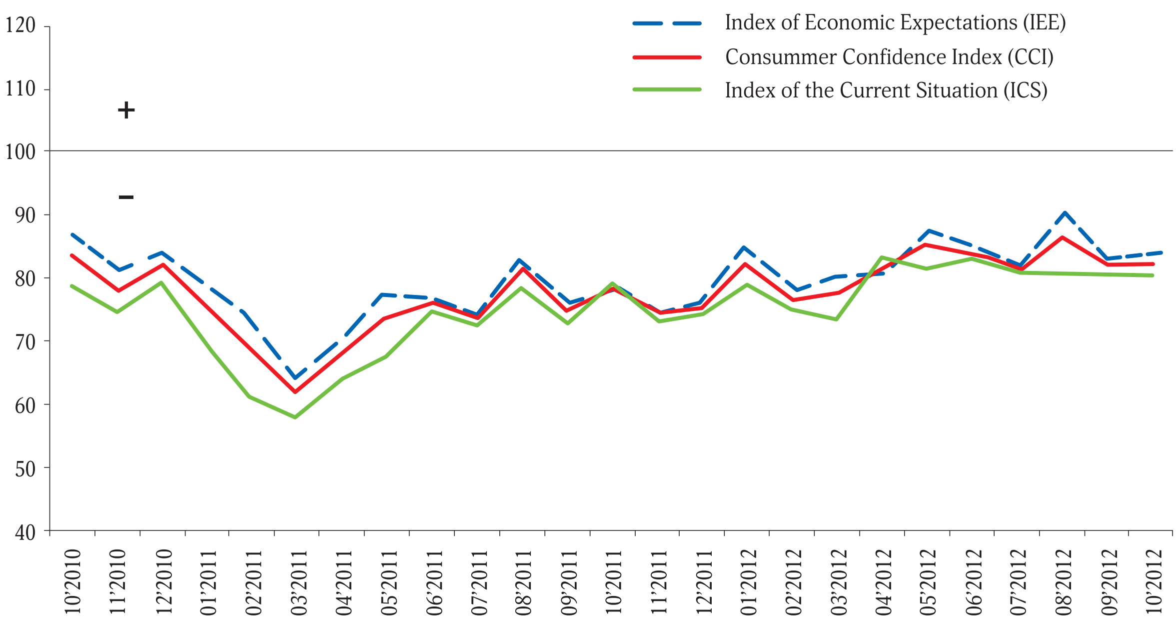
In May the Consumer Confidence Index reached its highest rate since July 2010. It had been increasing steadily during the previous four months. Growth was primarily due to the index of economic expectations against a background of reduced inflation fears, despite the significant increase in expectations of devaluation.

After decreasing during June and July, the CCI improved again in August. The improvement in consumer confidence was due to an increase in the economic expectations index of 10 p. in general and to an increase in the index of expected economic conditions in the country over the next year of 16 p. in particular. This occurred even as there was a deterioration of expectations regarding changes in unemployment: that indicator fell by 6 p., to the level of autumn, 2010. Indices of inflationary and devaluationary expectations, meanwhile, stabilized.

October saw an insignificant improvement in Ukrainian consumer confidence. The October consumer confidence index (CCI) is 82.4, which is just 0.6 p. higher than it was in September. In October, positive dynamics in terms of inflationary expectations were observed in parallel with the ongoing increase in devaluation expectations.

Fluctuations in the dollar exchange rate in early autumn were likely the main factor behind the deterioration in consumer confidence. The devaluation expectations index increased by 7 p., a record level of growth for the period since May; this growth pulled on the inflationary expectations index. As a result, the index of expected economic conditions for the next year saw the largest decrease yet; this index was once again the lowest of all the components of the Consumer Confidence Index. At the same time, the propensity to consume increased, which is often a positive response to devaluation expectations.

Consumer Confidence Index in Ukraine



Source: GfK Ukraine

Jobs represent the greatest cause for concern for Ukrainian consumers. According to the Nielsen Company, in the 3rd quarter of 2012 18% of Ukrainians identified preservation of jobs as the most perturbing topic for them (as compared to 15% in 2011). In second place was healthcare (14%) and in third place was the economy (13%).

As is usual when there are expectations of devaluation, the worsening of attitudes was observed mainly among the following: the economically active population aged up to 45 years; among both the richest and the poorest in cities with populations over 500,000; and in the south.

Dynamics of the Consumer Confidence Index in Ukraine

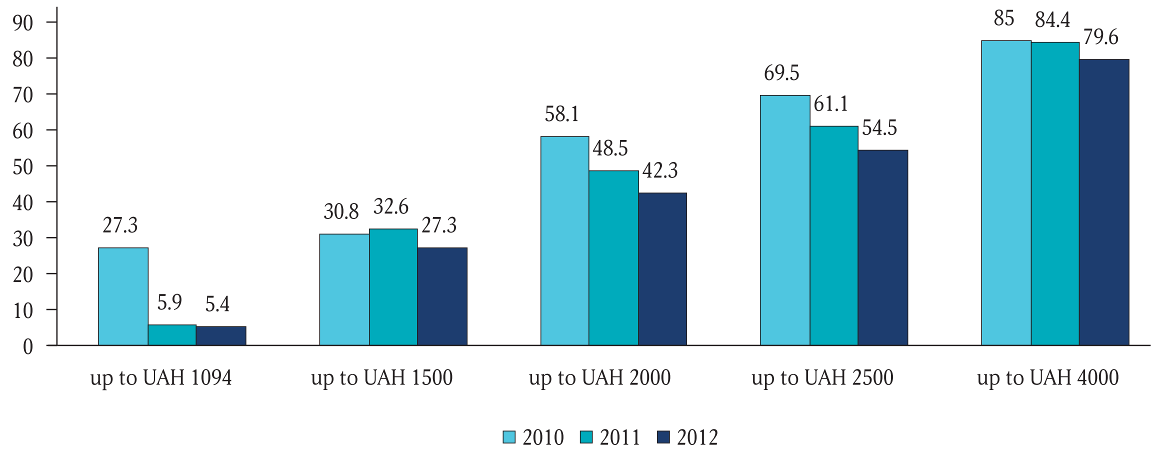
Month, year	Consumer Confidence Index (CCI)	Index of the Current Situation (ICS)	Index of Economic Expecta-tions (IEE)	Index of Inflationary Expecta-tions (IIE)	Index of Expectations of Changes in Un-employment (IECU)	Index of Devaluatio-nary Expec-tations (IDE)
10'12	82.4	80.5	83.7	181.8	126.9	144.9
09'12	81.8	80.6	82.6	185.2	127.4	142.1
11'11	83.6	78.7	86.8	183.8	119.5	–

Source: GfK Ukraine

According to the State Statistics Committee, nominal income increased by 15.2% in the second quarter of 2012 compared with the corresponding period of the previous year. Available income, or income that citizens can use to purchase goods and services, increased by 14.5%. Available income per capita for the second quarter of 2012 was 5749.1 UAH, which is 742.5 UAH more than in the corresponding period of the previous year. Household expenditures in the second quarter of 2012 compared to the same period last year increased by 16.3%. Savings increased by UAH 24,457 million.

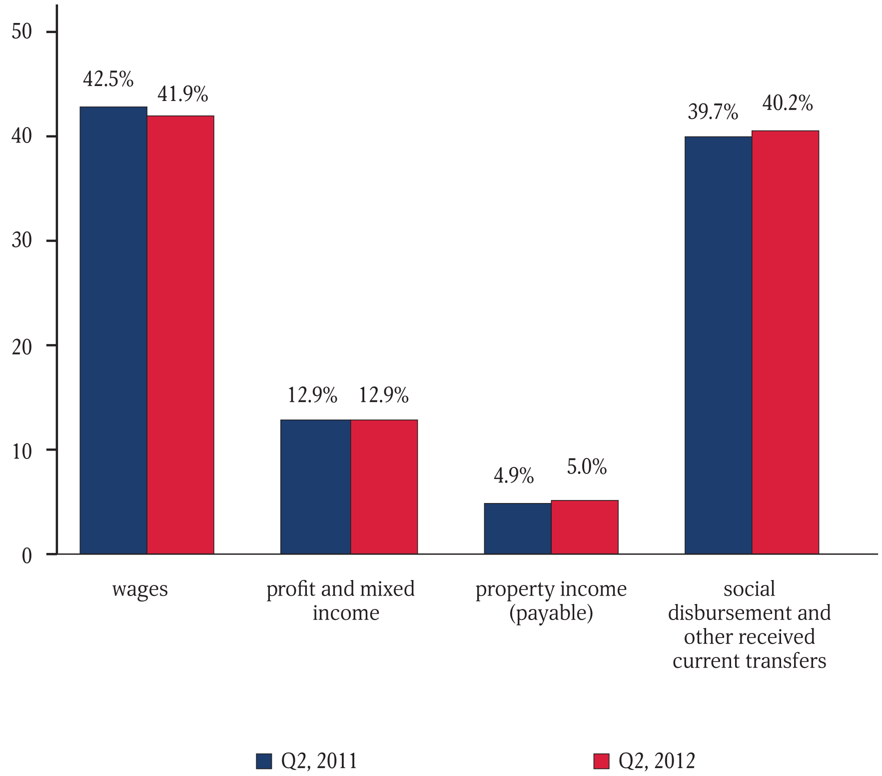
According to the State Statistics Committee, the average salary in Ukraine for the January-September 2012 period was 2,975 UAH The highest rates are in Kyiv city, Kyiv region, Donetsk region, and Dnipropetrovsk region.

Percentage of employees by average wages in September 2012

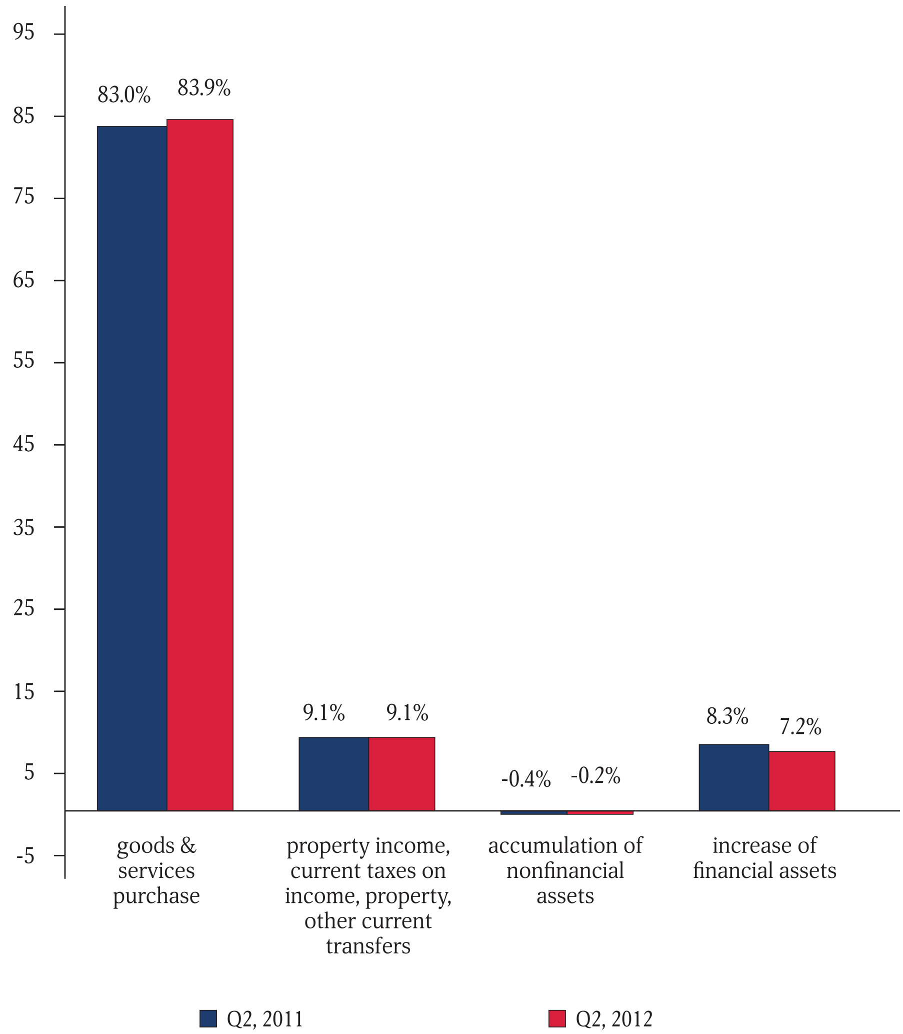


Source: State Statistics Committee

Household income structure



Household expenditures structure



Source: State Statistics Committee

In the second quarter of 2012 Ukrainians began to spend more as compared to the previous year. 83.9% of income was spent on goods and services (83.0% in 2011).

According to the State Statistics Committee, in January-October 2012 the prices for food and soft drinks decreased by 2.11% on average as compared to the same period in 2011. In particular, prices for fruits decreased by 6.10% and for sugar by 30.8%. However, meat became more expensive by 8.3%; bread by 5.7%; milk, cheese, and eggs by 4%; and fish by 5.1%.

3. Retail market overview

According to the State Statistics Committee total turnover in Ukraine for January-October 2012 increased by more than 15% and amounted to UAH 650.38 billion. Turnover of enterprises during the same period increased by 13.9% and amounted to UAH 329 billion, representing about 51% of total turnover. In 2011, 61.1% of turnover in the country was accounted for by non-food products.

There are still few international companies operating in Ukraine. The major investors are METRO GROUP, Auchan, Billa, Praktiker, and OBI. METRO GROUP is the biggest international investor in the Ukrainian retail market. It has invested around 530 million euros in the country's economy and created more than 7,400 jobs.

Top five retailers on the Ukrainian market according to Planet Retail in 2012

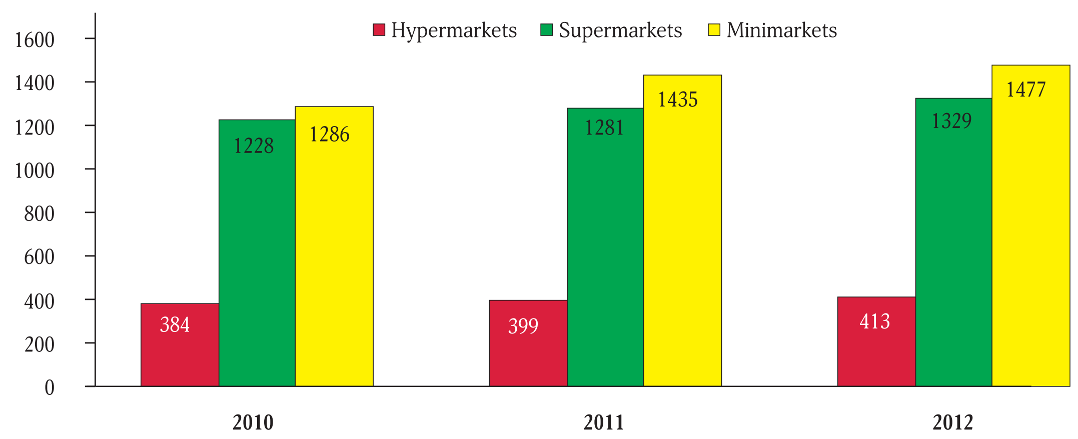
	2012 forecast				
Company	**Number of Outlets**	**Total Sales Area SQM**	**Average Sales Area SQM**	**Grocery Banner Sales (EUR)**	**Grocery Market Share %**
Fozzy	432	352,500	816	2,110,480,172	5.76
ATB Market	630	409,500	650	1,970,067,350	5.49
METRO GROUP	41	320,300	7,812	851,043,466	1.23
Retail Group	59	109,350	1,853	702,457,735	1.96
Furshet	113	185,300	1,640	623,819,784	1.74
Grand total:	1275	1,376,950	2554,20	6,257,868,507	16.18

According GT Partners Ukraine surveys, more or less active territorial expansion of all types of FMCG retailers in Ukraine is currently being practiced by local companies (present in one economic and geographic region) and national companies (present in four to five economic-geographic regions) companies. Regional companies (present in two to three economic-geographic regions) and international companies (with the central offices located abroad) evinced a less dynamic tendency to open new outlets in the first half of 2012. By and large, among foreign companies only METRO Cash & Carry, Billa, and SPAR opened new stores in Ukraine during 2012.

Retail formats are defined differently in Ukraine than they are in Europe and are adapted to the specificities of the local market. For example, the "cash and carry" format as implemented by Ukrainian companies means that a substantial proportion of sales is to end consumers. Hyper- and supermarkets often set low prices to attract more customers. Discounters offer an expanded product range and still have a very low share of their own in-house brands than do, by comparison, Germany's discounters. Convenient stores have more floor space (150–550 sq. m.) and broader assortments (2–2.5 articles).

According to a GT Partners Ukraine survey, the most popular FMCG outlet formats to open in Ukraine in the first half of 2012 were discounters (ATB Market opened 98% of these), corner shops, and supermarkets. Outlets from these three formats accounted for 95% of all the outlets put into exploitation during the period in question.

Total outlet quantity growth according to Nielsen Ukraine



According to Nielsen Ukraine, the minimarket format is the main driver of contemporary trade growth.

Supermarkets, neighborhood stores, and cash and carries are the leading formats in Ukraine. Yet the share of non-organized trade (open markets, kiosks, non-chain stores) remains very high. The majority of stores are operated by local players such as Fozzy Group, ATB Market, Furshet, and Velyka Kyshenia. Among foreign retailers, the key player is Auchan, which since 2008 has been operating in Ukraine and which has already opened eight stores in major cities. Other foreign investors are Rewe, with its Billa outlets, Perekrestok with its small network of stores (X5 Retail Group), and SPAR. With a relatively limited quantity of stores, Rewe is set to speed up its expansion and open around 10 stores each year, predominantly in towns with over a million inhabitants. X5 plans no Perekrestok openings and may even divest from Ukraine, whereas SPAR intends to expand across the country via franchisees.

Neighborhood stores are of immense importance to the national food supply. These outlets are usually supplied by thousands of regionally operating, small-scale wholesale businesses. Neighborhood stores are mostly Soviet-style outlets operated in a quite outdated manner, with old equipment and no modern approaches to marketing or merchandizing. In 2012 METRO Cash & Carry Ukraine launched the Schedriy Koshyk project to help its professional trader customers improve their shops and bring them in line with modern standards. Schedriy Koshy is a trade network of minimarkets that are developing successfully in Ukraine, all supported by METRO Cash & Carry Ukraine. Currently there are 18 Schedriy Koshyk stores in the Donetsk, Zaporizhya, Kharkiv, Luhansk, and Dnipropertovsk regions, and in Kyiv city. The company provides traders who join the Schedriy Koshyk program with rebranding, refurbishment and store reallocation, assortment and pricing optimization, and professional marketing support.

Thus, all the stores are being brought in line with international retail standards and receiving valuable experience from a leading retailer on the Ukrainian market.

4. Future of the market

According to Planet Retail's forecasts, retail sales will be driven mainly by Kyiv and regional cities such as Dnepropetrovsk, Donetsk, and Odessa, where consumer income is above the national average. Weak economic prospects and political instability may discourage foreign retailers from investment, which will give a few strong domestic retailers chances to establish footholds and expand into new regions. However, it will take a few more years before modern grocery stores come to the towns and the countryside.

As the retail scene continues to be underdeveloped, the winning formats in the medium term will be supermarkets and neighborhood stores.

Own brand (OB) development holds great potential for Ukrainian retailers. According to Nielsen Ukraine, OB sales hold a 5% share in Ukraine (Nielsen Key Accounts Index, June-August 2012). This is significantly less than on the developed markets of the European Union.

At the same time, OB products are showing high dynamic sales growth – growth that, according to Nielsen Ukraine, exceeds 25.3% in supermarkets (Nielsen Key Accounts Index, MAT[1] May-June 2012), in comparison to the corresponding period of 2011 (MAT May-June 2011). According

1 MAT (moving annual total) – sum for the last 12 months.

to Nielsen Ukraine, OB shares are growing in such popular product categories as breakfast foods (ready to eat), sunflower oil, ketchup, mustard, sauces, and canned vegetables, even when the prices are not lower than those of A-brand products. OB shares are growing in non-food product categories due to lower prices. The greatest sales growth is seen in those categories in which OB prices are significantly lower than the prices for A-brand goods. These categories are the following: baby wipes, hand and body care products, soaps, and detergents.

METRO Cash & Carry Ukraine is a market leader in terms of OB development, having introduced its own brands in 2003 – from the very start of its operations in Ukraine. The wholesaler has over 2,000 own brand articles under six strategic brand names – SIGMA, ARO, H-line, HoReCa Select, Fine Food\Fine Dreaming, and Rioba. In 2011 METRO Cash & Carry Ukraine launched a unique own brand solution, Rioba, providing everything needed to operate a branded café – from high quality coffee to a coffee machine, branded crockery, and outfits for staff. The first Rioba coffee bar opened this summer at Boryspil, the biggest national airport. Two more Rioba bars are operating at the Central and South Railway Stations in Kyiv. The wholesaler plans to expand the concept throughout Ukraine.

5. Fuel And Energy

AES Україна

Electricity Sector of Ukraine

Electricity distribution networks have an average operating time of more than 40 years, reaching a 60–85% level of depreciation.

The growth of electricity consumption in all consumer clusters requires significant investments, investments that will be feasible only given incentive-based regulation: a world-standard tool to enable network infrastructure reconstruction and development.

Incentive-based regulation should be directed at:

- **Sustainable investment stimulation** – by establishing a justified rate of return (the weighted average cost of capital or WACC concept) on the fair value of the asset base
- **Improvement of supply quality** – the full required operating expenditures (OPEX) and capital expenditures (CAPEX) should be covered by a distribution tariff before targets are set for efficiency improvement
- **A long-term regulatory period** that allows for achieving sustainability in investment planning and improving efficiency

The experiences of other countries prove the high effectiveness of incentive-based regulation. For instance, Great Britain managed to halve distribution company costs and distribution tariffs within 15 years. Romania reduced depreciation of assets from 75% to 48% over the course of the 2004–2011period.

Ukraine has initiated incentive-based regulation basedon amendments to the law "On Natural Monopolies."

As the next step, the State Property Fund has developed a methodology for network assets revaluation and the National Electricity Regulatory Commission has drafted a tariff methodology.

However, the Draft of the Tariff methodology does not meet the main purpose of the reform:

- There is no guidanceas to the Rate of Return (RoR) on the revaluated asset base calculation and the currently discussed levels of 0% to 3% are far lower than WACC, which makes investment in the sector financially unjustified
- An OPEX equal to the previous year's tariff level, which is lower than required for efficient operations.
- CAPEX is limited by the regulator
- A long-term regulatory period is not enabled, as the regulator is maintaining a place for numerous annual corrections–on OPEX savings, for example.

Thus, in order to avoid the risk of reform's failing, it is critical to adopt a light-handed long-term approach with an adequate rate of return on the fair value of the asset base and full coverage of the efficiently incurred OPEX. This will ensure necessary investment in infrastructure, encourage the efficient operation of networks, and provide incentives to distribution companies to focus on delivering the best service to customers.

Legal aspects of ESCOs, implementation of energy efficiency projects (ESCO model), and development of EPC conclusion practice

Saving energy and improving energy efficiency has become more important given energy price increases. Today energy savings and efficiency are priorities for Ukraine's state energy policy. These principles are set forth in a number of Laws of Ukraine: "On Energy Saving," "On Electricity," "On Heat Supply," "On Housing and Utility Services," "On Combined Heat and Power (Cogeneration) and Waste Energy Potential," and "On Alternative Fuels." They are also set forth in subordinate legislation.

In accordance with Article 3 of the Law of Ukraine "On Energy Saving," dated 1 July 1994, the main principles of state energy savings policy are energy efficiency in the implementation of economic, management, or other activities related to the extraction, processing, transportation, storage, production, and usage of energy resources; a combination of economic incentives and financial responsibility for the efficient use and economical consumption of fuel and energy resources; solving energy savings problem and implementing energy programs of Ukraine on the basis of broad international cooperation; and efficiently using energy resources with the help of combined heat and power production (cogeneration). There are others as well.

The world's most common energy savings mechanism is implementing efficiency projects through energy service companies.

As a rule, an energy service company (an "ESCO") is a specialized project company that provides services related to fundraising, engineering, and management of financial and technical risks related to energy savings project implementation. An ESCO provides certain guarantees on recoupment of investments and has the necessary experience and tools to attract project funding from private investors. In its classic form, an ESCO does more than just ensure the implementation of energy efficiency. It also provides proper operation and maintenance of project results during the period of cooperation with the client, and certainly during the project's payback period. The main source of an ESCO's income is the money a client saves as the result of cooperating with the ESCO.

The first ESCOs were established a century ago in France. The main activity of an ESCO was in the municipal field, to increase the efficiency of the heat supply in private and office buildings. The main source of an ESCO's income was its work supplying heat at a competitive price. The practice subsequently spread throughout Europe and North America. The global energy crisis has affected the activities and development of ESCOs. Many of them went bankrupt due to the rapid increase in fuel prices. At the same time, however, the crisis has led to the expansion of the range of ESCO types and services. The crisis has also led to the development and implementation of new projects and new income acquisition mechanisms.

With the development of a competitive market came the formation and standardization of procedures and mechanisms for implementing efficiency projects, including draft agreements and standard terms and conditions.

Relationships between ESCOs and clients are regulated by contracts. Typically, contracts are long-term (for more than three years). This is connected with the length of payback periods. The most common type of contract between an ESCO and a client is an energy performance contract, i.e. an energy efficiency contract (EPC).

In practice, there is no one example of an EPC. The conditions for an EPC may differ greatly depending on the types of services an ESCO provides or the requirements that a client stipulates. The aim of the contract (energy savings) and the manner in which the ESCO makes its income (from fostering energy savings) remain unaffected.

There are several types of EPC based on the method of providing savings and effecting distribution:

- **Shared savings contract:** this provides income distribution from savings that is effected via from modernization, renovation, or the technical re-equipment of an enterprise, of a separate business unit, or of a bloc of individual customer equipment, beginning from the achievement of the economic effect,
- **First out contract:** this provides an ESCO with income at 100% of the savings during the term of project recoupment; income distribution begins only after investment recoupment. Usually the results of the project remain with the ESCO for the entire term of the EPC, but in any case they remain so until the full project recoupment and until the receipt of the income agreed on by the client and the ESCO when the contract is signed.

The EPC is a contract (or a set of contracts) that provides income for both the ESCO and the client as the result of the client's lower energy costs. These lower costs in turn result from the technical re-equipment (modernization) of existing equipment or the installation of new energy-saving equipment.

The main characteristics of EPC projects are:

- full self-repayment and investment recoupment via energy savings,
- a high level of project development and the shifting of technical risks to ESCOs,
- an immediate effect after implementation,
- there is no need for the client to increase its staff,
- professional project management.

An EPC by its legal nature is a mixed contract in the sense of part 2 of Article 628 of the Civil Code of Ukraine. An EPC may combine components of different contracts, including a contractor's contract, a services contract (engineering, agency, consulting), a purchase and sale contract (including trade credit), a delivery contract, a financial contract, an operating lease contract, etc.

There are no legal definitions of ESCOs and EPCs in Ukraine and the market is developing most likely in spite of, not because of, government policy. Lack of regulation causes problems in those areas that are most interested in ESCO services, such as the public and municipal sectors.

Basic principles of Ukraine's state energy policy are also set forth in the country's subordinate legislation. For instance, the Decree of the President of Ukraine № 679/2008 of July 28, 2008 brought into effect the decision of the National Security and Defense Council "On Implementation of the State Policy on the Efficient Use of Fuel and Energy Resources." That decision encourages the efficient use of fuel and energy resources.

According to this document, the priority areas of state energy policy should be the following: to support ESCOs, to establish practice for drafting energy efficiency contracts, and to regulate ESCO activity related to projects in the public and utility sectors.

Today the legal uncertainty that surrounds, on the one hand, the ESCO as a specialized project company and, on the other hand, the EPC as a type of separate economic and legal contract, does not allow for the use of effective state mechanisms to implement energy savings projects with EPCs or to establish a real ESCO market in Ukraine. This "uncertainty" is a significant barrier to establishing a real ESCO market. Companies that consider themselves ESCOs should "reinvent the wheel" and implement projects on the basis of contractor, supply, leasing, and joint ventures contracts, among other things. They should also add conditions that allow for identifying such contracts as EPCs, as is necessary if projects are to be financed by specialized funds and other organizations.

6. Healthcare

Ukrainian Market of Clinical Trials Overview

Ukraine has a good opportunity to become one of Eastern and Central Europe's leading countries with regard to the number of clinical research studies it hosts, thus promoting medical science and providing its citizens with the newest medicinal products. To reach this the country possesses a sufficient number of qualified specialists and a well-developed healthcare system. Conducting clinical studies in Ukraine would cost sponsoring companies far less than in Europe or the USA. But certain unsolved legislative issues, not to mention the country's rather negative image from the perspective of global business, prevent Ukraine from a clinical trial "boom."

Ukraine is quite often considered a newcomer at international clinical trial conferences and summits. On the one hand that's somewhat unfair, as the country took its first steps towards clinical trials as far back as 1996, when the country's parliament ratified the GCP (Good Clinical Practice) standards. On the other hand, until the middle of this decade the sector developed quite slowly, as the bureaucratic and mental vestiges of the Soviet past had to be overcome. As the result, the clinical trial market in Ukraine is quite formed, but its size significantly differs compared to EU countries.

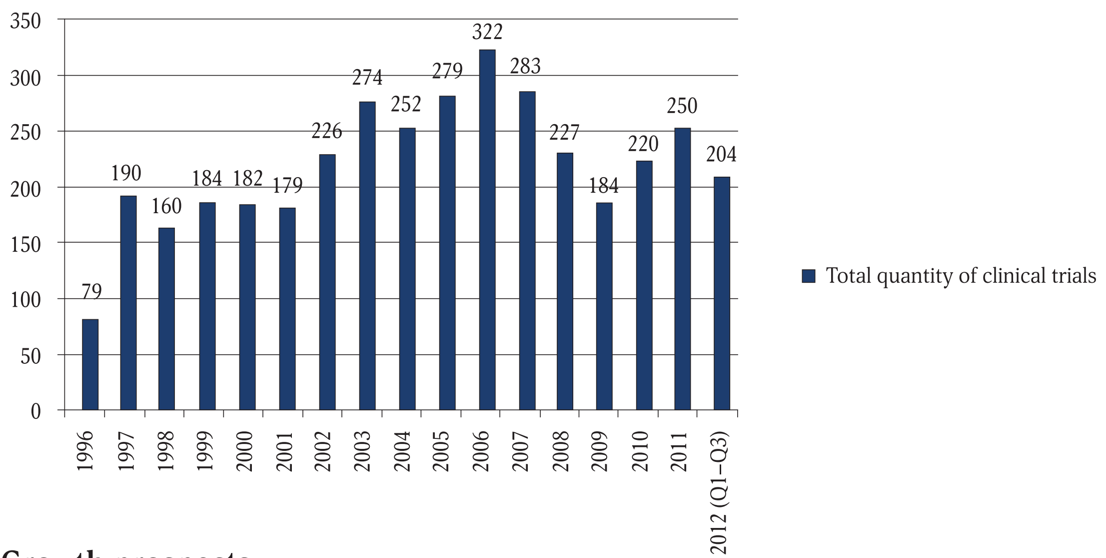
According to data from the State Expert Center of the Ministry of Health of Ukraine, 250 clinical research studies (phases I–IV) were registered in the country in 2011. This rate is three to four times lower than it is in neighboring Poland (not to mention Western Europe and North America). Ukraine's achievements are unimpressive even when we compare it to other CIS countries. According to the PMR report "Clinical trials in CIS countries 2012 – Russia, Ukraine, Belarus and Georgia, development forecasts for 2012–2014," almost two thirds of the clinical trial "pie" goes to Russia. Ukraine is content with a 33% share.

In analyzing the structure of clinical studies in Ukraine, we note its similarity with that in Central and Eastern Europe. There are several times more international multicentered clinical studies (those being conducted in several countries simultaneously) in the Czech Republic, Hungary, and Poland than there are domestic clinical trials: based on the results of the previous year, the ratio is 201 to 49. The main clinical trial sponsors have included such major foreign pharmaceutical companies as GlaxoSmithKline, Boehringer Ingelheim Pharmaceuticals, Nycomed, Bayer, Pfizer, and AstraZeneca. These have successfully developed the newest markets in the EU and continue to move eastward.

The overwhelming majority of clinical trials in Ukraine is third and second phase studies. During the previous year there were, respectively, 138 and 53 registered phase III and II studies, whereas only four phase I and six phase IV studies took place in 2011. This imbalance is primarily due to the need to involve in II and III phase studies more subjects than can be enrolled relatively quickly in Ukraine. I and IV phase studies are conducted in Ukraine less frequently due to these phases specific.

Ukraine is also quite similar in terms of the therapeutic areas of the studies. 25% of the studies involve anti-tumor drugs, while more than 10% are associated with digestive and metabolic disorders. Less than 10% of the medicines are for treating psychic and behavioral disorders. Studies to assess cardiovascular drugs stand out among the general statistics: in 2011 these studies held a 20% share, thus exceeding the average estimate for Central Europe. In principle, such numbers correlate with the high prevalence rates for such diseases in the country.

Total quantity of clinical trial approvals in Ukraine (1996 – Q3 2012)



Growth prospects

The experts give high rates when assessing the Ukrainian clinical trial market as compared to the markets of neighboring countries. According to the European Business Association, which has had a profile subcommittee for several years now, Ukraine currently uses only 10–15% of its potential in the clinical trial field. In upcoming years Ukraine will continue to catch up with its competitors if there is no dramatic deterioration of the global and local economic situations. According to the consulting company PMR, during the period from 2012 to 2014 there will be a 20% increase in the number of clinical trials in Ukraine, an unprecedented indicator.

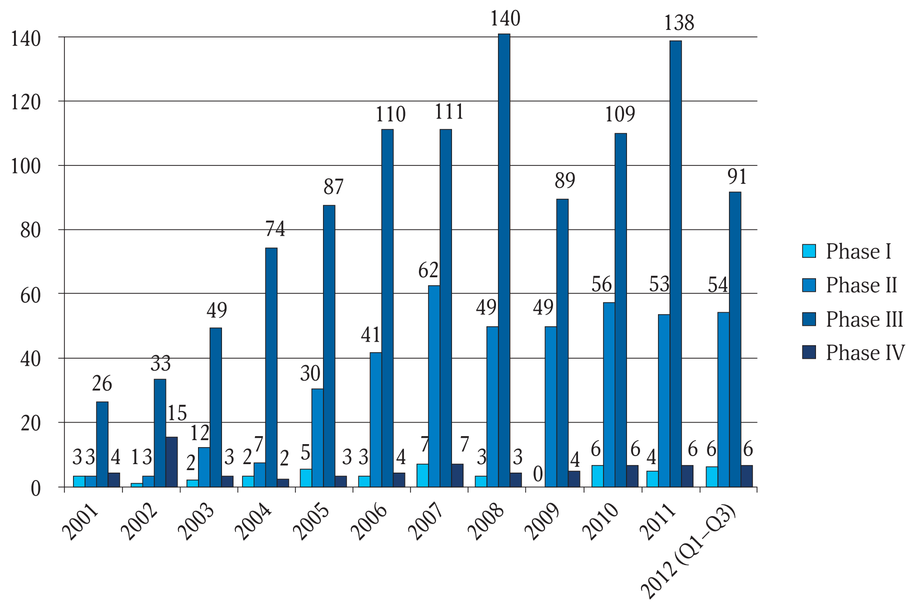
There are sufficient grounds for such an optimistic prognosis. First, as PricewaterhouseCoopers points out, pharmaceutical companies will try harder to optimize expenses on developing and registering drugs. Various data confirm that outsourcing studies to Eastern Europe will help cut costs by 15–20%. There will thus definitely be more relocation of clinical studies to less expensive regions. In this context Ukraine, where costs for logistics and labor are minimal, is quite competitive.

An important factor in Ukraine's appeal for clinical trial initiators is the rapid enrollment of subjects that is possible here. This has a simple explanation: the country has one of the largest populations on the continent: 46 million people. As cynical as it may seem, unsatisfactory healthcare funding, a poor environmental situation, and low income have turned the country into one of the largest patient bases in Europe. According to oncology statistics, Ukraine is seventh in terms of number of cancer patients, and a steady increase in these numbers is being seen. The situation is similar for respiratory and digestive disorders.

At the same time, there are sufficient numbers of qualified specialists and investigators in the country, people who can implement projects quite effectively. Although the medical education system is neither perfect nor ultramodern, the Soviet training methods that still operate allow us to assume the competitiveness of Ukrainian doctors even in the international arena. In addition, public authorities or private companies hold regular training sessions on running clinical trials in the country. Healthcare providers may obtain knowledge at such events and improve their competence.

Contract research organizations (CRO), which are involved in more than half of the clinical studies in Ukraine, also have professional personnel. Nowadays there are 40 CROs, although 99% of them are represented by affiliates of foreign companies, such as Quintiles, PPD, Icon, Parexel, PSI, PharmaNet, PRA International, Chiltern, Evidence, and SPRI. At the same time, a few years ago strictly Ukrainian companies (Axis-Group LTD, for instance) started to form and they continue to successfully operate on the Ukrainian market. Independent CROs are more mobile and ready to meet the wishes of clients, which guarantee optimal project outcomes.

Number of international multi-centered clinical trials (2001 – Q3 2012)



Twists and turns in legislative politics

Special attention should go to the state regulation of clinical trials, which in recent years has been significantly approaching European standards. The process has not been simple: until 2009 the market was been regulated by dozens of laws and orders, which often contradicted one another. Only three years ago did the Cabinet of Ministers of Ukraine make the first attempt to enact an integrated fundamental document containing all the rules and standards in this business field. MoH Ukraine Order of September 23, 2009 No.690 has resolved many unsolved problems, but still requires improvement.

In 2012 the government resumed improving the regulatory base for clinical trials by issuing Order No. 523 dated 12 July 2012 on changing MoH Order of Ukraine No. 690. The document has helped adjust the relations between all clinical trial participants. In particular, contractual relations between sponsors, medical and prophylactic establishments (MPEs), and patients were clarified; functions have been distributed more precisely between MPEs and investigators; and the procedures for paying for investigator services and reimbursing the expenses of hospitals or out-patient clinics for using their material and technical resources in studies have been clarified.

The standards have also been appended by clauses concerning the moral and ethical norms for conducting clinical trials. Until recently the issues were considered by a single governmental authority, the Central Ethics Committee of MOH Ukraine, but it was dissolved after the Order took force. Instead, every medical and prophylactic establishment involved in clinical trials will have a special ethics committee composed of its staff. It is assumed that such a system will improve monitoring and, importantly, minimize bureaucracy.

Legislative changes have also concerned the protection of patients' rights and interests, possible violations of which have often been criticized by the public and the mass media. As experts have noted, the level of protection that the new Order guarantees (in terms of patient life and health insurance) is significantly higher than in everyday medical practice. It should also be noted that, as compared to the levels of insurance payments made during the conduct of clinical trials within the EU, levels that increased again recently, the expenses of pharmaceutical companies in Ukraine are far more acceptable for sponsors.

Market participants have lately been supported by a specialized governmental authority, the State Expert Center (until recently the State Pharmacological Center) of the Ministry of Health, in solving issues arising in the clinical trial field. Its members helped develop the Order, and, at the 4th Clinical Trials of Medicinal Products in Ukraine scientific and practical conference, which took place in Kyiv in October 2012, they emphasized their intention to continue to participate in improving the regulatory base.

Subjects for discussion

At the same time, it's still early to talk about eliminating other factors restraining the development of the clinical trial market. Along with other markets, this one is impacted by those inconsistencies in economics, politics, and other spheres that are characteristic of developing countries. Getting authorization to conduct a clinical trial involves serious negotiations. While in the EU all the necessary papers can be obtained in only 10 days, in Ukraine the process can take up to 4,5 months. That Ukraine occupies the 137th position in the international "Doing Business" rating, yielding to Swaziland, Honduras, and Cambodia, is completely justified.

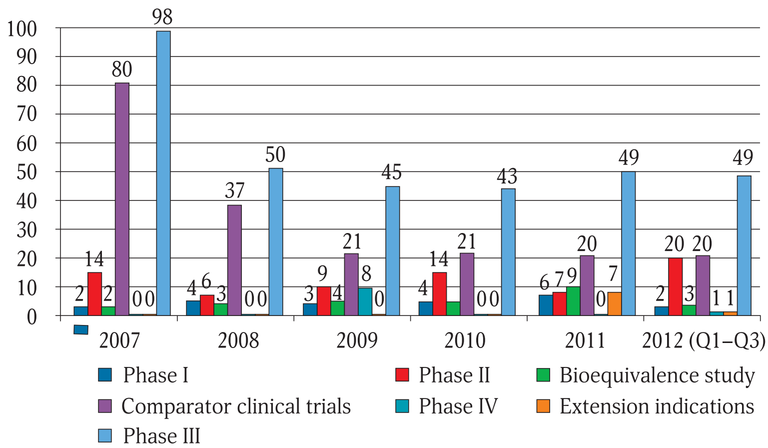
The adoption of the new Tax Code in 2010 led to unpleasant developments in this field. According to the new Code, unregistered medicinal products imported into Ukraine are subject to customs duty and VAT, which repels foreign investment in the country. Not only market participants, but also State Expert Center representatives, mention the unfavorable impact of this policy. The Tax Code should be up-dated to eliminate the taxation of unregistered medicines.

The Law "On Strengthening Responsibility for Falsifying Medicinal Drugs" adopted in the summer of 2012 was anotherstep backwards for the clinical trial market. Although the document was initially intended to eliminate fraud, it could victimize law-abiding researchers. Healthcare providers who breach purely formal procedures may risk prison sentences of three to five years. According to the previous legislation, such cases were subject to administrative responsibility.

It may seem that after the adoption of such a norm, the investigators will be more responsible in the execution of their work. But that is not quite true. As market participants have noted, this norm will make medical personnel less interested in participating in clinical trials, which may significantly retard the development of this field. Medical specialists have already joined together to revoke this norm, and it's reasonable to assume that the issue will soon be revisited at the highest levels.

Finally, the general public's failure to fully understand the essence of this process is yet another obstacle to clinical trials development in Ukraine. The general population has negative associations with regard to anything related to clinical studies for assessing new drugs, and the mass media constantly provokes suspicion with unfounded conclusions and sensational reporting. In fact, clinical trials are 10 timesless lethal than everyday medical practice.

Number of domestic clinical trials (2007 – Q 2012)



Evident benefits

Eliminating the obstacles to developing the clinical trial market will be beneficial for the country and its citizens. First of all, clinical trials would allow the authorities to boost inflows to state budget. Nowadays clinical trials bring the budget approximately UAH 180 million annually, which is comparable to the amount Ukraine gets for the use of underground resources. Taking into account the country's current potential, this number could increase five times.

In addition, clinical trials stimulate the renewal of hospital and polyclinic facilities and equipment and boost the salaries of participating doctors. As was repeatedly noted at the "Clinical Trials of Medicinal Products in Ukraine" conference, fees from study sponsors are becoming a principal factor keeping many specialists from changing their occupations or moving abroad.

It also should be noted that clinical trials give local patients access to drugs that they often would be unable to purchase by themselves. Consolidated data on sponsors' provision of patients with medicines in Ukraine have not been published, but the figures from foreign countries are impressive. PricewaterhouseCoopers estimates that approximately 4% of cancer patients in Poland have already participated in clinical trials. Sponsors reimbursed on average approximately 20% of the direct expenses for their treatment. In addition to the direct benefits that Ukraine and its citizens would get from the development of the clinical trial market, there are several indirect advantages. One is additional jobs. Today contract research organizations and the local offices of sponsoring companies employ approximately 2,000 people. Another is that the country would get more exposure to advanced medical science and research. Increasing the number of clinical trials would help the local healthcare system gain invaluable experience.

The current Ukrainian clinical trial market is thus quite unique. There are objective reasons for its relatively slow development, but there is also the fact that foreign sponsors from force of habit see primarily the country's disadvantages, and only later, if at all, take a look at its advantages. Ukraine's government authorities should work in two directions simultaneously to effect a breakthrough in the clinical trial field: modify the legislation and improve the country's reputation. Maximum attempts in these areas should be made as soon as possible.

Reference information from apteka.ua

Clinical trials *— a long-term and expensive part of the process of developing new drugs, and a part that is essential to confirming their efficacy and safety profiles. Clinical trials take up approximately two thirds of all the expenses associated with the development of new drugs.*

The standard procedure for developing a drug consists of four stages, and is primarily sponsored by the pharmaceutical company. After the non-clinical phase for the development of the drug has been successfully completed, clinical trials start. These are carried out according to Good Clinical Practice (GCP) requirements.

Clinical trials consist of four phases:

Phase I: *a primary assessment of the drug's safety profile and pharmacokinetic features; identification of adverse events and effects on the digestive system. This phase primarily involves a non-significant number of healthy volunteers (including on average 50–100 individuals);*

Phase II: *a more detailed assessment of the dose-dependent safety profile and the characteristics of the drug. During this phase pilot comparative studies also take place, such as studies to assess the results of investigational drug use as compared to standard treatment ad placebo. Patients are separated randomly into groups. The drug's action mechanism and safety profile are studied in a small group (consisting of 300–600 patients);*

Phase III: *the longest and the most expensive part of a clinical trial, when the final data on the drug's safety are collected. Sample size and study design are similar to those in phase II, but far more patients are usually enrolled — from several hundred to several thousand individuals. Successful completion of phase III clinical trials allows the sponsors to apply to register the medical product;*

Phase IIIB/IV: *additional studies conducted after the drug has been launched in order to confirm its efficacy for additional indications, as well as to prove the authenticity of previously obtained data and the drug's efficacy in the long-term perspective.*

SANOFI

The Healthcare Sector in Ukraine: Reforms and Pharma Companies' Involvement

The healthcare sector in Ukraine: on the way towards reform

The Ukrainian healthcare sector is still characterized mainly by medical services of not very good quality and often inaccessible and ineffective medical care. Spending rates on medicines in comparison with other European countries are low ($60 per person per year, as compared to $90 in Russia and $459 in France[1]). At the same time, the cost burden on patients is high, given the absence of medical insurance and reimbursement systems. The prevalence of NCDs and tuberculosis in Ukraine is huge and mortality rates among patients with cardiovascular and oncological diseases, especially breast cancer, remain high. Ukraine is second in the world in terms of mortality caused by acute heart failure (338 cases per 100,000 inhabitants, more than 10 times higher than in France) and there are 25 million people with cardiovascular pathologies.[2]

Ukrainian healthcare needs urgent reform. In 2012 the government took certain important steps in this area that appear to have a significant impact on patients and the industry: implementation of pilot projects for referent prices and reimbursement for anti-hypertensive drugs. In 2012 the Ukrainian state authorities also tightened their control over the functioning of the pharmaceutical market in the country.

In this process, not only the Cabinet of Ministers and the Ministry of Healthcare, but also the National Security and Defense Council of Ukraine play an active role. The state authorities intend to bring strict order to the market for medicinal products, with the aim expressed by the President: to provide Ukrainians with effective and safe drugs at affordable prices. But achieving that without dialog between all parties on the market will be unsuccessful.

Pilot projects on implementation of referent prices and reimbursement in Ukraine

In 2012 the government started a pilot project involving setting referent prices for anti-hypertensive drugs. Since August 2012 the retail prices for drugs included in the project (243 in total) must not exceed 37.5% of boundary wholesale and retail prices. The State Administration of Ukraine on Medicinal Products developed guidelines for pharmacies on first offering more affordable branded drugs to

1 http://www.medpharmconnect.com/News/5713.htm.

2 http://newsru.ua/ukraine/19sep2011/serdce.html.

consumers. The Ministry of Healthcare has done the same for doctors regarding prescribing drugs for hypertension.

Twelve million patients with hypertension have been registered in Ukraine (32% of the adult population). That number is increasing by a million annually. It is expected that referent prices implementation will cut the costs of anti-hypertensive drugs by 15% and mortality caused by hypertension complications (including stroke) by 45–50%.[3]

A pilot reimbursement project includes only anti-hypertensive drugs. The Ministry of Healthcare has stated that the estimated cost of implementing this reimbursement project in 2012 is about USD 300 million.[4]

Evaluating certain legislative initiatives in the healthcare sector

The reform of the pharmaceutical sphere consists of several measures which were established in bills initiated by the Prime Minister of Ukraine in June 2012. Certain provisions of these documents do not meet international practice, and their enactment violates the principles of free trade. They could become a barrier to importers of pharmaceutical products and lead to higher prices for imported medicines. These legislative initiatives establish additional regulatory restrictions on operations, complicate the business environment in Ukraine, and create additional risks and unequal conditions for foreign and domestic producers by favoring the latter. First and foremost, all these factors will negatively affect patients and restrict their access to the full range of qualitative imported products.

Bill **№10560** prohibits medical personnel from receiving rewards and product samples from pharmaceutical manufacturers and (or) distributors of medicines; it bans advertising for drugs and prescribing specific medical product brands. A patient is thus to decide on his own which brand of drug to buy and use, although it is beyond his competence and can work against effective treatment.

Bill **№10561** establishes criminal responsibility for violating established practice for pre-clinical studies, clinical trials, registration of medicines, and falsification of results. This initiative could reduce the number of clinical trials in Ukraine and delay the launch of innovative medicines (especially for such serious illnesses as cancer or various neurological diseases). Moreover, this initiative does not have a clear list of subjects of criminal liability for violation of legislation on clinical trials and it blurs the nature of these crimes.

Bill **№10562** mandates that imported drugs must be licensed by Ukrainian bodies on the territory of Ukraine — as opposed to EU practice, where the license to import is part of the license to produce. A procedure for licensing manufacturers, wholesalers, and retailers of pharmaceutical products already exists in Ukraine, meaning that this initiative appears to duplicate regulatory functions and create an additional administrative barrier for providing patients with necessary medicines.

Bill **№10563** establishes a total ban on advertising of medicines (including products for consumer health, which is not an acceptable practice), except for in specialized media for medical institutions and healthcare professionals. The bill also allows the advertizing of medical equipment and methods of prevention, diagnosis, treatment, and rehabilitation that are authorized by the special executive body only (which can also be an additional bureaucratic barrier).

3 http://www.moz.gov.ua/ua/portal/pre_20120807_2.html.

4 http://www.pharma.net.ua/ru/node/19161.

Public-private partnership in healthcare reform: pharma companies' involvement

The Ukrainian state authorities are currently initiating public-private partnerships (PPP) in Ukraine. Adoption of the Law of Ukraine "On Public-Private Partnership" on July 1, 2010[5] started this process. In 2012 information appeared to the effect that an important role in the implementation of PPP projects will be played by the Center of Public-Private Partnership at the State Agency for Investments and National Projects, which will be created with the assistance of the UNECE and become the Ukrainian branch of the International PPP Center of Excellence.[6] In June 2012 the Ministry of Healthcare established a working group on PPP issues, to work on the development, systematization, and improvement of investment projects by attracting private partners to the healthcare sector.[7] In August 2012 the Ministry announced the launch of a large-scale campaign in Ukraine to research, implement, and improve PPP mechanisms in the healthcare sector, particularly in the sphere of manufacturing and using domestic pharmaceutical products.[8]

The benefits of PPP in healthcare are the following: better identification of healthcare needs and optimal use of resources; informational support and expertise; technical assistance and operational support; stimulation and uniting of efforts to reform healthcare; and transparent and fair regulations. PPPs also provide additional non-state funds for projects of high social importance, funds that otherwise could not be (or could be only with difficulty) implemented by the state or NGO alone. For a patient, PPP improves availability and quality of medical services, helps the work and financing of medical institutions, and makes the use of budget funds more effective.

International companies in Ukraine, and particularly Sanofi, are realizing the transformation of their role from product providers to care providers that are involved in the improvement and development of the healthcare sector. International pharma companies are already playing an active role in reforming Ukraine's healthcare via partnerships with the state authorities, healthcare professionals, and patient organizations, mainly in the sphere of NCDs such as diabetes, cancer, cardiovascular and chronic respiratory diseases. These initiatives are in line with the global WHO Action Plan to Prevent and Control NCDs, which was signed by the members of the International Federation of Pharmaceutical Manufacturers & Associations (IFPMA), including Sanofi.

In Ukraine, PPP partnerships are realized not only by building new hospitals (the New Life project to create perinatal centers is an example of that), but also via production localization projects and different educational and awareness initiatives for healthcare professionals and patients that international pharma players support. For example, Sanofi in Ukraine has localized the production of several its products including OTC, insulin for patients with diabetes, and vaccines.

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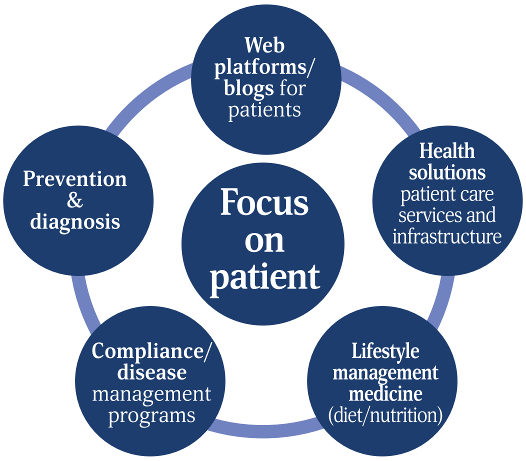
5 http://www.apteka.ua/article/154374.
6 http://news.liga.net/news/economics/613719-v_ukraine_budet_sozdan_tsentr_gosudarstvenno_chastnogo_partnerstva.htm.
7 http://www.apteka.ua/article/146424.
8 http://www.apteka.ua/article/154404.

Moving from product provider to care provider

Become a real actor in and contributor to the healthcare system:

- Be engaged with the healthcare authorities and with patients and healthcare professionals
- Provide quality treatment
- Be ready to invest and localize production
- Be a partner to the state and get involved in key problem solving

- Healthcare system reform
- Informational support and encouragement for patients
- Access to innovative medicines
- Awareness
- Prevention
- Better diagnostics
- Support for disease management



A partnership approach is needed

A leading global pharmaceutical group, Sanofi proposes a partnership approach in addressing the most pressing issues in Ukraine's healthcare sector: implementation of programs to improve access to medicines, educational initiatives for industry professionals, patients, and the wider public. For example, the most prominent Sanofi activities in addressing one of the most widespread NCDs in Ukraine, diabetes, are: the annual all-Ukrainian Drawing Competition for children with diabetes, photo exhibitions, the blood glucose screening in the Verkhovna Rada, the World Diabetes Day celebration in cooperation with IDF, and more. The intention to engage in productive dialog and take mutual efforts towards reform and disease management resulted in the signing of the Memorandum of Understanding between the Ministry of Healthcare of Ukraine and Sanofi. This document framed the company's concrete actions to improve early diagnostics of breast cancer, foster diabetes management on the national level, and support the state in reforming the healthcare sector.

To involve more pharma companies in PPP and healthcare reforms, the Ukrainian state authorities are expected to establish transparent and fair conditions and legislation, ensure equal market access for all market players, protect intellectual property rights, and maintain a healthcare economy and pricing policy that provide patients access to medicine. A partnership approach of this kind is the main way to implement effective structural changes in Ukrainian healthcare in the future, since to succeed in reforming healthcare and improving diseases management, all actors should be involved.

7. Hospitality and Tourism Sector Overview

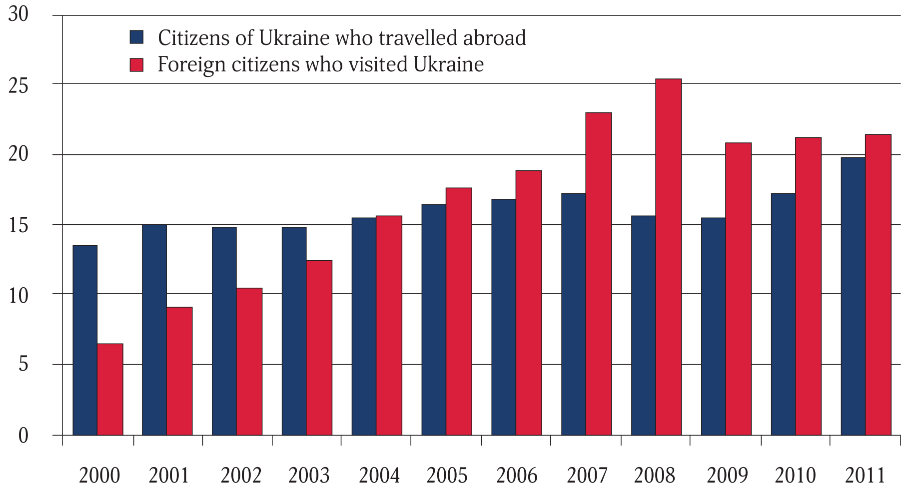
2012–2013 Partnership for Ukraine to Successfully Compete in the Global Economy Report

Since 2003 the hospitality and tourism sector has developed very dynamically. There were some general objective reasons for this, such as the progress in the country's economic transition, an increase in real incomes, and more interest in the region on the part of international businesses. International tourism receipts and expenditures for travel items increased more than fourfold during 2003–2010.

Two very important issues had a substantial influence on sector dynamics in 2007–2012: the preparation for the EURO 2012 tournament and the global economic crisis. At the beginning of 2007 Ukraine and Poland won a tender to host one of the world's biggest sports events – the European football championship, UEFA EURO 2012. This stimulated the rapid growth of the hospitality sector. 2007 became the first year in which the number of hotels exceeded the amount as of 1995, growing 12% as compared to 2006. According to the State Statistics Service of Ukraine, the number of foreign citizens that visited Ukraine increased in 2007 by 22% over 2006, exceeding 20M for the first time. At the same time, the industry suffered significantly from the 2008 global economic crisis, which decreased the number of Ukrainian citizens who traveled abroad by 11% in 2008 and the number of foreign citizens who visited Ukraine by 18% in 2009 (Figure 1).

Both tendencies prevailed in 2011–2012. The European football championship, however, had a more significant influence on the industry of the hosting cities. Starting in 2011 many "frozen projects" that had stopped due to the crisis were renewed. According to the ArtBuild Hotel Group, as of the beginning of 2012 there were about 100 hotels in Kyiv. Still, only 28% of Kyiv hotels were new or renovated and 72% of them were old and needed to be completely reconstructed. The most-developed part of the hospitality market is represented by 4 and 5 star hotels. There were four international hotel brands operating in Kyiv. As of the beginning of 2012 there were 3.2 hotel rooms in Kyiv per 1,000 people; in Bucharest there were

Figure 1: Number of inbound and outbound tourists in Ukraine, including one-day visitors, million persons



Source: State Statistics Service of Ukraine

5.2; in Warsaw there were 7.5; in Vienna there were 10.1; and in Berlin there were 16.8. Notably, 2 and 3 stars hotels remain underdeveloped, but they have big potential in Kyiv's hospitality market today.

Nevertheless, there are certain problems in Ukraine that pose a significant deterrent to economic growth in the hospitality and tourism sphere. The lack of regular and substantial funding as well as some legislation and regulatory problems prevent Ukraine from achieving competitive positions in the world tourist market.

Industry players have identified several directions that the Chamber Hospitality and Tourism Committee should address in 2012. The main objectives in the legislative field include amending the Law "On Tourism" and the Draft Law "On Tourism Resources."

Some other important issues that have to be tackled include changes in the tax legislation related to VAT taxation of travel agencies and operators and income tax holidays for hotels. In 2012 the Chamber continued advocating for the amendment of Article 207 of the Tax Code, which determines the order of VAT taxation for tourist services, and developed a corresponding Committee position. In May 2012 the industry also identified the need to develop a common position regarding the Draft Law "On Amendments to Article 268 of the Tax Code (On Tourist Tax)," as proposed by the Council for Tourism and Resorts of Ukraine. In the nearest future the elaboration of proposals and amendments to the Tax Code of Ukraine will remain the main objective and agenda of the Chamber Committee.

Companies operating in the field have also indicated that there are problems with the hotel classification system, with liability insurance for travel agencies and operators, and with tourist insurance. These questions were raised during meetings with the state authorities but have not yet been resolved.

In particular, the halted procedure for categorizing hotels is preventing newly-built and existing hotels from enjoying income tax privileges as provided for by the Tax Code. At the same time, the new procedure and criteria for hotel categorization that the State Agency has proposed are not in line with international standards and must be reconsidered. In particular, the proposed "declarative" principle of categorization will not ensure that customers obtain fair and adequate information regarding the quality of hotel property and services. Moreover, proposed sanctions amounting to 50% of a hotel's gross annual revenue for inconsistency with a declared star rating will certainly promote corruption and pressure on businesses. Taking this into account, the draft legislation regarding hotel categorization must be considerably revised, while the process of categorization must be resumed based on the existing legislation.

The state authorities admit that the tourism sector's economic efficiency is low. They explain this by citing the low efficiency of travel activity, the improper methodology of statistics, and the substantial size of the "hidden" economy. To increase the economic efficiency of tourism, the Agency for Tourism and Resorts of Ukraine, established in 2011, aims to create a rational resource use system and implement UNWTO methodology and international tourism classification and international accounting standards in tourism, as well as to use a deregulation and self-regulation system. The Chamber Committee is closely following its activities and is ready to assist in implementing related best practices in Ukraine.

At the same time, development of the hospitality and tourism sector and the enhancing of its competitiveness depend on reforming its complex legal and regulatory environment to create a business climate that is attractive for investment. Some steps are critical for the growth in Ukrainian tourism. They include:

- Improving the country's infrastructure;
- Ensuring that the level of tourist services in Ukraine corresponds to international standards;
- Developing new or enhanced diversified tourism products and destinations;
- Cultivating a skilled, educated, and motivated workforce with knowledge of English and other widely spoken languages;
- Building the country's brand and marketing it regionally, nationally, and internationally;
- Establishing a well-functioning network of information centers for visitors to ensure exchange and dissemination of complete and reliable information about Ukraine's tourism assets.

In general tourism development in Ukraine means creating a favorable organizational, legal, and economic environment as well as developing and marketing domestic tourist services that can compete regionally and internationally. All this can be accomplished using the natural, historic, and cultural potential of Ukraine, while protecting Ukraine's social and economic interests, historic sites, and environmental security.

8. Human Resources

NIKO

Major Human Resources Management Trends in 2012 and the Outlook for 2013

Recruiting and staff size

2012 saw a stagnating job market. Reviews from leading consulting companies show that for the last two years over half of the companies that took part in market and salary reviews have increased their staff sizes, while a quarter of them reduced staff and personnel and the other quarter made no changes. This somewhat contradicts the data of the Public Employment Agency, which could be due to the fact that the reviews included foreign companies and national Top-1000 companies and failed to consider medium-sized and small enterprises and other Ukrainian companies that were unprepared to participate.

Employers registered with the Public Employment Agency provided about 78,000 openings, 12% less than last year. There were 437,800 unemployed, 6.8% less than last year, and about 78,000 openings, 12% less than last year," says the Agency's Vitalii Riabukha. Between January and August 2012 the Agency registered 1,318,100 out of work citizens. Some 997,500 were officially recognized as unemployed; 827,800 of these received unemployment benefits.

Leading companies continue to compete for highly qualified staffers, while a surge in workers on the job market provides a huge workload for recruiting departments, since the number of CVs coming in is rising. Companies that downsized in 2012 have primarily optimized their administrative staffs.

The Internet is changing the way recruiters work. In 2012 people used social networks (Facebook, LinkedIn, Vkontakte) to search for professionals, using Skype for remote interviews.

What kind of recruiting policies will companies choose for 2013? Mainstream options include retaining personnel, engaging in headhunting, monitoring staff turnover, investing in training, and sustaining only highly qualified and high-performance personnel. The choice will depend on external factors, such as whether there will be a new financial crisis, and on internal ones connected to companies' exposures to external factors and to company goals. Cutthroat development is driving companies to recruit the best professionals from among their competitors. Improving performance means a company's sustaining 10% to 20% of its key employees and hiring the same number on the market.

Over 50% of companies seem inclined not to change the majority of their staffs in 2013, while a quarter of companies will eliminate redundancies. Demand will remain high for IT and retail specialists.

Salaries and perks

Experts believe that there several reasons for fluctuating salaries, including indexation and promotion. Indexation is caused by external factors, including increases in consumer basket costs and inflation. Promotion is the result of internal triggers (evaluation of performance, qualification, employment duties, and authority). In 2010 and 2011 the vast majority of companies indexed salaries by 5% to 10%. Most companies monitor remuneration and perks policy within their sector and region and amend their practices accordingly. As a rule, high-performance salary promotion occurs once a year.

The remuneration variable is linked with the performance of the entire company, a department, or (the most common case) a particular employee. Some 20% of companies participating in company reviews pay a thirteenth salary. Each fourth company pays guaranteed bonuses to its employees on the basis of innovation, his or her employment history, and certificates of proficiency he or she has earned.

Companies with foreign investment and leading companies on the national market have maintained employee perks that existed previously. On the other hand, leading companies have discussed cutting down on perks during various conferences and in their analytical reports. The categories of employees who are entitled to company cars, refundable petrol, and the like have also been reconsidered. Daily travel allowances are also under reconsideration. More than half of the companies considered in the review provide health insurance.

Leading companies have introduced working hour control systems and less than 20% of companies provide overtime remuneration.

Employee performance review

84% of companies maintain an employee performance review system. Specialists use the most widely-acknowledged performance review methods (KPI, MBO), as well as competence-based assessment, evaluation groups, and 360-degree feedback. Over half of the companies review their staff performance once a year.

Corporate training and development

Staff training expenses have not increased markedly, but remain at the 2011 level. However, the emphasis in terms of training has shifted from sales training to coaching and staff and time management training. Staff training and development is mainly carried out by line managers, since they lead in terms of skills and business management. Cutting down on external training expenses in favor of enterprise portals, web seminars, instructions, coaching, and self-study programs has proven to be lucrative for most companies.

One huge trend in corporate development will be skills development. Companies should develop human capital plans.

2013 and 2014 will be critical due to budget cuts, including cuts to training expenses. Organizations need to modify their training philosophies and institute “in-company training.” Company coaches and training providers also need to change the ways in which they prepare training plans. Managers will search for and try to retain skilled employees, while collaborative learning will be in the spotlight.

Sources

The following sources were used: released information from Hudson (HR trend 2012), PwC (PayWall 2011), and E&Y (Ukraine salary and remuneration review 2011); information from leading mass media experts was also used.

9. Information & Communication Technologies

IT Industry: Preparing for the Unpredictable

Waiting for the recession to ease is no longer a prudent strategy for companies that want to maximize future growth opportunities. Economic cycles are shortening and now, more than ever, businesses need to be agile and ready for anything. So says Chris Dedicoat, president for EMEAR at Cisco.

Organizations that remain wedded to existing business models are becoming increasingly vulnerable. They face threats not only from a difficult economy, but also from the emergence of unforeseen competitors in the form of new players – whether in their home markets or further afield.

Waiting for the economy to recover before making bold moves is a dangerous strategy. It is becoming increasingly clear that we are moving towards shorter, more unpredictable economic cycles than have been experienced traditionally, making it harder for businesses to know what to expect. Meanwhile, the pace of change has accelerated to unprecedented levels, compounding the situation for those trying to develop new company strategies.

As economic uncertainty continues to linger, exacerbated by the current eurozone crisis, many organizations across EMEAR now find themselves at a crossroads. Having now done much of the work needed to pare back their operations so that they are leaner and more efficient, they must now question their ability to flex and adapt, to innovate and develop new business models that exploit the way the market is moving.

Now more than ever technological innovation is the key to competitiveness. It affects how agile organizations are, and how innovative they can be in seizing new market opportunities and surprising customers.

A strong base to build on

Established markets in EMEAR have a strong history of IT innovation, with European countries dominating the top 10 positions for global IT competitiveness according to the World Economic Forum's latest Global Competitiveness Report. This gives companies in those countries a solid foundation to build on – provided they have not built themselves into a corner, and are able to stay on top of market changes.

But emerging markets are making good headway too, particularly the BRICS nations (Brazil, Russia, India, China, and South Africa), which are catching up quickly. The World Economic Forum predicts that by as soon as 2013 these economies will overtake established economies in their share of world GDP. In emerging markets, high growth rates provide a propitious environment for enhancing competitiveness through structural reforms and growth-enhancing investments in order to make economic development more sustainable.

The fact that businesses in emerging markets are not encumbered by out-of-date technologies offers them a strategic advantage in a global market. A report published by the Economist Intelligence Unit (EIU) in September 2011 highlights a direct correlation between a country's IT competitiveness and its overall competitiveness. Worryingly, although they have maintained a competitive position to date, traditional European markets have a relatively low IT spent as a proportion of GDP compared to the Americas and emerging economies – something that will need to change if businesses in these markets want to maintain and sharpen their edge.

Preparing for the unpredictable

As organizations across EMEAR contemplate the future, then, alongside their strategies and budget considerations for the immediate period they need to assess their readiness for the unforeseeable. All businesses should be asking themselves what the underlying technologies are that might affect them a year from now, two years from now, three years from now, and so on – refreshing this perspective every six months. Winding the clock back just a matter of years, few could have predicted how smartphones, tablets, and social networks would change the way companies do business. In years to come, new explosions of innovation will upset the status quo once more. Any organization that pins itself to a particular way of working today risks not being relevant to or ready for what happens next.

Innovation can be applied at a process level, to enhance productivity, but it can and should also be applied at a higher level, to enable the creation of new business models – changing an organization's very proposition, or the way it reaches customers. The more dynamic and flexible the underlying IT infrastructure, the more options companies have. Studies by the likes of PwC and market capitalization rankings by Forbes show that the more ambitious industry sectors and individual players have been during the difficult economy between 2008 and 2011, the more they have bucked the trend and achieved real business growth.

Specific examples can be seen in the cases of Allianz in the financial services sector and John Lewis in retail. Both organizations have broken down organizational boundaries, creating more fluidity in their operations, to make them more customer-centric in their business models. By pooling resources internally and collaborating more dynamically, they have become more productive and responsive; a platform- rather than silo-centric approach to information management, meanwhile, has enabled closer channel integration, giving these companies' customers more choice – and more opportunities to purchase. Customers are also being given more of a sense of control over the products they buy as well as over the channels through which they procure them. As a result of feeling they have more influence, these customers are more likely to stay loyal to the brands.

Keeping one eye on what's coming

A global survey by McKinsey last year (A Rising Role for IT) suggests that, as technology becomes a more important factor in reshaping industries, companies' boards of directors need to play a more active role in deciding how technology is incorporated into overall strategy – and that ideally discussions should address forward-looking assessments of technology trends as well as immediate priorities.

Such discussions must transcend specific issues such as security or compliance with data-handling or reporting regulations. The agility required to support any decent level of innovation means drilling down to the infrastructure level, where any significant maneuverability by the business will be determined. With the right underlying architecture in place, organizations will be better able to get to a position, at least logistically, where they can achieve much of the innovation they envisage. Get the ground-level platform right, and specific issues such as security, rights control, borderless data analysis and collaboration, mobilization, and personalized user or customer self-service become more viable propositions.

Flexible foundations

Intelligent networks facilitate all of this – allowing organizations to operate more fluidly, but without loss of control. A dynamic infrastructure, with inherent, centrally-managed security, offers businesses the essential building blocks on which to base new business models, streamline processes, harness the cloud, and deploy advanced remote and mobile capabilities. Without a consistent, integrated, yet infinitely malleable infrastructure to underpin any new business model, organizations could create more problems than they solve – by creating new silos or new points of data vulnerability, for example.

The next phase of Internet advancement depends on dynamic, secure interconnections, allowing new levels of spontaneity in the flow of business, in the way knowledge and resources are shared, and in the way that teams can form and disperse. Whether the challenge is to redraw the customer proposition; be more dynamic in the way knowledge is shared; or respond to users' demands to choose the technologies they use for work, an intelligent infrastructure is the essential facilitator of this controlled freedom. Once this is in place, companies can start to make strategic choices about whether to harness cloud-based applications and services, the types of collaboration tools they employ, the optimal approach for facilitating remote and flexible working, and new ways of adding value for customers.

For every two companies that are holding back on investment in growth and innovation, there will be at least one that is forging ahead, determined to command its share of new market opportunities as they emerge. This is certainly true in emerging economies where companies' ambitions know no bounds. As cautious as businesses in EMEAR feel they need to be financially at the moment, they should consider whether inertia might be the costlier risk if they are later unable to make up lost ground.

Microsoft

The Problem of IT Piracy in Ukraine

2012 will have been a significant one for the development of the Ukrainian IT industry. It will have shown whether counterfeit software use is diminishing in this country and how efficient the government's methods for struggling against it really are.

In fact, the piracy level decreased in Ukraine last year – for the first time in at least five years. According to a Business Software Alliance (BSA) report, in 2011 pirated software accounted for 84% of the software used, while from 2007 to 2010 the piracy level grew from 83% to 86%.

The reduction for this indicator gives rise to hope that the piracy situation is improving in Ukraine. Yet of course piracy fell by only 2%, and the level remains high. In addition, the total commercial cost of pirated software increased: from $571 million in 2010 to $647 million up to date in 2012, according to the BSA.

The BSA serves as the main initiator for research into the use of pirated software. It is a non-profit international organization which unites many software producers, among them Adobe, Apple, Autodesk, Corel, Microsoft, Quark, and Symantec. It promotes the application of legal software and the development of innovative technologies. The Alliance works with governments, helping them to develop legislative tools that protect copyright and information security.

The BSA has been operating in Ukraine since 2008. Over the period since it started, piracy growth has somewhat slowed. Nevertheless, the piracy level in Ukraine remains one of the highest in the world. It is twice as high as the world's average piracy indicator – 42%. Ukraine occupies 14th place out of 101 countries in which research was conducted. In Central and Eastern Europe the average piracy level is 62%. Yet things are going much better for our closest neighbors. In Russia, for example, the indicator is constantly falling and is at present 63%. In Romania the situation is the same. In Poland the indicator is 53%.

Losses to the economy

These figures might have remained abstract, and they could have invited neglect, if they didn't also correlate to levels of economic development. Indeed, piracy of intellectual property leads to direct economic losses. And not only to the owners of the intellectual rights: it also damages the state, the business community, and eventually society itself. For instance, the U.S Commercial Agency's "List 301" – which tracks malicious violators of copyright – shifted Ukraine from its Watch List to its Priority Watch List. The U.S Congress declared Ukraine one of the most piracy-ridden countries of the world. Such classifications, of course, can lead to economic sanctions.

Reducing piracy would not only improve the country's reputation, but also bring it direct financial benefits. First of all, the economy would suffer less from hackers who take advantage of cheap software. According to the company IDC, every fourth website today that allows the downloading of counterfeit software also loads harmful software onto computers.

In general, 43% of counterfeit software carries serious risks. Such software represents one of the main information security problems for both the state and business, not to mention regular IT-users.

One of the consequences of using such unlicensed software is that computers infected through it become parts of networks supervised by hackers – so-called botnets. Botnets carry out harmful tasks in a way that is imperceptible to the owner (spamming, password selection, attacks on web resources). They represent dangerous tools on the part of cyber-criminals. Because of all the pirated software here, Ukraine is high on the list by number for computers connected to botnets.

Pirated software can do significant harm to users themselves. They can lose credit card data and other valuable personal information. "Recently we conducted research into pirated disks that we purchased in Kyiv's Petrivka market and checked them using the standard antivirus programs. About 60% of these disks were infected with virus software of the highest complexity. It's weird – people put metal doors on their houses, spend money on alarm systems for their cars, and put their money in bank accounts, but at the same time they keep their doors open via their personal computers," says Yuriy Omelchenko, the head of the Department of Intellectual Property Protection at Microsoft Ukraine. A regrettable confirmation of this is the number of cases there have been in which viruses have blocked computers across all Ukraine, with the malefactors demanding money to unblock them.

Companies that install counterfeit software on their personal computers also increase their chances of losses. In trying to save on legal software, they only increase their critical business risks. Data from the Harrison Group research company testifies that companies that use pirated software have a 73% higher chance of losing valuable information. They also have a 43% higher chance of encountering critical failures of their IT infrastructure. IDC experts claim that resuming the operability of one computer costs a company an average of $1,000. Even if just regular problems associated with counterfeit software pop up, IT administrators spend 20–30% more time dealing with them. At the same time, polls about the advantages of legal software indicate that the vast majority of respondents recognize the worth of having access to technical assistance (88%) and to protection against cyber attacks and computer viruses (81%).

According to IDC calculations, cutting computer piracy in Ukraine by 10% over four years could bring an additional half a billion US dollars into Ukraine's economy. This sum would be sufficient for four-year salaries for nearly 40,000 Ukrainian teachers. The majority of this money would remain in the domestic market and thus promote new jobs and a broader tax base.

Creating awareness

The small decrease in the piracy rate last year is due to the fact that big business has started understanding the risks that counterfeit software carries. It's thus spending more and more on licensed software. As for medium and small businesses, the situation is difficult. In some regions more than 90% of small enterprises use pirated software. Lugansk leads among cities with the highest level of illegal software use in business.

Experts say the main reason for piracy in Ukraine is that intellectual property right was not acknowledged in the Soviet Union. There was no concept of private ownership. "People understand that it makes sense to pay for tangible things, but they don't understand paying for something intangible.

This understanding hasn't yet informed our society," says Microsoft Ukraine's Omelchenko. He says Ukrainian society must be educated via an evolutionary process, and that will take years.

The government could help. But the government still doesn't realize that intellectual property is the basis for the innovative development of the economy. This is the second big reason for the prevalence of piracy in Ukraine, says Omelchenko. "Innovation will form the basis for the future competitiveness of our country. It's impossible to speak about developing science and technology without effective instruments for protecting intellectual property," he explains. "Software or other technology created in Ukraine cannot be monetized, since it will be stolen in less than a month."

To decrease piracy BSA recommends that the government take a number of actions. The first is to allocate resources for law enforcement. This includes creating specialized divisions at law enforcement agencies, training their personnel and the appropriate judicial authorities, and setting up effective interaction between all competent agencies. The second is to increase people's awareness about both copyright and the risks of computer piracy. Competent law enforcement agencies in association with representatives of the business world should undertake this task. There is also a need to create effective laws that conform to the Copyright Agreement of the World Intellectual Property Organization (WIPO). In addition, the government should create effective enforcement mechanisms that protect copyright and related rights within the context of the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS). And, eventually, the government should set a good example when it comes to using legal software and to implementing programs pertaining to software license management.

What is most regrettable is that software management licensing is impracticable in Ukraine, since the biggest user of pirated software in the country is the government itself. Approximately 70% of the software that the executive authorities and state enterprises use is considered counterfeit. Take into account the counterfeit products that other manufacturing companies use and the situation is even bleaker.

But educational work in Ukraine is ongoing, and companies are playing the key role here. Microsoft Ukraine is one of the most active of these companies. It holds training sessions and seminars that promote intellectual property rights and explain the risks that counterfeit software entails.

Some bright spots

The struggle against piracy isn't limited solely to informational work in Ukraine. Copyright holders are eager to defend their rights and, where they can find adequate laws to rely on, the situation is gradually improving.

One striking example could be found in Zakarpatya Region at the end of October. Uzhgorod International Airport was found guilty of using counterfeit Microsoft software. More than a year ago the militia found out that the airport used computers with illegal software for administrative purposes and at its ticket offices. The judicial proceedings that followed lasted a long time because there was a lack of appropriate legal definitions.

The prosecution couldn't establish who exactly had installed the pirated software on the computers, but that didn't prevent the copyright holder from filing a lawsuit against the enterprise. "As the owner of the computers, [the enterprise] bears responsibility for the copies of software stored in digital form in the hard memory of those computers. This gives grounds to come to a conclusion about the illegal use of counterfeit (non-licensed) computer software," the economic court of the Zakarpatya Region declared. Uzhgorod International Airport is due to pay the copyright holder more than UAH 66,000 as compensation. The airport could have avoided this had it acquired legal software in due time. This was the first case against a municipal enterprise in which a court has found in favor of Microsoft.

Recent changes in court practice have given copyright holders more chances to protect their rights. In October the Plenary Assembly of the Supreme Economic Court of Ukraine adopted a resolution with a number of key provisions. They state, for example, that storing counterfeit copies of software in the hard memory of a computer is the same as distributing it. These provisions also define in what cases an electronic license is legal in Ukraine, how losses from illicit possession and distribution of software should be tallied up, and how a copyright holder can claim compensation from a violator.

Adopting these provisions eliminates many gaps in the Ukrainian legislation and helps create uniform court practice. According to Vladyslav Shapoval, Microsoft's legal representative, these changes in court practice have given copyright holders expanded opportunities to protect copyright.

Such things are going to happen more and more often. This year, for example, Ukrainian courts pronounced 27 condemnatory judgments concerning violators of Microsoft's copyright. In October alone Ukrainian courts fielded 60 criminal cases pertaining to violation of the intellectual property rights of corporations. In most cases, penalties from 3,400 UAH to 34,000 UAH have been applied as punishment – or else imprisonment of from one to three years. For officials the law contemplates disqualification from office for up to three years.

The next BSA research project will show how far these measures will help to improve the piracy level in Ukraine and eventually to reduce its influence on the economy. It will then be possible to say for sure whether the current methods are sufficient or whether the government should institute new ones.

miratech

The Ukrainian ICT Industry — 20 Years of Progress

Ukraine's information and communications technology industry tends to attract attention during periods of global turmoil. First Western analysts notice it, and then, exactly three years later, domestic researchers do.

After the dotcom bubble burst in 2000, the World Bank for the first time noticed Ukraine's emerging ICT industry and included Ukraine in its ICT service export statistics, among the World Development Indicators. Three years later a local Ukrainian research project about the IT industry was performed and a professional association, known as IT Ukraine, got its start.

In 2008, during an acute phase of the global financial crisis, Ukrainian ICT was rediscovered yet again. Gartner didn't only put Ukraine among the top 30 countries for IT outsourcing, but also listed it among the three most cost-attractive destinations. Accordingly, exactly three years later, in 2011, ICT saw active development in Ukraine itself — the IT Ukraine Association successfully lobbied for a bill to support the IT industry. Parliament adopted the bill as the Law "On State Support of the Software Industry" in 2012.

The local ICT industry is still under-researched. But by analyzing its history we can get a better grasp on the current status and future prospects of what is becoming an important part of the national economy.

The Scent of Money

In the Soviet Union, information technology was called cybernetics. In 1989, one of the pioneering IT companies in Ukraine, Miratech, was established at the Glushkov Institute of Cybernetics. Miratech aimed at the software development export market from the very beginning, signing its first contract with a Swiss software house that was later renamed Miracle AG. With a highly qualified core team of programmers from a world-recognized scientific think-tank, the company gradually gained a reputation and recognition on the global market. By 1999 the Miracle XRP enterprise resource planning system, developed primarily in Ukraine, was one of the 10 most popular ERP solutions in the world, along with SAP and PeopleSoft software. Miracle AG stock, traded on the Enrich Stock Exchange, increased fivefold in value over a three month period spanning 1999–2000. A Ukrainian joint venture was one of the shareholders in 2000, so the scent of money was in the air.

Nikolay Royenko, the founder and President of Miratech, remembers the business's first years: "Sometimes I ask myself: 'What were we doing for the whole decade prior to 2000?' And I can't come up with any other answer except, 'We learned to use Clipper, FoxPro, and other programming tools. But most importantly, we studied and mastered the world's best business practices.' Indeed, it was very, very difficult to study them before because of the Iron Curtain. How can you develop a business automation system for Western enterprise if you've never seen one? It would be difficult, to say the least. But in a few years we'd mastered the subject and the money began to flow. We didn't feel like millionaires for long, though. In 2000 the dotcoms failed and we had to start all over again."

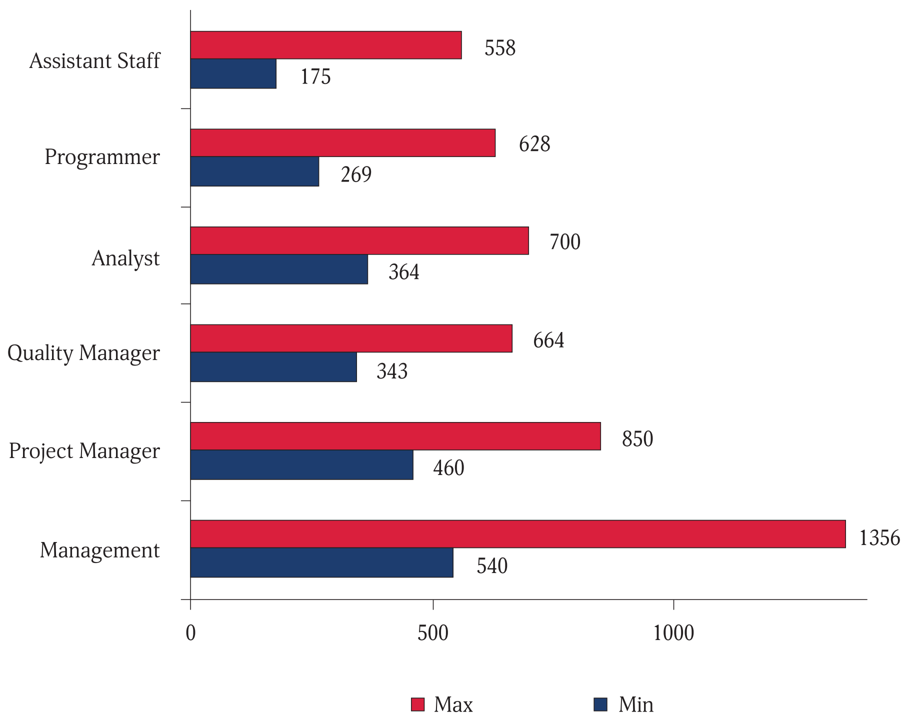
However, Ukrainian developers were not in the global IT community's spotlight. But then the World Bank included Ukraine in its list of ICT exporters, identifying its volume of exported ICT services at $95 million. In addition, more and more potential customers began to perceive Ukraine as a possible outsourcing destination for their projects.

The ICT Industry Recognizes Itself

Fast forward three years to 2003. Ukraine was celebrating its 12th year of independence, but on many issues the country still looked up to its Russian "big brother." Indeed, at that time Russia's IT industry was in many ways several years ahead of Ukraine's. Remarkably, St. Petersburg was considered the IT capital then, not Moscow. On September 9, 1999 the leading software development companies of Russia, Belarus, and Ukraine formed the Fort-Ross consortium. Its several Ukrainian companies combined to create a local chapter of the consortium. But to participate in the work of their own chapter and to communicate with colleagues, Ukrainian developers had to travel to Russia, instead of simply meeting up in Kyiv. Thus, the idea of an independent national professional association emerged and the IT Ukraine Association was established on April 2004. Six IT software development companies founded it: Miratech, Mirasoft, ProFIX, SoftLine, SoftServe, and Ukrsoft, with Miratech's Nikolay Royenko serving the first of his three year-long terms as Association President.

In 2003, TechInvest commissioned Gartner's official distributor, the Market-Visio consulting and research company, to carry out the first study of the IT industry in Ukraine, using Gartner techniques. Major companies were informally charged not only with filling out their own profiles, but also with helping to gather information from other market players.

Salary ranges in 2003, US$



The study did not actually surprise anyone, as the industry merely received scientific evidence of things everyone had already known about. Ten years later, however, is is clear that Market-Visio reports make it possible to analyze the state of the Ukrainian IT in a more conscious manner. The export growth rate, wages, and the list of top software development companies are most noteworthy.

In 2003, all seven Ukrainian market leaders – ELEKS, Miratech, Softline, SoftServe, Telesens, Tessart, and UkrSoft – as well as the vast majority of other IT companies belonged to Ukrainians. Almost no development centers of international companies were on the scene. It's safe to say, then, that in 2003 the Ukrainian outsourcing business was "independent." With just $100 million in IT exports, however, Ukraine wasn't having any tangible effect on the $500 billion worldwide industry. Other facts confirm this conclusion: only half a dozen companies boasted staffs of 100 people, and the entire market employed only about 8,000–10,000 IT professionals.

Whatever the circumstances, however, the list of major clients of Ukrainian companies is striking. Just the US companies on it form a representative sample of the Fortune 500: Boeing, CitiBank, DaimlerChrysler Aerospace, Delta Airlines, DHL, Disney, Ford, General Electrics, ING Bank, Intel, Microsoft, Motorola, NASA, NY Stock Exchange, Paramount Pictures, Scala, and more. The European Union is represented by Alcatel, Deloitte & Touche, Deutsche Telekom, Fiat Avia, France Telecom, Nokia, Philips, and Siemens, among others.

Given the complex supplier approval processes to which these reputable corporations adhere, one can say with no false modesty that the Ukrainian IT industry has started inspiring trust. Trust in the creativity of system architects, trust in the qualifications of programmers, trust in the thoroughness of testers, trust in the business reputations of management teams. Not many other industries in Ukraine could boast such trust from the international community in the early 2000s.

To strengthen this trust, many companies are beginning to certify their compliance with the highest international standards. They're starting to formulate their processes in accordance with ISO and industry-specific standards, such as Software CMMI. As businesses have grown and competition has intensified, financial compliance as proven by an reputable international auditor has become yet another indicator of a supplier's reliability.

Investment Boom

The 2006–2007 period saw the arrival of foreign investors, leading to towering acquisitions of Ukrainian IT businesses. A typical scheme was as follows: A major international software developer bought one or a few small to medium-sized local companies, using it or them as a foundation for building a large development center in Ukraine.

There are numerous reasons for this investor interest in Ukrainian programmers. They make up a highly skilled workforce, according to several indicators. For example, the World Economic Forum's Global Competitiveness Report evaluates the tertiary education enrollment rate in Ukraine at 79.4%, which puts Ukraine in 7th place among 183 countries. The high quality of Ukraine's math and science education was also praised – it earned 4.6 points (putting the country at #36 in the ranking). Hiring and firing practices were assessed at 4.8 points, placing Ukraine at #17 worldwide and demonstrating the potential for employing qualified experts.

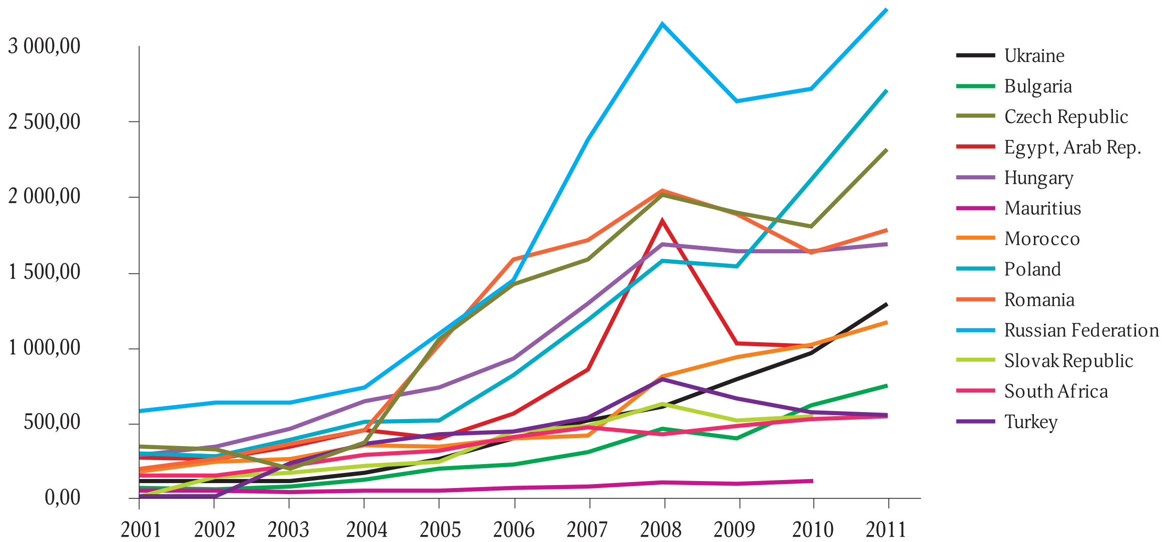
Given the investment flow, in 2007 the Ukrainian ICT export volume grew to $504 million according to World Bank data.

Advances During the Crisis

During the acute phase of the 2008–2009 global financial crisis, the volume of ICT exports generally declined. The drop wasn't critical, but it stopped the active growth trend: there was a 16% decline in Italy, an 11% decline in Great Britain, a 7% decline in India, 5% declines in Japan and Germany, and so on. Against the background of such failures, the international business community noticed Ukraine once again, as its ICT industry was more than just stable — Ukraine ended 2009 with 30% growth in exports, according to the World Bank.

After a 12-month study of ICT in different countries, Gartner not only included Ukraine in his Top 30 Countries for Offshore Services in 2010 list, but also named it one of the three most cost-attractive countries in the EMEA region. It's worth notice that of the 13 EMEA countries that made it onto the top 30 list all of them saw ICT export volumes fall in 2009, except for Morocco and Ukraine.

IT exports, US$ million



THE BLACK BOOK OF OUTSOURCING

2008 TOP TEN ITO OFFSHORE: EASTERN/CENTRAL EUROPE

2008 RANK	COMPANY
1	Luxoft
2	MiraTech
3	Auriga
4	Exigen
5	GlobalLogic
6	EPAM
7	SoftLine
8	Reksoft
9	Softserve
10	Technobridge

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Gartner's analysts were not alone in their conclusions. A year earlier, the 2008 Top Ten ITO Offshore: Eastern/Central Europe from The Black Book of Outsourcing research agency included two Ukrainian companies, as well as five more companies with large development centers in Ukraine. In total, Ukraine was home to seven of the 10 CEE market leaders. Five of them were members of IT Ukraine.

In addition, Ukraine received the ITO Destination of the Year Award 2011 from the Outsourcing Center – a well-known industry-oriented website that brings together outsourcing experts, promotes best practices, and hosts the Outsourcing Excellence Awards.

Objective data from the World Bank for 2011 confirm the validity of the analysts' high appraisals. ICT exports hit the $1.275 billion mark, with 35% year-on-year growth. Ukraine also ranks #11 worldwide for fixed broadband Internet tariffs and #16 for business monthly phone subscriptions – factors that directly affect the IT business.

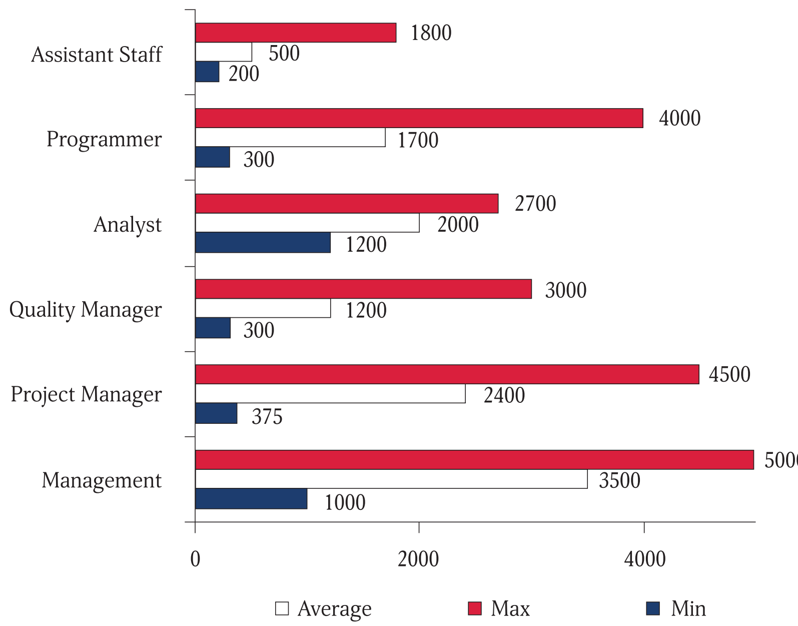
The ICT Industry Recognizes Itself Again

The 30–35% annual growth rate for Ukrainian ICT exports amounts to a remarkable success. In such an intellect-driven industry, people are the most valuable corporate asset. Even though many high-skilled programmers emigrated during and after the collapse of the USSR, the country's engineering potential remains excellent.

In 2011 many Ukrainian IT companies, including IT Ukraine members, started thinking about strategic ways of solidifying and enhancing industrial success.

Judging from periodic surveys of over 3,000 software development professionals performed by the DOU.ua website,

Salary ranges in 2012, US$



Ukraine's era of being economically attractive due solely to cheap labor is coming to an end. In high-tech industries, the workforce tends to flow to countries with higher salaries and a better quality of life. Thus, Ukrainian employers are forced to raise programmers' wages to prevent brain drain. Although wages in Ukraine are highly dependent on what region of the country is in question and on the qualifications of the employee, they show a 10–20% compound average growth rate, according to the same surveys.

There is thus a vital need to compensate for the rising cost of resources. This can be done by increasing governmental support to the IT industry; and indeed, governmental support to the industry is one of the major indicators analysts use to estimate a country's attractiveness as an outsourcing destination. The Global Information Technology Report 2010–2011 treats Ukraine as follows: Government prioritization of ICT – #120 out of 138; Importance of ICT to the government's vision – #130. For comparison, the corresponding figures for New Zealand, a popular emigration location for our programmers, are #13 and #18, respectively. Singapore holds a confident first place in both rankings. On the one hand, it is certainly an accomplishment that the Ukrainian ICT industry has been able to achieve such great results even without any viable support from the government. On the other hand, it's definitely wrong if the state does not support an industry that generates significant income for the country.

In 2010, then, the leadership of the IT Ukraine Association met with the government to initiate a draft law on state support of the software industry. To be sure, the country's positions in industrial rankings weren't the biggest stimuli behind the bill's development. Much more important was the need to give domestic companies a competitive edge on the global market, helping them in the fierce fight for customers.

On January 22, 2012 the bill passed the first reading with 277 votes for and 0 against. It is unfortunate that the President later gutted tax benefits for software companies, a move that left the IT community disappointed. The law, however, still represents a huge step forward, especially considering Ukraine's 130th place in the governmental support rating.

Current Market Disposition

As no fundamental research into the ICT industry in Ukraine has been published in recent years, we use instead the DOU.ua quarterly top 25 list of Ukrainian software companies by headcount.

Company	Headcount	Country
EPAM Systems	2600	USA
Luxoft	2475	Russia
SoftServe	2189	Ukraine
GlobalLogic	2130	USA
Ciklum	1771	Denmark
Infopulse Ukraine	866	Norway
ELEKS	687	Ukraine
Samsung R&D	680	South Korea
ISD	656	Ukraine
Miratech	600	Ukraine
Lohika	568	USA
Parus Corporation	550	Russia
Nix Solutions	520	Ukraine
NetCracker	475	USA
Software MacKiev	400	USA
DataArt	384	USA
Frog	360	USA
SysIQ	351	USA
Sigma Ukraine	350	Sweden
AM-SOFT	333	Ukraine
Terrasoft	330	Ukraine
CS Ltd.	301	Ukraine
Softline-IT	289	Ukraine
Magento	273	Ukraine
Cogniance	270	USA

Altogether the list includes 10 Ukrainian-owned companies, employing 6,178 people (30%), and 15 companies with foreign investments, employing 14,230 people (70%). This clearly demonstrates the current situation, both conceptually and by the numbers.

Using the top 25 list, ICT company revenue can be calculated quite easily. Assuming that payroll comprises roughly 70% of an IT company's expenses, and assuming 15% average profit margin in the industry, annual revenue equals the "average wage * headcount * 12 months / 0.7 / 0.85." For example, the annual gross operating revenue of all top 25 Ukrainian suppliers is about $ 700 million, or 55% of the total ICT exports from Ukraine.

Conclusion

The current pace of industrial development and the global economic environment will likely allow Ukraine to hit the $10 billion mark in annual IT exports by 2018. This is a serious amount of money for a country with total export in 2011 of $88 billion.

"Looking backwards, no global crisis has been able to stall the development of the Ukrainian IT industry. All of the major players are currently looking forward to further solid growth. Stagnation or decline are not among the possible scenarios," says Victor Valeev, executive director of IT Ukraine.

The companies are supporting their growth plans with practical action: each top 25 company lists up to 235 vacancies. Surely, the market is seeing some fighting over human resources, but the Ukrainian educational system is annually producing enough skilled professionals to satisfy market demands in the future.

We can say with confidence that over the years Ukraine has developed into a trustworthy, mature, competitive ICT state. It is an excellent nearshore destination with highly qualified human resources and huge outsourcing experience.

10. Intellectual Property Rights

Protecting Intellectual Property Rights on the Internet: Some Practical Aspects

The Internet is everywhere in today's world: we can buy or sell things through it, order services, read articles or novels, and on and on. We thus can't afford to underestimate the role it plays in the intellectual property rights area. Intellectual property objects like trademarks and service marks, utility models, industrial designs, and literature and art can all be accessed via the Internet. Situations in which copyright or intellectual rights registered in Ukraine are violated are commonplace.

The Law of Ukraine "On Protection of Trademarks and Service Marks" (hereinafter referred to as the Trademark Law) establishes that the use of a mark consists, specifically, in its use in business documents or advertising and on the Internet. According to the copyright legislation, dissemination of copyright and/or related rights objects can also be carried out by communicating them to the public so that the members of the public can access them from any place and at any time at their discretion. That includes via the Internet. Ukraine's legislation defines that placement of a trademark or a service mark and/or a work of art on a website constitutes its reproduction.

Article 4 of the Law of Ukraine "On Copyright and Related Rights" (hereinafter the Copyright Law) states that reproduction is the production of one or more copies of a work, videogram, or phonogram in any material form, as well as an item's recording for purposes of temporary or permanent storage in electronic (including digital), optical, or other computer-readable form. A copy is any reproduction of a work. Placement of work on the Internet in a form accessible for public consumption thus represents its reproduction. A copyright subject is granted (by Article 440, part 1 of the Civil Code of Ukraine) an exclusive right to use the work and the right to prevent unlawful use of the work.

One of the most common ways of protecting intellectual property rights on the Internet is via the courts. According to the Copyright Law, in the event of copyright violation **a court may render an award or a judgment:**

- to compensate moral (intangible) harm inflicted by violation of copyright and/or related rights and to define damages;
- to compensate damages inflicted by violation of copyright and/or related rights;

- to collect from the infringer of copyright and/or related rights all income gained from the violation;
- to award compensation in an amount defined by the court instead of awarding damages or collection of income (compensation may range from 10 to 50,000 minimum salaries, or from UAH 11,340 to UAH 56,700,000);
- to prohibit publication of works or their performance or production of copies of phonograms or videograms or their communication; to halt their distribution; to withdraw (seize) pirated copies of works, phonograms, videograms or broadcast programmes and equipment and materials intended for their production and reproduction; to force publication of information in the mass media about the violation, etc.

A court may also demand that offenders disclose information about third parties involved in the production and distribution of pirated material and about means of bypassing technical devices and distribution channels.

It is worth noting, however, that protecting intellectual property rights in court, particularly when it comes to unlawful use of copyright and/or trademarks and service marks on the Internet, has certain specific features. This is connected with the specific form that information provision takes on the Internet, with the complexity involved in identifying people liable for infringement on the Internet, and with the complicated procedure for proving a violation.

In line with Ruling No. 1 of the Plenary Session of the Supreme Court of Ukraine dated 27 February 2009 "On Court Practices in Cases Involving Protection of Individuals' Honor and Dignity and the Business Reputation of Individuals and Legal Entities," we can conclude that an author of information and a website owner shall be the proper defendants in the event of distribution of any disputable information on the Internet. The claimant should find out their identities and indicate to them that a claim has been made. When an author of disseminated information is unknown or his/her identity and/or place of residence cannot be established, and where information is anonymous and access to the website is public, the website owner shall be the proper defendant, since it is he who created the technological capability and conditions favorable for the dissemination of false information. By analogy of law, then, the same rules could apply to violation of intellectual property rights on the Internet. When copyright is violated or a work is unlawfully used on the Internet, the authors of the information and the website owner shall be the defendants in the case. In the event of unlawful use of someone else's trademark or service mark, the proper defendants shall be the author of information disseminated under someone else's trademark and the owner of the website on which the relevant information is posted.

Details about the website's owner may be requested according to the Code of Civil Procedure of Ukraine from the domain name and address registration system administrator of the Ukrainian segment of the Internet. The website owner's details can also be obtained at http://getserv.com.ua, where domain name and address registry details are available. A court, however, is unlikely to recognize information obtained in this way as proper proof.

Another problematic aspect of court trials in such cases is how complicated it is to obtain evidence of a violation on the Internet. The evidence is on the Internet itself, but it is hard to document the offence because Ukrainian notaries cannot attest websites, in contrast to the situation in the Russian Federation. Practice proves that a claimant can provide an opinion from an intellectual property or telecommunications system expert as proof of the defendant's violation. The expert would independently inspect the proof on the website and issue an opinion that the court will consider along with other proof, according to the procedural legislation. Often the violation will have been deleted from the website, however, thus complicating the matter.

Protecting intellectual property rights on the Internet is becoming a more and more urgent issue. The law provides protection, but there is still room to improve how it is applied in practice, and specifically the mechanism by which the claimant furnishes proofs of unlawful property use and the mechanism for obtaining reliable information about potential defendants.

11. Labor & Employment

BRAIN SOURCE INTERNATIONAL

Ukrainian Labor Market Trends in 2012. Forecast for the Year 2013

By ***Olga Marchenko***
Brain Source International

As expected, the year 2012 brought some noticeable activity to the Ukrainian labor market. The first quarter of 2012, at least, generated some activity among employers of the sort that could give rise to optimism.

After the post crisis years of 2009–2011, when many companies underwent restructuring and staff optimization, there came a period in which it was necessary to fill up empty labor reserves. As usual, sales personnel in FMCG, B2B, and retail were the most sought-after (as top and middle management had been preserved during the crisis). Salary levels were "unfrozen" and companies started to actively search for personnel. In addition, certain B2B segment players resumed their activity and decided to open branches in Ukraine's biggest cities. Admittedly, this process took place at the end of the year, so employment plans were postponed until the beginning of 2013. The trend is towards heightened trust on the part of job seekers in the B2B market segment – many qualified FMCG sales specialists decided to leave that sector and start careers in B2B.

The retail segment provided yet another stimulus to the increased demand for personnel. During the fourth quarter of 2012, because of expectations of higher sales, supermarkets started hiring retail personnel throughout Ukraine. Although the heightened demand is only temporary, at least 10–15 citizens in every town in which retail outlets are located will land a job, and a legal one.

The IT market has been as stable as ever. Demand is high for software developers, website support, and content specialists. Java, php and C++ developers are the most desirable employees. With qualified specialists still extremely hard to find, the market players know each other personally and negotiate directly, avoiding mediators. Unfortunately, these specifics make it harder for a recruitment company to conduct an exact analysis of IT market dynamics.

2012 gave rise to an interesting trend as to back office specialists and administrative personnel – they're still in great need, despite the waning demand for accountants, lawyers, and economists (which whom the market is hyper saturated.)

There is a stable demand for accountants with command of the latest version of 1C software, 1C8 in particular. An employee should not only know how to use this software, but also be able to teach others how to use it and facilitate a company's transfer to it. The same concerns lawyers: there is high demand for highly specialized employees, such as those with experience working with environment protection organizations or with land reserves.

Speaking of land reserves, the heightened activity on the agricultural market deserves a mention. Company mergers, market entrances, and power amplifications have led to the emergence of such interesting jobs as, for example, land manager. One more popular vacancy in the third quarter of 2012 was for chief agronomists.

We should also mention the Euro 2012 playoffs. The influence of this event on the Ukrainian labor market was discussed for as long as four years before it actually took place, but the main predictions emerged at the end of 2011. A lot of experts expected increased activity in the retail and HoReCa sectors.

At this point it's safe to state that these hopes were in vain: the companies in question didn't see the boost in job vacancies that was expected. There were vacancies connected with Euro 2012, but the large-scale increase we hoped for did not materialize.

In general, the year 2012 showed that despite all hopes or disappointments the Ukrainian business world continues to move forward and, accordingly, needs different kinds of specialists to satisfy its emerging demands. The market in 2012 was, at least, stable and predictable, and we didn't see it radically shift in any one direction.

Forecast for the Year 2013

As for labor market forecasts for 2013, there are certain risks: lack of external financing, diminishing access to foreign capital, and a degradation of external economic conditions (such as a prolongation of the current decrease of raw material prices).

These trends, the uncertain internal dollar rate, and expectations for a second wave of economic crisis are having a negative influence on the Ukrainian labor market. Companies are thus thinking of how to preserve the stability they've achieved rather than of new strategic developments.

We can't expect a radical increase in job openings in 2013. With practical experience of the number of personnel they need, companies are sticking with their tried and true staffs and avoiding hiring new people.

At the beginning of the year we will see positions that emerged back in 2012 fill up, and then economic conditions will show us what to expect. One opinion holds that the dynamics in 2013 will somewhat resemble those of 2011. We can be sure that employees who are highly qualified in very specific areas will be in big demand – online marketing specialists (SMM specialists), for example. This trend emerged back in 2012, although progress here shouldn't be extrapolated to other spheres.

The post crisis period brought some stability to the banking and insurance segments. The market was even characterized by a certain demand for management positions that served to sustain existing business models. But we shouldn't expect this trend to continue through 2013, as the banking segment is still very unstable.

In general, in 2013 both companies and job applicants should stick to one strategy – constant self-improvement. Employers will continue to choose the best of the best, and their list of demands of potential employees will continue to get longer.

On the other hand, the market is constantly changing, so in order to sustain success companies must keep perfecting their products and services and find new ways to promote them.

12. Leasing

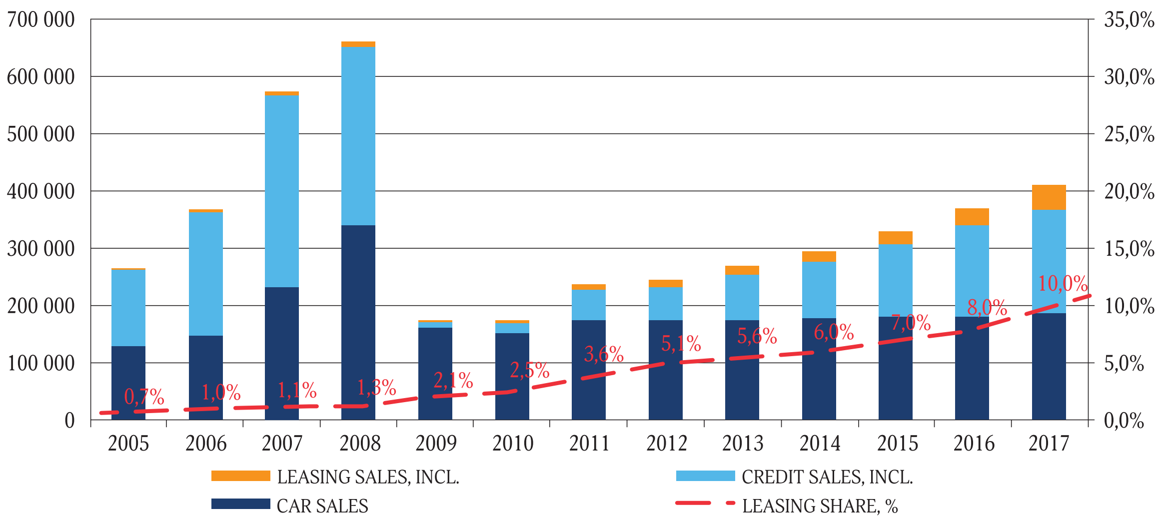
EURO LEASING
European financial service

The Leasing Market: Overview and Trends

The Ukrainian leasing market continues to show steady growth. At the end of 2012 leasing portfolio (financial leasing) have a value of 45 billion UAH, showing a 30% increase over the data at the end of 2011. There has also been a 10% increase in the number of new leasing contracts, with the overall volume of new such contracts amounting to 15.5 billion UAH by the year's end. The most productive period in terms of the cost of contracts was the 2nd quarter of 2012, when the total was 6.75 billion UAH (there were 2,552 contracts). This figure represents the highest number of concluded contracts for the entire period of leasing's existence in Ukraine. As for leasing's level of penetration in investment in fixed assets in Ukraine, there has been an increase of up to 6.2% (in 2011 the figure was 4.5%) due to the significant growth of leasing sales volumes and the slower growth of investment inflows. The European penetration rate for leasing in investments in 2012 was 16%, demonstrating the potential for the development of Ukraine's leasing industry.

The most popular leasing items in 2012 were vehicles (about 60% of all lease agreements). 5.1% of total passenger cars and commercial vehicles in 2012 were leased. It is forecasted that this figure could hit 5.6% in 2013.

Car Sales in Ukraine 2005–2017, PCS



Overall, 2012 was one of the most successful years in the history of leasing, despite the difficult situation in the country's banking sector. Many banks offered customers credit under financial leasing conditions. Leasing also grew because large companies renewed their lease fleets and because there was a slight increase in demand in the leasing sector for individuals.

It is expected that next year the car leasing market volume will reach 37,000 vehicles and that the segment involving leasing that includes overall fleet service will reach 16,800 cars by the end of 2013.

Euro Leasing specializes in financing business transport with additional service support and in providing customers with one invoice for the whole range of the products, for ease of planning and budgeting.

Euro Leasing is an expert in financing business transport. Our managers are always glad to assist with various issues (accounting, legal, etc.) to improve client fleet management.

13. Legal System Overview

BAKER & MCKENZIE

Court System

Introduction

Ukraine's courts are organized according to the principles of territoriality and specialization. They include local courts; appellate courts; Supreme Specialized Courts; and the Supreme Court of Ukraine, as shown in Diagram 1 below.

Since Ukraine is a civil law country, the exercise of judicial power is based on the application of statutes. However, due to recent changes in procedural rules, when resolving cases Ukrainian courts refer to and consider decisions of the Supreme Court of Ukraine regarding the provisions of Ukrainian laws applicable to the given dispute.

Diagram 1: The Ukrainian Court System

	Review of decisions of Supreme Specialized Courts in limited cases identified by procedural rules	**Supreme Court of Ukraine**		
Cassation Instance	Cassation review of commercial, administrative, civil, and criminal cases.	Supreme Specialized Court for Civil and Criminal Cases	Supreme Commercial Court	Supreme Administrative Court
Second Instance	Consideration of appeal cases	Appellate Courts of General Jurisdiction	Appellate Commercial Courts	Appellate Administrative Courts
First Instance	Initial consideration of cases	Local Courts of General Jurisdiction	Local Commercial Courts	Local Administrative Courts

Commercial Litigation in Ukraine

As a general rule, any business-related dispute between business entities (including individual entrepreneurs) will be reviewed by a commercial court. Commercial cases involving individuals will be adjudicated in local common courts.

In general there are no limitations (including monetary limits) on the jurisdiction of the commercial courts other than specialization and territorial factors.

Ukrainian court jurisdiction over a dispute involving a "foreign element" is established in accordance with the Law of Ukraine "On International Private Law." This law lists those disputes with a foreign element that are reviewed by Ukrainian courts. The list includes cases where (1) parties previously agreed on Ukrainian court jurisdiction; or (2) the damage that is the subject of the dispute was caused on the territory of Ukraine; or (3) the act or event that is the cause of the dispute took place on the territory of Ukraine, etc. This law also lists those disputes falling within the exclusive jurisdiction of Ukrainian courts. Such disputes include disputes (1) on real estate located in Ukraine; (2) on intellectual property rights that require registration on the territory of Ukraine; (3) about bankruptcy, provided that the debtor was incorporated under the laws of Ukraine; or (4) about cases related to issuance or annulment of securities originating in Ukraine, etc.

However, there still remains a certain inconsistency in the application of the above-mentioned provisions by the Ukrainian courts.

Commercial Arbitration

Currently there are two well-established arbitration institutions in Ukraine: the International Commercial Arbitration Court of the Chamber of Commerce and Industry of Ukraine and the Maritime Arbitration Commission of the Chamber of Commerce and Industry of Ukraine.

A business-related dispute between a foreign legal entity or individual entrepreneur and a Ukrainian legal entity or individual entrepreneur may, by agreement of the parties, be settled by either an ad hoc arbitration tribunal or by an arbitration institute, either within or outside Ukraine. A business-related dispute involving only Ukrainian parties may be referred to arbitration only on the territory of Ukraine and is not subject to international commercial arbitration. At the same time, disputes of Ukrainian legal entities with foreign investments between themselves and their participants as well as their disputes with other Ukrainian entities may be referred to international commercial arbitration.

Companies

The basic rules governing the establishment, maintenance, and liquidation of business legal entities and governing mergers and acquisitions in Ukraine are provided in the Civil Code of Ukraine (the Civil Code) and the Commercial Code of Ukraine (the Commercial Code), both of which were adopted on 16 January 2003 and took effect on 1 January 2004. Apart from the Civil Code and the Commercial Code, the Law of Ukraine "On Companies" (the Company Law) dated 19 September 1991 and the Law of Ukraine "On Joint Stock Companies" (the JSC Law) dated 17 September 2008 govern various issues related to mergers and acquisitions as well as to establishing, maintaining, and liquidating companies in Ukraine.

Under the Civil Code, legal entities that carry out entrepreneurial activities in order to earn profits must be established in the form of companies. The following types of companies may be established in Ukraine: general partnership companies, limited partnership companies, added liability companies, limited liability companies, and joint stock companies.

Of these, the most common vehicles for conducting business activities in Ukraine are joint stock companies (JSCs) and limited liability companies (LLCs), both of which embody the concept of limited liability for investors.

Joint Stock Companies

JSCs are very similar in form and operation to US corporations, German AGs, and French sociétés anonymes (SAs). A JSC is a company whose charter capital is divided into shares of equal par value. Shareholders of a JSC are liable for the latter's obligations only to the extent of their equity contributions to its charter capital.

A JSC may exist in the form of either a public or a private company (the rough equivalents of the open and closed JSCs that existed under the former legislation). A JSC may be established either by a single founder or by a group of founders. The number of shareholders in a private JSC may not be more than 100.

The first issuance of shares upon the establishment of either a public or a private JSC must be made exclusively by means of a private placement of shares among its founders.

A public JSC may issue additional shares by means of public and private placements of shares. Furthermore, a public JSC is obliged to include its shares on the list of at least one Ukrainian stock exchange.

A private JSC may issue additional shares only by means of a private placement of shares. If a shareholders' meeting of a private JSC adopts a decision to carry out a public placement of its shares, then the JSC's charter must be amended; in particular, the JSC's classification must be changed from private to public. Changing a JSC from private to public and vice versa is not considered to be transforming it.

An issuance of shares by either a private or a public JSC must be registered with the Ukrainian National Commission on Securities and the Stock Market (the Securities Commission) by registering the share issue and prospectus. There must also be a report on the results of the shares placement and the issuance of a certificate on the registration of the shares issue. If a JSC fails to register any issue of its shares with the Securities Commission, any and all share purchase agreements entered into with respect to this share issue, as well as with respect to any subsequent share issuance, will be deemed ineffective.

Limited Liability Companies

Legally an LLC is similar to that of a German GmbH or a French société à responsibilité limitée (SARL). Investors in an LLC, i.e., its interest-holders or participants, are liable for the LLC's commitments only to the extent of their contributions to its charter capital. Their participatory (i.e., ownership) interests in the LLC are expressed in the form of relevant percentages of the LLC's charter capital as owned by them. Participatory interests in an LLC do not qualify as "securities" for the purposes of applicable Ukrainian legislation and, therefore, are not subject to registration with the Securities Commission.

Similar to a JSC, an LLC may be established either by a single founder or by a group of founders. The maximum number of founders/participants in an LLC may not exceed 100 legal entities or individuals.

There are no legal restrictions on how the participatory interests of an LLC may be distributed; this issue remains entirely within the discretion of the founders of the LLC. Currently there is no minimum capitalization requirement for an LLC.

Representative Offices/Branches

Ukrainian legislation provides that representative offices are deemed to be structural divisions of an enterprise, albeit located in localities different from the locality of the headquarters of the enterprise. "Branches" of foreign enterprises do not technically exist in Ukraine; representative offices are their closest equivalent. A representative office does not enjoy the status of a separate legal entity.

A foreign legal entity may establish a representative office in Ukraine in order to carry out marketing, promotional, and other auxiliary functions on behalf of the foreign legal entity. It is less clear whether a foreign legal entity may also conduct trade or business through a representative office, although "commercial" representative offices (in effect, the equivalent of "branches" of foreign enterprises in most other countries) are quite common in Ukraine. Recent practice has been to permit a representative office to carry out a wide range of commercial activities (including signing contracts and conducting import, export, and other transactions). Normally, such practices result in the creation of a permanent establishment for the foreign company in Ukraine for tax purposes. The commercial representative office's activities thus become taxable in Ukraine (whereas, generally speaking, the activities of a representative office are non-taxable).

Antitrust & Competition

General

Antitrust and competition matters are governed by the Law of Ukraine "On the Protection of Economic Competition," which took effect on 2 March 2002 (the "Competition Law"). In 2005 the Competition Law was amended by the addition of a new requirement regarding transactions subject to the prior approval of the Antimonopoly Committee of Ukraine (the "AMC").

Transactions and Actions Subject to Prior AMC Approval

a. Merger control regulation

Pursuant to Article 22 of the Competition Law, the following transactions may be subject to prior AMC approval: (i) mergers or consolidations of business entities; (ii) the acquisition of direct or indirect control over a business entity; (iii) the establishment of a business entity by two or more business entities that will engage in business activities independently over a prolonged period, provided that such establishment does not result in the coordination of competitive conduct among the business entities that established this business entity, or between the business entities and the newly established business entity; and (iv) the direct or indirect acquisition of, obtaining of the ownership of, or assumption of management over the shares (participatory interests) of a business entity, if such acquisition results in the obtaining or the exceeding of 25% or 50% of the voting rights of the target business entity.

The foregoing types of transactions will be subject to prior AMC approval, subject to certain exceptions established by law:

- If the aggregate asset value or the aggregate sales volume of all of the participants to the transaction (the Participants) for the previous fiscal year exceeds the UAH equivalent of EUR 12 million (calculated on a worldwide basis) at the exchange rate of the NBU as of the last day of the previous fiscal year, provided that:
  - the aggregate asset value or the aggregate sales volume of at least two of the Participants (calculated on a worldwide basis) exceeds the UAH equivalent of EUR 1 million at the NBU exchange rate as of the last day of the previous fiscal year; and
  - the aggregate asset value or the aggregate sales volume of at least one Participant on the territory of Ukraine exceeds the UAH equivalent of EUR 1 million at the NBU exchange rate as of the last day of the previous fiscal year.
- Or (irrespective of the aggregate asset value or the aggregate sales volume of the Participants), if the market share of any Participant or the combined market share of the Participants in Ukraine exceeds 35 percent of the market on which the transaction takes place, and/or adjacent markets.

For the purposes of calculating the foregoing thresholds, the definition of "Participant" includes not only the actual merging, consolidating, establishing, or acquiring business entity, but also all of the business entities in any way controlling or controlled by such entity.

b. Concerted actions

According to Articles 5, 6 of the Competition Law any actions/arrangements/behavior of business entities that may limit, eliminate, or distort economic competition on any product market in Ukraine are prohibited unless such actions/arrangements/behavior are individually permitted by the AMC or fall under a limited number of exemptions provided by the Competition Law. Thus, any proposed concerted actions should be assessed separately on a case by case basis, since the AMC is quite active in this area and thoroughly investigates various product markets (particularly distribution arrangements, vertical arrangements, collusive behavior, etc.).

Capital Markets

The debt and equity securities markets in Ukraine are regulated by several laws, as well as by regulations and resolutions issued by the Securities Commission.

Types and Forms of Securities

Ukrainian legislation recognizes the following categories of securities: equity securities such as shares of capital stock and investment certificates; debt securities such as state bonds of Ukraine, municipal bonds, corporate bonds, treasury bills, deposit certificates, promissory notes, and bills of exchange; mortgage-backed securities such as mortgage-backed bonds, mortgage-backed certificates, mortgage receipts ("zastavni"), certificates of funds of operations with real estate ("certyficaty fondiv operatsiy s neruhomistyu"); privatization securities; derivative securities; and commodity-related securities (documents acknowledging the receipt of goods for shipment, such as bills of lading).

Ukrainian issuers may issue securities in registered (nominative) form, bearer form, and order form, as well as in documentary (certificated) form and non-documentary (book-entry or electronic) form.

The transfer of ownership rights to registered securities in documentary form is effected by means of assignment. Ownership rights to bearer securities issued in documentary form are transferred as of the moment of the physical transfer (d livery) of the securities to a new owner. Ownership rights to securities in documentary form, whether bearer or registered, are confirmed by the certificate of such securities. The transfer of ownership rights to both bearer and registered securities in documentary form, if such securities have been immobilized, as well as to registered securities originally issued in non-documentary form, is effected from the moment of their crediting to the new owner's securities account, maintained with a securities custodian. Ownership rights to such securities are evidenced by an excerpt from the custodian's registration system.

Securities Commission

The Securities Commission is the state agency authorized to determine and implement a uniform state policy in the area of the development and operation of the securities market in Ukraine, and to carry out state regulation and monitoring of the issuance and circulation of securities and derivates on the territory of Ukraine. The Securities Commission has been granted broad powers with respect to the formation of the overall legislative framework for the operation and development of Ukraine's securities market, as well as with respect to registration, licensing, and compliance monitoring and enforcement powers.

Registrars

The registration of ownership rights to registered securities issued in documentary form may be performed by either an issuer of registered securities that holds a permit (Registrar License) from the Securities Commission or an independent registrar that has obtained a Registrar License. An issuer is required to engage the services of an independent registrar if the total number of owners of the issuer's nominative securities exceeds 150.

Depository System

Ukrainian legislation establishes the National Depository System, consisting of two levels: the higher level and lower level.

The higher level comprises the National Depository of Ukraine and various depositories. The National Depository of Ukraine is a public joint stock company with the state of Ukraine as its majority shareholder, authorized to carry out certain regulatory functions with respect to the Ukrainian stock market. A depository is a legal entity organized in the form of a public joint stock company and engaged exclusively in depository activities, such as, for example, keeping global certificates for the issuance of non-documentary (book-entry) securities by Ukrainian issuers, maintaining accounts for custodians of securities, etc.

The lower level comprises custodians of securities and registrars of owners of registered securities. These activities require a license from the Securities Commission.

On 6 July 2012 the Ukrainian Parliament adopted the Law of Ukraine "On the Depository System of Ukraine" (the "Depositary System Law") which aims to introduce changes the competitive environment which was supported by the previous legislation and stipulates that there may only be one central securities depository (CSD) in Ukraine. The CSD will be established on the basis of one of the current securities depositaries: the National Securities Depositary of Ukraine. It appears that this change was introduced to alleviate the long lasting conflict between the two main competing depositors in the country. The Depositary System Law clarified the model for holding of intermediated securities by drawing a distinction between the securities and the "rights in securities." It also introduced a comprehensive basis for securities clearing and anticipated integration of foreign CSDs and international CSDs into the Ukrainian depositary system. The Depositary System Law was published on 11 October 2012 and will become effective 12 months after its official publication, except for certain provisions which become effective on the date of the publication.

Securities Traders

Securities traders may be licensed by the Securities Commission to perform any or all of the following activities with securities: brokering activities, dealing activities, and underwriting and securities management activities.

Stock Exchanges

Securities are traded in Ukraine on several stock exchanges and on the over-the-counter electronic market trading system, the PFTS. In 2006 the PFTS established a subsidiary, the PFTS Stock Exchange, which was licensed by the Securities Commission as a stock exchange in 2007. At the current time the secondary market for securities in Ukraine is highly volatile and its liquidity is inconsistent.

State Securities

The Ministry of Finance of Ukraine, acting upon the authorization of the Cabinet of Ministers of Ukraine, may issue bonds to finance domestic or external state debt.

Foreign entities and individuals are permitted to invest in domestic state bonds through Ukrainian custodians that are clients of the NBU as the depository of state securities. Since 2000 Ukraine has carried out a number of issuances of foreign state bonds (known as Eurobonds, denominated in euros and in US dollars) on the international capital markets. These bonds are currently being actively traded in the international capital markets.

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Production Sharing Agreements through the Eyes of a Lawyer and Tax Advisor

***Albert Sych**, Law Leader in Ukraine, Ernst & Young Ukraine, attorney-at-law*

***Iryna Kovalenko**, lawyer, Ernst & Young Ukraine*

The year 2012 can truly be called the year of production sharing agreements (PSAs) in Ukraine. It saw four tenders for concluding PSAs take place; three PSAs are currently under negotiation between the state and the tender winners. And it has recently become known that the state is going to announce another four tenders in the nearest future.

Despite all the issues associated with the PSAs (some of which we discuss below), a PSA can be a very attractive vehicle for companies, especially international companies, that want to invest in the Ukrainian natural resources sector.

This article intends to illustrate certain general aspects of PSA regulation in Ukraine and briefly analyze certain problems a foreign investor could face if it chooses a PSA as a legal instrument for exploring for and producing mineral resources in Ukraine.

The PSA regulation pattern

In Ukraine, the procedure for concluding and implementing PSAs is regulated by the special law "On Production Sharing Agreements," adopted in 1999. Taxation of the investor under a PSA is governed by a special chapter of the Tax Code.

Regrettably, the current Ukrainian PSA legislation is still far from the best practices and is riddled with gaps and discrepancies. The PSA rules are often of a framework nature and require a number of subsidiary procedures and regulations to be implemented in practice. The lack of adequate regulatory mechanisms leaves ample room for the state authorities' discretion.

In addition, there are no official opinions from the state authorities on how to apply the law. That is why it is difficult to predict how the law will be interpreted and applied in the future. This is partially because the only PSA concluded so far, back in 2007, has not yet become operational.

However, we can't but mention some positive tendencies in PSA regulation. Recently the Ukrainian Parliament has adopted two bills aimed at improving PSA regulation and taxation.

As we are writing this article, these bills have not yet been signed by the President and have not been published. It thus remains unclear what the final wording of the laws will be. Only after the official publication of the bills will it become clear which rules of the game PSA investors will have to live with going forward.

These amendments seem to represent a great step forward and create an additional foothold for future investment into Ukraine.

Ukrainian PSAs

The first PSAs in their current form were successfully concluded in Indonesia in the 1960s. PSAs then gradually spread to other oil and gas production countries of the world, such as Egypt, Libya, Kazakhstan, and Argentina. The PSA became an alternative to the concession agreement.

The PSA vehicle in Ukraine provides for special rules, privileges, and incentives, both regulatory and tax that in many respects differ from those that apply to other exploration and production vehicles.

Under a PSA, the state (represented by the Cabinet of Ministers) assigns an investor to explore and produce mineral resources in a specific subsoil field and to perform other works necessary to this end. The investor performs the assigned work at its own expense and risk. The investor is entitled to recover its expenses and to receive remuneration from the extracted production.

All production extracted under a PSA is distributed in a special manner between the state and the investors: part of the production is used to recover the investor's expenses related to performance of the PSA (this is the so-called cost recovery production), while the remaining part is distributed between the state and the investor as profit production. Prior to the distribution, all production extracted belongs to the state. After the distribution, the investor can freely dispose of its share of production, unless the PSA and/or the tender terms provide otherwise.

The quarterly share of cost recovery production may not exceed 70% of the total production extracted during the current period until the reimbursement of the investor's expenses in full.

A PSA can be bilateral, between the state and the investor, or multilateral, in which several investors participate. A PSA is concluded for a fixed term that may not exceed 50 years from the date of PSA signature, but may be extended.

Within the PSA framework, the investor pays only the taxes specifically set out in the law, namely corporate profit tax, VAT, and subsoil use payments. Production sharing substitutes the payment of other taxes. In addition, the investor must accrue, withhold, and pay to the state treasury personal income tax and the single social contribution for mandatory state social insurance and also pay state duties and fees for the state bodies' and agencies' services.

In many cases, taxes under PSAs are payable according to specific rules that differ from the general ones. With respect to certain taxes, such as subsoil use payments, the Tax Code allows the parties to negotiate their own conditions in a PSA. In practice, this discretion has both pros and cons for the investor.

As we have mentioned, the law provides for a number of regulatory and tax incentives for activities within a PSA that make the PSA instrument even more attractive to investors. To name but a few:

- Licensing and quota regimes do not apply to the investor or its contractors upon import of goods required for a PSA; nor do they apply to the investor upon sale or export of production. Some tax exemptions are also envisaged upon customs clearance of such goods and production.
- The foreign investor is guaranteed free conversion and repatriation from Ukraine of any cash it receives under a PSA.
- Requirements on mandatory sale of foreign currency proceeds do not apply to the investor.
- Regulations of the executive authorities and local governments that limit the rights of investors do not apply to the investor or its contractors, apart

from exceptions relating to health and environmental protection.

At the same time, the practical possibility of the investor's enjoying the incentives may be limited due to the imperfect wording of the law and to the lack of regulations detailing the procedures in question.

PSA gray areas

Below we comment on two major issues related to PSA regulation: multiparty PSAs and the bank account regime of a foreign investor in Ukraine. (There are other issues, of course, but a complete list and detailed analysis of all PSA issues currently known would turn this short article into a long legal treatise.)

As we have mentioned above, in a multiparty PSA several investors participate. The potential problem is that the activity of several investors can be regarded as a joint activity subject to special rules in Ukraine. The special regulation regarding multipartite PSAs and the special regulation regarding joint activity contain numerous contradictions and gaps. The combination of these two sets of regulations can multiply the problems twofold.

Unfortunately, this is not the only issue related to multiparty PSAs. Without going into detail, we will mention a few of them: obtaining special permits for subsoil use, the right of an operator to sell production belonging to other investors, accounting and financial reporting, and administration of taxes.

The recently adopted laws we mentioned above may partially resolve these problems. Among other things, the laws establish that the relations between PSA investors should be settled through the so-called "operational agreement." Such an agreement should not be considered a joint activity agreement or regulated by the joint activity legislation, including for tax purposes.

Other problems a foreign investor may encounter under a PSA are currency control regulations and the investor's bank account regime in Ukraine. According to the PSA Law, an investor under a PSA may open bank accounts in national or foreign currency "for servicing the works under the PSA." According to the law, such accounts may be used solely for servicing PSA-related activities.

The effective bank account regime for investments in a PSA does not appear to be suitable for performing a PSA in practice.

The problem could potentially be resolved through the use of the bank account of the investor's permanent establishment. This option, however, does not seem to be practically effective, because the foreign currency bank account of a permanent establishment is very limited. Moreover, it is unclear whether the guarantees, in particular those concerning free conversion and repatriation of currency, cover the permanent establishment of aforeign investor in Ukraine.

The recently adopted legislative changes may also resolve this issue. These changesextend the guarantees and incentives pertaining to the investor's bank accounts to the investor's permanent establishment and improve the PSA bank account regime. The changes also envisage establishingspecial currency control rules consistent with the specifics of a PSA. If the President signs these bills, the investor will not be bound by, among other things, restrictions on the terms of settlements during export and import transactions, restrictions in obtaining loans, or the necessity to obtain individual licenses for performance of certain transactions in foreign currency.

We have great hopes that by the time you read this article these improvements to the PSA regulation will have been made. They will collectively represent a big step for Ukraine on the way to implementing the PSA vehicle in practice.

14. Logistics and Transportation Sector Overview

2012–2013 Partnership for Ukraine to Successfully Compete in the Global Economy

The global and European trends in the logistics and transportation sector are as follows: globalization of operators' activity (30 companies cover about 35% of the market in Europe); attempts to ensure a full range of services for customers; and active involvement in supply chain management and development of 4PL and 5PL. Against this background, the Ukrainian logistics and transportation sector is in the formation and consolidation phase. During the economic downturn of 2008–2009, European and leading Ukrainian logistics companies focused on tailoring business processes to the individual needs of their customers. They increased the portion of so-called "value-added" services in their product portfolios and implemented advanced IT technologies in order to optimize standing costs. Meanwhile, other national logistics operators retained customers mainly by reducing the margin for operations.

The local logistics services market yields much to the European market, in terms of both quality and complexity. The national transportation and logistics infrastructure is undeveloped, principles of consolidation and distribution management are not used on a mass scale by freight owners, and the country poses administrative-economic risks.

Nevertheless, according to many international experts, logistics and transportation remains one of the few sectors in the Ukrainian economy that is attractive for investment (along with retail trade and agriculture). This market is developing relatively rapidly (by 15–30% annually). EBITDA for some key 3PL components may be 100% (20–30% on average), while the concept of "logistics outsourcing" is taking root in the minds of Ukrainian freight owners, displacing the "I will make it better than anybody else" philosophy and enabling commercial and industrial companies to focus more on their key competences. The investment threshold for providing high-quality logistics services (the service level is 97–99%) is currently sufficiently high, implying significant capital investment in material and non-material assets in the first place (advanced IT systems for operational logistics management). That threshold is unachievable for most domestic companies. The main risk for powerful international logistics operators is that Ukraine remains unpredictable in terms of legislation, law enforcement, regulatory state policy, and the business climate.

The logistics and transportation market is service-based, however, adjusting to the requirements of its customers (producers, distributors, retail chains). It can thus be said that a key factor impeding this sector's growth is the lack of demand for advanced logistics services on the part of freight owners, who are not prepared to pay for them. Using out-of-date management methods, most commercial and industrial companies in Ukraine fail to leverage developed management accounting systems or to apply efficient IT systems (for inventory, purchases, etc.). In certain cases they just lack a powerful "logistics intellect" and do not assign challenging tasks to their logistics units, which in the developed markets are normally executed by "outsourcers" of logistics services who can serve supply chains in the most effective way.

While there are very few 4PL companies in Ukraine, there are more than a dozen 3PL companies, and there are tens of thousands of suppliers of various products and "contract logistics" services (so-called 2PL operators). In particular, de-consolidation can be found in the freight forwarding services segment: Ukraine's truck fleet numbers over one million of vehicles and is owned and managed by tens of thousands of legal entities. Some 90% of them are private entrepreneurs who seem unable to establish, for instance, an advanced transportation management system (TMS) and maintain their vehicles in acceptable condition according to customer needs and legal requirements. In the international truck haul segment, one shipping company accounts for five freight forwarders. For this reason, service quality is often 60–70% of which it should be. Workflow, an integral part of modern materials flow, helps little, and often even deteriorates the ultimate service level, increasing the cost of products and services for Ukrainian consumers.

Recently the logistics business environment has witnessed significant changes on the level of legislation and regulation. There have been, for example, the new Tax and Customs Codes, the reforms of Ukrzaliznytsia, the new Law "On Sea Ports of Ukraine," and the "Transport Strategy of Ukraine for the Period until 2020." Despite the reforms under such slogans as "improving the investment climate," "reducing the government monopoly sector," "liberalizing pricing on the markets," etc., national regulatory policy often remains non-transparent and stifles competition.

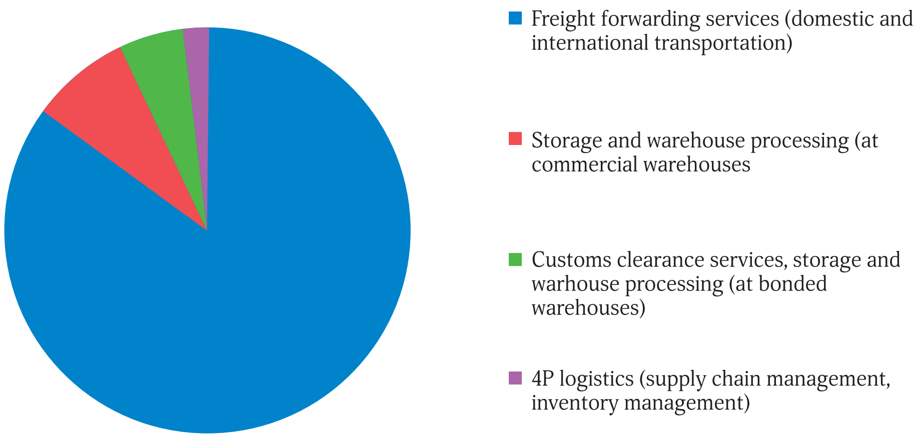
In addition to inefficient regulation, the key negative factor remains the quality of the transportation and logistics infrastructure. Of 21,100 kilometers of principal roads in the country, 40% do not meet durability requirements and 50% do not meet evenness requirements. Rolling railway equipment is 80–90% out-of-date. The river transportation and transshipment system requires immediate reform: European trends should be used as examples in order to reduce the volume of motor vehicle use and CO2 emissions, as well as river shipments being a good alternative to haulage or railroad use. EURO 2012 contributed to the improvement of domestic infrastructure. The airports in Kyiv, Donetsk, Kharkiv, and Lviv were renovated and expanded; high-speed passenger trains were introduced; several key highways, with a total length of over 1,000 kilometers, were built and rebuilt, such as the Lviv-Krakivets, Odesa-Reni, and Kyiv-Chop highways and the ring roads in Kharkiv and Donetsk.

Successful international best practices indicate that in order to optimize costs for logistics, transport and logistics centers (TLCs) must be established near "points of entry/exit" for commodity flows (seaports, border/customs terminals) and/or in the immediate vicinity of "points of sale" (shops, markets, etc.); new high-power main corridors must also be laid down and intermodal transport developed. In recent years it has been in the Euro-Asia region in which similar projects (TRACECA, the European transport corridors No. 3, No. 5, and No. 9) have taken on special meaning as far as goes strengthening the positions of the Asian states as key producers and the European countries (mainly the EU ones) as their largest consumers. Ukraine should pay certain attention to these issues so that it better exploits its transit potential. Important tasks for state transportation policy include improving the legislative and organizational principles for reorganizing transport infrastructure and developing a national network of TLCs and integrating it with the transport systems of Europe and Asia and with the Baltic and the Black Sea economic spaces. While the expected Ukraine-EU free trade area will create new opportunities for trade, an underdeveloped transport infrastructure may cause Ukraine significant economic losses and impede its economic growth.

Recent World Bank research has showed that according to the Logistics Performance Index (an integrated index the parameters for which are set in terms of customs procedures, infrastructure, the availability and quality of service providers, etc.), Ukraine currently ranks 66th out of 155 countries (it was 102nd in 2010). We believe that this 36-position improvement over two years reflects the latest reforms (including those that were implemented for EURO 2012) and is likely to represent a kind of "advance" to Ukraine from this international institution. Many trade companies, including small and medium-sized businesses, still complain about excessive document regulation of foodstuffs supply, the ambiguity of customs valuation rules for imported goods, the lack of a developed system for risk assessment and electronic customs clearance, the duplication of regulatory authorities' functions, and unfavorable tariffs and timeframes for the release of containers from Ukrainian ports (the ports of Turkey, Poland, Romania, and Georgia are three to four times more efficient as a result of these factors).

Other key issues in the local logistics and transportation market include insufficient development of "integrated logistics services" and the low level of leveraging of advanced information systems to foster efficient logistics flows management (see Figure 1).

Figure 1: The structure of the Ukrainian logistics services market in 2011, % of the money turnover



The prospects for logistics and transportation sector development are as follows:

1) further market consolidation, including the combining of financially powerful providers and local operators that are knowledgeable in the specifics of doing business;

2) raising the transparency of logistics companies and of their economic and operational activity indicators;

3) relations between providers and customers in joint supply management will have a more and more strategic and long-term nature;

4) cooperation among players will emerge to ensure common interregional access to markets and the formation of efficient industry-specific associations;

5) considering the growth in the professional competence of logistics companies, focus will shift from asset management to owning information;

6) the value of logistics operators as optimizers of the regular operational expenses of customers will increase, while their geography will expand into new products markets; active participants of CSM systems out of freight owners should develop "multi-level supply chains" within the framework of organization and improvement of their supplies;

7) there will be the establishment of nationwide physical distribution systems for every product segment: "temperature" products, construction materials, hazardous products, etc. (similar to the existing systems in the FMCG and pharmaceutical sectors).

The Chamber Logistics and Transportation Committee was established several years ago to ensure that Chamber Members can communicate with market participants and representatives of the government on all levels, including the Parliament of Ukraine, the Cabinet of Ministers, certain Ministries (the Ministry of Infrastructure in particular), and state agencies. The goal is to create transparent and beneficial rules of game — for participants in economic activity and for the state in general. The Committee also serves as a communications platform for experience exchange and discussion of logistics issues among shipping and logistics companies, express delivery carriers, FMCG companies, and retail chains.

The American Chamber of Commerce Working Group on Sea Ports Development, which works under the Committee's umbrella, advocates for a legislative framework for sea port development and addresses policy makers regarding the current situation of Ukraine's sea ports and the possibility of improving them.

FM LOGISTIC

Modern IT Solutions for Supply Chain Management

It's no secret that any company's success is based on obtaining exact information as fast as possible – information that takes into account each of its business activities as well as the activities of its clients. Such information is important at the planning and financial level, but it's even more important for operational process management. The speed and flexibility of a logistics chain define a company's tactical strength, which in the end affects sales.

Ukrainian manufacturers, logistics service providers, and retailers are showing interest in warehouse and supply chain management technologies, but talk about the structure of demand for informational systems remains premature. Currently the most active users of warehouse management systems in Ukraine are logistics operators and large manufacturing companies. A main driver of demand is the gradual transformation of certain large distributors into logistics operators. Taking into account the pace of development and Ukrainian market volumes, it's possible to predict that in the next 10 years different logistics management system solutions will see stable demand. The main forces driving market development remain modernization of outdated systems and growth of the logistics segment in general.

All of this, of course, intensifies competition and creates a need for efficient storage and handling services. The most typical international practice solution is to equip warehouse facilities with modern management systems. In Ukraine around 90% of companies try to organize their storage facilities independently. Today there are around 300 companies that specialize in implementing management systems around the world, but only about 10 such enterprises serve the Ukrainian market. Our experience shows that warehouse management system selection in Ukraine places more emphasis on criteria that aren't primary (such as, for example, the possibility of warehouse visualization) than on what is really important – the "heart" of the system. Choosing the right logistics management system isn't easy, given that the functional possibilities of the information systems on the Ukrainian market today are rather similar. But they differ in terms of their functions, the presence of additional modules that extend flexibility, the possibility of changing them or implementing other processes in the warehouse, the experience they offer the supplier, and, finally, cost.

The market demands high-quality automated solutions specially designed for clients. It's no longer enough simply to design modern IT technology software. You also have to offer cost saving and quality service projects to optimize the entire supply chain and you have to act as a strategic partner.

The company should realize the significance of IT solutions for supply chain management. It has to have an experience in creating and implementing innovative complex solutions for its clients. International transportation, customs clearance, warehousing, domestic distribution, and IT services add up to one integral way to solve the clients' problems. Information solutions to foster operative control and supply chain management increase transparency and optimize expenses. The Warehouse Management System (WMS) and Content Management System (CMS) along with the Transport Management System (TMS) and Supply Chain Management (CSM) should be specially designed and integrated systems in the information division:

- Inventory management and warehousing goods flow.
- Planning and management distribution.
- Management of co-packing activity.
- Supply chain planning and management.
- Electronic Data Interchange (EDI and EAI).
- Wireless Bar Code reading and voice technologies; RFID...

The main goal is to connect all productive processes into one structure and to allow for planning, optimization, control, and documentation of activity beginning with order placement and finishing with the shipment's arrival in real time. All this, along with ongoing development and service improvement, has a positive influence on all business processes, such as the speed and quality of activity, differentiating our logistics services and giving our clients additional possibilities every day. This makes possible for FM Logistic managing a warehouse space of 2,300,000 sq. m., preparing 900 million packs per year, producing 200 million consumer units per year, and making 1,300,000 deliveries per year worldwide.

This market accepts only those companies that are experts in the field, that can help their clients resolve their problems and reach their targets, and that can flexibly react to the changing business environment.

15. Real Estate

CBRE | Ukraine

PART OF THE CBRE AFFILIATE NETWORK

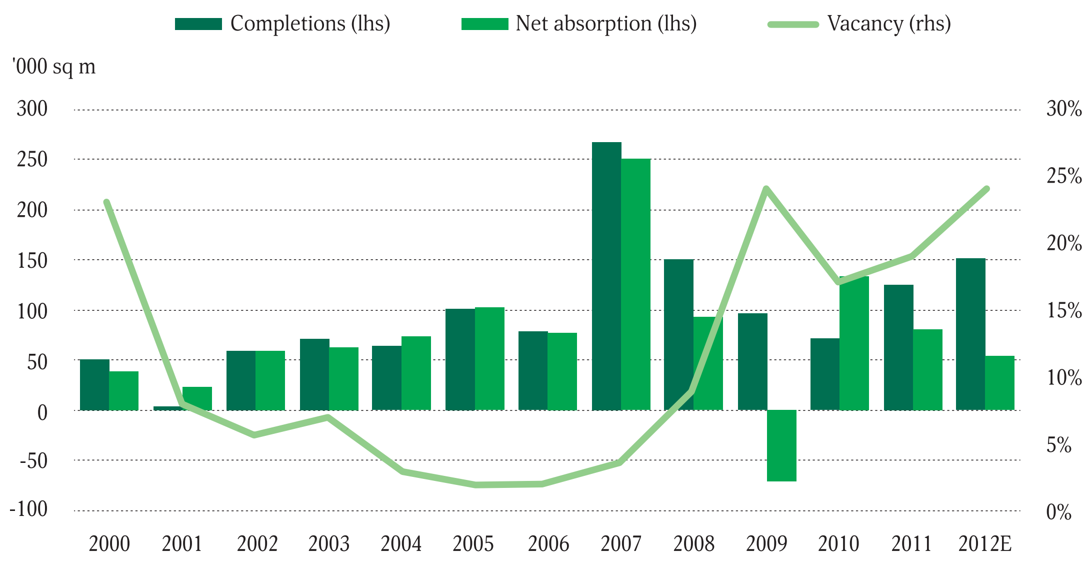
Office, Retail and Warehouse Markets Overview Q3 2012

Office Market

Fundamentals

The continuing uncertainty stemming from the euro zone's recession coupled with weak economic data are undermining occupiers' confidence in the market. Many occupiers are looking to postpone major real estate decisions in order to avoid costly relocations. As a result, demand for office premises has remained quite moderate for five consecutive quarters. Analysis of net absorption dynamics indicates that expansions of existing office space and leases driven by market entry are progressing very slowly, while new additions to the total office stock are considerable. By the year-end, it is anticipated that demand for office premises will remain subdued, reflecting weak economic fundamentals. In view of these trends, the vacancy rate is bound to continue its upward trend in 2012.

New Supply, Net Absorption and Vacancy Rate



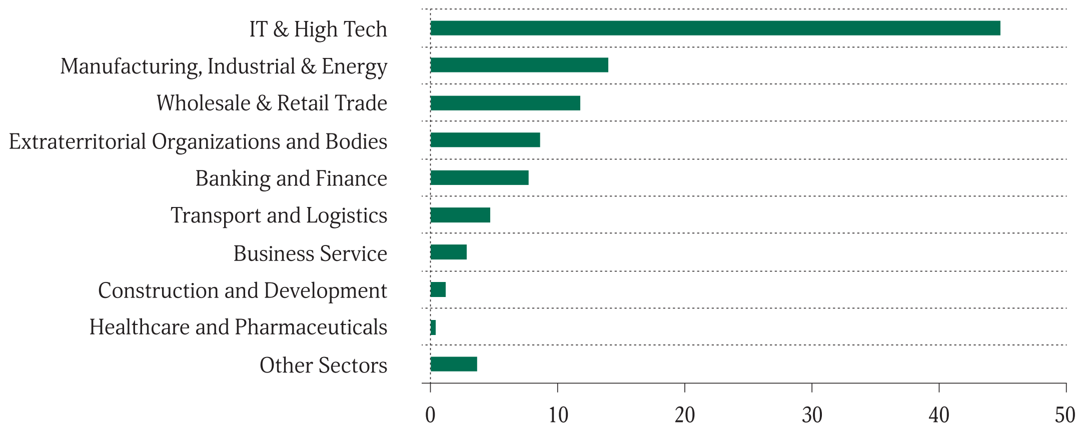
lhs – left hand scale
rhs – right hand scale
E – Estimate
Source: CBRE

Demand

In the first nine months of 2012, take-up equaled just over 58,000 sqm, representing a 38% y-o-y decrease, with 27% of it accounted for by a single deal – the 15,700 sqm let to Samsung in 101 Tower. Most of the remaining transactions were still largely driven by companies' consolidation plans or their intentions to move to premises of better quality in terms of class or location. It should be noted that almost all of the transactions in excess of 1,000 sqm were completed in new office buildings.

In terms of industry sector breakdown, take-up was still driven by occupiers from the IT and high tech and telecommunications sectors, accounting for 45% of the total. The demand from banking, finance and business services companies, which were the main users of office space in the past, remains weak, as they make up only 11% of the volume.

Take-up by Industry in Q1-Q3 2012



Source: CBRE

Supply

While development completions are declining across much of Europe, the Kyiv office market is experiencing a rise in the amount of new supply for the second consecutive year. Completion levels are expected to reach slightly more than 150,000 sqm in 2012, which is 20% ahead of 2011 and twice as much as in 2010. The total competitive stock will thus reach ca. 1.38 million sqm by the end of the year. Another 176,400 sqm of office space currently under construction could enter the market in 2013. It should be noted that this amount also includes schemes that were initially planned for delivery in 2012.

Among the most notable deliveries of 2012 are two large mixed-use schemes, initiated before the crisis and including a considerable volume of Class A premises – Gulliver (GLA ca. 60,000 sqm) and Toronto-Kyiv (GLA ca. 35,000 sqm). Almost all the new office schemes are located on the right bank of Kyiv. The only exception is the Crystal office building (GLA ca. 9,000 sqm), delivered in Q2 2012. The geographical imbalance within the office stock will, therefore, continue to grow.

In 2012 the Olympijskyi submarket grew significantly in terms of new class A supply, while in 2013 large office schemes are scheduled for delivery in Podil and Pechersk. No significant increase in new supply is expected in the Prime and Shevchenkiskyi submarkets over the course of 2013.

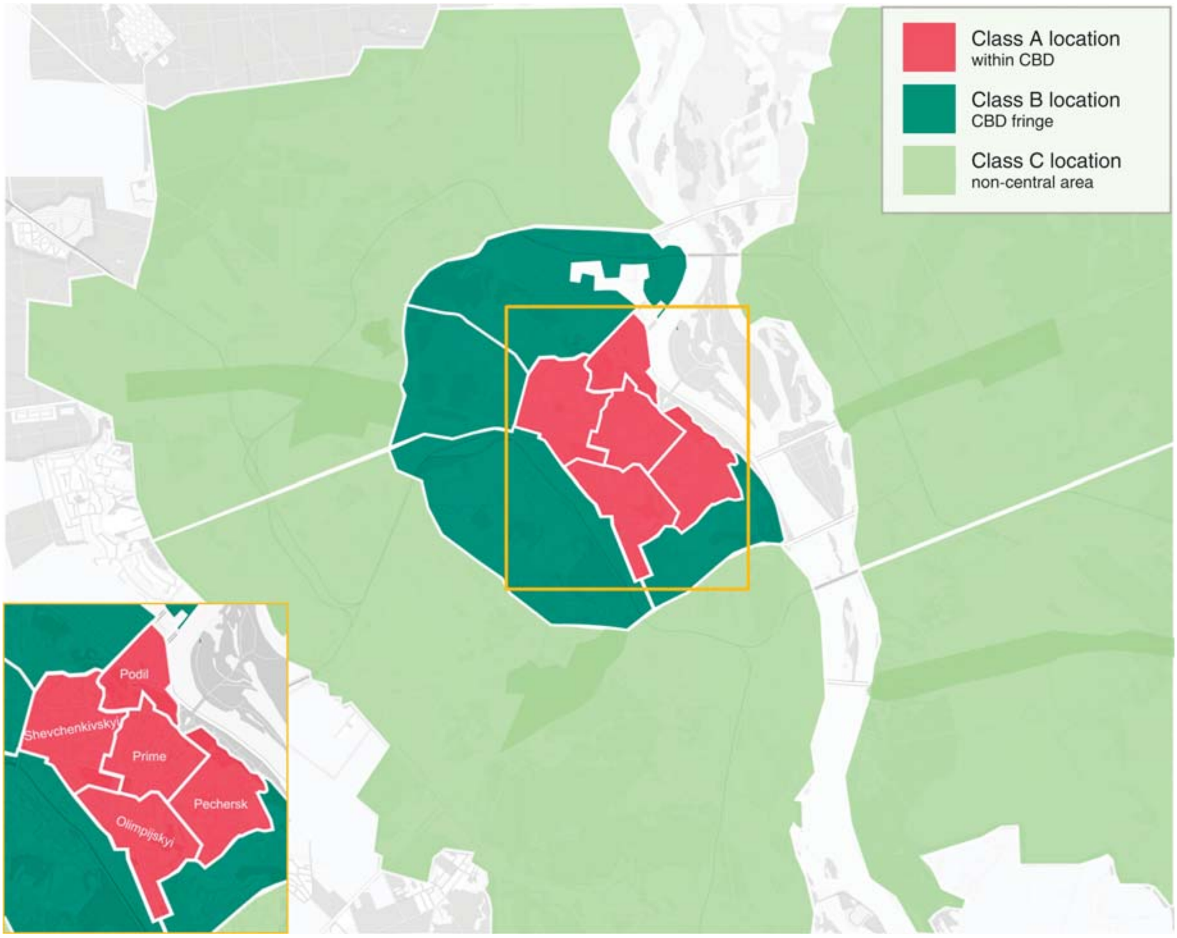
Vacancy and Rents

The slow pace of office space absorption in combination with the growth of new supply caused the average vacancy rate to increase to 25% in Q3 2012 (+5.8% from Q4 2011). The high vacancy rate on the office market, in turn, is continuing to prevent recovery in office rents – over the first nine months the benchmark prime rent in core areas stayed flat at $35/sqm/month.

In terms of submarkets, rents and vacancy rates vary markedly. By the end of Q3 2012, base rental rates for Class A properties in CBD continued to stay within the $25-$42/sqm/month range, whereas those for Class B properties remained in the $12-$30/sqm/month range. Asking rents in prime-located Class A office schemes can still reach up to $45/sqm/month.

Despite the fact that rents generally did not undergo fluctuations, the rising vacancy rate on the market has gradually started to increase the levels of the incentives that landlords offer. This means that even though base rents remained stable, the downward pressure on net effective rent has increased over Q1-Q3 2012 through either increases in landlord contributions to fit-out costs, increases in rent-free periods, or a combination of both.

Map of Office Submarkets in Kyiv



Source: CBRE

*Kyiv Office Base Rental Range and Vacancy as of Q3 2012 (USD/sqm/month)**

Class A location	Quality A	Quality B	Vacancy
Prime	$35–42	$25–30	6.6%
Pechersk	$35–42	$25–30	11.5%
Podil	$28–35	$23–25	10.9%
Shevchenkivskyi	–	$22–28	15.8%
Olimpijskyi	$25–32	$23–27	41.1%
Class B location	**Quality A**	**Quality B**	**Vacancy**
CBD fringe	$20–25	$14–20	15.2%
Class C location	**Quality A**	**Quality B**	**Vacancy**
Non-central area	–	$12–15	36.5%

** – data was presented according to expanded CBD boundaries and the new business center classification introduced by CBRE in September 2011*

Source: CBRE

Outlook

Ukraine's under par economic performance will continue to cast a shadow over demand for office premises in 2013. The large volume of new supply in 2012, the development pipeline for 2013, and a slow pace of absorption indicate that the vacancy rate will remain high, further spurring competition among business centers. 2013 will therefore continue to be a tenant's market, with an increasing menu of concessions on offer. Once the general economy begins to recover, occupiers' confidence will improve, which will feed through to the occupational market. In the meantime, however, the most likely scenario is one of continued subdued activity.

Retail Market

Fundamentals

Record low inflation (+1,1%[1] CPI) coupled with an upturn in real wages (+13.2% y-o-y) set preconditions for strong domestic demand, which in turn resulted in healthy retail sales in Kyiv (+14.9%1 y-o-y). This supported a moderate demand for retail space among retailers.

Demand

Demand for retail space in the grocery segment in 2012 came from both national chains (Fozzy Group, ATB, EKO-market, Retail Group) and their international counterparts (Metro Group, Spar, Novus, Billa). ATB, a discounter, and Silpo, a local supermarket chain, are still the leaders in terms of the number of openings. Due to the lack of high-quality retail space, hypermarket chains are expanding slowly and are actively renting space in newly-delivered shopping centers as well as in schemes under construction. The prominent opening of Real, the first hypermarket of the German retail chain in Kyiv, has taken place in the Ocean Plaza Shopping Center. The grocery segment has recently been characterized by retailers explor-

[1] The data is for January — September 2012.

ing new formats. In 2012, Fozzy Group launched Le Silpo, its new premium-class chain, while Retail Group and Varus are actively developing "corner shop" formats named BK-Express and Varus-market, respectively.

Currently the most active players in fashion retail are the international chains Inditex Group and L.P.P. SA Group, the Russian chains Sportmaster, MD Group, and CentrObuv, and the national chains MTI and ARGO.

A record number of new retail chains in predominantly fashion retail entered the market during January – November 2012. In particular, several new entrants in the luxury segment (Prada, Valentino, Dolce & Gabbana, Armani Collezioni etc.) opened stores in major street retail destinations as well as in shopping centers located in the city center. In the mid-price segment the majority of new retailers opened their flagship stores in the newly-delivered Ocean Plaza Shopping Center.

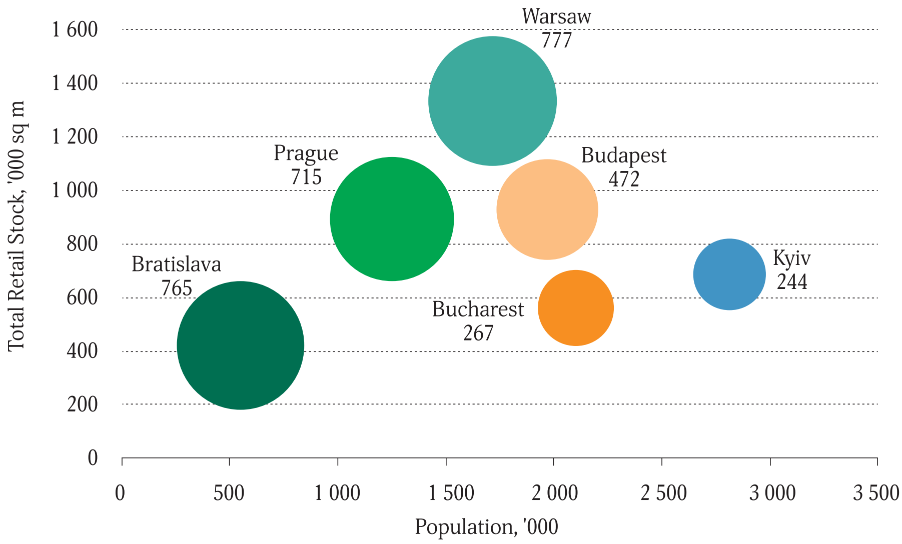
New Entries 2012

MID-RANGE FASHION	LUXURY FASHION
Max Mara Weekend	Dolce&Gabbana
Trussardi Jeans	Prada
Diesel	Valentino
s.Oliver	Billionaire Italian Couture
Reiss	Armani Collezioni
W52 Jeans	Agent Provocateur
Pepe Jeans London	ERES
MICHAEL Michael Kors	**FOOTWEAR&ACCESSORIES**
BCBGMAXAZRIA	Rebeca Sanver
bebe	Longchamp
OVS, OVS kids	Camper
Piazza Italia	Denis
Fornarina	Why Denis
Cinque	Kari
Camicissima	Karma of Charme
Napapijri	Wojas
Atelier de Courcelles	Evita Peroni
Meucci	**OTHERS**
Blanco	KFC
LC Waikiki	Hesburger
lady&gentlemen CITY	Sega Fredo
Black Star	Pellini
Suvari	Happylon

Supply

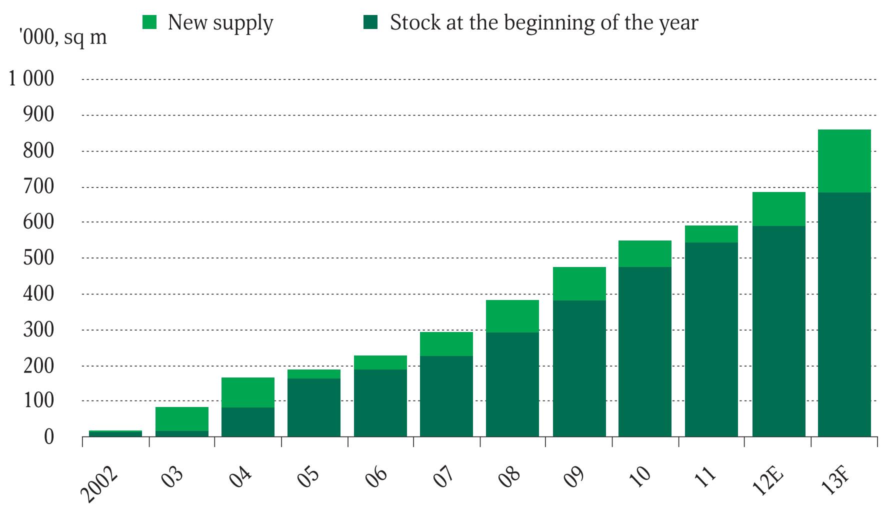
Despite a substantial volume of retail space scheduled for delivery in 2012, less than half of the announced volume actually reached the market in the past year. Deliveries of the majority of retail schemes expected in 2012, including the Silver Breeze, Gulliver, Atmosphera (Phase II of Domosfera), Art Mall (Alacor City), and Marmelad shopping centers, were postponed until 2013. Hence, new supply in 2012 has been significantly reduced to 96,000 sqm from the forecasted 251,000 sqm, which is nonetheless more than twice as much as in the prior year. With the delivery of two professional shopping centers in Phase I of Ocean Plaza (72,000 sqm GLA) and RayON (24,000 sqm) total retail stock[2] increased by 16% y-o-y and amounts to 686,200 sqm. Even though the Kyiv provision rate for retail space rose from 210 sqm to 244 sqm per 1,000 inhabitants, it is still rather low, especially when compared with other capitals in Central and Eastern Europe (CEE).

Retail Premises per 1,000 Inhabitants in Selected CEE Capitals, sqm



Source: CBRE

Kyiv Shopping Center Stock



E – Estimate
F – Forecast
Source: CBRE

[2] [A shopping center] is a retail property that is planned, built, and managed as a single entity, comprising units and "communal" areas, with a minimum gross leasable area (GLA) of 5,000 sqm; 50% of the tenant mix should consist of chain retailers.

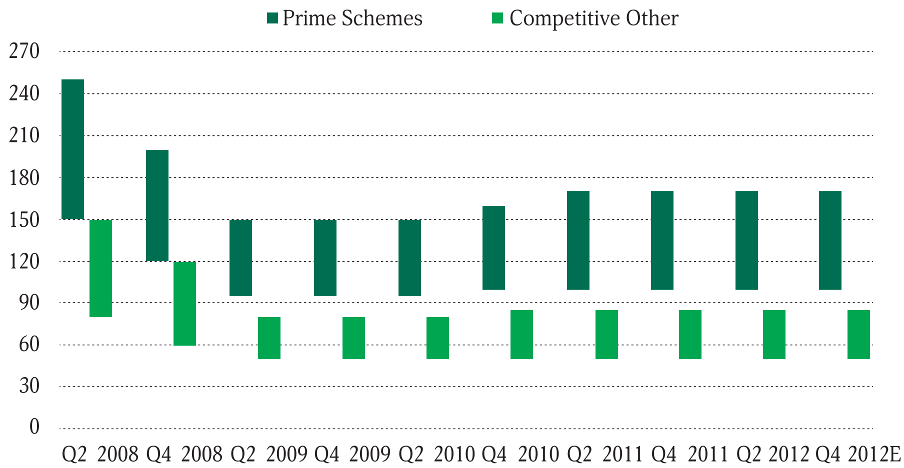
What is remarkable, however, is that retail schemes are increasingly becoming large in format. A good example would be the Respublika Shopping Center (139,000 sqm), construction of which commenced in H1 2012. It is the largest scheme in Ukraine among both existing shopping centers and those under construction.

Vacancy and Rents

As of the middle of December 2012 rental rates had remained unchanged, as uncertainty about the economic outlook set in and retailers were expanding only moderately. Prime rents were in the range of $100–170/sqm/month (triple net) for typical gallery units of 100–200 sqm. Secondary base rents stayed at $55–85/sqm/month for gallery tenants.

Even though the supply of quality retail premises rose in 2012, the vacancy rate in prime retail schemes continued to remain low, at 0–2%, due to rapid absorption of space within the newly delivered shopping centers. Secondary vacancy remained within the 3% to 5% range.

Kyiv Base Rents (USD/sqm/month)



E – Estimate
Source: CBRE

Outlook

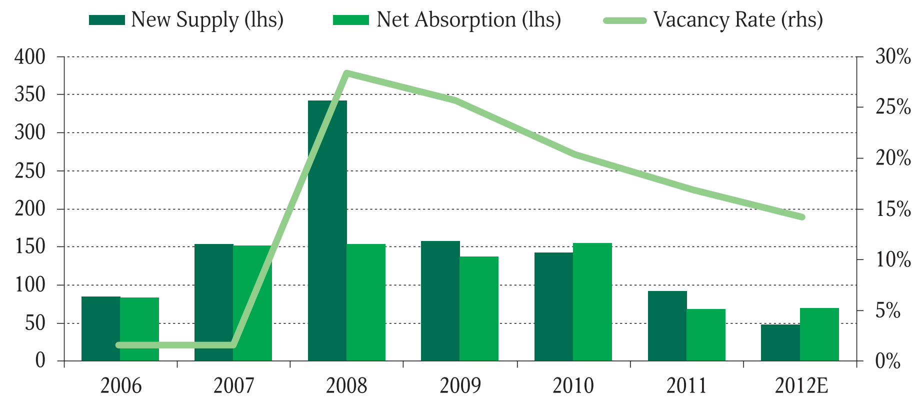
Due to the postponement of delivery of several retail schemes until 2013, 172,500 sqm of new supply is expected in 2013. In case of timely delivery of the planned schemes, total professional retail stock will grow by 25% y-o-y, reflecting stable development in this segment of the real estate market. Even with such a significant increase in supply, the vacancy rate in prime shopping centers is expected to remain low given the strong focus on quality space among retailers. Rental growth is not expected in the near future, while new supply is being absorbed and the financial market remains constrained.

Warehouse Market

Fundamentals

Strong retail sales had a positive impact on leasing activity on the part of retailers of both retail and warehouse premises. However, it would be premature to state that the warehouse market has recovered, as the vacancy rate remained high at around 14% across the board at the end of Q3 2012. Despite the fact that new supply has been declining for the past four consecutive years, tenants' demands for warehouse premises has not been growing fast enough to bring the vacancy rate down sufficiently to re-establish market equilibrium. We therefore do not anticipate a significant change in vacancy by the end of the year.

New Supply, Net Absorption and Vacancy Rate: Past and Future



lhs — left hand scale
rhs — right hand scale
E — Estimate
Source: CBRE

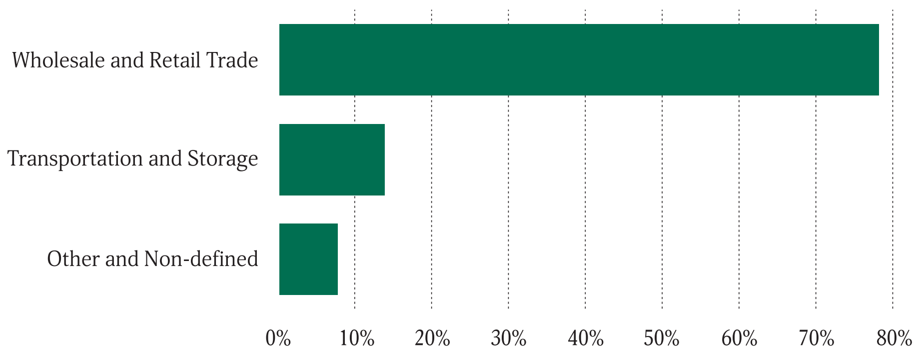
Demand

Over the first nine months of 2012, take-up of warehouse space reached around 123,000 sqm, which is 26% less than over the same period a year ago. However, it is worth noting that last year's results were boosted by a number of large transactions for owner-occupation, whereas this year only one such transaction was completed.

The structure of take-up has changed substantially: the share of the East (Left) Bank in the total number of transactions has reached 75% (last year it was only 37%) thanks to a lower pricing policy in comparison to the offers on the West (Right) Bank. For example, Unilogic Park in Brovary (approx. 22,000 sqm), which was delivered in Q4 2011, has been completely leased out in less than six months.

Retail chains and distributors continue to dominate the take-up structure, account-

Take-up Structure by Industry in Q1-Q3 2012*



* *base — volume of transactions, sqm*
Source: CBRE

ing for ca. 78% of take-up in Q1-Q3 2012 (+17 pp. y-o-y). While retail chains have been mostly upgrading their premises and were relocating to better quality properties, transactions involving logistics operators were driven primarily by expansion (14% in the total take-up structure).

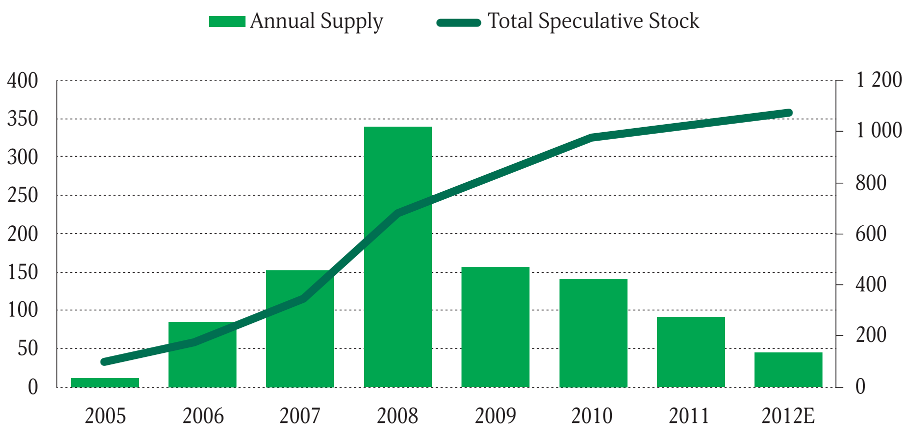
Supply

New supply in 2012 will equal a meager 47,300 sqm, mostly due to the delay in delivery of Phase II of the Amtel Logistics Complex, thereby marking a fourth straight year with a diminishing volume of new supply.

Overall, by the end of Q3 2012, professional warehouse stock amounted to:

- Total stock: approx. 1,616,000 sqm
- Speculative supply: approx. 1,072,000 sqm

Kyiv Annual Development Completions and Total Speculative Stock ('000 sqm)



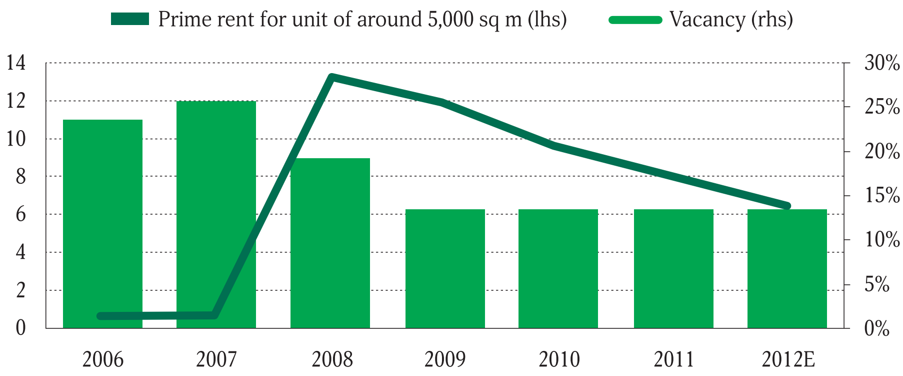
lhs – left hand scale
rhs – right hand scale
E– Estimate
Source: CBRE

Rents and Vacancy

Largely due to sluggish supply, the overall vacancy rate on the market fell from 17.1% in Q4 2011 to 14% in Q3 2012. The bulk of unoccupied space remains concentrated along the Moscow Highway (M-01, E-95). Nevertheless, the absorption rate on that submarket picked up recently. As of Q3 2012, the share of the Moscow Highway in the total volume of unoccupied space amounted to ca. 43%, having declined by 17 pp. from Q4 2011. On the West (Right) Bank the biggest amount of vacant space is concentrated in a single property, Phase I of the Amtel Logistics Complex (a submarket between the M-05 and M-06 highways).

Prime rents remained unchanged over the past nine months, at $5.5 to $6.5/sqm/month triple net. Asking rents for warehouse space located close to the city range from $6.0 to $9.0/sqm/month. Vacant space on the Right (West) Bank is offered at $5.5–7.5/sqm/month, while professional schemes on the Left (East Bank) are priced at $5.0–7.0/sqm/month. It should be noted that landlords' expectations have increased recently, with their minimal acceptable offers being $0.5 higher than a year earlier. Furthermore, rental rates on the Left (East) Bank began to firm up: landlords of properties located along the Moscow and Kharkiv (M-03, E-40) Highways are showing less willingness to negotiate as the space in their schemes is being gradually taken up. Landlords on the Right Bank, however, are more open to bargains, having lowered the upper limit of their asking rents by $0.5.

Average Prime Rental Rate (USD/sqm/month) and Vacancy Rate



E – Estimate
Source: CBRE

Outlook

In 2013 no significant new additions to the speculative total stock are expected, and there is only one large scheme announced for delivery. Nevertheless, the number of “paper” warehouse projects is significant and the volume of new supply may increase dramatically in a short period of time, should developers see a solid and broad-based increase in demand.

It is expected that existing occupiers will continue to optimize and/or expand their operations, relocating into better-quality space on better terms. However, the pace of warehouse absorption is likely to stay moderate in 2013, as the availability of secondary space will be growing. As a result, we anticipate vacancy to stay at a two-digit level next year.

Generally, under conditions of an uncertain economic outlook and due to the fact that the overall vacancy rate remains above market equilibrium, most tenants cannot be expected to pay higher rents for warehouse space. In terms of submarkets, further strengthening of rental rates is expected on the Left Bank, a phenomenon driven by increased tenant interest in this area and by a falling vacancy rate. Rental rates for vacant warehouse space on the Right Bank are likely to remain flat on the back of moderate demand.

MIROPLAST
WHEN QUALITY MATCHES DESIGN

PVC Window Profile Systems 2012–2013: Trend Shows a Reduction in the Number of Profile Manufacturers

An Overview

Following the 2009 financial crisis, the PVC (polyvinyl chloride) window and door profile market declined by 43%. The market partly recovered in 2010 but then remained static in 2011. The market potential is estimated at approximately 7 million windows per year which translates into one window for every seven Ukrainians. Leaving a fairly large potential for years to come.

According to recent market research, 60% of Ukrainians have installed PVC windows in their homes over the past six years. So it is still too early to talk about market saturation. It is known that people who installed new windows 10 years ago will be in the market soon, either to replace or install in newly acquired premises.

Competition among producers has intensified in the past years which clearly has influenced the number of manufacturers and their sizes. Since the beginning of 2011 both manufactures of PVC profiles and window producers have started to consolidate. Large window producers are selecting profile suppliers with significant and increasing production capacities, not only to meet their expanding demands but to supply improved product quality and service.

Forecasts indicate that 2013 will reflect the 2012 experience. Results for 2012 show that the market has bottomed out and will either maintain existing volumes or expand slowly, even though the number of small producers are sure to decline. In addition, the market will require more quality retail service, more professional installation services, better after-sales services, and guaranteed newly-installed windows quality and maintenance.

2012 market trends in detail:

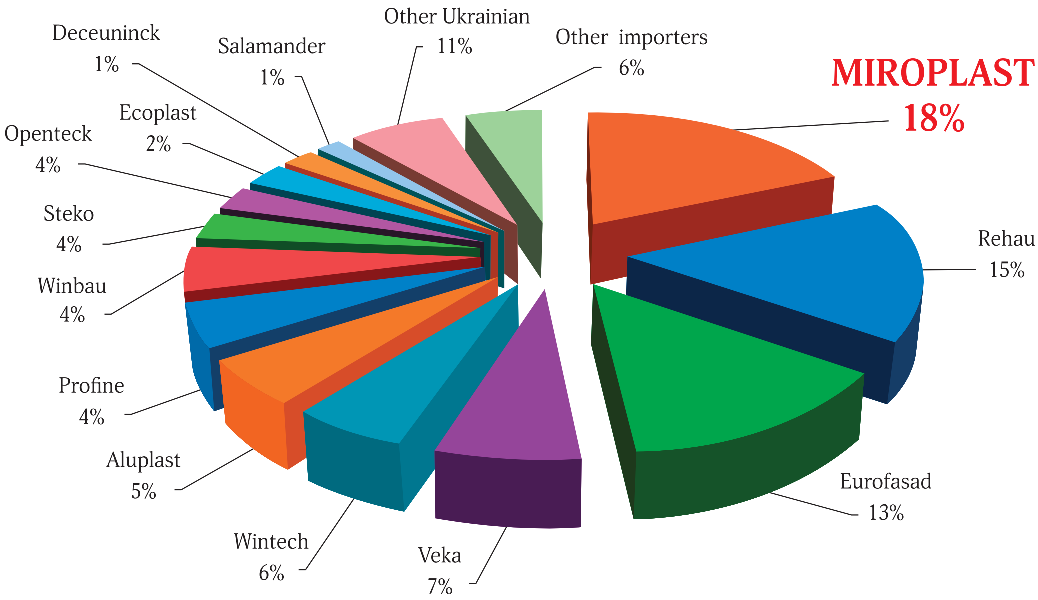
- **Share of imported profile systems drops to 27%:** Smaller importers were pushed out of the market and in general the volume of imported PVC profiles shrunk. More and more European profile producers have started production in Ukraine to claim local production.
- **Classification of profile systems by price:** If we classify PVC window profiles by price, the “medium priced” segment held 60% of the market while the “medium-minus” group registered 18% and the “economy” segment 20%, the latter down from 30% two years ago. Customers are increasingly demanding profile systems with added value: better energy saving efficiency, more aesthetically appealing designs compared

to profiles with more common characteristics. The "premium class" segment (2%) is still in a formative stage. This class consists of windows with mounting depths of more than 80 mm and 6 or more chambers.

Share of PVC window profiles by price segment, 2012

Segment	Market Share
Premium class	2%
Medium-Medium+	60%
Medium-	18%
Economy	20%

- **Drop in number of profile system manufactures:** Eight sizable profile manufacturers account for 78% of the market. Three of these dominate the market with a combined market share of slightly more than 48%.



Figures in 2012 (indicative data)

- **Window producers keep on consolidating:** About 115 window producers make up 85 to 90% of the window retail market. This number has decreased a lot since 2008. Yet at the same time, the capacity, productivity and performance of the remaining companies have improved more than 40 percent.

  Window producers simply have to increase and improve their production capacities in order to develop their market shares, systemize logistics and company procedures, and to increase product quality and product range. Otherwise it will be impossible to survive in a market that has steadily contracted over the past three years. Some window producers are managing to implement these changes, but most of them are failing to do so. The indisputable fact is: the future belongs to those window producers who know what their customers need and want, and who are ready to provide them in a timely and cost effective manner.

- **More pro-active retailing:** Consistent rental increases for retail space are forcing entrepreneurs to find new ways to attract new window customers. Passive sales techniques (such as opening a salon in every residential district and waiting for customers to buy) are gradually passing into history. Such sales strategies simply won't guarantee profits anymore. The era in which companies advertised in local newspapers and waited for their customers to show up, is over.

The new trend is towards actively searching for customers and once found to persuade them that as a dealer you are a professional with intimate knowledge of the windows market. Only such methods will generate a sufficient number of customer orders to satisfy the return on investment entrepreneurs need to prosper. The future belongs to those window producers and their dealers who open one well-equipped and professionally staffed showroom with a good selection of product samples and options, and with several energetic sales agents. The sales manager's task is to monitor private cottage or housing developments, establish contacts with property developers and construction companies – decision-makers who need window products that the market and customers demand.

Furthermore, a sales manager should search for, almost sniff out, customers whose homes or apartments are in need of renovation and convince them to buy windows that will enhance the appearance of their homes and create more comfortable living condition, not to mention increase the value of their properties. If a customer would like to see the windows or samples before deciding to buy, he (she in many cases) can be directed to a professional showroom fully equipped to demonstrate state of the art windows and accessories.

- **Customers are becoming more demanding:** Customers no longer trust cheap profile systems and their windows. Shop assistants no longer want to sell them. It is clearly more profitable, not to mention more pleasing to the customer, to have a wide range of window styles and colors on display in your retail shop. It is therefore important for window producers to be able to produce non-standard geometrical widows (arches, trapezes, tilting and easy to clean windows) and value added windows with better performance (like thermal insulation, sun resistance, and sound proofing).

MIROPLAST is a leader in PVC profile systems manufacturing on the Ukrainian market, with an 18% share. The company produces a wide range of window and door profile systems that meet international and local technical standards head on. Its profile brands cover the price spectrum. The trade mark WDS is acclaimed by window producers and dealers throughout Ukraine and exported to neighboring countries with growing success.

16. Taxation

BAKER TILLY

Two Years of Paying Taxes under the Tax Code: Outcomes and Perspectives

Roman Zharko, *PhD*
Baker Tilly

For years the instability of the Ukrainian tax system has been one of the most significant challenges for Ukrainian taxpayers and foreign investors. When the question of creating a new Tax Code came up, then, there were expectations that it would help stabilize the tax rules and make tax administration more predictable. However, these expectations did not entirely come true and were confounded on many occasions.

Since passing into law in 2011, the Tax Code has been amended 36 times; a majority of amendments have been substantive and have changed the tax landscape once again. Despite this flurry of amendments and alterations, the government is currently considering further crucial changes in the near future.

This article aims to highlight, in certain areas, the tax impact that the Code has had on businesses in Ukraine and to outline proposals the Tax Authorities have made as regards planned changes to the tax laws.

Corporate profit tax

One of the most obvious changes in the taxation of company profits since the Tax Code took force is the proclaimed reduction of tax rates. Specifically, the corporate profit tax (CPT) fell from 25% in 2010 to 23% in 2011 and to 21% in 2012. In 2013 the rate is expected to be 19%.

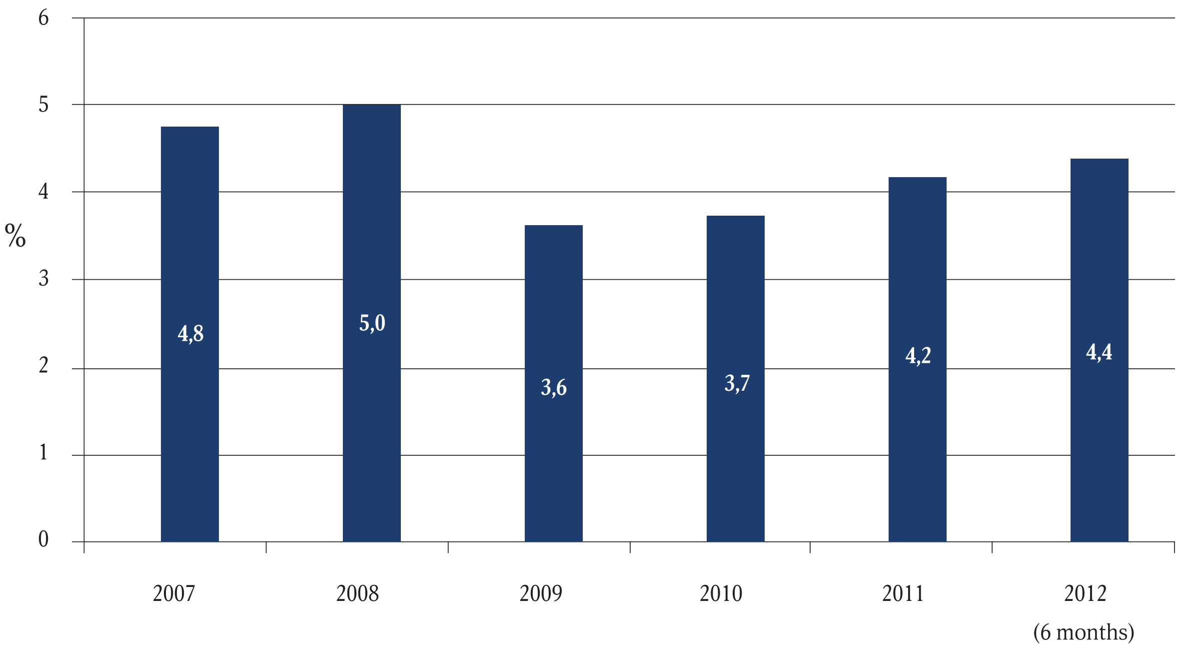
In the short run, reduction of the corporate tax rate, in combination with the general economic slowdown, could lead to a shrinkage in the state tax revenue base. The percentage of state revenues from CPT in Ukraine's GDP has grown, however, since its fall in 2009 (see the diagram, page 70). The reason for this is administrative pressure on business by the tax authorities.

One example of this administrative pressure is the restriction on carrying forward losses and forcing taxpayers to overpay the tax. These issues are discussed below.

There was a restriction on losses carrying forward in 2010, when only 20% of losses accumulated as at 1 January 2010 could be carried forward; the remaining 80% of the losses were allowed as deduction in 2011. However, in 2011 and 2012 the tax authorities took action against carrying losses forward.

Due to the entering into force of section III of the Tax Code governing corporate profit tax on 1 April 2011, there have been two CPT taxperiods in 2011: 1Q 2011 and

Percentage of corporate profit taxing GDP of Ukraine



the remaining three quarters. Basing their action on the wording of the Transitional Provisions of the Tax Code, and forced by the need to raise budget revenues, the State Tax Service of Ukraine (STSU) denied the right of taxpayers to carry forward losses incurred before 1Q 2011, including 80% of losses not utilized in 2010.

The wording of the Transitional Provisions that the STSU used to support its position was not strict enough to avoid ambiguity, but it can hardly be construed as prohibiting taxpayers from carrying forward all losses incurred in 1Q 2011 and before. In spite of this, the court practice was controversial, and decisions were taken in favor of both sides in very similar cases.

The long disputes between the business community and the tax authorities resulted finally in adoption of amendments to the Tax Code reflecting a compromise decision allowing the utilization of losses accumulated as at 1 January 2012 (including losses as at 1 January 2011) in four installments of 25% each in 2012–2015.

In addition, the Highest Administrative Court of Ukraine issued a letter to courts of lower instances explaining that there are no legal grounds to restrict taxpayer rights to include losses occurred before 1Q 2011 in further tax periods, provided that the losses occurred legitimately. However, in many instances court hearings have continued after these decisions.

Another STSU method to raise budget revenues is forcing companies to pay CPT in advance in lieu of obtaining a VAT refund, though this has no legal ground.

This has all showed that the tax authorities have been keeping up tax revenues at the expense of the future tax payments. In 2013 the CPT rate will have to fall further to 19%, which will put additional pressure on state tax revenues. The government thus has to contemplate other ways to raise funds. It has responded to this challenge by developing two draft laws to amend the Tax Code: as regards transfer pricing and as regards reforming the country's tax system. We discuss the main features of these initiatives below.

Along with pressure on business via restrictions on carry forward of losses and other methods, there have also been positive changes. Here we should mention changes to CPT administration and tax incentives for the IT industry.

The CPT administration novelties take force on 1 January 2013 and consist of the following. Quarterly tax reporting will be abolished with an exception for companies declaring tax losses. Companies with annual income exceeding UAH 10m (approx. EUR 1m) will be required to pay monthly advance tax in the amount of 1/12 of the tax paid in the preceding year, with further adjustments in accordance with the annual tax return. Companies with annual income below the threshold, agricultural entities, non-for-profit organizations, and new companies in the year of their establishment will be required to remit tax on an annual basis without monthly advance payments.

These provisions will ease the administrative burden on taxpayers by reducing reporting, while budget revenues will arrive more smoothly throughout the year. Hopefully, this will improve assessments of the investment climate in Ukraine. There are certain unclear provisions in the new administrative rules that have yet to be resolved, but in general the changes will ease the administrative burden for many.

Another positive change is the introduction of tax incentives for entities engaged in the IT industry. The eligible entities may register for the special tax regime and apply a 5% CPT rate to profits derived from the sale of goods and provision of services of an IT nature. The reduced tax rate may be used for 10 years: from 1 January 2013 till 1 January 2023. Along with an exemption for supply of the prescribed categories of goods and services from VAT, the special tax regime may promote development of the IT industry in Ukraine.

Further developments: Transfer pricing rules

Ukraine has not as of this moment implemented well-developed transfer pricing (TP) rules or comprehensive TP legislation in line with OECD standards.The result is price manipulation, which results in deterioration of the CPT base in Ukraine and the outflow of the income to low-tax jurisdictions, leaving little (if any) taxes for the state budget.

Pursuant to the initial provisions of the Tax Code, article 39 takes force on January 1, 2013, establishing transfer pricing rules. However, the Ministry of Finance has developed more comprehensive TP legislation in the Draft Law "On Amendments to the Tax Code of Ukraine (regarding transfer pricing)." Its authors claim that it implements OECD transfer pricing practices. After reviewing this Draft, we would like to highlight certain issues with it:

1. According to the Draft, the TP rules apply to so-called "controllable transactions," which are not only transactions between related parties, but also transactions with entities that are not CPT payers, or CPT payers declaring losses during two consecutive periods before the transaction, or entities applying a 0% CPT rate or that are subject to special tax regimes, etc.

   Controllable transactions also include those with specified goods, such as coal, oil, metals, crops, etc., if the volume of such transactions exceeds UAH 10m per year.

   The scope of transfer pricing legislation will thus affect a large part of Ukrainian businesses, much larger than required by the OECD Transfer Pricing Guidelines.

   Taxpayers will be required to check the tax returns and tax status of their counteragents in order to determine whether the transaction is controllable or not. This will require additional administrative work and create the risk of non-compliance.

2. The Draft envisages that the duration of checks of compliance with the TP rules will be not more than six months, although the period can be extended. With all the extensions, the check may last 15 months. In addition, other tax checks may take place in addition to TP checks. Again, this will result in an additional administrative burden on taxpayers and increase the overall tax burden.
3. The Draft proposes to implement advanced transfer pricing agreements only for so-called big taxpayers, leaving other companies aside. This is a discriminatory provision that deprives a major part of the taxpayers of the possibility of arranging TP issues in advance.
4. In the case of inquiries regarding compliance with the TP rules, the taxpayer will be required to present information proving the correctness of the prices used. The burden of proof is on the taxpayer.
5. The Draft was submitted for public consideration only in August 2012 and as of the date of this writing had not been passed by the Verkhovna Rada. However, the government intends to implement the new rules in 2013. Such a rush to implement a serious tax tool affecting a large portion of Ukrainian companies may cause serious harm for the business environment in Ukraine and undermine the investment climate. Neither businesses nor the tax authorities are ready for implementation: both sides lack qualified personnel able to deal with the new rules; there are as yet no price databases; and so on.

The issues we mention above must be resolved. We hope that the government postpones the implementation of the provisions the Draft envisages until 2014.

Tax reform

Another novelty in the tax system that could dramatically change taxation in Ukraine is in the Draft Law “On Amendments to the Tax Code of Ukraine (regarding tax reform).”

The changes proposed in this Draft Law clearly indicate that despite the positive tax payment statistics, there are serious problems with maintaining the required level of the state income. Below we discuss briefly the proposed changes.

1. Introduction of progressive tax rates for the personal income tax. If implemented, the rates for this tax will vary from nil to 20% as follows:

- Annual income up to UAH 18,000 – nil
- Annual income from UAH 18,000 to UAH 3m – 10%
- Annual income from UAH 3m to UAH 8m – 15%
- Annual income exceeding UAH 8m – 20%

Considering that the average salaries in Ukraine are lower UAH 3,000 per month, such a change will ease the tax burden on the majority of taxpayers, as the current 15% rate applies to salaries of any size.

The Draft also envisages cutting single social charge (SSC) rates, but at the same time proposes abolishing the maximum amount of income that is subject to SSC.

Currently SSC rates vary from 36.76 to 49.7% depending on the class of risk of accidents and the occupational deceases pertaining to certain classes of economic activity. The suggestion the Draft makes is to set up a single SSC rate of 15%. Obviously, such a reduction could ease the tax burden on salaries considerably and contribute to the legalization of salaries, which are often paid without being taxed.

2. Imposition of a 3% charge for the Pension Fund of Ukraine on purchases of non-cash foreign currencies.

   Cutting SSC rates will decrease revenues to the social security funds and the Pension Fund, so implementation of this 3% charge on purchases of foreign currencies aims at the partial compensation of those losses. The charge is not new to Ukraine: it had been in force until 2011, though at a lower rate. The measure is controversial. On the one hand, it will increase the cost of imported goods and foreign debt capital, which will boost prices and inflation. On the other hand, the charge could help to restrict the devaluation of hryvnya by increasing the cost of foreign currencies and limiting currency speculation.

3. Changes in the VAT.

   A range of amendments are proposed in the VAT rules. They consist of the following:

- Introduction of new rates: 7%, 0%, and 12%.

  The increased tax rate (12%) will apply to import of goods and their further supply, to supply of excisable goods, to supply of electricity, gas, oil, water, etc. Supply of services will also be taxed at 12% VAT. There is no exception for socially important services.

- Abolishment of the first-event rule in recognition of input and output VAT. It is proposed that output VAT will be accounted for on the date of dispatch of the goods or of the arrangement of the documents confirming the provision of the services. The right to recognize input VAT will arise upon the receipt of the goods or services, as confirmed by the VAT invoices.

- Massive reduction of the list of tax incentives and currently non-taxable operations.

- Introduction of a 2% sales tax. According to the Draft, all VAT-able transactions (not excluding export) will be subject to this tax. We believe that this measure will have a huge negative impact on the Ukrainian economy. The drawbacks of the sales tax are widely discussed in the theory of taxation and we will not repeat them. But it must be considered that its introduction will undermine the development of high-tech industries and boost prices and inflation.

- It is proposed to settle VAT refund incurred before 1 January 2013 usingstate bonds.

Highlighted above are the most significant and in our view the most likely scenarios for the future. The Draft needs serious improvement in many aspects and experts should vet the proposed changes. However, some of the proposals might take effect in 2013.

This shows that the Ukrainian tax system is still far from being stable. On the one hand, the government wants to establish an internationally competitive tax system by reducing tax rates, but at the same time its need to maintain tax revenues forces it to find ways to generate the required funds. The above proposals should be widely discussed before implementation. In accordance with the principle of stability enacted in Art. 4.1.9 of the Tax Code, amendments to any tax laws cannot be made later than six months before the commencement of the budget period in which the amendments will take effect. These proposals surfaced after this deadline had passed and it is likely that some of these novelties will find implementation in 2013.

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Investing in Ukraine: Beware of Taxes

It would not surprise anyone to say that the tax situation in Ukraine is difficult. It's not widely known, however, that under the Tax Code a foreign investor must start worrying about taxes even before the funds get to Ukraine, indeed from the very moment the investor formally decides to invest. This sounds quite weird. Yet the Ukrainian tax authorities seem to support that position.

This is to say that a foreign investment into a Ukrainian legal entity may result in taxes even before it is actually made if the Ukrainian hryvnia is subject to devaluation against the currency of investment.The point is that the Tax Code can be interpreted in such way as to state that Ukrainian legal entities must record foreign exchange differences on outstanding contributions to charter capital that are to be made in foreign currency.

This issue is relatively new and still often ignored in practice. Before April 1, 2011 corporate profit tax (CPT) was regulated by the CPT Law. This Law stipulated special rules on foreign exchange difference taxation according to which there were no grounds for taxing foreign exchange differences on outstanding contributions made in foreign currency.

This situation changed when the Tax Code took force for CPT purposes on April 1, 2011.

The Tax Code(sub-para.153.1.3 of Art.153) stipulates that foreign exchange differences should be determined with respect to transactions and indebtedness in foreign currency according to the accounting provisions (standards). Profit (positive foreign currency differences) should be recorded as the income of the taxpayer and losses (negative foreign currency differences) should be recorded as the deductible expenses of the taxpayer.

Although the term "indebtedness" is not defined for tax purposes, given the general usage of this term it is possible to conclude that the outstanding monetary contributions of participants may also be deemed to be "indebtedness" for taxation purposes.

However, foreign exchange differences for such outstanding contributions must be recorded only if the accounting provisions (standards) require.

The Ukrainian accounting provisions (standards)[1] state that monetary items in foreign currency are to be translated into Ukrainian hryvnia according to the foreign exchange rate as of the "date of balance" (i.e. the last day of each calendar quarter). Foreign exchange differences are determined with respect to monetary items in foreign currency as of the date of the transaction and as of the date of balance.

Another question to be addressed, then, is whether outstanding contributions to charter capital shall be deemed to be a

[1] Sections 7 and 8 of accounting provision (standard) 21 "Impact of foreign exchange rate fluctuations," adopted by the order of the Ministry of Finance of August 10, 2000 #193.

monetary item in accordance with Ukrainian accounting provisions (standards).

We believe that there are strong grounds for concluding that monetary contributions in foreign currency shall not be deemed to be a monetary item for Ukrainian accounting purposes.

According to the definition, monetary items are articles of the balance sheet (i) on monetary funds and (ii) on such assets and liabilities as are to be received or paid in fixed (or determined) amounts of monetary funds or their equivalents.[2]

Based on an analysis of the Ukrainian accounting provisions (standards), it is possible to conclude that neither of the above categories is entirely apt for covering outstanding contributions.

It is thus evident from the definition that it mentions the articles from the balance sheet. At the same time, according to the form of the balance sheet that Ukrainian accounting provisions (standards)[3] stipulate, outstanding contributions are recorded in chapter I of the balance sheet, "Equity," which stands separately from assets and liabilities. We also believe that outstanding contributions in foreign currency cannot be treated as articles on monetary funds. Thus, according to the balance sheet articles on monetary funds are grouped under the category "Monetary funds and their equivalents."

To recap the above, outstanding contributions in a foreign currency shall not be treated as monetary items under Ukrainian accounting provisions (standards). It thus should not be required to record foreign exchange differences on such outstanding contributions in foreign currency. Hence, foreign exchange rate fluctuations shall not result in taxes, notwithstanding such outstanding contributions.

This conclusion is principally in line with the general treatment of contributions into the charter fund of a taxpayer. Such contributions are not recorded as income for profit tax purposes. Moreover, everything received on top of the par value of the share is deemed to be a share premium, which also remains unrecorded as income for tax purposes.

However, Ukrainian tax authorities seem not to agree with this approach.

The tax authorities have commented in the Unified Tax Database[4] that outstanding contributions in foreign currency should be deemed to be a monetary item and hence that foreign exchange differences must be recorded on this indebtedness.

Certain independent experts in recent specialized publications support this approach. This approach is grounded by a reference to international accounting standards, according to which outstanding contributions in a foreign currency may be treated as a monetary item.

It is, however, possible to question this approach.

Thus, the above clearly shows that there is at least ambiguity in the interpretation of these Tax Code rules. This is the basis for applying the rule on the presumption of the rightfulness of a taxpayer's decision, if a rule may be interpreted both in favor of the taxpayer and in favor of the tax authorities (para. 4.1.4 of Art. 4 of the Tax Code). If foreign exchange differences on outstanding contributions result in additional taxes, then the decision in fa-

[2] Section 4 of accounting provision (standard) of 21 "Impact of foreign exchange rate fluctuations," adopted by the order of the Ministry of Finance of August 10, 2000 #193.

[3] Accounting provision (standard) 2 "Balance sheet," adopted by the order of the Ministry of Finance of March 31, 1999 #87.

[4] The database containing the tax authorities' answers to various questions from taxpayers (http://sts.gov.ua/ebpz/).

vor of the taxpayer will evidently mean an approach according to which foreign exchange differences must not be recorded on the outstanding contributions.

In addition to that, this situation provides grounds for the conclusion that this is sueis not being properly regulated on the legal level. The Tax Code does not address the question of whether the devaluation of the Ukrainian hryvnia triggers taxes in this case. The approach depends on the interpretation of implementation provisions the primary purpose of which is unrelated to taxation.

And this situation is in direct contradiction to the basic principle of the tax system of Ukraine regarding a uniform approach to imposing taxes and contributions (subpara. 4.1.11 of Art. 4 of the Tax Code). This principle implies that all mandatory tax elements should be determined on the level of law.

Summarizing the above, there are strong arguments for concluding that outstanding contributions in foreign currency shall not result in additional taxes as the result of exchange rate fluctuations.

Yet during tax audits the tax authorities are likely to follow an approach according to which foreign exchange differences are recorded on amounts of outstanding contributions in a foreign currency. Ahead of the expected devaluation of the Ukrainian hryvnia after the parliamentary elections, this approach is likely to help in raising additional profit tax, which is hardly needed by the Ukrainian budget.

With this in view, it is strongly advisable to take into account the issue that we outlined above, since it may result in material additional taxes for Ukrainian legal entities with outstanding monetary contributions from foreign participants recorded in the accounting. Although there are arguments in favor of the position that no taxes should arise notwithstanding exchange fluctuations, it is likely that this approach will have to be defended in court. We also note for the sake of completeness that there could exist certain mitigation techniques.

We have considered quite a specific issue here. But it's an issue that provides a good illustration of the general situation as regards tax regulation in Ukraine. The Tax Code is often unclear and a lot depends on interpretation. This makes taxes a very good instrument for collecting budget funds, obviously at the expense of tax predictability for the business community.

KPMG

Transfer Pricing Regulations: the New Tax Realities for Ukraine

The transfer pricing rules in Ukraine have historically been vague and uncertain and the Ukrainian tax authorities seldom applied them. They were more likely to challenge a loss-making transaction between related parties based on the lack of a business rationale and assess the relevant tax liabilities than to apply the arm's length principle. Many Ukrainian businesses took advantage of the underdeveloped transfer pricing rules and siphoned earnings from Ukraine without any meaningful resistance from the Ukrainian tax authorities. Eventually these earnings accumulated in the bank accounts of Ukrainian beneficiaries that had been opened in low-tax jurisdictions.

During the economic crisis many governments experienced a shortfall in tax revenues, which prompted them to become more proactive in finding additional sources of financing budget needs. The Ukrainian government was no exception to this trend, and transfer pricing was a natural area to look at, one that promised a real bonanza.

The Ukrainian government thus introduced Article 39 to the Tax Code and draconian measures limiting the deductibility of many valid business expenses.

Article 39, however, which is set to take force on January 1, 2013, does not look to be a sound mechanism for surmounting the artificial tax disproportions between companies in a multinational group. In its current wording it enables the tax authorities to challenge pricing policies and assess additional tax liabilities and penalties only if the price deviates from the arm's length price by more than 20%. Meanwhile, it does not contain any fair explanation of the following:

- how to identify and quantify such a deviation
- why exactly the threshold is set at 20%, given that for some taxpayers such a deviation is huge and for others it is insignificant
- which transactions should clearly be subject to transfer pricing control
- how to apply transfer pricing methods in practice.

The situation is even more impenetrable than that, since the transfer pricing regulation is mainly of a subjective nature and is based on numerous hypotheses and assumptions. Consequently, the absence of a comprehensive and clear legal framework could encourage the Ukrainian tax authorities to take a fiscal approach in auditing the taxpayers and, as a result, lead to an even more unfair and unpredictable tax system.

Aware of Article 39's inefficiencies and inspired by the recent transfer pricing reform in Russia, the Ukrainian government has initiated a revision of the article. First, the Ministry of Social Policy headed by Sergiy Tigipko has been lobbying for transfer pricing reform for almost a year, although the transfer pricing bill that has been suggested has never been registered in the Ukrainian Parliament. In addition, as a temporary measure before the new transfer pricing regulations take force, the Social Ministry has proposed introducing a special pension fund charge that applies to all transactions with entities operating in or through offshore jurisdictions. This tax initiative, however, has not materialized either.

Next, in the summer of 2012, the Ukrainian tax authorities revealed their plans to create a transfer pricing bill. They indeed developed a tax bill on transfer pricing, but for some reason they preferred to keep it for internal purposes only, and it did not make its way to the public.

Then, on August 22, 2012 the Ministry of Finance announced amendments to Article 39 and proposed to make them effective as of January 1, 2013. The draft transfer pricing bill has been posted on the Ministry's website and has been open for comments and suggestions from the business community.

The Finance Ministry declared that they had involved experts from the Ukrainian-European Policy and Legal Advice Centre (UEPLAC) to enhance the existing transfer pricing legislation. A reading of the transfer pricing bill, however, reveals that it was to a great extent based on the Russian transfer pricing rules.[1] It's worth noting that the Russian Federation implemented new transfer pricing regulations based on OECD principles on January 1, 2012 and that Ukraine can indeed benefit from the Russian transfer pricing experience and practice.

So, what should Ukrainian businesses expect in 2013 in terms of transfer pricing?

At the very minimum, Article 39 will take force on January 1, 2013. This, together with clause 153.2. and certain other transfer-pricing provisions scattered through the Tax Code, will create the following major tax implications for Ukrainian businesses:

a) The general premise is that the contractual price is deemed to be the arm's length price unless the Tax Code clearly states otherwise and the tax authorities prove the discrepancy between the contractual price and the arm's length price

b) The Ukrainian transfer pricing rules apply not only to transactions between Ukrainian companies and persons related[2] to them, but also to transactions of Ukrainian companies with persons that are not subject to (or that are exempt from) corporate income tax or that pay corporate income tax at privileged tax rates. The latter implies that all transactions with non-residents of Ukraine, businesses that are subject to special taxation regimes, and even unrelated private businessmen should also fall within the ambit of the transfer pricing rules. The arm's length requirements also apply to barter transactions; transactions with tangible and intangible assets, land, and real estate; distributions of dividends in kind; and transactions that involve receipt of goods or services for no consideration

c) The Ukrainian tax authorities can adjust the contractual price to bring it in line with the arm's length price only if the contractual price deviates from the arm's length price by more than 20%

d) The fair market price can be determined using one of the following methods: comparable uncontrolled price, resale price, cost plus, profit dis-

1 The law of the Russian Federation "On introducing changes to the Tax Code of the Russian Federation relating to transfer pricing regulations" #227-FZ dated 18 July 2011.

2 "Related persons" include legal entities and/or individuals that have a special relationship whereby they can affect the conditions or results of their activity or the activities of the entities that they represent. Among other things, a related person includes a legal entity that exercises control over a taxpayer, is controlled by a taxpayer, or is under common control with a taxpayer (including an individual (or a family member thereof) who exercises control over the taxpayer). There are low threshold requirements in terms of control, and the latter means holding, directly or indirectly, at least 20% of the taxpayer's shares, or exercising, directly or indirectly, influence over the business activities of the taxpayer (for example, by means of decisive influence on the composition, voting results, and/or decisions of the taxpayer's management bodies, etc.).

tribution, and net profit. If there is no information sufficient to determine the arm's length price, the latter can be estimated with reference to the independent valuation of property or property rights. It appears that there are no requirements as to the priority or sequence of applying the transfer pricing methods referred to above. A taxpayer can apply the method that is most appropriate in the circumstances

e) Large taxpayers will have the right to sign advance pricing arrangements with the tax authorities

f) The onus of proof that the contractual price does not meet the arm's length requirements is on the tax authorities. If a taxpayer objects to the price adjustment or does not pay the assessed taxes, the notice of assessment is deemed revoked. Then the head of the local tax office shall bring the price adjustment matter for consideration to an administrative court.

Meanwhile, on December 4, 2012 a transfer pricing bill was registered in the Ukrainian Parliament that proposed important and comprehensive changes to Article 39. Even though this tax bill was recalled a week later, many tax experts believe that the recall is just a temporary measure linked to the internal processes of the recently-elected Parliament, and that the tax and business community will witness a reincarnation of the bill sooner or later. Using this transfer pricing bill and the comments of high-ranking tax officials as a basis, let's try to predict the shape of future changes to the transfer pricing rules:

a) The 20% safe-harbor rule could be eliminated

b) The list of controlled transactions could potentially be narrowed down to transactions with related parties and non-residents only. It is also possible that a minimum monetary threshold would be introduced for the controlled transactions

c) Special transfer pricing rules could apply to certain industries (i.e., agriculture, mining and metals, etc.)

d) The specifics and procedure for applying transfer pricing methods could be elaborated;

e) There could be a special mechanism enabling the tax authorities to monitor and audit compliance with the transfer pricing rules

f) It is expected that the transfer pricing reporting requirements and tax penalties for failure to comply with them will be introduced

g) There could be special rules with respect to preparing and/or filing contemporaneous transfer pricing documentation by prescribed taxpayers.

It is now clear that the Ukrainian government will move forward with transfer pricing reform. Ukrainian businesses can assess the impact of Article 39 on their business models and pricing policies starting January 1, 2013.

At the very minimum, Ukrainian businesses that have material transactions with related persons or non-residents of Ukraine must give thorough consideration to their existing pricing policies and practices and prepare internal transfer pricing policies (regulations) to substantiate their transfer pricing positions. On a go-forward basis, Ukrainian businesses must monitor further developments in transfer pricing rules, as these rules could potentially have a major impact on their financial and tax positions, and on the tax compliance requirements.

Where necessary, your tax advisors can help your business adjust to the new transfer pricing and tax compliance requirements. Specifically, they can perform diagnostics of transfer pricing risks, draft transfer pricing policies (regulations), prepare contemporaneous transfer pricing documentation and tax filings, and help you negotiate advance pricing agreements with the Ukrainian tax authorities.

Marketing Research in Ukraine

According to the Ukrainian Marketing Association, the following are the top 10 industry leaders in the field: GfK Ukraine, Ukrainian Marketing Group (UMG), ACNielsen, IPSOS, ARMI, Medical Data Management, R&B, KIIS, and Advanter Group.

The leaders have maintained their market positions: their common share of the marketing research field comes to 85.2% (the year before it came to 81%). These companies' total turnover this year was $34.982 million excluding VAT.

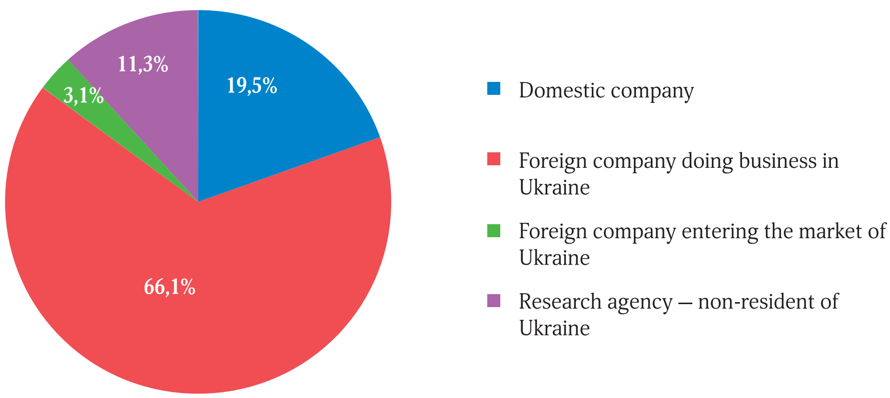
Under the current conditions, the threshold for entering the ranks of the top 10 large agencies is $1.5 million in turnover. The gaps between the turnovers of the various top 10 companies, however, can be significant.

The market is growing overall at 10%. Total market volume in the national currency is 354.6 mln., or $44.4 mln.

Just as in previous periods, those agencies that focus on orders from foreign companies demonstrate relative stability.

There is a trend towards a decrease in orders from domestic companies. Foreign companies doing business in Ukraine are the research agencies' main clients.

Structure of Ukrainian Market Research by Category of Customers for the last year (%)

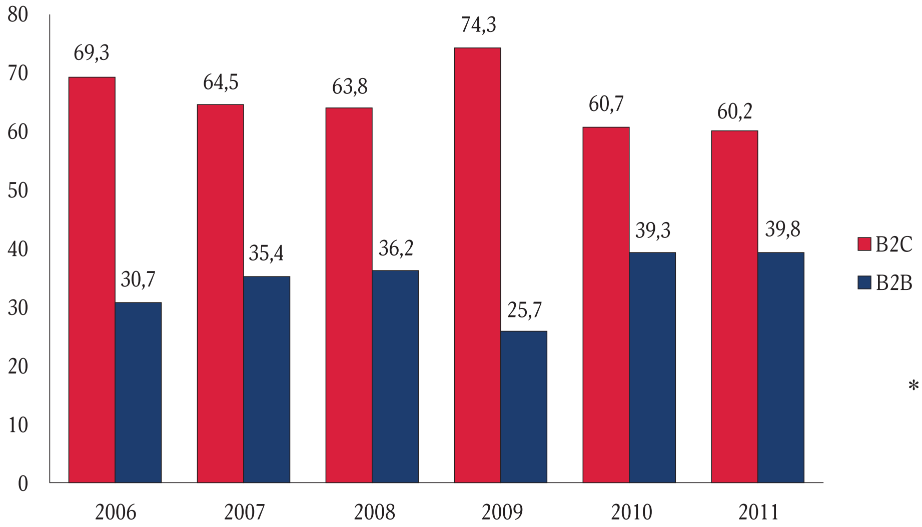


** Data provided by the Ukrainian Marketing Association*

At the same time, non-resident research agencies are still maintaining their share of orders, in the context of multi-national research projects. The fact that Ukraine, despite the crisis, is still being observed by foreign companies explains this trend.

The Ukrainian research market finds its major customers particularly among companies that function on consumer markets (B2C). Competition and the increasing demands of Ukrainian consumers have shaped the demand for these studies. At the same time, business strategies are driving a growth trend for customers that represent different B2B sectors. This market segment has grown in both absolute and relative terms.

Dynamic of Ukrainian Market research by types (B2B vs. B2C) per year (%)



* *Data provided by the Ukrainian Marketing Association*

There is also an increase in the share of qualitative methods and thus both absolute and relative declines in the share of quantitative research. One major trend is that companies continue to order the "complex": that is, research plus consulting.

Online and Internet research increased in prevalence 3.5 times over the year, but the phone and "face-to-face" polling are still the main methods that research agencies use.

Omnibus surveys became popular during the crisis.

In addition, customers' attention to consumer satisfaction research has increased greatly. The domestic market for marketing research is moving closer to European Union standards. In the EU, consumer satisfaction research has become a "must have" element of market complex analysis.

There was an increase in market research volumes this year. The market growth rates are positive, standing at +10%, but inflation-adjusted real income grew by about 3% (based on the official inflation rate) or even decreased by 6% (using an "alternative" inflation rate calculation).

The key market leaders held their positions. Agencies are strengthening their positions on particular markets. Research methods are changing, the share of online methods increasing. Customers are more inclined to regard research agencies as partners.

According to next year's forecast, the marketing research sphere will stay where it is or slightly reduce its rate of growth. The main reason for this is the common desire among clients to reduce costs and a general underestimation of the role that research can play in battling the second wave of the crisis.

"Despite the fact that market research has always been important, some companies, fearing the crisis, have cut their research budgets."

"But the wave of anxiety will necessarily yield to an understanding that the consumer is changing faster than ever before and requires more study than ever. Many products are today seeing changes in their target audiences. And in order to talk to new customers, you need to study them well."**

* The Ukrainian Marketing Association (UMA), an all-Ukrainian public organization, annually conducts industrial surveys of market research trends. The purpose is to study total market research based on data on the structure of the turnovers of research agencies in a given period and to define development prospects for upcoming years.

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Notes


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The 2013 Country Profile is an exclusive publication that provides a comprehensive overview of Ukraine's economy broken down by sector.

This analytical publication provides unique insight and is developed with the help of leading experts among the American Chamber of Commerce membership.

The electronic version is also available in English and Ukrainian on the Chamber web-site at: **www.chamber.ua** as well as partner online resources.

UKRAINE ACC
THE CHAMBER OF COMMERCE

Horizon Park Business Center
12 Amosova Street, 15th Floor
Kyiv 03680, Ukraine

(380-44) 490-5800 Phone
(380-44) 490-5801 Fax

chamber@chamber.ua
www.chamber.ua