



SigmaBleyzer

Where Opportunities Emerge.

2001: A Ukrainian Odyssey Boom or Bust?

March 29, 2001

CSIS Briefing

Michael Bleyzer

SigmaBleyzer and UGF

- Largest Private Equity Fund in Ukraine
- Seven years in Ukraine
- International investor base
- Institutions and high net worth individuals / families
- Ukrainian Growth Funds – a family of three funds with \$100M under management
- Investments in over 70 Ukrainian companies
- Substantial experience in restructuring / managing Ukrainian companies
- Significant number of successful exits
- Significant Ukrainian infrastructure

International Private Capital Task Force (IPCTF)

- **Objective: Develop actionable strategies to attract private capital and improve investment climate**
- **Specific Steps:**
 - Analyze world Capital Markets and Capital Flows
 - Focus on Capital Markets in Emerging Markets
 - Analyze Ukrainian Capital Markets
 - Benchmarking
 - Compare policies and strategies in benchmarked countries
 - Develop policies, programs, and strategies for Ukraine
 - Economic modeling for Ukrainian strategies

➤ **Action Plan**

IPCTF Study

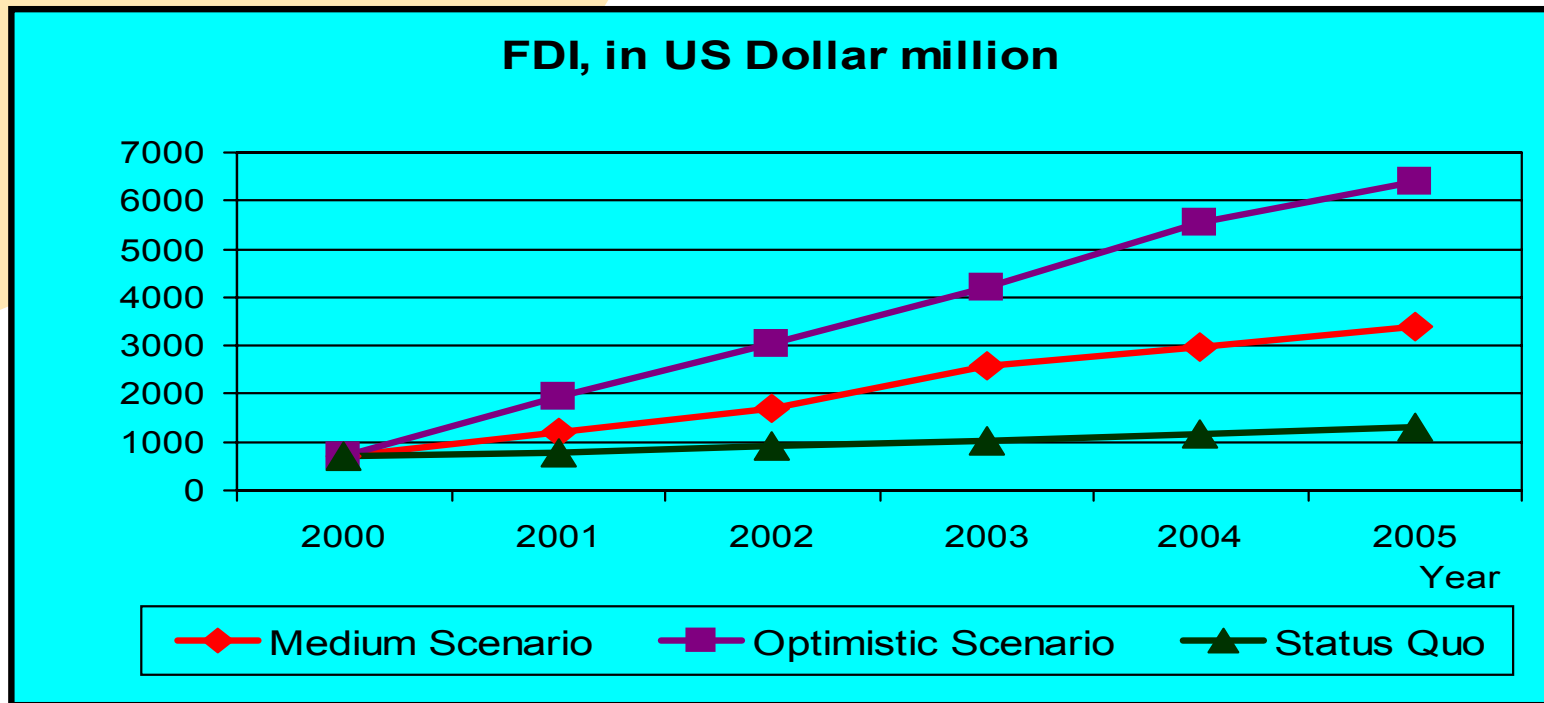
- IPCTF Steering Committee:
 - Largest foreign private companies in Ukraine.
 - Representatives of international agencies
 - Economic NGOs
 - Government officials.
- The study was conducted by SigmaBleyzer and the Thunderbird Corporate Consulting Group, the consulting arm of one of the best international business schools in the US.
- *The views expressed in this study are those of the authors and do not necessarily coincide with those of individual members of the IPCTF Steering Committee or the organizations they represent*

IPCTF Steering Committee

World Bank, EBRD, IMF, IFC, USAID,
European Commission, US Embassy, American
Chamber of Commerce, International Center
for Strategic Studies, Harvard Institute for
International Development, AGCO,
SigmaBleyzer, Coca Cola, Citibank,
Commerzbank, Credit Lyonnais, FMI,
PricewaterhouseCoopers, Leo Burnett, DuPont

FDI For Ukraine- Possible Scenarios

- Ukraine can choose between three possible scenarios for FDI, depending on its business environment:



- The **Middle Scenario** would generate an incremental GDP growth rate of 4.8% per annum.

Conclusions

- **With continuation of current policies**, capital inflows **will not increase** from its current level of under **US\$1.0 billion per year** (except for ad-hoc flows related to large privatizations).
- **Under a middle scenario**, with policy actions to **reduce in five years 50%** of the policy level differential with the Bests-in-Class, Ukraine could increase FDI to about **US\$3.4 billion per year**.
- **Under a more aggressive scenario**, with stronger policy actions to **reduce in five years 80%** of the policy level differential with the Bests-in-Class, the level of foreign direct investments could increase to **US\$6.4 billion per year**.

Key Drivers / Policy Action Groups

- *A policy pre-condition of the study is macroeconomic stabilization, derived from sound fiscal and monetary policies.*
- The study identified the following key “policy actions”, which stimulated foreign investments in other countries:
 - 1. Liberalize and De-Regulate Business Activities**
 - 2. Provide a Stable and Predictable Legal Environment**
 - 3. Enhance Governance & Reform Public Administration**
 - 4. Remove International Capital & Trade Restrictions**
 - 5. Facilitate Financing of Businesses**
 - 6. Eliminate Corruption**
 - 7. Reduce Political Risks (non-economic country risks)**
 - 8. Expand Country Promotion**
 - 9. Rationalize Investment Incentives**

Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
---------	--------	--------	---------	-------	-----------

Business Liberalization Score

18	49	87	80	89	62
----	----	----	----	----	----

Legal Environment Score

17	62	99	93	89	65
----	----	----	----	----	----

Financial Sector Score

10	39	62	68	74	39
----	----	----	----	----	----

Governance and Privatization Score

29	30	89	82	80	65
----	----	----	----	----	----

Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
---------	--------	--------	---------	-------	-----------

Political Risk Score

65	49	83	82	71	75
----	----	----	----	----	----

International Capital Controls & Foreign Trade Score

63	45	78	79	84	69
----	----	----	----	----	----

Corruption Score

15	21	41	52	74	35
----	----	----	----	----	----

Governmental Promotional Effort Score

20	30	80	100	90	75
----	----	----	-----	----	----

Tax and Investment Incentives Score

31	48	78	82	63	70
----	----	----	----	----	----

Proposed Action Plan for Ukraine

Liberalize Business Activity

1. Finalize and communicate widely the Government's De-regulation Policy, consistent with international standards, and rapidly implement it to simplify and facilitate registration of new businesses, the operations of existing businesses, and import/export of goods.
2. Establish an appropriate on-going mechanism to liberalize business activities, establish deregulation priorities, and monitor legislation to support business liberalization.
3. Eliminate current incentives to excessive Government intervention, such as the right of some agencies to retain part of the fines they impose on businesses.

Provide an Stable and Predictable Legal Environment

1. Create an independent and incorruptible judiciary, separate from the Executive branch.
2. Pass well-conceived new laws or modify existing legislation as needed to provide a more favorable framework for business, including the civil code, the labor code, the criminal code the tax code and others.
3. Establish an efficient legislative process to coordinate and expedite the drafting of laws and regulations.

Enhance Corporate and Public Governance and Accelerate Privatization

Corporate Governance

1. Demonstrate corporate financial discipline by closing 10-20 big loss-making state companies within next two years.
2. Enact the Joint Stock Company Law of Ukraine to modernize Ukrainian corporate governance legislation.
3. Require all publicly traded (listed) companies to use international accounting standards and to regular reports and audited annual financial statements.

Public Governance

1. Implement public administration reform to reduce the size of state agencies, raise salaries of key civil servants, and redefine the Government's role as that of supporting -- not replacing -- private activities.
2. Extend administrative reform to local state bodies.
3. Reduce shadow economy activities by drastically cutting red tape and lowering cost of compliance with laws in effect.

Privatization

1. Secure the quick approval and implementation of the Land Code to promote private ownership and registration of land.
2. Encourage the independence of the State Property Fund (SPF) by passing the Law on the State Property Fund and subordinating it to the Executive branch.
3. Take early actions to prepare state companies for privatization (including actions to protect minority shareholder rights and transfer social assets to local authorities) and complete expeditiously the privatization of energy sector and other major enterprises under clear and transparent procedures.

Reduce International Capital and Foreign Trade Restrictions

1. Liberalize foreign exchange transactions and eliminate restrictions on foreign direct investments in certain sectors - insurance, publishing, broadcasting and telecom.
2. Reduce restrictions to imports and exports, including high import duties, the critical import list, export quotas, duties, indicative prices, advance deposits, forex surrender requirements.
3. Simplify and expedite custom services, including procedures for custom clearances and for certification of imported products.

Facilitate Business Financing by the Financial Sector

1. Increase the independence of the banking sector, including the NBU, improve and enforce commercial bank supervision and prudential regulations.
2. Strengthen the Securities and Stock Market State Commission mandates in security-related activities of all financial institutions.
3. Accelerate the adoption of the Law On the Institutions of Joint Investments.

Eliminate Corruption

1. Undertake measures to “prevent” corruption, reducing the opportunities for corruption and making corruption more difficult to undertake, starting with key areas such as barter and the energy sector.
2. Develop the legal framework needed to ensure better enforcement of anticorruption measures and impose visible, harsh, swift and certain penalties for corruption of Government officials.
3. Get public support for anti-corruption programs by making people aware of their rights and the rules of the game.

Reduce Political Risks

1. Demonstrate understanding of the importance that foreign investors place to expropriation, including “creeping expropriation”.
2. Bring tax collectors and local authorities under the control of the central administration.
3. Government enterprises in competition with private business in the same sector should not get preferential treatment.

Expand Country Promotion

1. Announce and disseminate widely the Government's policy and commitment to implement strong market oriented policies and show implementation progress.
2. Vocally support foreign investment by changing the attitude of officials at central and local levels.
3. Require all Ukrainian embassies abroad to have their commercial section strengthened, and to go on sales drives to better disseminate business opportunities.

Rationalize Investment Incentives

1. Institute a level playing field by eliminating any special incentives for particular sectors, companies or geographical zones.
2. Enact the new Tax Code that would decrease the number of taxes and surcharges, reduce tax rates, eliminate tax privileges, and rationalize the value-added tax, personal income tax, and corporate income tax systems.
3. After a rational Tax Code has been passed, aim to minimize subsequent tax changes by imposing a moratorium.

Questions for US Policy-Makers

- Is Ukraine Strategically Important Country for US National Security Interest?
- Are we prepared to concede Ukraine to newly emerging Russian superpower?
- Can we ensure long-term independence of Ukraine without democracy and market-based economy
- Can Ukraine be truly independent Nation without energy independence

Action Plan for US

- Develop and clearly communicate US policy towards Ukraine
- Build strong Western coalition to bring independence through democracy and market-based economy to Ukraine
- Restructure or streamline all foreign aid / assistance to Ukraine
- Focus on developing private business: SMEs from within Ukraine, multinationals for strategic sectors like Energy, Telecom, Defense Conversion, etc.
- Tough but specific conditionality
- Hands-on implementation assistance
- Leverage foreign private investments
- Reduce “blind pools of money” disbursements and government-to-government financial assistance

Ukraine Is Bound to Succeed!

"Україна приречена на успіх"



Where Opportunities Emerge.

www.sigmableyzer.com

www.volia.com

www.meta-ukraine.com

www.finance.com.ua

www.softline-solutions.com

www.paco.net

Houston: (713) 621-3111 (tel)

Houston: (713) 621-4666 (fax)

Kiev: 380-44-244-9487 (tel)

Kiev: 380-44-244-9488 (fax)

Kharkov: 380-572-141-180 (tel)

Kharkov: 380-572-141-188 (fax)