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UKRAINE

UKRAINE: FROM CRISIS TO BOOM?

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"ATTRACTIVE FOR LABOUR-INTENSIVE PRODUCTION"

The Ukrainian GDP grew by 4.6 percent in the second quarter of 2019. What are the reasons for this significant growth? To what extent is this the beginning of a long-term economic recovery?

In fact, Ukrainian economic growth has clearly exceeded expectations. We had assumed that in the double election year 2019, due to the political uncertainties, there will be a subdued growth of 2-3%.

However, consumer confidence in the population has improved this year and expectations of many Ukrainian companies remain positive. As a result, growth for the full year 2019 should exceed 3%. Among other things, the strong growth is due to the significant increase in real wages of around 10% year-on-year, which is leading to a strong increase in retail sales and increased construction activity.

Due to good harvest results, the agricultural sector is developing into another important growth driver. However, there are also clear weaknesses: The manufacturing sector shrank in the first half of 2019 by -4% compared to the previous year. Sectors such as light industry, food processing, metallurgy and mechanical engineering have so far declined in 2019. Remittances from Ukrainian migrant workers from abroad, especially from Poland, also support consumption. As a result, we expect domestic demand to continue to rise in the coming year.

Whether there is a long-term economic recovery depends very much on the policy of the new President Volodymyr Selensky and his government. The president has promised to fight rampant corruption in the country, end the war in the east of the country and improve economic and social conditions for citizens. The new PM intends to increase economic growth to between 5% and 7% per annum over the next few years through reforms and the country's opening to direct investment. A first boost shall be made possible by a land reform in the coming year, which will enable the purchase and sale of agricultural land.

Why are Western European companies still investing very cautiously in Ukraine? What can the Ukrainian government do to attract more foreign direct investment?

Despite his inexperience, the new president has received a high degree of trust at home and abroad. Foreign investment on a large scale - which is indispensable to the government's ambitious growth plans - will only flow into the country if legal certainty is increased.

A reform of the corrupt court system is planned, but a successful implementation is far from settled. The extent of the influence of oligarchs on the new government is also unclear. In particular, the businessman Ihor Kolomojskyj, who was in business relations with Selenskyj, is under suspicion of exerting influence on the president. Kolomojskyj is currently fighting in court over the return of his former „PrivatBank", which was nationalized a few years ago due to massive irregularities in lending and undercapitalization.

The nationalization had cost the Ukrainian taxpayer about 5 billion euros. If Kolomojskyj wins the case (and gets the bank back) this would be a very negative sign for investors. The International Monetary Fund, on whose favour and credit Ukraine still depends, monitors the „PrivatBank case" closely.

President Selenskyj should therefore emphasize his independence from the private economic interests of individuals. It is also important to preserve the independence of the central bank and to maintain a flexible exchange rate. We are cautious on the economic outlook and predict economic growth of „only" 3% in the coming years, assuming there is no renewed political or other crisis.

To what extent is Ukraine already integrated into the EU and the European internal market today? Which further steps of integration are planned?

Ukraine has had an association agreement with the EU since the end of 2014. Since 2016, the Deep and Comprehensive Free Trade Area (DCFTA) has existed between the EU and Ukraine.

This stipulates that Ukraine will successively adopt EU standards in the coming years (a period of ten years is planned) and thereby obtain free access to the EU internal market. Since the DCFTA entered into force, the trading volume has increased significantly. From 2015 to 2018, there was an increase of 50% to 40 billion euros, which is about the level of 2012.

However, the increase in trade is also due to the recovery of the economy after the economic crisis of 2015 and the decreasing role of Russia in Ukraine's foreign trade. In addition, at least during the start-up phase, there were still restrictions on the export volumes of agricultural goods to the EU. This indicates that the free trade agreement had positive effects, but the effects should not be overestimated. Should Ukraine continue to pursue a reform course in the spirit of the DCFTA, the volume of trade and successive investment could continue to rise.

What opportunities does Ukraine offer for companies?

Ukraine currently stands out above all for its low wage level compared to other Eastern European markets. For example, labour costs are less than half than in Poland. This could make the country attractive for labour-intensive production.

Second, as in other Central and Eastern European countries, there is a growing IT outsourcing industry. In addition, the agricultural and food processing sectors continue to have potential. The planned land reform, which shall suspend a moratorium on agricultural land sales for domestic investors from 2020, could have a positive impact on agricultural production.

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"MANY SECTORS NEED TO CATCH UP"

Heiko Kreisel
Managing Director of Zeppelin Ukraine, Kiev. The company acts as the official representative of Caterpillar (construction and mining machinery) and AGCO (agricultural machinery) in the Ukraine. Heiko Kreisel lives in Kiev since 2014.

How do you assess the current market situation in Ukraine for your company? What development do you expect in the short and medium term?

After the crisis years of 2014 and 2015 with the sometimes civil-warlike conditions, we are now back on track for growth. At the height of the crisis, we reduced our workforce to 300, and now employ more than 550 people - more than ever before in Ukraine. Today, we are represented at fourteen locations between Lviv and Dnipro, Kiev and Odessa.

Around 50% of our sales are generated by the mining segment, 20% by construction and road construction machinery, 15% by drives and gas engines. The agricultural machines achieve 15% of the sales volume.

The drivers of the mining segment are commodity prices, which in turn depend on the global economy. Due to the positive development since 2009, there were stable prices and thus also demand for mining equipment.

Ukraine exports many raw materials, for example iron ore. Thanks in part to the sharp devaluation of the Ukrainian hryvnia, the sector is in good shape, as the exchange rate ensures low production costs per tonne. Despite global gloom, for example in China, I still expect stability here, especially in the maintenance of existing fleets. Nonetheless, there will be no large investments in new mines and expansions before 2022.

The infrastructure sector is more volatile because it depends heavily on political developments. If reforms are implemented, then growth is possible here. The infrastructure is largely run down and politicians have understood that investment must be made in order to initiate a sustainable economic recovery. After the change of government there are many changes of personnel at the moment, but the outlook is positive on the whole. Growth rates of over 3% for the years 2020 and 2021 are currently expected.

In agriculture, which accounts for a quarter of Ukrainian GDP, the picture is ambiguous. The current discussions to lift the existing moratorium on the purchase of agricultural land cause reluctance to invest in the short term.

However, international companies will be able to invest in the medium term if the moratorium is lifted in the future. Soil improvement and technologies such as Precision Farming and AgriTech will then result in higher yields per hectare.

Ukraine is considered a country with problems in the areas of bureaucracy and corruption. To what extent are you confronted with these issues in your work and how do you deal with them?

Bureaucracy and corruption unfortunately cause us the biggest headache. Above all, bureaucracy bothers us - as a foreign company, it is relatively easy for us to refuse bribes. However, things can then take a long time, so we were busy for about two and a half years with the purchase of a plot of land.

Corruption and bureaucracy always go hand in hand, because corruption is ultimately only a shortcut through bureaucracy. The situation in this area is certainly one of the reasons for the deselection of the previous government.
Corruption also affects large local companies, e.g. during tenders. Despite some progress in recent years, corruption is still particularly prevalent in the legal apparatus, too.

As a company, we have a strict compliance policy. We do not pay bribes, even if we lose orders or have to wait longer.

Why should a Western European company get involved in Ukraine? What opportunities does the market offer?

Ukraine has a large domestic market with over 40 million people. Many sectors need to catch up, so the demand for products of all kinds is high.

Manufacturers benefit from the low wage level, which is well below half of the labour costs in Poland. The automotive industry already uses this advantage for outward processing. The IT sector is also strong because there are well-trained mathematicians and computer scientists.
The infrastructure sector is a growth area with high potential due to investment. Ukraine also benefits from its favourable geographical position between Europe and Asia.

What experience have you gained in recruiting and managing employees in Ukraine?

The „brain drain" caused by the outbound migration of labour is very harmful to Ukraine. About a quarter of the candidates relevant to us have emigrated to Western and Eastern Europe.

Recruiting good staff is one of the main challenges. Another is the inflexible labour law, which has been largely composed in the Soviet Union.
Employee retention is a difficult topic. Many employees quit when they get more money elsewhere. While our long-established construction equipment business is stable, employees in the relatively new agricultural machinery sector are subject to high turnover.

Western European companies should maintain a Western European style of leadership. The boss should not act like a dictator, as is customary in Ukrainian companies. However, management is expected to make decisions. What is needed is a mixed style that unites democratic and more authoritarian elements.

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"UKRAINE IS STILL AN EMPLOYER MARKET"

Christian Tegethoff
Managing Director CT Executive Search

How would you describe the Ukrainian executive market today?

In the years before 2014, Ukraine was the second most important market among the successor states of the Soviet Union for us. Even though the volume was not comparable to Russia at that time, we have worked for a considerable number of companies every year. Unfortunately, demand dropped sharply during the political and economic crisis in 2014 and 2015, and the interest of Western European companies in Ukraine was very low.

However, we observe that sentiment has begun to turn again since the presidential election this year. Ukrainian politics and European trade associations have contributed to a higher visibility of the country internationally. My impression is that the opportunities of the Ukrainian market are coming to the foreground again at the moment.

Nevertheless, Ukraine is still clearly an employer market today. Western European companies have excellent cards in the search for specialists and executives. Expanding companies enjoy a first mover advantage as there are still few foreign companies investing in Ukraine. Candidates looking for opportunities have limited options, so the advantage lies with the recruiting company. Western European employers are popular with Ukrainian candidates.

In Ukraine, there is now a fairly large pool of candidates with experience in international companies and good English language skills. The salary expectations of even highly qualified candidates are moderate compared to neighbouring countries like Poland or Russia. From an HR point of view, the situation in the executive segment is therefore comfortable for the companies.

What kind of mandates are you currently working in Ukraine?

In Ukraine, we are predominantly working for medium-sized companies who want to strengthen their local teams or make a change at the head of the Ukrainian subsidiary. Typical positions are Country Manager or Managing Director, Representative or Sales Director.

We do not yet see a rush of international companies wanting to establish manufacturing sites in Ukraine. However, we expect that direct investments will pick up in the next few years.

Ukraine can score with low labour costs and a rather well-educated workforce. There will certainly be companies wanting to take advantage of these opportunities. In the medium term, therefore, demand for production-related specialists and managers will increase.

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